The Development of Iran’s Upstream Oil and Gas Industry

This book critically examines different forms of petroleum contracts, the historical perspective of the oil and gas industry and the political economy of the petroleum development in Iran.

In doing this, the author provides analysis of the concept of concession in oil and gas development. This is discussed through the main forms of concession contracts; namely, the classic concession contract (CCC) and the new concession contract (NCC). The book ties together much of the existing work on the history of oil and gas regulation in Iran and builds on that foundation to propose a coherent and balanced approach within the framework of the NCC. To consider the role of the NCC in developing national upstream oil and gas industry, comparative examples are drawn from countries currently using, or having previously used, NCC oil and gas contracts. The selected developed and developing countries are Brazil, Thailand, the United Kingdom, Australia and Norway. The analysis considers the extent to which the NCC has served to advance the objectives and national interests of the national governments in this industry. The book involves a comparative exploration of the utilisation of NCCs in other jurisdictions and synthesises a framework through which Iran may develop its underutilised oil and gas resources.

Of interest to academics, students and practitioners throughout the world, this book focuses on the relevant aspects of Iran’s Constitution and natural resource laws and makes recommendations for law reform to Iran’s legal frameworks.

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The Development of Iran’s Upstream Oil and Gas Industry
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Mahmoud Fard Kardel
The Development of Iran’s Upstream Oil and Gas Industry
The Potential Role of New Concession Contracts

Mahmoud Fard Kardel
This book is dedicated to:

God Almighty, my creator, my source of inspiration, wisdom, knowledge and understanding;

My honourable father and all great martyrs who are eternal teachers;

My admirable mother, the symbol of sacrifice and a person who taught me that even the largest task can be accomplished if it is accomplished one step at a time; and

My beloved brother, who stood by me in difficult times and is always a symbol of loyalty.
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The types and forms of oil and gas contracts play an important role in the negotiation of financing, operations and risk and profit sharing in the development of the upstream oil and gas industry in Iran. Different forms of contracts co-exist in this globalised industry dominated by multinational oil and gas corporations. Increasingly, developed and developing countries have found it necessary to reconsider the forms of contract they enter into in consideration of whether they have served the nation’s interests in oil and gas development in the past or are likely to in the future.

Iran has a unique historical context and legal system in relation to oil and gas exploration and exploitation. This book focuses on the legal and contractual framework of the Iranian oil and gas industry from discovery to present day. This has been classified into three periods: from exploration of oil in Iran to nationalisation (1901–1951), from nationalisation to the Islamic revolution (1951–1979) and from revolution to the present day (1979–2018). It considers the strengths and weaknesses of past and present contractual forms having regard to the national interests of the Iranian government.

Exerting State control over all oil and gas production stages, especially upstream stages, has been popular from a historical perspective. However, regard should be given to the high costs of investment in oil projects and the risks where profitability and return of the capital is doubtful. In addition, oil-rich countries like Iran generally lack the required technology to efficiently exploit its resource fields as well as the financial resources for infrastructure development. The result has been a distortion of negotiations, particularly over all aspects of financing, infrastructure and the allocation of project risks.

The central theme of this book is the analysis of the concept of concession in oil and gas development. This is discussed through the main forms of concession contract; namely, the classic concession contract (hereafter referred to as CCC) and the new concession contract (hereafter referred to as NCC). The present study examines the nature and features of the NCC as both a unique type of oil and gas contract and as a modified version of a concession contract. The research reviews other forms of contracts to have been adopted in Iran and compares them with other arrangement such as joint venture contracts, production sharing agreements, service contracts and buy-backs used internationally by sectors of the oil and gas industry.
Abstract

To consider the role of the NCC in developing national upstream oil and gas industry, comparative examples are drawn from countries currently using, or having previously used, NCC oil and gas contracts. The selected developed and developing countries are Brazil, Thailand, the United Kingdom, Australia and Norway. The analysis considers the extent to which the NCC has served to advance the objectives and national interests of the national governments in this industry. The implications for future contractual arrangements for this sector in Iran are considered, having regard to the experiences of the NCC discussed.

The final chapters of the book focus on the relevant aspects of Iran’s Constitution and natural resource laws and make recommendations for law reform to Iran’s legal frameworks. It argues such reforms are required to implement the NCC as a contractual form for future upstream oil and gas development in Iran.
Selected acronyms

AGIP Azienda Generale Italiana Petroli
AIOC Anglo-Iranian Oil Company
APOC Anglo-Persian Oil Company
BBL unit of volume for crude oil and petroleum products
BOT Build, Operate and Transfer
BP British Petroleum
BPD Barrels Per Day
BBC Buy-Back Contract
CCC Classic Concession Contract
CFP Company France petroleum
DCF Discounted Cash Flow
DA Designated Authority
DMR Department of Mineral Resources
ERAP Entreprise de Rechereche et d'Activités Pétrolières
EBG Exclusive Benefit to Government
EEA European Economic Area
FIPPA Foreign Investment Promotion and Protection Act
FDI Foreign Direct Investment
GSF Geological Stability Factor
ICJ International Court of Justice
ICL International Constitution Law
IEA International Energy Agency
ILUA Indigenous Land Use Agreements
IOC International Oil Company
IPAC Iran Pan American Corporation
IPC Iran Petroleum Contract
JA Joint Authority
JOA Joint Operation Agreement
JVA Joint Venture Agreement
LPG Liquefied Petroleum Gas
LIBOR London Interbank Offered Rate
LTEOSA Long-Term Export Oil Sale Agreement
MEP Minimum Exploration Plan
<table>
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<tr>
<th>Acronym</th>
<th>Description</th>
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<tbody>
<tr>
<td>MCC</td>
<td>Modern Concession Contract</td>
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<tr>
<td>MLR</td>
<td>Modern licensing Regime</td>
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<tr>
<td>NCC</td>
<td>New Concession Contract</td>
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<tr>
<td>NCS</td>
<td>Norwegian Continental Shelf</td>
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<tr>
<td>NEPC</td>
<td>National Energy Policy Council</td>
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<td>NIOC</td>
<td>National Iran Oil Company</td>
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<tr>
<td>NPA</td>
<td>National Petroleum Agency</td>
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<tr>
<td>NSW</td>
<td>New South Wales</td>
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<tr>
<td>OPGGSA</td>
<td>Offshore Petroleum and Greenhouse Gases Storage Act</td>
</tr>
<tr>
<td>OC</td>
<td>Oil Company</td>
</tr>
<tr>
<td>OPEC</td>
<td>Organization of Petroleum Exporting Countries</td>
</tr>
<tr>
<td>PEM</td>
<td>Plano Exploratorio Minimo</td>
</tr>
<tr>
<td>PEPR</td>
<td>Program for Environment Protection and Rehabilitation</td>
</tr>
<tr>
<td>PRT</td>
<td>Petroleum Revenue Tax</td>
</tr>
<tr>
<td>PSA</td>
<td>Production Sharing Agreement</td>
</tr>
<tr>
<td>PSC</td>
<td>Production Sharing Contract</td>
</tr>
<tr>
<td>ROR</td>
<td>Rate Of Return</td>
</tr>
<tr>
<td>RSA</td>
<td>Risk Sharing Agreement</td>
</tr>
<tr>
<td>SA</td>
<td>Southern Australia</td>
</tr>
<tr>
<td>SIRIP</td>
<td>Societe Irano-Italienne des Petroles</td>
</tr>
<tr>
<td>SRB</td>
<td>Special Remunerator Benefit</td>
</tr>
<tr>
<td>SDFI</td>
<td>State Direct Financial Interest</td>
</tr>
<tr>
<td>TCF</td>
<td>Trillion Cubic Feet</td>
</tr>
<tr>
<td>UK</td>
<td>United Kingdom</td>
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<tr>
<td>US</td>
<td>United States</td>
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<tr>
<td>UGPC</td>
<td>Upstream Government Petroleum Contract</td>
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<td>WA</td>
<td>Western Australia</td>
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Key definitions

**Agreement**: A mutual understanding between two or more persons about their relative rights and duties regarding past or future performances; a manifestation of mutual assent by two or more persons.¹

**Contract**: An agreement between two or more parties creating obligations that is enforceable or otherwise recognisable at law.²

Upstream oil and gas industry: Exploration, extraction, exploitation and production of crude oil and natural gas.³

**Downstream oil and gas industry**: Transportation, refining and marketing of crude oil and natural gas.⁴

**Classic Concession Contract**: Specific privileges⁵ to natural or juridical persons. The Concession is an arrangement whereby the International Oil Company (IOC) is granted the right to explore and exploit oil and gas in exchange for the payment of all costs and also specific taxes related to the operation.⁶

**New Concession Contract**: An agreement which retains the basic legal format of the classic concession, but which has significant modification to the financial terms and features of its prototype.⁷

**Production Sharing Agreement**: An oil and gas contract between a multinational oil and gas company and a host government, in which the corporation provides capital investment in exchange for control over an oil and gas field and access to a large share of the revenues from it.⁸

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⁴ Ibid.
⁵ Campbell, above n 1 361.
**Key definitions**

**Joint Venture**: One form of current oil and gas contract involving a business undertaking by two or more persons engaged in a single defined project.\(^9\)

**Buy-back Contract**: A financing arrangement in which the developer sells a property to an investor and then buys it back under a long-term sales contract.\(^10\)

**License**: Grants the investor the right to exploit a defined area in consideration of a fee and/or royalty payment.\(^11\)

**Exploration license**: A permit to only geological and geophysical surveying and the drilling of shallow wells to get petroleum.

**Production License**: An exclusive right on the licensee to search and bore for petroleum.

**Reservoir**: A subsurface, porous, permeable rock formation in which oil and gas are found.\(^12\)

**Service Contract**: An agreement whereby the government (state) would grant contractual (but not proprietary) right to an oil company, however retains majority control over the operations and the contractor provides the necessary services required to carry out the project.\(^13\)

**Oil and Gas Royalty**: Payment expressed as a percentage of the oil and/or natural gas volumes produced by the licensee in a concession contract which is payable in cash or kind (as government prefers) to the owner of the petroleum in situ, to both onshore and offshore production.\(^14\)

**Oil and Gas Income Tax**: is included in the profit oil and gas (that is calculated by subtracting the royalties paid, transportation cost, amortisation cost and exploitation costs from the gross income) received by the government.\(^15\)

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\(^9\) Campbell, above n 1, 973.


\(^11\) Mohammad Alramahi, *Oil and Gas Law in the UK* (Bloomsbury, 2012) 5.

\(^12\) Anthony Jennings, *Oil and Gas Exploration Contracts* (Sweet & Maxwell Publish, 2002) 56.

\(^13\) Alramahi, above n 11, 6.


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1 Introduction

1.1 Classic concession contract

A CCC is a contract by which a government, or a governmental organ, hands over the administration of an organisation or a public service such as mines to natural or juridical persons. These persons put in their own capital to cover costs within a specified and limited time against which sums are collected from the users of the public services.\(^1\) Payments are made to the government in consideration of the benefits gained from the use of public resources for a lengthy, but also fixed, period of time through mechanisms such as royalty payments.\(^2\) The features of a CCC include a long time period public service lease (usually 75 years or more) and territorial coverage that in some cases includes the whole or large part of countries such as Iraq, Libya, Oman and Iran.\(^3\) In these contracts, arbitration is used to resolve disputes between the parties, and the formula for calculating taxation is simple, or there is no provision for taxation.\(^4\) This older form of concession contract is sometimes referred to as the CCC.

1.2 New concession contract

The NCC is an agreement between a government and an international oil company (IOC). The government authority grants rights and agrees to the obligations to be undertaken by the IOCs in relation to the construction, refurbishment or provision of infrastructure, or to explore for and exploit the country’s petroleum. It also reserves and transfers considerable discretion over most aspects of development to the country.\(^5\) The term ‘new’ not only suggests

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4 Taher Estakhti, above n 1, 32.
5 Rainer Geiger and Aril Seren, *Basic Elements of a Law on Concession Agreements* (Organization for Economic Co-Operation and Development (OECD), Multilateral Centre for Private Sector Development Istanbul, 2001) 8.
2 Introduction

a new area in which the contracts are concluded but also refers to the incorporation of new trends into the contract and an attempt at a rational development of the country’s natural resources. To take control over resources, the relationship between developing countries and IOCs evolved from collector of royalty payments to equal profit sharing. In addition, the role of the host country had essentially changed from a passive rent collector to an active partner. An example of an NCC is provided by Thailand. The Thailand concession system, patterned on the traditional concession agreement which is a model contract of standard terms and conditions, clearly represents an example of NCC, and this is discussed in Chapter 4 of this book.

The NCC has several distinguishing features from the CCC such as shorter contract periods, a work obligation, relinquishment clause, bonus payment and higher royalty. In fact, the NCC provides for the host country to have a more active role and a corresponding decrease in the responsibilities and rights of the IOC. Such modifications, however, did not alter the legal nature of the concession agreement. Only the terms were different under the early concession systems with the result that the features most disadvantageous for the host country were progressively eliminated.

It should be noted that the NCC has advantages and satisfies most of the major demands of the host countries including its authority to exercise some review of, and control over, the concessionaire’s decision. However, it is extremely persuasive IOCs to expand their investments in new oil and gas fields and its high revenues.

1.3 Need for Iran to transition to NCC

Governments can select different kinds of contracts depending on their circumstances; resource geology and economic, social and political conditions. A state can negotiate many types of contractual frameworks, taking into consideration different conditions in matters such as global markets, geographical situation, production costs and field-related risk factors. Iran requires hundreds of billions of dollars in investments to explore and exploit its oil and gas fields over the next two decades. For this to occur, Iran needs to address the desirability and interests of international investing companies in the types of concession contracts it offers.

The NCC and associated legal regime for Iranian oil and gas fields may help to attract overseas investors with the appropriate technical expertise. The costs and risks are high in some Iranian oil and gas fields such as those which have no exploitation record, no extraction infrastructure installations, the possibility of

6 Blinn et al, above n 3, 276.
yielding no product and located in difficult and mountainous regions. While an NCC often grants an oil company exclusive rights to explore, extract, develop, sell and export oil or minerals extracted from a specified area for a fixed period of time, the biggest advantage of NCC for a country like Iran is that the state bears no liability as to the different risks inherent to every oil and gas project.

This research study examines the legal framework of Iran’s oil and gas contracts with legal and comparative analysis between them (Chapter 2). The analysis involves identifying the distinguishing characteristics of NCC and CCC (Chapter 3), discussing comparative contractual approaches in selected countries (Brazil, Thailand, Australia, the UK and Norway) that used, or are still using, the NCC in their oil and gas fields (Chapter 4). The purpose of the comparative examples is to consider the appropriateness of NCCs for the future development of Iran’s upstream oil and gas industry. This book considers other current oil and gas contract frameworks (e.g., production sharing agreement, participation agreement, joint venture, service contract), and the book also considers the positive and negative aspects of the CCC and NCC compared to these other contracts (Chapter 5). Finally, the book reviews the existing legal framework in Iran and the opportunities and barriers to adopting the most appropriate form of contract (Chapter 6).

1.4 Main question

The main question addressed is:

How desirable is the NCC for the future development of Iran’s oil and gas fields?

This is the major focus of the related main questions detailed below:

1. What are the legal frameworks and key characteristics of past and present oil and gas contracts in Iran?
2. What are the strengths and weaknesses of these past and present contractual forms (considered through comparative legal analysis) having regard to Iran’s national interest in the development of the upstream oil and gas industry and in the context of Iran’s legal system?
3. What contractual form is most appropriate to develop the future upstream oil and gas industry in Iran having regard to the interest of the government of Iran?
4. To what extent would the chosen contractual form need to be modified to overcome weaknesses in prior practices and to meet the future needs of developing Iran’s upstream oil and gas industry?
5. What reform is necessary to Iran’s legal frameworks that would be required to implement this recommendation?

9 Ameri and Shirmardi, above n 7, 89.
1.5 Background of Iran’s oil and gas contracts

Iran, as one of the Organisation of Petroleum Exporting Countries’ (OPEC) founding members, is the OPEC’s second largest oil producer and the fourth-largest crude oil exporter in the world. Iran holds around 158 billion barrels of proven oil reserves, which is approximately 10 percent of the world’s total proven petroleum reserves. Iran also holds the world’s second-largest natural gas reserves. The legal frameworks of the Iranian oil industry have generally been classified into three distinct time periods.

1.5.1 Pre-nationalisation period (1901–1951)

There was never an oil law before the oil Nationalisation Law of 1951. Generally, in that time, agreements were through bilateral negotiations for producing oil. In other words, there were no existing legal frameworks in place to inform the negotiation process between the two parties.

Basically, concessions were typically signed between Iranian rulers and foreign individuals or companies like other oil-rich countries at the time. Regarding the absence of oil legislation, the rulers were not subjected to legal restrictions on the type of contracts, terms and conditions that they could agree upon. The two main agreements entered into, before the nationalisation of Iran’s oil industry in 1951, were the D’Arcy Concession (1901) and the 1933 Concession Agreement. Regarding the D’Arcy Concession (1901), D’Arcy was given exclusive privilege to Iran’s oil exploration throughout all of Iran (except five provinces) for a period of 60 years. In exchange, D’Arcy agreed to pay to the government a few bonuses and 16 percent of the company’s annual profit. Regarding the 1933 Concession Agreement, the Anglo-Iranian Oil Company (AIOC) sought to extend the D’Arcy Concession by 20 years. After long negotiation, though the AIOC and the government agreed to a payment of 750,000 pounds annually plus a royalty to the government however, the concession structure remained in place. These concessions will be described in greater detail in Chapter 2.

10 OPEC was formed in 1960 when five oil-producing nations: Iran, Iraq, Kuwait, Saudi Arabia and Venezuela met to address the question of falling oil prices.
14 Ibid. 113.
15 Ibid. 113.
16 Anglo-Persian Oil Company, Agreement of 28th May, 1901 (the D’Arcy Concession) between, the Governments of His Imperial Majesty the Shah of Persia Ad William Knox D’Arcy (London) appendix to annex 1419.
1.5.2 Hybrid period (1951–1979)

Nationalisation in Iran, like every country with nationalisation experience, was impacted by several factors such as financial inequalities, rampant poverty, revival of lost dignity and the non-acceptance of foreign interference. These factors gave rise to a nationalistic movement in Iran pioneered by Prime Minister Mosaddegh, which culminated in the nationalisation of the Iranian oil and gas industry in 1951. The Nationalisation Law was validated by the Iranian parliaments in 1951. Before the 1979 revolution, two parliaments (the National Parliament and the Senate) were both required to validate concessions before they could come into force. The entire oil and gas industry was nationalised and all relevant stages “including exploration, development and exploitation were to be carried out and controlled solely by the Iranian government.” For the first time in the history of Iran, the country was legally considered the owner of its petroleum wealth.

At the time of the nationalisation of Iran’s oil and gas industry, Britain and America felt that their economic interests were being threatened and orchestrated a political coup in Iran in 1953. In the summer of 1953, the Iranian coup d’état, known in Iran as the 28 Mordad coup, ended in the downfall of Mosaddegh and his cabinet. The coup was orchestrated by the United Kingdom (UK) under the name, ‘Operation Boot’ and the United States (US) under the name, TPAJAX Project. As Palash Ghush mentioned: “Mosaddegh’s ‘crime’ had been to support the nationalization of Iran’s key oil industry – a grave affront to British oil companies. The 1953 coup ended Iran’s attempt to control its own hugely lucrative petroleum sector”.

Following the political coup, the 1954 Consortium Contract was signed with IOC. The consortium consisted of the AIOC (which later changed to British Petroleum Company), Royal Dutch-Shell, the five US companies (Standard Oil (NJ), Socony, Socal, Texas and Gulf) and Compagnie Française des Pétroles. The Consortium Contract 1954 was thus a contract between Iran and a consortium of IOCs for the exploration of Iran’s resources which substantially revised to provide more benefits to the IOCs.

This contract, called an ‘Amini-Page Contract’, involved the Iranian government granting rights to oil and gas exploration, extraction and selling phases to IOCs, despite the 1951 Nationalisation Oil Act. Also, Iran agreed to royalty

17 Nasrollahi Shahri, above n 13, 4.
19 Mark Gasiorowski, Mohammad Mosaddeq and the 1953 Coup in Iran (Syracuse University Press, 2004) 130.
20 Ibid. 137.
22 The major objectives of Iran’s nationalisation consisted of: the establishment of Iran’s sovereignty, ownership and control of the country’s oil industry and resources, and to control all operations of exploration, extraction, and exploitation.
payments (under the somewhat vague name of ‘declared payment’). The consortium agreed to share profits on a 50-50 basis with Iran, “but not to open its books to Iranian auditors or to allow Iranians onto its board of directors”. 23

During this period, both the Petroleum Act 1957 (as Iran’s first Petroleum Act) and the Petroleum Act 1974 were approved. The Petroleum Act 1957 permitted production sharing agreements and the Petroleum Act 1974 permitted service contracts25 (the concept of “Risk Service Contract” (RSC) was introduced for the first time in Article No. 3)26 for Iran’s oil and gas sectors.

1.5.3 Contemporary period (1979–2018)

The 1954 Consortium agreements, as well as all other contracts thought of as contrary to Iranian law, were unilaterally ended after the 1979 Islamic Revolution. All petroleum contracts now had to accord with Iran’s new Constitution (Islamic Republic of Iran Constitution),27 the 1987 Petroleum Act and other petroleum Acts and legislations.28 The significance of this Act was that it outlawed foreign investment completely, rendering Iran’s petroleum industry independent from any foreign assistance or participation. For this reason, the Petroleum Act of 1987 ratified on 1st October of that year cancelled all foreign investments in Iran’s petroleum industry.29

1.6 Overview of Iran’s oil and gas legal development

The beginning of the oil and gas industry in Iran was marked by the exploration of the nation’s sedimentary basins. Officially, it commenced with the concession granted to W.K. D’Arcy by the Iranian government (Persia) in 1901 for the extraction and production of oil. Therefore, the early concessions go back more than 100 years.30 The first significant point regarding the early concessions was that the geographic area of operation was very wide. The next distinguishing

25 In this contract, the contractor (IOC) had to conduct upstream exploration entirely at its own risk, and had no right to the reserves discovered or to the production from any field developed. If exploration led to a commercial discovery, the IOC had to develop the oil field under the supervision of the NIOC.
26 The text of the Act was published by Public Relations Affairs, Iranian Oil Industry in 1974.
feature of early concessions is related to the duration of the agreement. Sometimes, this sort of agreement was binding for more than 60 years – a very long time. The remarkable point in respect to these kinds of agreements is that the foreign companies were regarded as the exclusive owner of the petroleum reserves in the area covered by the agreement. The ownership and control over equipment and installations used for the purpose of the contract remained with the concessioner.31

For this reason, from 1954 the concession regimes and associated Consortium Contracts in Iran’s oil and gas sector were amended and revised. In order to encourage private investment in oil and gas, the Iranian Parliament passed a new Petroleum Law in July, 1957.32 It aimed at providing a different basis for Iranian oil and gas operations that provided a middle way between the concession system (where the Iranian Government had to assume the role of bystander and rent collector with no control over the management or direction of this most strategic industry) and the opposite extreme epitomised by the Nationalisation Law of 1951.33 The Iranian parliament decided to revise the structure of the oil and gas concession framework soon after Iran’s independence as it desired to earn higher oil and gas revenues with more direct participation by the national government.34 This placed heavier financial burdens and greater risks on the international companies.35 The government sought to control all operations of exploration, extraction and exploitation.36

The severe economic consequences following the ratification of the 1951 Oil Nationalisation Act demonstrated that a more pragmatic approach was required to attract and retain investment in Iran’s crucial oil and gas sector. In July 1957, the parliament passed the Petroleum Act 1957. Based on this law, the government wanted active involvement in this key industry through partnerships with foreign corporations holding the expertise and capital to undertake the risky and invariably long-term investments that characterised it. The Petroleum Act 1957 was an enabling statute authorising the National Iran Oil Company (NIOC) to enter into agreements with Iranian or foreign companies with a view to extending as rapidly as possible the research, exploration and petroleum extraction operations throughout the country and the continental shelf.37

31 Blinn et al, above n 3, 54.
32 Wall, above n 24, 8.
37 Wall, above n 24, 8.
Immediately after the passing of the Petroleum Act 1957, several oil and gas contracts were concluded between the NIOC and foreign companies. The first, in 1957, was with the Italian government-owned AGIP Mineral, which provided for the formation of an Iranian company, SIRIP. A second oil and gas contract was signed with Pan American Petroleum Corporation and led to the formation of the Iran Pan American Corporation (IPAC) in 1958. At the time, there was considerable media speculation about the fiscal terms of these contracts, which appeared to give the NIOC 75 percent of net profits realised from the investment. Such fiscal terms were unheard-of in petroleum investments at this time. In fact, the new contracts were participation agreements with IOCs in which risks and rewards were shared equally with the NIOC. However, because the IOC had to pay 50 percent of its share of profits as tax to the government of Iran, it effectively meant that 75 percent of the profit share went to Iran (i.e., the NIOC’s 50 percent share plus 50 percent of the second party’s profit of 50 percent). However, the IOC still received 50 percent of profits realised from its actual investment.

This type of contractual arrangement continued to operate in Iran as the basis of upstream contracts with the IOCs until 1974, when the worldwide petroleum industry’s fiscal system took on another dimension because of the first oil price shock, driving changes in Iran’s regime. Until the late 1960s, the global oil price had remained relatively low. However, there was an almost three-fold increase in crude oil prices from US$3.39 to US$9.35/Per Oil Barrel (BBL) during the five-year period from 1970 to 1974. This led to excessive profits for oil companies and drove home the disadvantages of the concession system to the host countries. This situation was one of the major factors that gave birth to new types of petroleum agreements. Indeed, many host countries introduced RSCs – whereby the contractor bears the entire financial risk and has no ownership rights either to the reserves discovered or to the production from the agreed area – and other service contracts. Alternatively, some host countries amended existing participation agreements.

After the Iranian Islamic Republic revolution of 1979, Iran implemented new Petroleum Law as part of the Petroleum Act 1987. This permitted buy-back contracts between the Ministry of Petroleum, state companies and local and foreign nationals. Buy-back contracts have similar features to RSCs. The contracts were originally designed in 1995 to develop existing oil and gas fields, but by...
2003 they had been extended to include the exploration and development phases for onshore and offshore oil and gas fields. The main features of a buy-back contract include contract duration of between five and seven years, and a fixed rate of return of 15 percent to 20 percent. The IOC is also required to transfer capital, technology and management skills. The project’s executive management is formed under the supervision of a six-member committee, comprising three representatives from each side. In the first year, the chairman of the committee is Iranian, with the nationality of the chair rotating thereafter on an annual basis. In addition:

- ‘the contractor has no further interest in the field after all costs have been recovered at the end of the amortisation period;
- the NIOC takes over the operation of the field upon the commencement of production and is responsible for the operating costs; and
- the contractor holds no equity in the field’.

Exerting government control over all oil and gas production stages, especially upstream stages, has been popular from an historical point of view as well as politically popular. However, due to problems such as the high costs of investment in oil and gas projects, the high level of risk, the costs the government is bound to pay in these agreements and the Iranian government’s reluctance to invest public funds in fields where the profitability and return of the capital is doubtful, the realisation of these policies was improbable. This gap requires a better understanding of the reality that oil rich countries, like Iran, often face the problem of a lack of adequate financial resources for infrastructure investments. This led to a practice in the various contracts concluded by Iran whereby, irrespective of which contractual framework was utilised, a clause was incorporated stating that if the operating company incurs costs from the exploration phase up to the time the production becomes commercial, the government is bound to pay the investment costs only if the operation leads to the commercial outcome. Therefore, the oil- and gas-producing states could devise a formula which exempts them from the heavy costs of investment and at the same time recognise the share of the state in the revenues of the project. Different projects required different
frameworks and, in this sense, using a single type of contractual form for all projects was not justifiable.51

History has shown that the government may be forced to resort to complicated or indirect mechanisms such as buy-back contracts, with ambiguous rights and duties of parties that are subject to misinterpretation because of the complex structure of such mechanisms. Because of its long history, the concession system has a track record of making the rights of the parties more transparent in a dispute about the interpretation of contract provisions where a wide range of legal and judicial precedents and customs exist.52

The literature also suggests that the advantage of the concession system for a country like Iran is that the state bears no liability as to different risks inherent to every oil and gas project.53 Costs may put added pressure upon the public budget, and considering the economic problems the Iranian government must deal with to regulate its public finance, it is a matter which is undoubtedly unpleasant to the Iranian government. In buy-back systems, the government tried to discharge its financial obligations by incorporating clauses into the contracts, but in the concession system the discharge of the state’s financial liabilities is the essence of the contract.54

Finally, there is evidence that the concession contractual framework may more efficiently deal with the lack of adequate financial resources for investment for the discovery and exploitation of oil and gas in many of the regions of the Iran Plateau.55 It is important to consider the viability of the NCC, and its transformation to one of the recognised and accepted types in the Iranian legal system, as a way to provide an improved contractual framework for attracting investment in new fields and improved trade competitiveness (particularly with Saudi Arabia).56

1.7 Methodology

This book follows a qualitative research method. Qualitative research methods attempt to glean the insider’s view of the topic, not necessarily the objective truth, but the truth as the information perceives it.57 Qualitative methods have links with postmodernism, whereby the multifaceted aspects of experience are duly recognised. Qualitative research methodologies acknowledge that there is

51 Ansari, above n 8, 98.
52 Jenik Radon, ‘The ABCs of Petroleum Contracts: License-Concession Agreement, Joint Ventures, and Production Sharing Agreements’ 63–64.
54 Shiravi and Ebrahimi, above n 43, 201.
56 Iran and Saudi Arabia are traditional rival in OPEC and they have continuous competitive in terms of oil production amount.
not one overriding reality, but that reality is situational, personal and between context and individuals. In other words, qualitative research methods are particularly suitable for gaining an in-depth understanding of underlying reasons and motivations. It provides insights into the setting of a problem. At the same time, it frequently generates ideas.\textsuperscript{58} It also uses theoretical, analytical, historical and comparative approaches to oil and gas contractual forms and evolution in selected comparable countries. This book, like most legal books and researches, applies the two-part doctrinal method: locating the sources of the law in legal system in Iran, and then interpreting and analysing the text of these laws. It also uses form-oriented approaches that have regard to the national interests of the government of Iran in the future development of upstream oil and gas fields.

This book reviews current Iranian legal regimes governing oil and gas contracts for the development of the upstream oil and gas industry. This review, as well as the comparative theoretical analysis of contractual forms, provides the basis for recommendations on the future development of oil and gas contracts in Iran.

This research includes secondary resources such as articles, books, Iran’s Foreign Ministry and oil and gas documents, magazines, theses and dissertations undertaken at domestic and foreign universities, expert bulletins of multinational oil and gas companies, international investment recommendations of United Nations (UN) Economic and Social Council and the publicly available texts of concluded contracts in the field of oil and gas in Iran and other countries relying on the upstream oil and gas industry. The focus is on the CCC and NCC.

Issues of confidentiality and access to commercial negotiations mean that it was necessary to heavily rely on secondary resources such as those described above. The important research dimension is the application of research to the relevant aspects of the Iranian legal system for the future development of Iranian oil and gas contractual frameworks.

1.8 \textbf{Book structure}

To achieve the above goals, this book has been divided into six separate chapters, each divided into several parts.

Chapter 2 outlines the history and legal framework of Iran’s oil and gas contracts such as concession contracts, production sharing agreements, service contracts and buy-back contracts with legal and comparative analysis between them. In addition, the characteristics of the upstream oil and gas industry in Iran and related exploration issues are discussed.

Chapter 3 explains the nature and features of the CCC and the characteristics that distinguish it from the NCC. Part one considers the nature and features of CCC, part two explains the nature and features of NCC and part three distinguishes the difference between them.

\textsuperscript{58} Terry Hutchinson, \textit{Researching and Writhing in Law} (Thomson Reuters, 3rd ed, 2010) 106.
Chapter 4 examines the NCC in upstream oil and gas industries including Brazil, Thailand, Australia, the UK and Norway, with a critique of the special features of NCC having regard to the circumstances of Iran.

Chapter 5 considers the regimes competing with the NCC such as production sharing agreement, joint ventures, service contract and buy-back contracts as current oil and gas contractual agreements in Iran. The new Iranian Petroleum Contract is examined. Attention is also given to the positive and negative points of the NCC having regard to these other contract forms.

Chapter 6 critiques the NCC under the Iranian legal system and the viability of these contract types to support Iran’s oil-based economy to attract more foreign investment. This chapter also considers what reforms to Iran’s legal frameworks are necessary and what reforms to the NCC framework are necessary to better comply with Iran’s statutes. This requires the context of Islamic law in Iran, an overview of existing oil and gas legal framework in Iran and consideration of the opportunities and barriers to adopting the NCC for upstream oil and gas development. Regard is given to the Iranian legal system and to proposing the NCC framework for Iran’s upstream oil and gas industry.

1.9 Conclusion

This chapter defines the key terms and concepts used throughout this book. The central questions for this book are identified and the associated methodology and book structure are outlined. Further, a brief review of Iran’s oil and gas legal history and framework since the discovery and extraction of Iran’s oil is provided, along with details of the development of the original CCC in Iran. The potential NCC is also discussed.
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