

New Interpretations of Article 44 of the Constitution Paves Way for Privatization

The Expediency Council has provided new and liberal interpretations of Article 44 of the Constitution following years of ambiguity, debate and controversy concerning private sector activity (domestic and foreign) in Iran. This article in relevant part provides:

“The economy of the Islamic Republic of Iran is to consist of three sectors: state, cooperative, and private, and is to be based on systematic and sound planning.

The state sector is to include all large-scale and mother industries, foreign trade, major minerals, banking, insurance, power generation, dams and large-scale irrigation networks, radio and television, post, telegraph and telephone services, aviation, shipping, roads, railroads and the like; all these will be publicly owned and

administered by the State.

The cooperative sector is to include cooperative companies and enterprises concerned with production and distribution, in urban and rural areas, in accordance with Islamic criteria.

The private sector consists of those activities concerned with agriculture, animal husbandry, industry, trade, and services that supplement the economic activities of the state and cooperative sectors.

The [precise] scope of each of these sectors, as well as the regulations and conditions governing their operation, will be specified by law.”

As evident from the comprehensive definition of the state sector, most major economic activities of Iran fall under a state monopoly. Nevertheless, in recent years a more liberal and pragmatic

interpretation was applied in order to legitimize the government's efforts of privatization. The major example of such approach was reflected in the law of the Third Five Year Development Plan. Although the Guardian Council objected to privatization provisions in the Third Plan based on Article 44, the Expediency Council (the highest body who resolved disputes between the Guardian Council and parliament) let those provisions stand.

Notwithstanding, the Guardian Council has consistently objected to any legislation which runs afoul of the principals articulated in Article 44. The most recent objections were made to the Fourth Five Year Plan ratified by the previous parliament provisions of privatization.

Given the ongoing uncertainty regarding Article 44 and the disputes between the

government, parliament and Guardian Council concerning its applicability, the Expediency Council has finally stepped in to provide a binding interpretation of this article. After months of deliberation, The Expediency Council has commenced providing its interpretation (as the highest body in Iran) and policies on this subject. In sessions held last week of September and first week of October, the Expediency Council has ratified two major provisions concerning Article 44 which are as follows.

- (i) the government is obligated to disengage from those economic activities that private sector participation is permitted by the end of the Fourth Development Plan (i.e. 2010). In case necessary, such participation by the government will only be permitted by proposal of the cabinet and ratification by the parliament for a specified time.
- (ii) In order to foster economic growth and development

investment, ownership and management in those fields provided in Article 44 shall be permissible, as provided below, by the public non government organs, private and cooperative sector:

- a. Large industry, mother industry (including large oil and gas downstream industry) and large mines (excluding oil and gas);
- b. International trade activities within the framework of the country's trade and foreign currency policies and so long as it does not create a monopoly;
- c. Banking and Insurance;
- d. Power generation including production for domestic and export consumption;
- e. Dams and large irrigation networks;
- f. All post and telecommunications with the exception of mother telecommunications networks, transfer of frequencies and exchange and distribution of basis

mail services;

- g. Roads and railways;
- h. Aviation and shipping;

Based on the foregoing, private sector participation is clearly authorized in most sectors that were once deemed under the exclusive control and monopoly of the government. Upstream oil and gas activity remain as the most significant exception to private participation whereby the government is to maintain a monopoly.

This directive by the Expediency Council has for the first time provided a clear and transparent interpretation of Article 44 and thus disallowing any further objections by the Guardian Council concerning privatization efforts by the government and parliament.

Iranian Parliament Ratifies Unprecedented Legislation to Approve Certain Foreign Awarded Projects

On 26 September 2004, the Iranian legislature took the

unprecedented step requiring parliamentary approval for certain projects concerning privatization efforts by the government. This law, titled as the *Single Article on Requirement of the Government to Obtain Islamic Assembly's Approval in the Two Contracts, the Instances of Articles 124 and 130 of the Law of Third Economic, Social & Cultural Development Plan of IRI* provides as follows:

“Agreement concerning the mobile phone network which is based on Article 124 of the Third Development Plan known as Irancell and also the contract for the development, equipment and maintenance of Imam Khomeini International Airport which is based on Para A of Article 130 of the Third Development Plan known as TAV contract are effective upon the approval of the Parliament.”

The initial parliamentary proposal was for most foreign investments of more than 49% to obtain legislative approval. However, the initiative did not obtain necessary votes in the parliament and resulted in a law targeting very specific projects led by two Turkish

companies.

The government had recently awarded the second GSM license to Irancell, a consortium led by Turkcell of Turkey following a tender. An award had also been made to TAV of Turkey for operation of the new airport in Tehran. Subsequently, due to national security objections, TAV's contract was suspended causing a delay in the opening of the new airport which continues until today. In the meantime, the award of the second GSM license to Irancell became a topic of hot debate between the parliament and executive branch making the award leading to this law.

It is worth noting that both these agreements were based on Iran's law of Third Five Year Development Plan (2000-2005) which for the first time authorized private and foreign participation in many sectors including telecommunications and transportation sectors. Specifically, Articles 125 and 130 of the Third Five Year Development Plan respectively in relevant part stipulate:

Telecom: “the non-public sector shall be permitted to engage in the following postal and communication services

within the domain of the non-parent telecommunication sector through parallel and independent postal and telecommunication, upon authorization of the Cabinet:

- (i) Mobile telephone network
- (ii) Paging network
- (iii) Low capacity telephone centers of up to five thousand numbers
- (iv) Data transfer network
- (v) Value added service provision network
- (vi) Postal network
- (vii) Postal courier network”

Aviation: “The State Aviation Organization is authorized [to] take measures in order to complete and execute the airport and flight projects and develop the air fleet by attracting domestic and foreign investment and through joint-venture contracts, forward sales of the airport and flight services and settling the relevant obligations.”

These provisions provided the legal basis for the government to privatize, for the first time, activities in the telecommunications and airport services sector which until now were under a state monopoly.

This new legislation requiring parliamentary approval and the events leading to it have caused

much concern among the executive branch as well as many foreign investors. While the law has limited applicability to all foreign investments being considered in Iran, it has caused concern on potential interjections by the parliament in the future.

Both Irancell and TAV await the outcome of Parliament's actions. Arguably, in spite of being awarded the contracts by the government, this act of parliament has imposed a new retroactive condition for the agreements to become final. Interestingly, this law puts no limits on other foreign companies being awarded the contract or requiring parliamentary approval as specific reference is made only to Irancell and TAV. In other words, should the parliament reject these contracts, there is no current legal requirement that the substitute foreign companies obtain parliamentary approval as well. It is not clear whether this omission was intentional.

At the same time, Iran's Fourth Five Year Development Plan is also under serious debate by the parliament. This law which was ratified by the previous parliament provides for a more comprehensive privatization scheme including restructuring

of the National Iranian Oil Company's financial operations as well as allowing foreign banking in Iran. However this draft was rejected by the Guardian Council (a body in charge of vetting legislation for compliance with Islamic principals and the constitution). The Fourth Plan is now before the new parliament who has undertaken many changes to the original version.

As of the writing of this report, the fate of these projects and the relevant provisions of the Fourth Plan remain in the parliament's hand with no decision yet.

All rights reserved.

This copy is just for the recipient's information and may not be copied in any manner physically or electronically for any purpose.