The Petroleum Legal Framework of Iran: History, Trends and the Way Forward

Nima Nasrollahi Shahri

ABSTRACT
This study offers an overview of the Petroleum legal framework of Iran since oil discoveries in 1907 with an emphasis on the possible reasons for the creation of, or changes to, the country’s petroleum legislations. All petroleum laws and some of the important contractual regimes of the history of upstream petroleum industry of the country will be expounded duly. Besides, a concise account of the present legal atmosphere and Petroleum Laws in force is given. This paper also assesses possible alteration to these laws. The study shows how the petroleum legal policy of the country has been moving toward pragmatism as a result of growing needs for foreign investment as more time passes from the Islamic revolution of 1979. On the same grounds, it concludes that changes to the present legal framework i.e., Buy-Back Agreements are very likely to happen although a full-blown return to Production Sharing Agreements is almost a non-issue due to the negative connotation they carry in the country.

Keywords • Iran • Petroleum Industry • Petroleum Law • Constitution of Iran • Buy-back Agreements • National Iranian Oil Company (NIOC)

Introduction
Iran, which possesses the second largest oil and gas resources in the world, was the first oil producing country in the Middle East with

* Nima Nasrollahi Shahri holds a Masters in International Commercial Law from Shahid Beheshti University of Tehran, Iran. He is completing another law degree on Petroleum Law and Policy (LLM) at the Centre for Energy, Petroleum and Mineral Law and Policy (CEPMLP) at the University of Dundee, Scotland, UK.

discoveries as early as the first years of the twentieth century. Petroleum laws typically evolve in response to the growth of the industry to meet ever-rising changes and challenges. Petroleum was not considered a precious enough commodity to necessitate legislation up until the middle of the twentieth century. This was not least because countries were not considered owners of their reservoirs in the then popular concessionary regimes to have to regulate them.

Before 1957, when the first petroleum law of Iran was drafted, western countries had the opportunity to take advantage of the state of lawlessness regarding its petroleum industry reaping substantial profits resulting in massive loss of national revenues for Iran which would have probably not have happened had there been a proper legal framework in place. However, contractual frameworks existed to regulate the relationship between the state and the International Oil Companies (IOCs); Iran is an interesting and probably rare example of a country that has experienced almost all valid and prototypical contractual regimes of all times, namely concessions, Production Sharing Agreements (PSA) and service contracts, all once very popular around the world. The legal frameworks of the oil industry have generally been classified into three categories: (1) general legislation system, (2) individually negotiated agreements, (3) hybrid system. Intriguingly, Iran in its oil history has undergone all three phases in response to global and regional necessities. In this study, the legal framework which has thus far regulated the oil industry in Iran will be examined in order to identify the possible sources of and reasons for these sweeping changes.

Iran started with its much debated oil nationalization of 1951, drafting its first petroleum law a few years later in 1957. She went on to enact another law in 1974, as expected, shortly after the first oil shock. Finally, in 1987, the first and last petroleum law of the Islamic republic was validated in the Islamic parliament of Iran. There have been legislative additions serving to modify this act, however not in the form of an independent Petroleum Law. Besides, the 1979 constitution of Iran alludes to the issue of resources briefly, which had huge ramifications in petroleum contracts. Along with petroleum laws, the different petroleum contractual regimes that have been in force in Iran since the beginning of the industry will be briefly examined here. Although this study is not exclusively legal in nature, it does not particularly concern fiscal specifications of contracts. Special attention will be given to four fundamental issues regarding the legal framework, namely the type of compatible contracts, risk burdens, ownership of petroleum reserves and legitimacy of foreign investment. Finally, this author will share some

---

thoughts on the likely course Iranian legislation will take in the years ahead.

The paper presents the Iran’s oil history in three periods. The first period covers the Individually Negotiated Period, from the discovery of oil to its nationalization. What epitomizes this period was a lack of legal grounds and prevalence of concessions. The second period details the Hybrid Period from 1957 until the Islamic revolution during which two separate parallel regimes, the 1953 oil Consortium and Parliament legislations, co-existed. The final period is the General Legislative Period after the 1979 revolution when all petroleum contracts had to accord with law.

The Individually Negotiated Contracts Period

Until 1951 when the Iranian parliament nationalized its oil industry, there was no particular legislative framework and agreements were individually negotiated with no pre-conditions. In other words, there were no existing legal frameworks in place during the negotiating process between the two parties. However, these individual contracts were validated in the Iranian Parliament to become legally binding once agreement is reached. Normally, and like any other oil rich country at the time, concessions were typically signed between Iranian rulers and foreign individuals or companies. Due to the absence of relevant legislation, the rulers did not encounter any legal restrictions on the type of contracts, terms and conditions, they could agree upon. The two main agreements entered before the nationalization of oil industry in 1951 were the Darcy Concession and the 1933 Concession.

D’Arcy Concession

The first concession ever granted in the whole of the Middle East was in Iran, to William D’Arcy, which led to oil discoveries in the year 1908. The Darcy Concession was typical of a traditional concession with a 60-year term, starting from 1901 lasting up to 1961, including almost all territories of Iran, except for the five Northern provinces which were the traditional preserve of Russia. A consolation as it was, it produced a very small yet constant flow of income for Iranian Kings who were blissfully unaware of the course the fate of the commodity was meant to take in the years to come. The Anglo-Persian Oil Company (APOC) was formed in 1909 in London. The British government procured 51 percent of its shares in 1914, revealing the significance of cheap Iranian oil for Britain. The company was subsequently renamed Anglo-Iranian Oil Company (AIOC) in 1935, and better known today as British Petroleum (BP).
According to the concession, the concessionaire enjoyed the exclusive right to explore, develop, exploit and transport petroleum in return for which the Iranian government was entitled to 16 percent of the net profit on all operations. The Iranian media and Reza Shah objected to the concession after the First World War because little money was paid to the Iranian government, causing acrimony in the conduct of the agreement.

The 1933 Concession

Attempts by Reza Shah as well as an unspoken willingness on the part of the British brought the D’Arcy concession to a premature end. The 1933 concession superseded the D’Arcy Concession but in a way, it only renewed and extended it with terms and conditions not substantially different from those stated in the D’Arcy Concession. The 1933 Concession was agreed for another sixty years (1933-1993). Mohammad Malek identified the key specifications of the 1933 concession as follows:

- A minimum guaranteed payment (of 750,000 pounds annually) plus a royalty of 4s (gold) per ton of oil produced;
- 4 percent as tax to Iran (with a minimum guaranteed tax of 230,000 pounds annually);
- Iran’s representation on the board;
- Payment of one million pounds (by APOC) as settlement of all past claims;
- Investment by APOC on Iranians so that this would minimise dependency on skilled foreign employees;
- Reduction of the area to 100,000 square miles;
- Full cancellation of the exclusive right of transportation of oil, 20% of the share to Iran;
- Cheaper oil for Iranians.

The consortium, despite all its disadvantages, enabled Iran to negotiate new concessions on the fields reduced by it. On April 1937, a 60 year old concession with comparable terms and conditions to the 1933 agreement was given to the Americans. However, they did not meet with any success in exploration lost interests in the fields in 1938. Throughout this period, the ownership of all petroleum reserves underlying the concessionary territory was vested in the concessionaire. It was the

---

5 Ibid.
concessionaire who decided what it wished to do with its petroleum reserves as well as any other mineral resources it could extract within that territory. Concessions were normally agreed for a long time. There were no legal bans on foreign investment. Risks were totally undertaken by the concessionaire and the governments were not inclined in any way to have any involvement or control.

Hybrid Period: Following the Nationalization of the Iranian Oil Industry

A set of reasons including, above all, financial inequalities and rampant poverty in Iran\(^6\) gave rise to a nationalistic movement in Iran pioneered by Mosadeq which culminated in the nationalization of Iranian oil Industry in 1951. Chart 1 highlights the shared petroleum taxation revenues between the British and Iranian governments. It can be noted that the British government made far more money from petroleum taxation than did Iran from royalties. The scale of poverty in Iran as well as this sheer inequality might have affected nationalistic movements in Iran.\(^7\)

**Chart 1. A Comparison Between Iran and Britain Tax Income**


---


According to the nationalization law validated by both Iranian Parliaments\(^8\), the entire oil industry was nationalized and all relevant stages “including exploration, development and exploitation were to be carried out and controlled solely by the Iranian government.”\(^9\) For the first time in the history of Iran, the country was legally considered the owner of its petroleum wealth. However, financial difficulties as well as deliberate attempts by the intelligence of the United States undermined the Mosadeq government. The plans for nationalization and Iranian ownership of its oil assets were brought to an early end in 1953 through a U.S.-British backed military coup.\(^10\)

**1953 Oil Consortium**

After Mosadeq’s government was overthrown, negotiations restarted resulting in an agreement with a consortium consisting of seven major American oil companies and British Petroleum as its shareholders. The agreement was a very complicated and long document composed of 51 articles attempting to reconcile its concessionary nature with the Iranian Nationalization Act concealing its sheer lopsidedness. For example, the word “stated payment” was used instead of Royalty, because of the negative connotation attached to the latter, and Iran was even denied its share in the consortium\(^11\). The title to oil was transferred to the consortium once the oil reached wellhead,\(^12\) making the Iranian government an owner with no rights.\(^13\) The contract was for 25 years but could easily be extended for up to another 15 more years. In fact the Consortium was an agent working on behalf of the National Iranian Oil Company (NIOC). Based on Article 28 of the agreement, the consortium was exempted of all custom tariffs and taxation.

---

\(^{8}\) Before the 1979 revolution, the Country used to have two Parliaments namely The National Parliament and the Senate, both of which were required to validate Concessions before they would come to force.

\(^{9}\) Nationalization Act, Iran National Parliament, (1951).

\(^{10}\) For more information on The Iranian Oil Industry and Mosadeq’s movement see: Mostafa Elm, *Oil, Power and Principle: Iran’s Oil Nationalization and its Aftermath* (New York: Syracuse University Press, 1992).


\(^{13}\) Harvey O’Connor, “How the international oil cartel carved up the oil resources of Iran after the overthrow of Mossadegh; A full account of a little-known story by an expert in the oil-industry field: The Iranian Oil Grab,” (1955), <http://www.marxists.org/history/etol/newspape/amersocialist/amersoc_5504-a.htm> (January 12, 2010).
1957 Petroleum Law\textsuperscript{14}

Before the 1951 Nationalization of the Iranian Oil Industry, all operations were conducted by the foreigners and the government played the role of a bystander watching.\textsuperscript{15} According to Ramazani,

“After the passage of the Nationalization law (1951), the Iranian government went to the other extreme by controlling ‘all operations of exploration, extraction and exploitation’. The grave economic and political conditions that ensued in the subsequent years revealed that realism demanded modernization. Thus, it was decided to encourage the flow of foreign investment in oil, but at the same time provide for Iran’s participation through some kind of partnership with foreign oil concerns.”\textsuperscript{16}

Four years after the Consortium agreement, the first petroleum law of the Iranian history was drafted. However, it did not address the territories already granted to the Consortium.\textsuperscript{17} It was rather an essential legal background to further cooperation with other IOCs for attracting much needed investment and technology. During this period, Iran had a contractual regime unaffected by legislation, the Consortium, and a separate legislative framework for areas outside of the Consortium territories. The Act prescribed Joint Ventures with government participation. The minimum share for National Iranian Oil Company (NIOC) participation in any of the ventures had to be 30 percent\textsuperscript{18}, which was a principle not always adhered to. As was the case with the 1953 Consortium, contracts were to be agreed for a period of 25 years\textsuperscript{19} with compulsory relinquishment requirements starting after 10 years\textsuperscript{20} not leaving the IOC with more than 1000 square kilometers.\textsuperscript{21} Agreements had to contain a minimum IOC operational undertaking and be passed by both Iranian Parliaments. Contrary to the Consortium agreement, foreign companies were liable to all forms of taxes. Until 1974, based on this Act, a number of Joint Operating Agreements (JOAs) and Production Sharing Agreements between Iran and IOCs were struck.

\begin{itemize}
\item \textsuperscript{14} The Law regarding exploration, discovery and extraction of Oil in all regions of the country and Continental Shelf, National Parliament of Iran, 1957.
\item \textsuperscript{16} Ibid.
\item \textsuperscript{17} Article 1, The Law regarding exploration, discovery and extraction of Oil in all regions of the country and Continental Shelf, National Parliament of Iran, 1957.
\item \textsuperscript{18} Ibid., Article 6.
\item \textsuperscript{19} Ibid., Article 7, Paragraph 4.
\item \textsuperscript{20} Ibid., Article 7, Paragraph 3.
\item \textsuperscript{21} Ibid., Article 8, Paragraph 6.
\end{itemize}
1974 Petroleum Law

The National Iranian Parliament passed the Petroleum Law in 1974. As a result, the 1957 law was abolished. This law was enacted merely one year after the first oil shock in 1973 justifying a different legal regime. Based on this law, the oil industry of Iran was once again declared national, this time in a true sense, although the NIOC was permitted to attract investments only through service contracts. Based on this contractual mechanism, foreign concerns are merely contractors which receive remuneration in return for the services they provide and are not entitled to any oil neither in the reservoir nor at well head in contrast with previously used mechanisms such as Concessions and Production sharing Agreements. For the first time, a systematic and competitive bidding system was established and specific provisions as to remunerations were devised; it was dictated that they were to be paid only in the form of discount for crude oil.

The 1973 oil shock obviously elevated the bargaining position of the Iranian government which, following the latest global trends, longed for a more efficient contractual regime with higher government takes and maximum control. Service contracts catered for such demands. Based on the Act, the NIOC was allowed to add provisions tailored to meet the interests of the country to individual contracts it negotiated, which required parliamentary approval. Contract terms would be divided between exploration and exploitation, the former being extendable for another five year period. During this period, ownership of oil belonged to the state. However, until 1974 oil at well-head could be owned by the IOC. Based on the 1974 Act, PSAs were no more than a valid contractual regime. Needless to mention, the Consortium remained in force and unaffected by Parliamentary legislations until the 1979 Islamic revolution.

General Legislation Framework

The Consortium agreement as well as all other contracts thought of as contrary to law were unilaterally ended after the 1979 Islamic Revolution, marking the birth of a new era of Petroleum legal framework in Iran. During this period the discretion of the state as to what type of contractual regime it could engage in was completely confined within the Legislative Framework in place.

---

23 Ibid., Article 29, Paragraph 6.
24 Ibid., Article 3, Paragraph 1.
25 Ibid.
26 Ibid., Article 10.
1987 Law

This was the first and last Petroleum Law of Iran after the 1979 revolution and it abolished all previous legislations, it was validated during the exhausting eight-year war against Iraq which obviously influenced the mentality of law makers. A notable change of wording in this Act was the replacement of the NIOC, held in all previous legislations to be the one authority responsible for all petroleum activities in the industry, with the Petroleum Ministry, established after the Islamic revolution, in all relevant articles of this law. However, it should be noted that the NIOC as well as other national companies in the petroleum sector has continued, to this day, to deal with all petroleum related issues of the country under the auspices of the Petroleum Ministry. According to Article 2 of this law, all petroleum reserves count as Public Wealth in the disposal of the Islamic Regime. The significance of this law is in forbidding foreign investment completely as an attempt to domesticate the petroleum industry rendering it independent from any foreign assistance or participation. The reason for this can be traced in the ideological atmosphere of the war-stricken Iran. Financial investment had to be made by the state from the country’s annual budget. This, however, was a very hard goal to achieve. Pure service contracts were the only viable option during this period and foreign companies rendered services without investment in return for a fixed amount of remuneration paid from sales of oil.

1979 Iranian Constitution

Iran’s Mashroule Constitution of 1906 did not contain any regulation as to the state’s rights and obligations regarding its natural resources except for requiring Parliamentary validation of all types of concessions. However, partly as a result of the allegedly poor management of natural resources before the revolution, the Islamic Constitution of 1979 made specific reference to natural resources and concessions. It took an ideistically strict position so as to minimize corruption, foreign control and mismanagement.

In this study, the author will examine the key articles of the constitution relevant to natural resources. There are a number of articles in the constitution having to do with mineral resources and inevitably

28 Ibid., Article 12.
29 Ibid., Article 6.
30 Ibid.
31 Whether it did in fact achieve its goals, as well as whether there had been mismanagement at all, are subject to debate and study among researchers.
with the oil and gas industry one way or another. As will be noted, they tend to be vague and require more detailed parliamentary legislation.

**Article 44 - Nationalization of Major Industries:** According to Article 44 of the 1979 Constitution, all the mother industries are owned and controlled by the state. This article in fact indicated the nationalization of all major industries in the sense that private ownership in these industries was disallowed after the Islamic revolution. However, privatization of most mother industries became legally feasible later on through legislation,\(^{32}\) with the petroleum industry remaining an exception. Thus, even now, the petroleum industry cannot be privatized like, for example, the electricity sector. In fact, Article 44 of the Constitution not only forbids any form of private ownership but also prohibits private participation i.e. investment, be it foreign or domestic since it uses the words “owned and controlled by the state”. The 1987 Petroleum law takes the same policy and explicitly declares foreign investment illegal.

**Article 45 - Natural Resources as “Anfal”:** This article regards mineral resources as “Anfal,” namely, public wealth and property, which is an Islamic concept mentioned in the Holy Koran.\(^{33}\) It states that,

> “Anfal i.e, Public wealth and property, such as uncultivated or abandoned land, mineral deposits, seas, lakes, rivers and other public water-ways, mountains, valleys, forests, marshlands, natural forests, unenclosed pastureland, legacies without heirs, property of undetermined ownership, and public property recovered from usurpers, shall be at the disposal of the Islamic government for it to utilize in accordance with the public interest. Law will specify detailed procedures for the utilization of each of the foregoing items.”

Based on the Holy Koran, Anfal belongs to God and the Prophet. All Iranian laws are based on and should accord with Shia Islamic teachings.\(^{34}\) This article leaves Anfal to the government which will utilize it in pursuit of public interest. Based on Shia Islamic teachings, Anfal cannot be transferred or sold to anybody. This is therefore a serious barrier in negotiating any agreement that might give title to oil, either in place or at well-head, to a private party be it foreign or domestic.

---


\(^{33}\) Holy Koran, Anfal, 001.

\(^{34}\) Article 4, The Constitution Of the Islamic Republic of Iran, Constitutional Council of Wise Experts, 1979.
Article 81 - On Foreign Concessions: This article forbids the concessionary system completely. It states that,

“The granting of concessions to foreigners or the formation of companies or institutions dealing with commerce, industry, agriculture, service, or mineral extraction, is absolutely forbidden.”

The phrase “absolutely forbidden” in the context of the 1979 Iranian Constitution means it cannot be legitimized even if approved by the Parliament. As well as precluding the Iranian government from being party to concessions, it prohibits the government from giving foreigners the right to form companies or institutions dealing with mineral extraction. This article is often used as a reason why Joint Operating Agreements or joint ventures are not legally possible. In other words, the government is the only authority which can legitimately deal with natural resources.

Therefore, it can be inferred that based on the three mentioned articles of the IRIC, concessions as well as PSA and Joint Operating Agreements or any other contractual regime involving foreign participation and control (Article 44), ownership (Article 45), or establishment of foreign companies (Article 81) is not allowed.

The Legal Basis of Buy-Back Agreements:
In early 1980s, the government used engineering, procurement and construction (EPC) or Turn-key contracts which were thought to be compatible with the constitution and used public funds. In 1987, as a response to the dearth of funding, NIOC was authorized to obtain short- and medium-term loans from foreign financial institutions to finance five of its oil and gas projects. In the year 1993, for the first time after the 1979 revolution, the 1993 Budget Act allowed the NIOC to have contracts of up to US$2.6 billions with competent foreign companies on a number of conditions. It was the Budget Act of 1994 that did in fact introduce the terminology and mechanism of buy-back contracts as the legitimate source of attracting investment. Buy-back agreements, succinctly put, are risk service

36 Ibid.
contracts by which oil, or money from oil sales, is paid to the foreign Company as remuneration fee. According to Note 29 of the Budget act\textsuperscript{38}, a maximum of US$3.5 billion dollars of foreign investment was allowed provided that it did not create any commitment for the government and state banks and all the instalments were to be paid out of the proceeds. This was a leap financially justified and Constitutionally legitimate, as Budget Acts are validated by the Parliament.

More attention was given to buy-back contracts during the second and third Plans for Economic Social and Political Development Acts. The Budget Acts continued on an annual basis, for five years until 1999, to consent such levels of foreign investment until a separate piece of legislation validated Buy-back agreements as the main upstream oil and gas contractual mechanism of the country. There have been three different generations of Buy-back each attempting to create more incentive for foreign investment.\textsuperscript{39} In 2003, for example, based on the 2003 Budget Act NIOC was authorized to include both exploration and development in Buy-Back contracts.\textsuperscript{40} Some, however, view legitimizing foreign investment, as a step backward arguing it does not serve the benefits of the country’s independence and opens doors for corruption and rent seeking.\textsuperscript{41}

\textbf{General Reasons for Legal Changes:}

Table 1. reflected below summarizes the changes in petroleum legal regimes, including legislation and contracts, over the course of Iran's oil history. As can be seen in the table, petroleum laws in Iran increasingly grew stricter. This trend is similar to many other resource rich countries in the world. In the case of Iran, it was only during the 1990s, after 8 years of prohibition, when the government decided to use foreign investment again through buy-back contracts. Ever since then, the government has tried to present more appealing buy-back models increasingly loosening the conditions.

Iran started with its 1957 petroleum law which has been described as pragmatic.\textsuperscript{42} This was the first-ever detailed legislation considering natural resources. However, as discussed above, a few years before this law, the Iranian Parliaments had nationalized the petroleum industry completely, which could not survive for more than two years and has been described as radical and unrealistic.\textsuperscript{43} An important incentive for Iran was to participate in production and maintain a degree of control on its own resources.

The 1974 law was more of a response to the 1973 oil shock and an attempt to capture a greater proportion of the resource rent. This prescribed service contracts and was a reflection of the maturity of the Iranian oil industry. The 1987 law was however, an ideologically driven legislation which obviously stemmed from the statist attitude of the Islamic Republic towards the economy, and underscored its pessimistic attitude towards foreign participation, obviously exacerbated during the war. However, the pressing need of the Iranian petroleum industry for capital did not allow this mind-set to last beyond 10 years. A more pragmatic attitude was adopted from the 1990s onwards at attracting foreign investment. The change was necessary because of an obvious failure in and an inadequacy of the previous system in prescribing pure service contracts. In other words, it was a return to the 1974 law with only an insignificant alteration of the terms used i.e., prescription of Buy-back instead of Risk service contracts.

The Enactment of Protection and Encouragement of Foreign Investment Act\textsuperscript{44} in 2003 bears testimony to the claim that the Iranian Regime was changing its previously strict and xenophobic attitude towards foreign investment. The act which grants assurance to foreign investors, facilitates the approval procedure and introduces new

\begin{table}[h]
\centering
\caption{Iran's Changing Petroleum Legal Regimes (1971 - Present)}
\begin{tabular}{|c|c|c|c|c|}
\hline
Period & Title to Oil & Foreign Investment & Compatible contracts & Risks \\
\hline
1971-1953 & IOC & ALLOWED & All & IOC \\
1957-1974 & STATE & ALLOWED & PSA/JOA & IOC \\
1974-1987 & STATE & ALLOWED & Service & IOC \\
1987-1994 & STATE & N/ALLOWED & Pure service & STATE \\
1994-Now & STATE & ALLOWED & Buy-Back & IOC \\
\hline
\end{tabular}
\end{table}

\textsuperscript{42} Ramezani, “Oil and Law in Iran”.
\textsuperscript{43} Ibid.
\textsuperscript{44} Protection and Encouragement of Foreign Investment Act, Islamic Parliament of Iran, March 23, 2003.
contractual mechanisms for foreign investment was the first of its kind after the 1979 Revolution. This new found pragmatism, more than anything else, had to do with the country’s inability to provide funds for its very capital intensive economic projects particularly in the upstream petroleum industry, along with the stressed role of foreign investment in development of the country during the Presidency of President Mohammad Khatami (1997-2005). It was during this period that the government demonstrated willingness to engage itself in bilateral investment treaties and Double taxation treaties with developed countries. More signs of pragmatism can be detected in a massive privatization program aimed at transferring ownership of most mother industries to private owners starting in 2005.45

The Iranian experience suggests a number of reasons giving rise to or justifying legislative changes. This can be summarized under three headings. It should be acknowledged that more often than not it is not a single reason but a combination of these reasons lead to changes in legal policies:

• Ideology: This was particularly obvious in the case of the 1987 law. The 1951 nationalization of the Iranian oil industry was also ideologically driven.

• Oil Price Fluctuations: Changes in oil prices affect the bargaining position of oil producing countries vis-à-vis foreign IOCs. At times when prices are higher, there certainly exists more willingness for investment and risks are welcomed in return for prospectively higher revenues. After the 1973 oil boom, the government modified its contractual mechanisms to obtain higher income.

• Failure of Existing System: Petroleum laws are always legislated with a number of implicit goals. The establishment of the Consortium and legislation of the 1957 was a tacit acknowledgement of the failure of the previous system i.e. complete control and ownership provided for by the Oil Nationalization Act of 1951. Buy-back mechanism also owes its existence, at least partly, to the failure of the state in funding the petroleum industry from its own budgetary resources.

The Way Ahead

Iran, with a production capacity of 4.2 billion barrels a day, is in need of US$70 billion of investment in the mid-term to raise its production capacity to an ideal level of seven million barrels per day in 2020.\(^{46}\) It is predicted that if the country does not get sufficient investment in the upstream oil business, its current capacity will decrease to less than 3 million barrels per day.\(^{47}\) The question of whether buy-back contracts have been successful or not is usually not answered affirmatively. The mechanism has failed to meet the country’s pressing need for investment and needs to be reviewed.\(^{48}\) Iranian buy-back is not investor friendly enough and does not provide investors with the certainty they seek compared with its alternatives namely PSA and License agreements.\(^{49}\)

Changes to this mechanism seem almost inevitable. The failure of buy-back contracts to attract sufficient investment, as well as other issues like U.S. sanctions, compounded with the ever increasing need for foreign investment, and increasing domestic consumption, necessitate modifications in the present legal system. As seen so far, changes happen in response to circumstances, for example, the legal ban on foreign investment in the petroleum sector was lifted in Iran through the introduction of Buy-Back agreements at least partly because of the need of the country to attract investment. Therefore, changes are very likely to be made to the law, to allow for contracts that are more favourable to foreign investors especially as more and more petroleum reservoirs are being depleted. Besides, highly unfavourable contracts have so far deprived the country of its much required Foreign Direct Investment in gas and petroleum related projects. This is especially true when non-unitized common oil and gas reservoirs, such as the South Pars which create some kind of a competition between the country and its neighbours, are concerned.

Whether the country would give up its buy-back regime in favour of a classic production sharing arrangement in its Southern Reserves is almost a non-issue due to the legal ownership of oil and very low geological risks in those regions. However, there have been serious discussions about the possibility of granting PSAs in the Caspian Sea.\(^{50}\)

---

\(^{49}\) Abdolhossein Shiravi and Nasrollah Ebrahimi., “Exploration and development of Iran’s oilfields through buyback,” p. 13.
\(^{50}\) A report from legal infringements in Petroleum contracts (September 3, 2008), <http://www.advarnews.us/politic/7825.aspx> (January 18, 2010).
where investment is not yet very attractive. Undoubtedly, such a decision will face domestic resistance and displeasure and is likely to be regarded as a step backward.

**Conclusion**

A historical study of the trend of the Iranian petroleum legal framework reveals that it has thus far been a reflection of political, ideological and global significance attached to natural resources as well as internal developments. Iran’s history is fraught with moments of emotional and nationalistic radicalism as well as workable pragmatism. Based on the presented material, it can be concluded that as more time passes by from the Islamic Revolution of 1979 the trend is that more pragmatism is creeping into the country’s petroleum policy causing the country to call for more foreign investment. Since the present system of Buy-Back Agreements, has not met with considerable success, some amendment to the present framework seems inevitable. This is particularly more probable with respect to Northern Caspian Sea reserves, which do not benefit from the same low risk conditions of the south, or gas reserves. The offshore Caspian fields require substantial investment in return for less financial prospect, and are therefore less attractive for prospective investors. However, it should be stressed that there is very little likelihood that a classic Production Sharing or License agreement can be adopted in Iran without arousing much objection. The reason for this can be traced back to the history of the country’s petroleum industry and the negative attitude it has developed towards foreign control and participation as a result.