

May 2014

Iran announces new plans for privatisation and structural reform in the power sector

Written by Adrian Creed and Dr Amir Kordvani.

In May 2014, Iran announced a plan under which 183 government-owned companies, including power companies, will be listed on the Tehran Stock Exchange (**TSE**) by the end of 2014 or early 2015.

This announcement is the latest in a series of developments over the last 20 years where the Iranian government has sought to modernise the country's power sector. In this update, we look at the historical background to Iran's power industry and analyse how the latest developments will be transforming the way Iran manages this significant sector of its economy.

Historical background

Iran embarked on an ambitious power market reform and privatisation in the early 1990s to meet rapidly rising electricity demand and increase its generation capacity.¹

However, the first attempt to privatise the power sector failed to deliver any meaningful results mainly because the power plants were not run as companies. Rather, they were treated as part of the assets held by the relevant state-owned provincial power companies. In addition, there was no clear regulation on how to value the assets (including the power plants) and equipment held by the provincial power companies.

Due to high political and economic risk factors, foreign companies were not interested in investing in the Iranian power sector. The Iranian private sector did not have the technical capabilities and financial resources to invest in those companies. The other factors contributing to the lack of investment in the country's power sector include:

- the majority of the power plants have passed or are reaching the end of their life cycle and require major new capital investment;
- legacy management problems;
- uncertainties with respect to fuel supply obligations by the transmission companies;

- uncertainties with respect to power purchase tariff in terms of tariff setting and purchase obligations of the Iranian government (**Government**) (as the off-taker);
- the privatisation process was initially only considered for thermal power plants which generally are not considered to be cost-efficient generators;
- no public tender was issued for the power plants that were intended to be privatised;
- substantial subsidies on electricity paid by the Government;
- the ownership of some of the power plants was transferred to the local banks as a form of government repayment of its debt but the banks did not have any interest or expertise in operating those plants; and
- sanctions which have had significant implications for power companies limiting their access to equipment and finance.

The second attempt at power sector reform was made in the early 2000s through restructuring of the power companies. As a first step, the electricity sector was unbundled into generation, transmission, distribution and supply. In 2004, a law was passed under which TAVANIR (Iran's vertically integrated Power Generation, Transmission and Distribution Company) was authorised to incorporate a number of power plants as separate companies and sell 65% of their shares on the TSE. In the same year, the Iran Electricity Grid Management Company (**IEGMC**) was established (as a proprietary company fully owned by TAVANIR) to operate and manage the transmission network.

As a result of the second phase of the power sector reform and privatisation which started in 2004, four major power plants were privatised and sold to domestic private companies by 2013. The total value of the transactions was reportedly about IRR 140,000 billion².

Recent developments

Since 2010, Iran has taken significant steps to address some of the challenges on the privatisation process in the power sector and attract foreign investment and technology. For instance, in 2010, the Targeted Subsidies Act was introduced under which the prices of domestic energy, public utilities and eventually other subsidised items will be adjusted by 2015 to reflect real production costs. Additionally, a draft Public-Private Partnership Law has been prepared and is currently being considered by the Council of Ministers, although the content of the draft law has not yet been disclosed and there is no indication of when the draft law is expected to come into force.

In March this year, in another effort to encourage foreign and domestic private investment, the Minister of Energy announced that the Government had allocated IRR 12,000 billion to the Ministry of Energy and companies associated with it (such as TAVANIR) to enter into BOT and BOO contracts for investment in the power sector.

The announcement in May of the plan to list 103 Mega and Major Companies on the TSE, including power companies, is the latest step in the restructuring and privatisation of the Iranian power sector. Mega companies are those companies whose total shares are valued above Iranian Rials (**IRR**) 10,000 billion. Major companies are those with a total share value of between IRR 1,000 billion and IRR 10,000 billion.

The following Mega and Major Companies (all which were established in the 2000s to manage and operate power plants in different parts of the country) will be listed on the TSE:

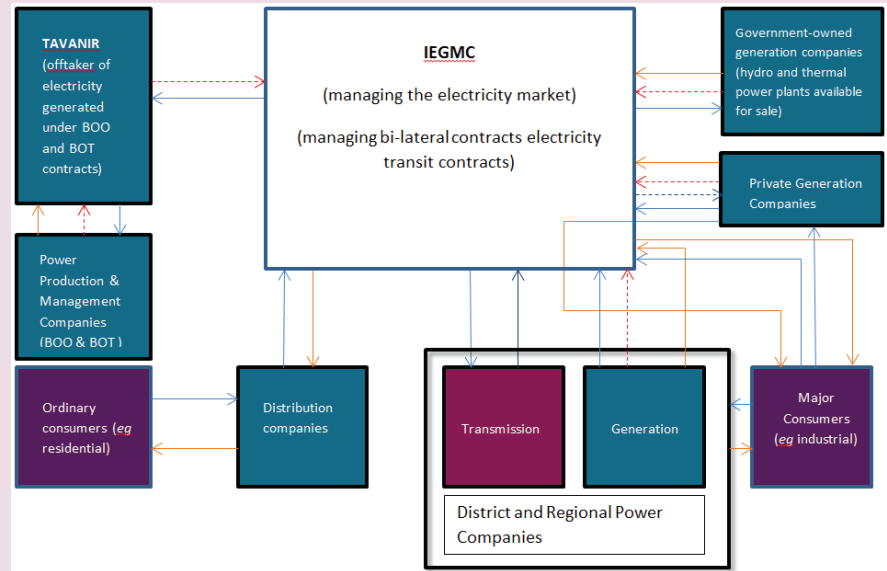
Mega power companies	Type of power plant	Major power companies	Type of power plant
Azerbaijan Power Production Management Co	Thermal	Manjil Power Production Management Co (wind)	Wind
Zahedan Power Production Management Co	Gas	Loshan Power Production Management Co	Thermal
Hamedan (Mofatteh) Power Production Management Co	Thermal	Shahrud Power Production Management Co	Mixed cycle
Qazvin (Rajaei) Power Production Management Co	Thermal and mixed cycle		
Sahand (East Azerbaijan) Power Production Management Co	Thermal		
Persian Gulf (Hormozgan) Power Production Management Co	Gas		

In addition, the Government is planning to establish one single, publicly-owned national power distribution company. The new distribution company's main function will be to incorporate all provincial power distribution companies as private companies and facilitate their listing on the TSE. The listing of the distribution companies is expected to be completed within the next 8 months.

Despite all these efforts, with the economic sanctions still in place and an uncertain legal and regulatory landscape, it remains to be seen if Iran can succeed in attracting the investment that it needs to replace aging plants and add new capacity to meet growing electricity demand. If it does, and if the P5+1 negotiations with Iran prove to be successful, the opportunities for foreign companies and investors alike could be very significant indeed.

Iran's planned restructuring of the electricity sector under the 2004 law

Note: as at the date of this Article, the restructuring of the electricity has not yet been completed.



Key:

- Electricity
- - - → Associated services (eg frequency control, radioactive power)
- - - → Transit services
- Transmission services
- Payment

Further information

If you would like further information on any issue raised in this update please contact:

Adrian Creed, Partner

E: adrian.creed@clydeco.com

Dr Amir Kordvani, Associate

E: amir.kordvani@clydeco.com

Clyde & Co LLP
PO Box 7001
Level 15, Rolex Tower
Sheikh Zayed Road
Dubai, United Arab Emirates

T: +971 4 384 4000

F: +971 4 384 4004

Clyde & Co accepts no responsibility for loss occasioned to any person acting or refraining from acting as a result of material contained in this summary.

Clyde & Co LLP is a limited liability partnership registered in England and Wales. Regulated by the Solicitors Regulation Authority. QFC Branch licensed by the QFCA. Abdulaziz A. Al-Bosaily Law Office in association with Clyde & Co LLP is licensed in Riyadh – see www.albosailylawoffice.com for licence detail.

© Clyde & Co LLP 2014

¹ According to the latest reports, Iran's electricity generation capacity is approximately 70 GW.

² 1 USD = IRR 25,556 (at the time of preparing this article)