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THE IMPORTANCE OF FOREIGN INVESTMENT ATTRACTION IN OIL AND GAS INDUSTRY

ABOUTALEB BAZVAND

Research Scholar, Law Department, Osmania University, Hyderabad, India

ABSTRACT

The oil and gas industry has been one of the controversial issues among activists. The industry plays a crucial role in the securing economy of the oil-rich countries; apparently, their economies depend on oil and gas industry which has several sections. Clearly, investment in upstream oil and gas operation is substantial in the exploration and development of oil and gas field. There are different rules and regulations in upstream operation. The strict rules in this kind of contract exist because their attempt is to save the parties which are mostly governments or a foreign investor rights. These essential rules are applicable but disputes cannot be ignored due to some disagreements. If any foreign investment in upstream section is one of the parties, ownership of oil and gas resources right, the host government rules and the risk of investor are very important issues that have to be considered. This paper aims to examine these issues and study some of these related laws, as well as to provide an answer to the question as to what extent these laws and rules are able to provide an immune legal structure either for host government or foreign investment in upstream oil activities.

KEYWORDS*:* Oil and Gas Industry, Foreign Investment, Contract, Upstream, Rules

INTRODUCTION

Historically the basic source of financing in Iranian oil and gasindustry has been foreign investment. The upstream oil and gas contracts began with an unprecedented concession, The D'Arcy Concession[1], in 1901 between William Knox D'Arcy and Mozzafar al-Din Shah of Persia[2] in order to get the exclusive entitlement to prospect for oil in Iran (Paine 5-6).

Following the nationalization of oil in Iran and putting signature on 1954 Consortium Contract in 1954, Iran decided to open up itself to international investment and technology regarding exploration, drilling, and development of essential oil fields. On account of this, Iran transferred two laws and regulations: one in 1957 and another one in 1974. These laws and regulations have been arranged and adjusted devolving onIranian oil industry' ability to accomplish different levels of operations in production. Oil and gas contracts were started with full foreign ownership of the reservoirs in 1901 and with the related businesses within the framework of concession agreements. On the basis of these contracts, a foreign company supposed exclusive rights for all the oil it within Iran. The first of these contracts was agreed

[1] .Paine, Schoenberger, "Iranian Nationalism and the Great Powers: 1872–1954." MERIP Reports, 37, (1975), pp.5-6.
[2] . Yergin, The Prize: The Epic Quest for Oil, Money & Power. Free Press, 2008, p.119.

upon in 1872, as a form of full concession to Baron Julius de Reuters. [3]Then to 1901's D'Arcy Oil Concession, which was valid for sixty years.[4]

There are a great number of economic, political and legal ways of boosting the field for stimulating foreigners to inject their investment and finance in Iranian oil/gas industry. Yet, each one of these strategies may assist the other to do something in the best way, so they depend on the other person closely.

Iranian Constitution in Article 43 advises foreign financial domination in the country's commercial life whilst paragraph 2 of Article 44 proclaims that the state sector is to add all large ranges and "mother" market sectors including main minerals and Article 45 vests the disposition of public wealth and property, such as mineral deposits, in the Islamic state. More, regarding the Petroleum Act (1974), only service contracts are permitted. It has authorized by the Petroleum Act of 1987 that allow the establishment of contracts between your Ministry of Petroleum, the government companies and "local and foreign natural persons and legal entities. Actually, the bar on foreign ownership of minerals in the Islamic Republic of Iran has been expanded to mean a bar on the foreign control of reserves, a commentary that necessarily dictates that any foreign oil company might only practice as a Contractor to National Iranian Oil Company (NIOC) much less main party or owner.

Additionally, Article (3) of "Code on Encouragement and Protection of Foreign Investment" and its section (B) expresses that BOT, Buyback and Civil Partnership contracts could appreciate the legal facilities and assurance conceded by code. The mentioned "Civil Partnership "in this code generally interprets to incorporate Joint Venture contracts that are in reality a sort of partnership contract. Really as the Code explains, there is a creeping pattern in a new generation of economic regulation to open the Iranian market sector to outsiders and encourage them to invest in Iran, even through the legislation that is opposed of the Iranian governors' mottos at the first decade of revolution. The late pioneer's governmental instruction about principle 44 of the constitution for privatization of a considerable rundown of enterprises in Iran aside from upstream oil and gas industry is clearly observed a positive development with over 20 year delay.[5]

Concept of Upstream

Petroleum companies are generally divided into three sections: upstream, midstream and downstream. Upstream companies deal primarily with the exploration and prime production stages of the oil and gas industry. A huge number of major oil companies are called "integrated" due to mix upstream activities involving midstream and downstream operations, which take place after the production phase through to the point of sale.

What is the Difference Between Upstream and Downstream Oil and Gas Contracts?

Upstream oil and gas exercises recognize deposits, drill wells and recoup crude materials from underground. This area likewise incorporates related services, for example, rig operations, probability studies, and machinery rental and extraction chemical supply. China National Offshore Oil Corporation and Schlumberger are cases of larger companies that focus on upstream services.

[3] .Yeganehshakib, Reza.Iran's New Generation of Oil and Gas Contracts: Historical Mistrust and the Need for Foreign Investment, 2015.

[4] . Commonwealth Survey, Volume 5,page 431,Central Office of Information, 1959 - Great Britain

[5] . Mabadi , Amir Hussein. Legal strategies in upstream oil and gas contracts to attract foreign investment: iran's case, 2008.

Some of the largest upstream are the major enhanced oil and gas companies, for example, Exxon-Mobil. [6]

The Midstream section of the oil industry has a significant financial effect on a varied selection of people, firms, and countries worldwide even. It is an enormous, essential part that efficiently manages one of the very most difficult logistical obstacles in the global world.

As well regarding the economic contribution of the business enterprise itself additionally it is important to think about what the midstream section is really accomplishing.Finally the midstream sector provides an important interconnection between your upstream and downstream industries. That is also allows for the end consumers to acquire the products and use the services they are reliant on. Given the far-reaching characteristics of the oil industry and the huge amount of difference products that this plays a part in, it is clear why the industry is growing and usage is high at an all-time.[7]

Downstream operations comprise refineries and marketing. These services change the unrefined petroleum into utilizable items, for example, gas, fuel oils and petroleum-based items.Marketing services move the completed items from vitality organizations to retailers or end clients. Marathon Petroleum and Phillips 66 are two impressive cases of downstream companies**.** [8]

Host government contracts in the upstream oil and gas sector: Lately, the oil and gas industry has seen a surge in resource nationalism furthermore a huge shift in the complexity of host government allowing instruments. While as of late, the stream of resource nationalism appears to have stemmed, with different governments endeavoring to support international investment, particularly to unconventional or challenging reserves, host government share of profits from such operations keeps on rising. Since the spike of unrefined petroleum costs in the late spring of 2008, host governments around the globe have been attempting to assert a more rate of saw bonanza benefits in exploration and production ("E&P") operations.[9]

Oil and Gas Ownership Rights

There is private Ownership and Sovereign ownership of petroleum resources. These provide the owner with the Right to Royalty and Right to Petroleum tax etc.

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There is private Ownership and Sovereign owner of petroleum assets. These give the proprietor the Right to Royalty and Right to Petroleum charge and so on (oil and gas possession rights in Ghana and ramifications of the legacy

[7] . The Three Oil and Gas Energy Markets: What Is Midstream? STI group

[8] .Salkeld, Mark and ElizabethAquin, Patrick Delaney. The Petroleum Services Association of Canada (PSAC). June 29, 2012

[9].OGEL 4 (2010), inEditoria

reserve).[10]In the most nations in the whole world every single mineral resources is have a place with the government. This comprises every single worth rock, minerals, oil or gas found on or underground. Institution or people in those nations can't legitimately concentrate and offer any mineral stock without first getting an approval from the government.

Charge straightforward is the most essential sort of ownership. The owner governs the surface, the subsurface and the air upper a property. The owner and in addition has flexibility to offer, rent, abundance or twig these rights independently or totally to others. In the event that we audit the time before boring and mining, land exchanges were charge straightforward exchanges. Albeit, once commercial mineral production got to be plausible, the routes in which individuals own property getting an excess of confused. These days, the rent, deals, endowments and twig of the past have delivered a point of view where numerous individuals or companies have a fractional possession or rights to a few real estate parts.

A large number of states have decides the transfer of mineral rights starting with one owner then onto the next. They additionally have laws that control mining and drilling acting. These laws are unique in relation to one state to another. Concentrating on a mineral rights exchange or have enthusiasm about mineral extraction close to property it is important to understand the laws of state (mineral rights/oil and gas lease and eminence data –geology.com).[11]

Foreign companies working in Iran's oil and gas activities will take no privileges of possession or power over the nation's hydrocarbon holds or any production facility. In the new model of oil contracts, contractors take no rights over reservoirs, facilities or even production and NIOC is allowed to pay the contractors by cash or in the form of product. Generation from oil and gas fields will be done under the immediate supervision, control and authorization of the National Iranian Oil Company and the contractual worker is just an operational variable.

Production from oil and gas fields will be done under the direct supervision, control and enactment of the National Iranian Oil Company and the contractor is only an operational factor.The government has been taking a shot at the new contractual model as a substitution for buyback gets that have been set up in Iran's energy section for more than two decades. It demonstrates that buyback condition were not sufficiently appealing even before the fixing of worldwide sanction and constraint over Iran's economy.[12]

Contractor Risk and Absence of Return Investment from the Government in Iran

The new descendant of oil and gas contracts, (forth generation) will be still buy-back or service contracts. As indicated by Article 1, Section 27 and Article 8, Section 5, these contracts are like Open Capex[13](*Capital expenditure)*

[10] . Oil And Gas Ownership Rights In Ghana And Implications Of The Heritage Fund

[11] .Fitzgerald ,Timothy. Mineral Rights, Leasing, and Royalties Primer on Oil & Gas for Montana Landowners. Dept. of Ag. Econ. & Econ. Montana St. University.2015.

[12]. NIOC Underscores Iran’s Rights in Oil, Gas Contracts) August 17, 2016,Energy Wednesday.

[13] .As Margaret Rouse asserts that “A capital expenditure (Capex) is money invested by a company to acquire or upgrade fixed, physical, non-consumable assets, such as property, buildings and equipment or a new business. There are two types of Capex – those that are invested in to maintain existing levels of operation within a company and those that are invested in something new to foster future growth. Customarily, regardless of the manner of investment, Capex is money spent with the intent of initiating future cash flow and a substantial return on investment (ROI). Capex’s counterpart, operational expenditures (Opex), refers to the day-to-day costs of operation. A similar but not closely related term, forex,

that implies there is no cap on the contractual worker's costs in various phases of the operations. What's more, predicted in these contracts indicated by Article 6, Section 2, Subsection 2, in spite of the fact although the contractor (the second party) admits all the risks of exploration, if the investigation is not effective in discovery a commercial-scale field or reservoir, another exploration block will be determined to him with the same conditions expressed in the primary contract.

As indicated by Article 3, Section 1, in every one of the contracts these principles ought to be sought after: the government of the Islamic Republic of Iran 's right of ownership of the oil and natural gas resources and tank, that is rehearsed through the Ministry of Oil. Article 11, Section 5, additionally clearly expressed that the oil, gas or gas condensates or any material delivered as an aftereffect of production operation is the property of the first party that is Iran's Ministry of Oil.

Likewise, based on Article 3, Section 7, every one of the operations done by the temporary worker is under the supervision, possession, and for the benefit of the Iranian Ministry of Oil (First Party of the agreement), and the greater part of the property, for example, structures, products, gear, wells, and establishments, including those over-ground and underground, have a place with the Iranian Ministry of Oil since the starting date of the agreement.

It must be notice that under the same Note 2(s), the Ministry of Petroleum is approved to go into BOT, FBOT (fund, manufacture, work and exchange), FBO (back, form and work), turnkey plan and work, PPP (public–private company) and BOO (construct, own and work) understandings.

The Ministry of Petroleum has utilized four eras of buy-back contracts after presenting each new era; the MoP quit utilizing the earlier arrangement of buy-back contracts. To consider this reality the buy-back contracts can cover a drawn out stretch of time, a portion of the third era buy-back understandings (egJofayr Oil Field Development Project) are still as a result however no more issued.

This just means, the temporary worker ought to vigorously put resources into every one of the operations from the preparatory periods of the operation (investigations) to the advancement and generation organizes yet has no possession directly over neither hardware nor the delivered oil and gas. In view of Article 3, Section 3, All the temporary worker's (costs) including Direct Capital Cost (DCC), Indirect Cost (IDC), Cost of Money (CoM), Fees, and Operation Costs (Opex) ought to be secured from a part (Maximum half) of the delivered oil and gas from the field or the benefits made by the execution of the agreement taking into account the genuine cost of the created oil or gas at the season of payback.[14]

The IPC is, in general, more attractive to international oil companies as it offers more flexible terms with respect

stands for foreign exchange. To add, for tax purposes, CAPEX is a cost which cannot be deducted in the year in which it is paid or incurred and must be capitalized. The general rule is that if the acquired property's useful life is longer than the taxable year, then the cost must be capitalized. The capital expenditure costs are then amortized or depreciated over the life of the asset in question. Further to the above, CAPEX creates or adds basis to the asset or property, which once adjusted, will determine tax liability in the event of sale or transfer. In the US, Internal Revenue Code §§263 and 263A deal extensively with capitalization requirements and exceptions. Donaldson, Samuel A. Federal Income Taxation Of Individuals: Cases, Problems and Materials (2nd ed.). St. Paul: Thomson West, 2007. pg. 173

[14] .Yeganehshakib, Reza.Iran's New Generation of Oil and Gas Contracts: Historical Mistrust and the Need for Foreign Investment, 2015.

to price fluctuations and investment risks, and allows foreign investors to take equity stakes in joint venture companies, though the Iranian partner must hold the majority of the shares. The old buyback agreements covered only the exploration and development phases of a project and the fields were taken over by the National Iranian Oil Company (NIOC) once those phases were completed. In contrast, the IPC allows contracts terms of up to 25 years.

Iran has as of late executed another model for oil and gas contracts. The new Iran Petroleum Contract (IPC) substitutes the buyback agreements that prevented foreign investors from holding shares and from booking reserves in Iranian companies. The IPC is, by and large, more alluring to global oil companys as it offers more adaptable terms regarding value vacillations and speculation chances, and permits foreign speculators to take value stakes in joint endeavor companys, however the Iranian accomplice must hold most of the shares. The old buyback understandings secured just the investigation and improvement periods of a task and the fields were assumed control by the National Iranian Oil Company (NIOC) once those stages were finished. Conversely, the IPC permits contracts terms of up to 25 years.

Foreign investment is to utilize foreign capitals in exercises in which the danger of investment and interests are bore by investor. Iranian classifies it in two key methods.

Foreign investment: a. Legal contribution (direct investment): it intends to put a part of foreign investment in a current or new Iranian company. The measure of shares by foreign investor in Iranian company is not constrained and the investor can assume part in dealing with the Company as far as his shares. b. Contractual arrangements: it alludes to an arrangement of techniques by which foreign capital issued just in light of common understandings. No privilege is made for foreign investment because of his immediate commitment in capital of Iranian company; rather, it is just relied on upon shared legally mutual contractual arrangements. Foreign investment is executable in all area under the structure of legally binding courses of action. Investment return and premiums in such investments are procured through the execution of investment arrangement and without depending to guarantee by government, banks or governmental companies. In this manner, contractual arrangements mean sorts of financing techniques in the system of civil contribution methods, buyback and BOT. In areas that are government by government, for example, petroleum industry, foreign investment is just performable within contractual arrangements.[15]

The New Iranian Petroleum Contract (Ipc) Structure

The proposed IPC system is intended to address a portion of the apparent impediments of the buy-back contracting structure and result in financial matters that will urge IOCs to invest in a portion of some of country's more challenging projects. The IPC structure is expected to be offered for investment in some places somewhere around 34 and 74 oil fields.The IPC terms have not been openly revealed and stay subject to change. So, the accompanying potential key components of the IPC system have been accounted for in openly accessible sources: 1) Joint Venture Structure; Booking of Reserves.2) Participation in Production and Enhanced Oil Recovery Phases 3) Compensation.4) Work Program and Budget.5) Local Content; Technology Sharing.[16]

[15].Farley,waston& Williams. Briefing Foreign Investment Promotion in Iran, 2016.

[16].David F. Asmus Partner, Houston& Jonathan H. Hines Partner.Potential Upstream Investment Under the New Iranian Petroleum Contract,. 2015.

Private investment in upstream petroleum

Foreign investment in all area with the systems civil partnership buy-back, and build, operate and transfer (BOT) that the return of principal and benefit get up just through the financial activity of the same investment project and is not based on any guarantee by the government, banks or government companies.

Direct foreign investment in the petroleum upstream operation is restricted on the grounds that under generally accepted commentary of Article 44 of the Constitution, privately owned businesses are not approved to be required in those exercises. Thusly, foreign companies can just put resources into Iran through "contractual arrangements." Under Note 2(s) of the Budget Act of Iran (2014-15), foreign can go into buy-back contracts with the Iranian national companies, including NIOC and NIGC. In this way, the Ministry of oil has presented four eras of buy-back. Every one of them can be qualified as risk service contracts. It must be notice that under the same Note 2(s), the Ministry of Petroleum is approved to go into BOT, FBOT (finance, build, operate and transfer), FBO (finance, build and operate), turnkey plan and work, PPP (public–private partnership) and BOO (build, own and operate) agreement.

The Ministry of Petroleum has utilized four eras of buy-back contracts after presenting each new era; the MoP quit utilizing the earlier arrangement of buy back contracts.

Considering this reality the buyback contracts can cover a drawn out stretch of time, a portion of the third era of buy back understandings (egJofayr Oil Field Development Project) are still as a result however no more issued. [17]

CONCLUSIONS

Iran's foreign investment regulations are generally positive for foreign investors. Both the FIPPA (the freedom of information and protection of privacy act) and a few bilateral treaties provide insurance against seizure and Discrimination, and assurance repatriation of capital and benefits. In Iranian constitution the avoidance of foreign economic dominance on the economy of nation has been underscored hence constitution condition clause 44 huge scale and fundamental industry and large mines is only to government.In the clause 45 mines are among Anfal and it's for the Islamic government and act as the public interest. In the article 81 concessions in the arrangement of companies or foundations are forbidden to nonnatives, on the grounds that in the constitutions view mines and oil and gas upstream activities are represented only in the hands of the government.

Since the interest in upstream operations are completed as the form of investment contract, based on the contracts, the contract position in Iran is unclear. Article 5 of the 2011 change oil contracts between the service of oil or critical operational units with domestic and foreign natural and legal persons subject to controls that have been situated by the service (Foreign investment in all sections within the frameworks of "civil partnership," "buy-back," and "build, operate and transfer (BOT)" where the return of principal and profit emerges just through the economic activity of the same investment project and does not depend on any guarantee by the government, banks or government companies).

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