

Renewable energy projects in Iran: solar focus

We note that other countries, including Canada, also continue to maintain sanctions against Iran that go beyond the limited sanctions imposed by the UN. To the extent there is any connection to such other countries in particular transactions, country-specific sanctions compliance advice should also be sought.

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Despite huge hydrocarbons reserves, Iran is likely to face significant energy challenges over the next few years. Driven by a projected increase in the rate of economic growth following the lifting of sanctions and a growing population, demand for power has increased. To date, this issue has been compounded by poor resource management, with a lack of investment resulting in an ageing and inefficient infrastructure, and an over-generous subsidy regime leading to energy wastage and economic losses.

The government of Iran is well aware of these crucial challenges and has begun to implement various

policies to address them. Given the high energy intensity of the Iranian economy, one of the main thrusts of the government's policy is the implementation of energy saving and efficiency measures at all stages in the domestic energy supply chain. Iran continues to explore the various ways it might achieve these objectives in order to have the greatest beneficial impact on its economy.

As a significant oil and gas producer, Iran sees greater benefits in maximising its exports of fossil fuels than in using them for local demand, including by generating foreign currency reserves for

Iran's substantial developmental needs. Domestic consumption can be minimised by imposing energy conservation measures and upgrading infrastructure. Electricity wastage through Iran's ailing electricity transmission system is estimated to be up to 20% of power generated and steps have been taken to invest in smart power grids.

Naturally, another obvious way to reduce domestic fossil fuel consumption is by increasing the power generating capacity derived from non-conventional generation sources, including renewables. Accordingly, the Supreme Leader, Ayatollah Khamenei, has approved



guidelines stipulating that the development of renewable energy resources is necessary for the country, setting a target of 5,000 MW installed capacity in the next five years, incentivised by a guaranteed power purchase regime (see below). Iran already has in place legislation obliging the Minister of Energy to purchase electricity produced by non-governmental renewable power plants (Financial Regulations Act 1380/2001) and under long-term contracts with guaranteed tariffs (Law of Modifying Consumption Patterns 1390/2011) adjusted for inflation and currency fluctuation. As outlined further below, the state-owned Renewable Energy Organization of Iran (SUNA) oversees the regulatory and contractual

framework for renewables, with a streamlined licensing process and further financial incentives for renewables developers and equipment suppliers.

Increasing renewable generation capacity has the additional benefit of assisting Iran in meeting its commitments under the Paris Agreement (COP 21), where Iran has identified development of renewable energy as a key element of its strategy to reduce greenhouse gas emissions.

It is important to note that, while still not widespread, renewable power is not new to Iran. A long-time proponent of hydroelectric power, Iran also commissioned its first significant wind farm, at Manjil and

Rudbar, in 1994. Moreover, Iran has a young and highly educated populace who are well aware of green issues and who will be receptive to government policies that are favourable to the environment. Iran is a vast country with advantageous conditions for renewable power generation due, variously, to its latitude, climate, topography and geography.

With the lifting of sanctions, Iranian entities should now be able to partner more easily with foreign investors to obtain the requisite renewable technology and project financing assistance. However, involvement in Iranian projects remains potentially challenging for non-Iranian developers, banks, contractors and investors – both because of the general continuing complexities of doing business in Iran and for sector-specific reasons.

This note seeks to expand upon the regulatory framework in respect of solar power generation and identify a number of the key issues of which investors should be aware.

Electricity market

Iran's total installed power generating capacity currently is approximately 75 GW. Over the past 10 years, demand for power in its domestic market has grown by 6.5% annually, and the country has also started to export significant amounts of power to its neighbours.

In 2013, it was reported that renewables made up only 0.2% of Iran's installed generation capacity. The total installed capacity of PV

power plants was under 90 kWp, most of which supplied electricity to street lighting.

At the present time, renewables contribute little more than 1% of Iran's total primary energy consumption, with the large majority of this made up of long-standing hydroelectric power.

Iran is a large country with diverse climate and topography. In terms of wind resource, estimates of the total potential capacity in Iran range from 30 GW to 100 GW. Solar resources are also abundant, with much of the country having in excess of 300 days of sunshine annually. It is thought that the country's geology may support the deployment of significant amounts of geothermal energy. Finally, there is potential for using a substantial number of waste-streams for energy generation purposes.

Overview of government incentives

The development of renewable energy has the backing of the Supreme Leader and according to the Sixth Development Plan (2016) 5,000 MW of renewable generating capacity is to be added by 2018. In addition, The Iranian power utility TAVANIR expects renewables to provide 10% of Iranian power by 2021.

The recent lifting of nuclear-related sanctions has re-ignited interest amongst players in the global renewables industry, further encouraged by the regulatory support and incentives offered to renewables developers by the Iranian government, as outlined below.



The Ministry of Energy, acting through the SUNA, purchases all electricity generated from renewable sources by approved private sector projects at specific feed-in tariffs (FiTs). Under the current regulatory framework, developers will be granted a 20-year power purchase agreement (PPA) negotiated on the basis of SUNA's model-form.

The level of FiT available depends upon a number of factors, including project size (i.e. generating capacity) and technology-type. The Ministry of Energy determines and publishes revised FiTs (in Iranian Rials per kWh) each year.

The Iranian government has endeavoured to set the FiT at a level that is designed to attract investors, both domestic and foreign, in order to support the rapid development of their somewhat nascent renewable power sector. However, it is notable

that the most recent FiTs published by the Ministry (in May 2016) have seen a slight reduction in the level of FiT offered across the board. The current FiT for solar plants can be found on SUNA's website (www.suna.org.ir/en/home).

Under the most recent directive issued by the Ministry, tariffs may be increased by up to 30% where plants are constructed using locally produced equipment, technology, know-how, design and manufacturing. This marks an increase in the top-up in tariff for use of local content which, under the previous tariff regime, was limited to a 15% increase. However, this may not buoy investors in technologies which have little or no local supply chain. Clearly, investors will need to satisfy themselves of the extent to which such resources are readily available in the local market and seek clarification from SUNA as to how local participation will be assessed in order to qualify for such additional incentives.

Securing the available benefits

Feasibility studies

As might be expected, developers will need to carry out extensive due diligence before embarking on a solar project in Iran, both in relation to any potential Iranian joint venture partners and in relation to various project risks and feasibility. Before reviewing Construction Permit applications submitted by developers and assessing their viability, SUNA expects them to have carried out economic modelling and undertaken technical feasibility studies on the proposed



project (including identifying and investigating the appropriate sites together with an analysis of the solar resource and plant design).

It is important for potential investors to note that SUNA does not currently provide any formal assistance to investors in site identification or liaising with other governmental or local authorities to obtain any necessary permits to undertake feasibility studies. It should not be viewed as a “one-stop shop” for coordinating projects and/or liaising with key stakeholders once a Construction Permit is issued, although it will provide letters of introduction to various relevant authorities where necessary.

[Construction Permit](#)

Once feasibility studies have been completed, developers may submit an application to SUNA for a Construction Permit (consisting of Forms A and B) accompanied by

relevant information pertaining to a developer’s technical and financial capability and general details of the proposed project, in order for SUNA to evaluate whether the application should proceed. It is important to note that the articles of association for the investment vehicle must include, as one of its objectives, the generation of power from renewable sources. Once SUNA is satisfied with its evaluation of the application, it will issue a Construction Permit to the developer and introduce it to TAVANIR so that it can arrange a Grid Connection Permit.

The decree issued by the Ministry of Energy in May 2016 publishing the current FiT also included a number of additional conditions of which developers should be aware. Notably, no developer may hold more than two Construction Permits at any given time. A developer is required to wait until a project reaches commercial operations before SUNA

will grant it a Construction Permit for a new plant. It is as yet unclear how this will be applied in practice, as there is clearly a risk that this restriction may impact investment decisions in some cases.

[Grid Connection Permit](#)

TAVANIR will then also analyse the developer’s proposals and, satisfied with the proposals, approve the issuance of a Grid Connection Permit. The issuing body for plants of more than 7 MW will be the relevant regional electricity company. At this stage, it is important that investors are aware that TAVANIR, in most cases, expects developers to bear the full construction costs of any grid connection, as well as any necessary substations and/or line reinforcement, unless a departure from this approach is agreed under the connection agreement. SUNA bears no connection risk under the model form PPA, so this is an issue

that will be need to be addressed under the connection agreement.

Environmental Permits and land rights

The developer will also need to obtain an Environmental Preservation Organization Permit from the Department of Environment. This will only be issued where such department is satisfied that the project complies with certain environmental criteria.

Where the land on which the plant is to be developed is state-owned (as is usually the case), the developer must enter into a lease with the Land Affairs Organization of Iran. Lease negotiations may take a significant amount of time (perhaps six months). On the other hand, where the land is privately-owned, the developer is free to negotiate for the purchase or lease of the land – a process which would usually be somewhat shorter than negotiation with the government.

PPA negotiation

Once the developer has all the required permits in place, SUNA will invite it to start negotiating a PPA. It is important to note that Construction Permits are not transferable so must be obtained in the name of the legal entity that is intended to own the plant.

Under the current regulatory regime (as reflected in the PPA issued by SUNA), a developer may lose its right to the preferential FiT agreed where the plant does not reach commercial operations, in the case of solar, within 15 months of entering into the PPA. In such cases, the



developer will be offered the lower of the agreed FiT rate or the latest base rate approved by the Ministry. This could have a material impact on project economics over the term of a PPA. It remains to be seen whether developers are successful in negotiating adequate protections into the PPA to ensure that relief is granted for delays caused by force majeure. If not, this could have an impact on bankability.

It is worth noting that developers are required to provide SUNA with a bank guarantee to cover the development period (i.e. from execution of the PPA until commercial operations) up to an agreed percentage of the contract value, which may be called by SUNA should the developer fail to perform its obligation during this period, such as obtaining environmental permits, or completing the grid connection. During operations, SUNA's payment is secured by a rolling letter of credit from an Iranian bank covering the

next six months' worth of its payment obligations under the PPA. It will be interesting to see whether lenders to international investors are satisfied with SUNA's financial covenant and the security offered.

Insurance

Currently there is not investment insurance cover available for foreign investments, including PV systems in Iran (by Iranian insurance companies) due to the lack of experience in this regard. There are normal liability, engineering and risk insurances (for the installation and operation phase) for fossil fuel power plants, which could be extended to the renewable energy field, but this is a market that needs to be developed.

Foreign investment in Iran

Dentons has published a detailed guide on Doing Business in Iran containing key information for those considering investing in the country (including options available



to investors in terms of setting up a presence there). Given the somewhat unique circumstances that prevail in the relationship between Iran and the international community, all investors should, however, also be made aware of the on-going sanctions regime applicable to Iran and, at a high level, the protections available to investors in the country. These matters are covered below.

Sanctions

Prior to Implementation Day (16 January 2016), there were multiple UN Security Council (UNSC) resolutions in place imposing sanctions on Iran for its nuclear proliferation activities, with numerous restrictions on dealing with Iran and Iranian individuals or entities. As of Implementation Day, however, UNSC Resolution 2231 (2015) (Resolution 2231) terminated the provisions of these UN resolutions.

The only remaining UN measures currently in force are those provided in Resolution 2231 (including “snap-back” provisions as outlined below). The UNSC has lifted all sanctions with the exception of certain restrictions on dealing in sensitive material and technology.

The residual EU sanctions broadly mirror the surviving UN restrictions (imposing restrictions on dealing in nuclear proliferation technology, dual-use goods, military equipment etc.).

Notwithstanding that a large number of the energy and financial sector sanctions have now been lifted in the EU, the US sanctions aimed at US persons, equipment and technology remain (US Primary Sanctions) while US sanctions on non-US persons (US Secondary Sanctions) have been lifted. This makes sanctions compliance for global organisations with global workforces challenging. Dentons has guided many international organisations through the patchwork of remaining sanctions prohibitions against Iran.

Given that US Primary Sanctions remain in force, companies will need to take care not to involve US nationals or green card holders on the project. Project costs cannot be denominated in US dollars and care will need to be taken when working with US equipment and any contractors, insurers, banks, software providers and others who are based in the US or otherwise subject to US sanctions. “General License H”, issued by the US Office of Foreign

Asset Control (OFAC), permits foreign subsidiaries of US companies to engage in trade with Iran but does not allow US companies to assist non-US companies to engage in Iranian trade. Projects, therefore, need to be carefully structured with these restrictions in mind.

Although establishing a company does not legally require an Iranian partner, foreign companies are likely to find establishing an Iranian partnership beneficial. Given the on-going sanctions regime, companies will need to take care to undertake thorough independent due diligence in respect of their proposed business partners. For a prospective solar project with an Iranian partner, it will be essential from the outset to understand the ownership structure and control of all Iranian counterparts and this issue should be considered alongside legal advice as to any potential exposure to sanctions. While it is possible to obtain the names of key company representatives (such as the Chairman, CEO and Board members), the ownership structures and shareholdings of Iranian-registered companies are not publicly available.

Investor protection

Bilateral investment treaties (BITs) and multilateral investment treaties provide comprehensive, effective protection for investors against political risks. Investors are protected from government interference, which may include expropriation without compensation, unfair or inequitable treatment, less favourable treatment than nationals or other investors, and restrictions on currency transfers.

Appropriate corporate structuring to take advantage of treaties can provide rights of action directly against a state under international law. This type of structuring is not expensive or burdensome, and may simply involve inserting a holding company in the corporate chain. It can create significant savings as compared with political risk insurance. As described further below, there are a number of ways this type of protection can be obtained:

- BITs;
- Multilateral investment protection treaties; and
- Iranian investment protection legislation.

Iran has 48 BITs in force with other countries and has signed a further 11, which are not yet in force. These BITs are not all the same and can contain different protections and have different requirements for protection. In general, the BITs with Iran offer:

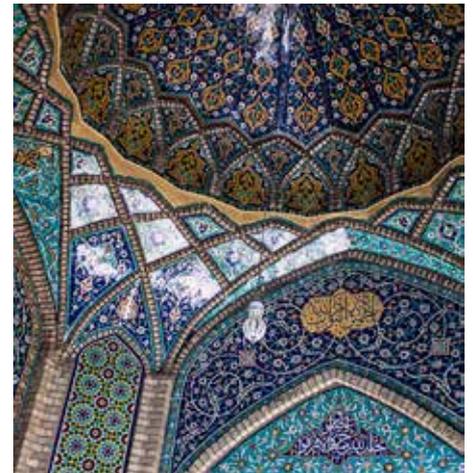
- an undertaking of fair and equal treatment;

- a guarantee of free transfer of funds outside the country; and
- recourse against Iran, in an ad hoc international arbitration outside Iran in case of expropriation or loss of investment due to a decision or action of an Iranian governmental body.

Certain of these BITs require investments to be approved by the Iranian investment authority. This requires that foreign investors register investments and obtain a certificate of admission or an investment licence under FIPPA (see below) which sets out the conditions on which an investment is admitted into the country.

Iran is a signatory to two multilateral investment protection treaties: (i) the Agreement on Promotion, Protection and Guarantee of Investments among the Member States of the Organization of the Islamic Conference 1981 (OIC Treaty) and (ii) the Agreement on Promotion and Protection of Investment among Member States of the Economic Cooperation Organization 2005 (ECO treaty). The protections in these treaties are more limited in nature and BIT protection is usually preferable.

Iran also has a Foreign Investment Promotion and Protection Act (known as FIPPA) and Implementation Regulations. FIPPA is designed to encourage and protect foreign investments in Iran, whether by way of equity investment in Iranian companies or in the financing of Iranian projects.



Our experience shows that the FIPPA licence reduces bureaucracy and facilitates certain administrative issues, such as residency and work permits for employees of the foreign investor.

Pursuant to FIPPA, all areas of the Iranian economy are open to private sector investment, under build, operate and transfer (BOT) schemes, buy-back agreements and civil partnership. In these areas, foreign investors benefit from the same rights and exemptions available to local investors. FIPPA contains provisions whereby foreign investors cannot be deprived of their ownership rights unless such expropriation is in the public interest/benefit, and then only in accordance with a prescribed procedure and the payment of fair compensation. Generally speaking, however, FIPPA does not grant sufficient protection unless supported by the protection of a BIT.

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Lucille specialises in energy projects and regulation, both domestic and international. She has developed the firm's UK solar practice and has lead and closed over 100 large-scale solar projects with a capacity of over 2GWp. This involved the design, construction and operation of the projects, the acquisition from third parties of project rights, detailed advice and structuring of arrangements in the light of changes to various subsidy regime, and negotiation of power purchase agreements with power offtakers and utilities.



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Nadir has over 12 years' experience advising on transactions in the energy sector across a variety of jurisdictions, in particular the Middle East and Africa. Nadir spent over six years working in our Muscat and Dubai offices and is now based in our London office. He has extensive experience acting for both Governments and developers on major projects and regulatory matters in both power and upstream and downstream oil and gas.

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