INVESTMENT IN IRAN

AFTER IMPLEMENTATION DAY

With secondary sanctions against Iran lifted, what protective mechanisms are available to investors including Iran's domestic legislation and appropriate treaties? **Danielle Morris**, counsel, and **Desley Horton**, senior associate, at **WilmerHale**, identify factors investors should consider, including the use of international arbitration in resolving potential disputes and maximising protection for foreign investment

January 16, 2016, marked the Implementation Day that recognised the certification by the International Atomic Energy Agency that Iran had met its obligations under the July 2015 Joint Comprehensive Plan of Action (JCPOA), a deal between Iran, the **European Union**, France, Germany, the United Kingdom, China, the Russian Federation and the United States, to lift nuclear-related sanctions in exchange for Iran dismantling elements of its nuclear programme.

With this certification, a number of the sanctions that have strangled the Iranian economy (from the EU+3 group of countries mentioned above, among many others) since 2005 were lifted. While some US sanctions against Iran will be maintained (those sanctions relating to Iran's support for terrorism and its human rights record), at least 300 Iranian companies and individuals have been removed from the sanctions list and, conservatively, USD 40 billion worth of assets have been unfrozen.

With the lifting of sanctions, not only are European countries anticipating investment from Iranians removed from the sanctions list, but there is an expectation that capital will flow into Iran from investors interested in the opportunities available.

Investment is likely to be made in large-scale infrastructure projects, the financial services sector and the oil and gas industry (which has suffered from a shortage of capital investment and remains underdeveloped). In addition to European investment, substantial investment

is expected to come from increased trade with China, India, Japan and South Korea (to whom Iran has consistently sold oil), as well as traditional trading partners such as Turkey and Pakistan.

Before eager investors seek out opportunities to invest in Iran, there are relevant concerns about the protection such investments would receive. Although Iran is no stranger to international adjudication procedures, having participated in long-running proceedings before the **Iran-US Claims Tribunal** (established by the Algiers Accords in the wake of the US Embassy hostage crisis), that body's jurisdiction is limited to claims arising before February 1982 – and thus cannot offer any protection to prospective investors. We discuss current protections for foreign investment below.

Iran's Foreign Investment Promotion and Protection Act

All foreign investments made pursuant to an investment license from the Organization for Investment, Economic and Technical Assistance of Iran (OIETAI) are guaranteed a series of substantive protections under Iran's Foreign Investment Promotion and Protection Act (FIPPA), which was enacted in 2002.

These include the same rights, protections and facilities available to domestic investors, protection against expropriation and nationalisation, and the free transfer and repatriation of foreign capital and profits. Although these standards of protection resemble those often found in bilateral investment treaties (BITs), there are some important differences.

First, although the FIPPA provides compensation for direct expropriation where the Iranian government transfers physical ownership or title of an asset to a state entity or third party, it is less clear whether it protects against indirect expropriation. There is debate among commentators that it may not, on the basis that the Article under which compensation is granted for adverse legislative changes is confined to project finance agreements, to the exclusion of foreign direct

investment projects. This position, if upheld by the Iranian courts, would significantly limit the scope of protection under the FIPPA against adverse regulatory changes.

Second, under the FIPPA, profits from foreign capital and investment are only transferable abroad following the approval of the OIETAI Board (constituted pursuant to the Act) and the Minister of Economic Affairs and Finance. In the case of capital, an investor must also give three months' notice of the intended transfer.

Third, and most importantly, should an investor wish to challenge a state action that has damaged its investment, the FIPPA provides that the only recourse is to Iran's domestic courts unless the investor can rely on a BIT providing a different dispute resolution mechanism.

Any available BIT, however, is likely to include substantive protections at least as favourable as those in the Act. Given the benefits of international arbitration, the FIPPA has significant disadvantages compared to the protections offered by BITs. This is especially true in light of the current lack of information available on the interpretation of the FIPPA by Iranian courts.

Bilateral Investment Treaties

In light of these potential concerns, the best protection available to foreign investors is likely to be BITs. For a nation with a recent history that includes substantial periods of isolation from the international community, Iran has concluded a large number of BITs: there are currently 52 BITs in force between Iran and other nations (predominantly entered into after Iran issued its Model BIT in 2001, and predominantly with nations in Central and Eastern Europe).

Despite the perhaps surprising breadth of Iran's BIT programme to date, there are nevertheless many states whose investors are unlikely to be covered by a BIT unless they structure investment carefully. For example, the US has only lifted secondary sanctions (applying to non-US nationals or companies), meaning that US nationals and companies are still not permitted to invest directly in Iran.

Although Iran is no stranger to international adjudication procedures, having participated in long-running proceedings before the Iran-US Claims Tribunal (established by the Algiers Accords in the wake of the US Embassy hostage crisis), that body's jurisdiction is limited to claims arising before February 1982 – and thus cannot offer any protection to prospective investors

Instead, US investors must invest via non-US special purpose vehicles (SPVs), preferably incorporated in countries that have negotiated favourable BIT protections. There are other investors in a similar position.

A number of nations that have lifted sanctions, or have stated an intention to do so, do not have BITs with Iran (for example, Japan, Canada and Australia). Nor do several nations that are typically used for investment structuring purposes (such as the Netherlands, Singapore or Luxembourg). As with US nationals, investors from these countries would need to invest via SPVs in order to ensure BIT protection for their investments.

In choosing among the BITs in force, investors may wish to pay particular attention to the definition of a qualifying investor, the applicable substantive protections and the available dispute resolution mechanisms. We address each of these below.

- ***The definition of a qualifying investor***

Some of Iran's BITs only protect companies that are incorporated and have their "real economic activities" in the other contracting state. The requirement of "real economic activities" is likely to exclude SPVs. Other BITs, however, require only incorporation or incorporation and seat in the other contracting state. Both of these definitions are likely to provide coverage for investment vehicles like SPVs and so may be more attractive to foreign investors seeking to structure their investment through a third country.

- ***The applicable substantive protections***

The vast majority of Iran's BITs offer investors national and most favoured nation treatment, compensation for both direct and indirect expropriation, the right to fair and equitable treatment, and free admission and repatriation of foreign capital and investment profits. Accordingly, the applicable substantive protections are unlikely to be determinative of a decision as to how to structure an investment in Iran.

- ***The available dispute resolution mechanisms***

Under Iran's Model BIT and the majority of its concluded BITs, the parties must first engage in negotiations to settle the dispute amicably. If that is not possible, the BIT provides recourse to international arbitration, as an alternative to adjudication before domestic courts. Unusually, however, Iran's Model BIT and many of its concluded BITs provide that either the investor or the host state has the option to file a claim before the domestic courts or to refer the dispute to arbitration. Such a provision raises the risk that Iran may bring parallel proceedings to any BIT arbitration in its domestic courts.

Arbitration

As for possible arbitral fora, Iran has agreed in the majority of its concluded BITs to refer disputes to ad hoc arbitration under the **UNCITRAL** Rules. In some cases, it has also provided for arbitration according to the rules of the **ICC**, **LCIA**, **SCC** and/or **DIS** (The German Institute of Arbitration), or any other rules agreed upon between the parties.

Although Iran has not acceded to the ICSID Convention, several BITs provide for referral to **ICSID** if both parties become member states. In short, there are a number of adequate arbitration mechanisms for investors to use.

There is a risk that Iran may refer to a provision of the Iranian Constitution in seeking to defend against an arbitration under one of its BITs. Specifically, there is a constitutional prohibition on referral to arbitration of a dispute involving Iranian public or government property without the prior approval of the legislature "in each case".

It is highly questionable whether such a domestic law requirement would have any bearing on Iran's international law obligations under a BIT – regardless of whether the BIT includes an express consent to arbitrate or implied consent by providing for investor-state dispute settlement.

Although Iran raised this objection in an ICC arbitration (and subsequent enforcement proceedings) against a British company (*Cementation International Ltd v. Republique Islamique D'Iran*), both the tribunal and the Swiss courts rejected the argument. There is no evidence that Iran has raised this objection again in any subsequent cases (including the recent *Turkcell* dispute). Nevertheless, there is still a risk that Iran could raise such an objection in the future.

Organisation of Islamic Cooperation (OIC)

Investors may also potentially utilise the Agreement on Promotion, Protection and Guarantee of Investments Among Member States of the Organisation of the Islamic Conference (APPGI), which entered into force in 1986. The APPGI provides investment protection to investors from the 27 member states of the OIC that have signed and ratified the agreement (of which Iran is one). The definition of a qualifying investor under the APPGI is broad and requires only incorporation in a member state.

Some of the APPGI's substantive protections appear less robust than typical BIT protections. For example, the APPGI does not contain reference to the fair and equitable treatment standard. The APPGI does include a most favoured nation (MFN) clause that might be used to incorporate more favourable standards, but it is difficult to predict with any certainty how such a claim might fare, with only one arbitration having been heard under the APPGI to date (the recent case of *Al Warraq v Indonesia*).

Although the claimant in *Al Warraq* was successful, with the tribunal upholding the claimant's interpretation regarding the operation of the MFN clause to find a breach of fair and equitable treatment by Indonesia, the debate among practitioners and academics as to the effect of MFN clauses remains. To that extent, there is uncertainty about the exact scope of the APPGI's substantive protections.

Conclusion

Iran has taken positive steps to promote and protect foreign investment. In addition to the economics of a particular project, investors seeking to make the most of the opportunities now available in Iran should carefully consider the protections available, and the real differences that may exist among the various mechanisms discussed above, in deciding how to structure their investments. ■

About the authors

Danielle Morris is a counsel in the litigation/controversy team at Wilmer Cutler Pickering Hale and Dorr LLP, and a member of the firm's international arbitration practice group in Washington D.C., focusing on both private and public international law. She advises clients on the substantive protections and dispute resolution mechanisms under various investment treaties, both bilateral and multilateral, and has represented both investors and States in investor-State arbitrations. Before entering private practice, she represented the US Government in arbitrations under the NAFTA and the Algiers Accords at the US Department of State.

Desley Horton is a senior associate in the litigation/controversy team at Wilmer Cutler Pickering Hale and Dorr LLP, and a member of the firm's international arbitration practice group in London. She has experience with representation of both private sector and government clients in international arbitration proceedings governed by various substantive and procedural laws. She has formerly practised as a barrister in Auckland, New Zealand.

www.wilmerhale.com