Legal Newsletter

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Iran's Fourth Five Year Plan Ratified

Following months of controversy involving the government, previous parliament, current parliament, the Guardian Council and the Expediency Council, the Law of the Fourth Five Year Economic, Social, and Cultural Plan of Iran (the "Fourth Plan") was finally ratified and published in October 2004. The Fourth Plan covers the periods of 2005 to 2010 and since ratified by the Parliament, has the force of law in Iran.

The following are some of the highlights of the Fourth Plan:

1. Government Investments

The Fourth Plan mandates the government and government companies to cease investing in and/or withdraw from investments in areas in which the private sector can be engaged. In this regard, state-owned companies may only participate in activities where:

- The government holds exclusive presence in form of monopoly; or
- The private sector has no incentive to partake in that activity.

Similar to the Third Plan, new government companies may be established only pursuant to the permission of the parliament. It should be noted that under Iranian laws, government companies are those that are majority-owned (more than 50%) by the government or government instrumentalities. Further, changing companies that are less than 50% owned by the government to a government company, is not permitted. That means, without legal permission, the government company may not acquire more than 50% of the shares of a private company, as it would ultimately classify the latter as a government company. Further, participation and investment of government companies – with the exception of banks, insurance and investment companies – in other government companies requires the permission of the cabinet. Finally, the Fourth Plan clearly provides for the first time that when the government holds less than 50% shares of a company, that company will be exempt from application of regulations and laws pertaining to government companies.

2. Foreign Currency Policy and Transactions

Government entities are required to conduct all of their foreign currency transaction through banks and foreign currency accounts that have been approved by the Central Bank of Iran ("CBI"). Further, new foreign currency accounts outside of the country can only be maintained upon approval of the CBI.

The government is also required to schedule repayment of all short and long term foreign debts and

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obligations in such manner that during the last year of the Fourth Plan the annual installment of such debts and obligations (without considering buy back obligations) does not exceed more than 30% of the foreign currency earnings of the government. Furthermore, the amount of foreign obligations and debts of the government shall not exceed more than US $30 Billion at the last year of the Fourth Plan.

Commercial and specialized banks are permitted to obtain foreign finance facilities for the non-government sector, providing that the above ceilings are observed and no government guarantees are required.

In those cases where executive organs of the government utilize foreign financing for their investment projects, the observance of the following guidelines is necessary:

- The minister or highest organ of the entity must take responsibility for the plan and obtain the approval of the Economy Council. Such investments must have financial, technical and economic justification and must comply with local content requirements;

- Prior to execution of the agreement, the permission of the Management and Planning Organization must be obtained;

- All transactions and contracts in excess of US $1,000,000 must comply with local content law requirements, as well as being conducted through limited and/or international tenders. Exceptions can only be granted through a special committee.

The CBI is permitted to provide provisions only for those obligations that are in compliance with the foregoing and have the confirmation of the relevant minister or highest executive in that organ.

3. Oil and Gas

In order to increase oil production, maintain and improve Iran's OPEC position, and attract foreign investment and resources in the upstream oil and gas, among others, NIOC is permitted to conclude contracts with foreign persons or qualified domestic companies for exploration and development of fields under the following conditions:

(i) Maintaining and exercising government's ownership over the oil and gas resources of the country;

(ii) Requiring no government, CBI or governmental bank guarantees assuring the undertakings by the government;

(iii) Paying the original investment, interest, risks and expenses associated with finance and all other related expenses for carrying out the project from the sale of the products of the said field based on market prices at the time of sale of the products;

(iv) Contractors accepting the risks associated with not reaching the goals of the contract, non-commerciality of the field, or insufficiency of the products for remunerating contractors;

(v) Determining the rate of return for contractors based on the conditions of each project and with purpose of creating incentives for utilization of superior methods for exploration, development, and exploitation;

(vi) Guaranteeing preservation of oil and gas reserves for the duration of the contract;

(vii) Complying with local content laws of Iran;

(viii) Observing and complying with environmental laws and regulations

Specifically, NIOC has been permitted to conclude contracts for increasing crude oil production by one million barrels per day and 250 million cubic meters of natural gas and to repay the contractual obligations from each project exclusively from the excess production of each project.

NIOC is also permitted to conclude contracts for collecting accompanying gas, injection of gas, renovation and renewal of oil establishments, conversion of natural gas to liquid products (i.e. DME, GTL, LNG) and repayment of its obligations from excess products of those projects themselves.

The Fourth Plan also provides authorization to NIOC to conclude exploration and exploitation contracts with third parties including foreign entities, for the purpose of increasing oil and gas capacity as mentioned earlier. The conditions for such contracts are as the following:

- All risks of finding commercial fields are with the contractor;
- All direct and indirect costs of exploration and exploitation of such fields shall be repaid from the sale of products of those fields;
- The issued permits have time limits and can be renewed only once;
- In circumstances where no commercial field is discovered after the exploration period, the contract will be deemed to be terminated and the contractor will have no right for reimbursement whatsoever.

The Fourth Plan also reauthorizes the provisions of the Third Plan, allowing for the building of and ownership of downstream refineries by foreign and domestic persons. Moreover, the government has been obliged – while maintaining ownership – to transfer at least 10% of activities concerning exploration, exploitation and production of oil and gas, refining, distribution and transportation of oil products to the domestic private sector.

4. Insurance

The government is authorized to transfer its shares in government insurance companies to the private and cooperative sector.

5. Government Guarantees

Under Iranian law, government guarantees require legal permission. The Fourth Plan has provided for limited such guarantees concerning those investments made under Article 3(b) of the Foreign Investment Promotion and Protection Act ("FIPPA").

In this regard, the Fourth Plan authorizes the government to guarantee payment of all obligations of government entities where the products of the project can only be purchased by the government. The government shall undertake measures to make payment from the resources of the contracting government entity itself. Other public funds shall not be utilized in connection with the mentioned guarantees. Also, the guarantee cannot cover commercial risks or faults attributable to the investor.

6. Power Generation

The authority granted under the Third Five Year Plan concerning the establishment and ownership of new power plants by foreign and domestic persons has been carried over to the Fourth Plan.

In addition, the government has authorized to accede at least 10% of its activities concerning the production and distribution of power, to the private domestic persons.

7. Telecommunications

The Fourth Plan does not extend the authority to the private sector to participate in activities concerning the mobile network. In other words, under the current plan, no operator may be engaged in providing such services other than the government.

It should be noted that this would not undermine the authority granted by the Third Plan concerning the existing consortium led by Turkcell to be the second operator and currently under scrutiny of the parliament. However, as of March 2004, the entry of new operators would be possible only through new legislation.

8. Transportation

Absent in the Fourth Plan is the authority granted under its predecessor concerning the management of the country's airports by foreign contractors. Based on the Fourth Plan the security forces shall be solely responsible for the security management of the airports.

The government is authorized to offer to the non-government sector, up to 49% of the shares of Iran Air Company.

9. Foreign Trade

Government policies for the promotion of non-oil exports have to be continued under the Fourth Plan. Export of non-oil products shall be exempt from any permit requirements (except for mandatory standards) and from payment of taxes and duties. However, the government is authorized to impose duties on the export of unprocessed raw materials. The goal is to reach an annual increase of 10.3% in the non-oil exports of the country.

The government shall eliminate all non-tariff and non-technical barriers on the import of goods by the end of the first year of the Fourth Plan. However the government is authorized to put into practice antidumping measures, as and if necessary.

Also, the government is required to amend the Import-Export laws, Customs Act, regulations of free trade zones, and draft antidumping laws.

All business concerns are required to comply with the regulations of the Ministry of Commerce that shall be drafted for the renovation of the distribution networks of the country in order to facilitate Iran's admission to the WTO.

10. Corporate Affairs

Taking into account that the Commercial Code does not provide for merger and amalgamation of companies, the Fourth Plan provides legal permission for such. Based on this authority, a merger shall be approved by four fifth of the shareholders of the merging companies. Upon merger, the new company will become the successor-in-interest to the former companies. This means, all of the assets and debts of the merged companies will be automatically transferred to the

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new company and the employees of the former companies will become employees of the new company. However, surplus workforce can be terminated with the agreement of the employees unions or with the approval of a special committee consisting of the representatives of the government, employers and employees.

11. Labor Issues

The government is required to amend the current Labor Law with the following purposes:

- To transfer social security affairs from Labor Law to the Law of Social Security;
- To provide for more flexible processes for settlement of disputes between employees and employers; and
- To provide for specific provisions for different economic sectors.

12. Antimonopoly

The government is required to draft the antimonopoly law and send it for the approval of the parliament by the end of the first year of the Fourth Plan.

13. Intellectual Property

Taking into account the legal gap in the field of the intellectual property laws and copy rights, the Fourth Plan requires government to establish a comprehensive structure for protection of intellectual property. This can involve new legislations and regulations that recognize copy rights, patents and other intellectual property.

14. Environment

Further to certain requirements for the Government to promote the environmental conditions and adopt protective measures, the Fourth Plan provides for the establishment of a self-declaration system. Based on this system, pollution making units may be compelled to provide periodic reports about their environmental situation and the extent of the pollution they emit into the environment.

15. Foreign Currency Rates

The government shall maintain the controlled floating rate method to supervise over the exchange rates. Based on this method, the government does not declare any official (mandatory) exchange rate but manipulates the market to prevent big fluctuations.

New Interpretation of Article 44 of the Constitution

As mentioned in our October 2004 newsletter, the Expediency Council embarked on new interpretations of Article 44 of the Constitution. The Expediency Council has now finalized its interpretation of Article 44 of the Constitution providing a great leeway for the private sector (both Iranian and foreign) to participate in economic activities which have been so far under the monopoly of the government.

Based on the new and liberal interpretation, the private sector is authorized to participate in major economic activities including investment, ownership and management of:

a) Large industries, mother industry (including large oil and gas downstream industry) and large mines (excluding oil and gas);

b) International trade activities within 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 basic mail services;

g) Roads and railways; and,

h) Aviation and shipping.

Exceptions to the privatization rules are military and upstream oil and gas activities which shall remain under the exclusive control of the state sector, and matters where involvement of the government is necessary, and is permitted pursuant to the cabinet's proposal and approval of the Parliament.

In order to facilitate such privatizations, the Expediency Council provided that the government shall completely cease participating in any new or previously commenced economic activity that is not subject to limitations of the Article 44, by the end of the Fourth Five-Year Development Plan.

Furthermore, with regard to those state-run ventures that are subject to limitations of Article 44, the Expediency Council provided that up to 65% of the government stake in such ventures shall be transferred to the private, non-state public and cooperative sectors. Again, military and security matters and national oil companies are excluded. This provision specified the following as industries that shall be partially-owned by non-state sectors:

- All government banks except for the Central Bank of Iran, Bank Melli Iran, Bank of Industry and Mine, Agriculture Bank, Bank Maskan, Bank Sepah, and Exports Development Bank;

- All commercial insurance companies except the Iranian Central Insurance;

- Power provision companies except for the main power transfer networks;

- All post and telecommunications with the exception of mother telecommunication networks, transfer of frequencies and exchange and distribution of basis mail services; and,

- All government aviation and shipping organizations except for Civil Aviation Organization and Ports and Shipping Organization.

The Expediency Council also provided that privatization goals shall be in line with major strategic policies such as, gradual offering of the big concerns in the stock exchange market in order to secure a base price; strengthening the transitioning bodies, and favoring the cooperative sector in equal conditions while providing equal opportunities for all.

The government shall utilize the proceeds of the privatization activities in accordance to the 1384 Budget Bill. Therefore, the sums accrued through conveyance of government companies to the private sector, shall be transferred to the state treasury and be secured for the following purposes:

- Social security and campaign against poverty,

- Developing structures for development of deprived areas,

- Granting facilities to private ventures especially to those privatized and in support of private investments in underdeveloped areas,

- Government participation in partnerships with the private sector for the purpose of developing less-developed areas, provided that the government holds a stake of less than 50% of the partnership; and,

- Completion of existing projects and development of new projects based on general policies of the government.

The revenue accrued through privatization of banks shall be first utilized for forfeiting the government debts to other banks and then toward increasing the government's capital in the remaining non-private banks.

According to these policies, the amounts gained from privatization of insurance companies shall be used to increase the capital of the government in the central insurance of Iran.

Despite the Expediency Council's direction, the aforementioned policies cannot be automatically executed and shall be made into law before being implemented. However the approval of these policies should facilitate the ratification of more legislation by the parliament to accelerate the trend of privatization in the country. This should also clarify the ambiguities surrounding privatization due to the limitations provided in Article 44.

It is worth noting that all the areas cleared for privatization have been specifically reserved as a state monopoly according to the provisions of Article 44.

1384 Budget Law Submitted to Parliament

The government recently submitted its next fiscal (March 2005 to March 2006) budget to the parliament for approval. This is the first budget under the Fourth Five Year Plan. The budget has been fixed at 1,546,000 billion rls. (approximately $171.77 billion), up by 30.5 percent compared with that of the current year.

The following are the highlights of 1384 Budget Bill:

- The budget draft stipulates for the revenues and expenditure ceiling of more than 1,546,000 billion rls, which is 30.5% more than current year's annual budget;
- The oil revenue has been estimated to reach $14.128 billion during the next year, showing a fall of $1.972 billion as compared to the current year's figure;
- Petrochemical production will increase to 27 million tons, showing a rise of 37 percent as compared to this year's figure. Exports of petrochemical products will also increase to $3.6 billion from $1.67 billion in the current year;
- Increase in the share of the research and technology up to 1.2% if the general budget;
- Completion of all development projects that are due by the end of the next year;
- Increase in tourism credit at least up to 1% of national budget;
- Credit Provisions for filling the revenue gaps in education, health and training, defense sectors and martyrs foundation.
- Implementation of rural areas development project;
- Allocation of $8 billion to implementation of the Article I of the Fourth Five Year Development Plan, from the Foreign Exchange Reserve Funds;
- Exploitation of phases 1,4, and 5 of the South Pars project.

Parliament Ratifies Second Mobile Operator with Major Changes

Last year, the Iranian parliament ratified an unprecedented law providing that the execution of the second GSM license granted to a consortium led by Turkcell license is subject to parliamentary approval. On 15 February 2005, the Iranian Parliament ratified a law providing the conditions on which the consortium could carry out the project. Major changes were made in the parliamentary law compared to the terms and conditions provided for in the tender that was won by the Turckcell. The conditions articulated in this parliamentary act include, among others, the following:

1. The foreign shareholding in the consortium has been lowered to 49%. The Iranian shareholding cannot be less than 51% under any circumstances for the life of the license. The original license allowed a foreign shareholding in excess of 60%.

2. At least 51% of the financial value of the needed equipment must be procured from within Iran and must be made domestically.

3. Technical management and technical support of the second operator must be in the hands of the Iranian members of the consortium.

4. At least 50% of the Iranian members of the consortium must agree with all decisions of the shareholders and directors meetings.

5. The consortium cannot charge more than 20% over the tariffs charged by the first operator. It should be noted that the tender documents allowed for up to 40% surcharge.

The Guardian Council – which is in charge of vetting parliamentary laws – in March 2005 objected to a number of the provisions based on Articles in the Constitution dealing with state monopoly as well as national security. The parliament has not yet responded to the objections of the Guardian Council. It has the option of either accepting the objections and changing the provisions accordingly or referring the matter to the Expediency Council for final resolution.

Recent Treaties between Iran and Other Countries

Bilateral Investment Treaties

In addition to our list provided before, Iran has ratified Bilateral Investment Treaties further with:

- Algeria
- China

Double Taxation Treaties

Also, more Double Taxation Treaties are ratified between Iran and:

- Tunisia
- Spain

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