

WATSON FARLEY & WILLIAMS

BRIEFING

RENEWABLE ENERGY IN IRAN

MAY 2016

- IRAN OFFERS VERY ATTRACTIVE FEED-IN TARIFFS.
- GUARANTEED TERM OF POWER PURCHASE AGREEMENT OF 20 YEARS.
- TARGET OF 5,000 MW IN THE NEXT FIVE YEARS.



Iran is becoming a highly attractive emerging market for renewable energy projects. The government announced the target of 5,000 MW of installed capacity from renewable power plants in the next five years and has implemented laws guaranteeing power purchase for a period of up to 20 years at very lucrative tariffs. This briefing gives an overview of the conditions, procedural steps and challenges of implementing renewable energy projects in Iran.

“IRAN ENJOYS A DNI OF UP TO 5.5 KWH/SQM/DAY AND AN AVERAGE OF 300 SUNNY DAYS PER YEAR.”

Geographic and climatic conditions

The geographic and climatic conditions in Iran are very favorable for renewable energy. With a huge land area of 1,648,195 square kilometres, the Alborz Mountains in the north-west, the deserts in the East, the Caspian Sea in the North and the Persian Gulf in the South, it comprises a wide variety of natural environments. The country enjoys an outstanding DNI (direct normal irradiation) of up to 5.5 kWh/sqm/day and an average of 300 sunny days per year. In particular the central and southern regions of Iran have high solar irradiation, such as the provinces of Yazd, Fars and Kerman with a DNI of about 5.2 to 5.4 kWh/sqm/day. Similarly, there is huge potential for harnessing wind energy. According to a presentation of the Renewable Energy Organization of Iran (SUNA) it estimates the potential installed capacity of wind power to be 30,000 MW.

Iran's high level of energy consumption and CO² emissions, and costly electricity production by fossil fuels which are highly subsidised by the government, are just some of the reasons why Iran's policymakers are keen to utilise these natural conditions to attract private sector investments in the renewable energy market.

Guaranteed power purchase for a period of up to 20 years

To increase incentives for investing in renewable energy, Iran amended its laws in 2015. The previous regulations provided for a term of only five years for the power purchase agreement and a uniform tariff for all types of technology. Pursuant to the new laws, a new system of feed-in tariffs differentiating by type of technology has been implemented. Moreover, the guaranteed period for power purchase has been extended to 20 years (except for turbo expanders, waste recovery in industrial processes and hydropower plants, for which the term is only 10 years). However, the term of the agreement starts with the signing date, hence, the construction period falls into the 20 years' period, and this should be taken into account in the financial modelling.

The power purchase agreement is entered into with SUNA, a subdivision of the Ministry of Energy in Iran specifically established for renewable energy matters and responsible for planning, policy making and promotion of renewable energy. SUNA is managed and supervised by TAVANIR, the power generation, transmission and distribution holding company in Iran.

Feed-in tariffs

The applicable tariffs are reviewed on a yearly basis and determined by SUNA. SUNA pursues a policy of reducing the feed-in tariffs in relation to the increase of installed capacities. The tariffs for the new Iranian year (1395) which started on 21 March 2016 have not been officially announced yet. However, the tariffs for the last Iranian year (1394) were as follows:

POWER PLANT TYPE		FEED-IN TARIFF (IRANIAN RIALS PER KWH)	APPROXIMATE AMOUNT CONVERTED IN EUR (open market rate as of 1 May 2016)
Biomass	Landfill	2,900	0.073
	Anaerobic digestion	3,150	0.080
	Incineration	5,870	0.15
Wind farm	over 50 MW	4,060	0.10
	50 MW and less	4,970	0.13
	1 MW and less*	5,930	0.15
Solar farm	over 10 MW	5,600	0.14
	10 MW and less	6,750	0.17
	100 kW and less*	8,730	0.22
	20 kW and less*	9,770	0.25
Geothermal (including drilling and equipment procurement)		5,770	0.15
Turbo expanders		1,800	0.045
Waste heat recovery in industrial processes		3,050	0.077
Small hydropower (10 MW and less)		3,700	0.094
Other types of renewable and clean power plants (except hydropower)		4,873	0.12

* Only for end-users and limited to the line capacity.

“TARIFFS ARE SUBJECT TO AN ADJUSTMENT FORMULA TO REFLECT ANNUAL EXCHANGE AND INFLATION RATE FLUCTUATIONS.”

The tariffs are subject to some adjustment factors; they include a formula to reflect annual exchange and inflation rate fluctuations. To promote domestication, a bonus of up to 15% applies to the tariffs for power plants constructed using local equipment, technology, knowhow, design and manufacturing. Moreover, from the beginning of the eleventh year of the power purchase agreement, the tariffs – subject to some specific provisions for wind energy – will be multiplied by 0.7, hence, a reduction of 30% takes place for the second half of the term of the power purchase agreement.

The budget for the feed-in tariffs is being accumulated by an electricity levy of 30 Iranian Rials per kWh charged to the end-consumer. However, it should be noted that the current amount of the levy would be nowhere near sufficient to meet the target of 5,000 MW.

In order to give the owner of the power plant and seller of the generated power more assurance, SUNA, as the power purchaser, will open a revolving bank guarantee (letter of credit) by an Iranian bank for payment in Iranian Rials, covering payments under the power purchase agreement for the next six months. Moreover, for delays in payment a penalty of 2% p.a. above the minimum interest rate as determined yearly by the government for each delayed 1 million Iranian Rial (about €25) applies.

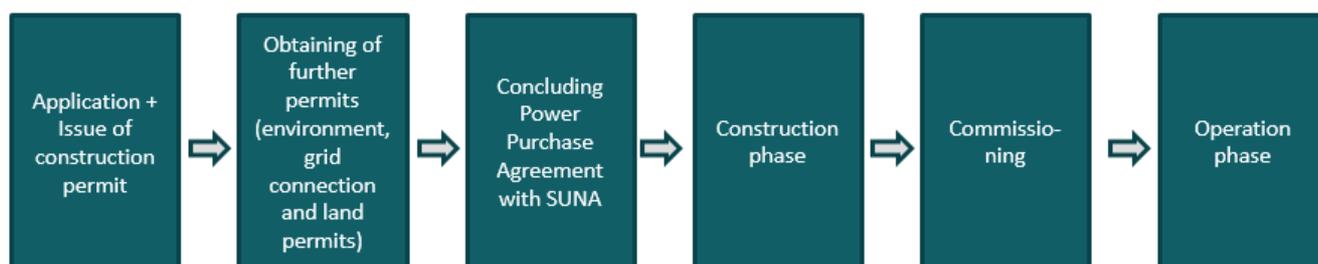
Procedural steps

In order to start constructing a renewable energy power plant in Iran, an application must be submitted to SUNA containing details of the project, such as location and estimated capacity of the plant. The applicant must be non-governmental. Moreover, it must be an Iranian person, thus, foreign investors are required to form a company in Iran (or to enter into a joint venture with a local partner). However, it is permissible for foreign investors to hold 100% of the share capital in an Iranian company (see the WFW Briefing note entitled “[Foreign Investment Promotion in Iran](#)” for more information).

Upon verification of the aforementioned requirements, and on the condition that no overlap exists with the sites of previously registered projects, SUNA will issue a construction permit to the applicant.

Following the issuance of the construction permit, the applicant shall obtain other necessary permits such as environment preservation, grid connection and land permits. Thereafter, a power purchase agreement can be entered into with SUNA and the construction of the power plant can commence. During the construction period, the project company is required to periodically submit progress reports to SUNA. SUNA controls and supervises the construction, and coordinates the grid connection tests and inspections through the Iran Grid Management Company.

The plant must be commissioned within 18 months of the conclusion of the power purchase agreement, otherwise the tariff in force at the time of commissioning will be applied, rather than the tariff in force at the conclusion of the power purchase agreement.



“SUNA’S APPROVAL IS REQUIRED FOR BOTH TRANSFER OF CONSTRUCTION TITLE AND MORE THAN 25% OF THE SHARES IN THE HOLDING COMPANY.”

Structuring issues

It is not permissible to transfer the construction permit to another party without SUNA’s approval. Nor is it possible to transfer more than 25% of the shares in the company holding the permit prior to commissioning. Therefore, a special purpose vehicle (SPV) for each project should be formed and should be the named holder of the construction permit (and other project rights). Applying and registering a project with an operating company should be avoided, instead a separate SPV should be used for each project. The transfer restriction also becomes relevant if the developer or EPC contractor of the project who is also a shareholder of the SPV wishes to sell the project by way of a share deal prior to commissioning to an investor. This should be taken into account when the EPC contractor agrees milestone payments with the investor against proportional transfer of the shares in the SPV to the investor.

There are tax exemptions which apply to investments in certain less developed regions in Iran. These should be taken into consideration when determining where to establish renewable energy projects.

Foreign investors will also need to apply for an investment license under the Iranian Foreign Investment Promotion and Protection Act (FIPPA) which grants protection against expropriation and nationalisation, and assures free transfer of foreign capital and profits of investment abroad (see the WFW Briefing note entitled “[Foreign Investment Promotion in Iran](#)” for more detail). In the case of renewable energy investments, the investment license would be particularly relevant for the SUNA payments under the power purchase agreement which shall eventually be forwarded to the investor abroad.

Challenges

By far the biggest challenge to renewable energy projects in Iran is obtaining financing. Local banks in Iran demand extremely high interest rates (more than 20%) and, moreover, many of them do not have sufficient liquidity to finance large scale projects. European banks are mindful of the exorbitantly high penalties levied for US sanctions violations in the past and so are still reluctant to finance projects in Iran.

Loans at reasonable interest rates from the National Development Fund (NDF), which was formed in Iran to transform a portion of oil and gas revenues to productive investments, are currently under discussion. However, in view of the drop in oil prices it is questionable if and to what extent the NDF will provide such loans.

“BY FAR THE BIGGEST CHALLENGE IS TO OBTAIN FINANCING.”

Despite the fact that due to the relief of sanctions in January 2016 SWIFT payments are now permitted for Iranian banks, persons and entities (see the WFW Briefing note entitled “*Doing Business in Iran*”), European banks are still reticent to do business with Iran. This leads to difficulties in payment transactions regarding money transfers into Iran and of the investment return to the investors abroad (including prior conversion of Iranian Rials into foreign currency). Though some regional, medium-sized banks with no US exposure, such as in Germany, Italy and Austria, have started to establish corresponding relationships with Iranian banks, large institutional investors are likely to require that payments shall be done through international banks with which they regularly do business, but which have not been willing to engage in Iranian transactions yet.

Furthermore, the renewable energy industry in Iran is in its infancy – only about 0.2% of the current power capacity comes from wind, photovoltaic and biogas plants. There is a lack of sufficient experience from existing operational renewable power plants which international developers and investors could refer to for verification of their business plans. Though SUNA has implemented standardised administrative procedures, such as securing state-owned land, such procedures are still untested and standards for the grid connection are undefined.

“THE RENEWABLE ENERGY MARKET OFFERS THE OPPORTUNITY TO ACCOMPLISH A LONG-LASTING ‘WIN-WIN’ SITUATION.”

Opportunities

Despite these challenges the renewable energy market offers the opportunity to accomplish a long-lasting “win-win” situation for both international investors and the country of Iran. Excellent geographic and topographic conditions, very attractive feed-in tariffs and a high electrification rate of 99.8% offer investors a new, untapped market with a high rate of return. In turn, Iran can reduce its dependency on finite oil and gas reserves while at the same time increase its exports, promote the flow of foreign currency into the country, gain from knowhow and technology transfer from mature renewable energy countries like Germany, France or Italy, and last but not least accomplish international commitments to reduce Greenhouse gas emissions.

FOR MORE INFORMATION

Should you like to discuss any of the matters raised in this Briefing, please contact Dr. Ahmad Khonsari or any other member of WFW's Iran group as mentioned below or your regular contact at Watson Farley & Williams.



DR. AHMAD KHONSARI
Partner – Munich
+49 89 237 086 240
akhonsari@wfw.com



ANDREW BAIRD
Partner – Dubai
+971 4 278 2301
abaird@wfw.com



SIMON ALSEY
Partner – London
+44 20 7814 8214
salsey@wfw.com



JEREMY ROBINSON
Partner – London
+44 203 036 9800
jrobinson@wfw.com



VINCENT TREVISANI
Partner – Paris
+33 1 56 88 60 47
vtrevisani@wfw.com



EUGENIO TRANCHINO
Partner – Milan, Rome
+39 02 721 7071 /
+39 06 684 0581
etranchino@wfw.com



NIKOLAOS KOSTIKAS
Partner – Athens
+30 210 455 7338
nkostikas@wfw.com



RODRIGO BERASATEGUI
Partner – Madrid
+34 91 515 6302
rberasategui@wfw.com

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