FOREIGN CORPORATIONS IN THE LAW OF IRAN

Executive summary

The term "foreign corporation" is composed of two parts: corporation, and foreign. To understand the real and actual sense of these two terms in the law of Iran, we need to explain how, why and when these two concepts came to existence, lived their life, and finally took their current shape in the legal environment of Iran.

After getting to know about their history, we need to look at what they actually are. This requires that we explain their legal functions in the socio-economic context of Iran. These functions, in their turn, are subject to the laws and regulations of Iran, including the Civil Code and the New Commercial Code that define the contour of foreign corporation in our legal system.

The last issue in this News & Analysis is to understand the exact meaning of the term 'foreign' when it qualifies a corporation. Iranian lawyers have put forward few interpretations for this term based on the place of establishing a company, or the place of its head office, or the place of its management. It is also interesting to note that the level of 'control' - normally determined by looking at the percentages of ownership of shareholders - must be distinguished from the concepts and methods used to determine whether a corporation is foreign or not.

Concept of 'corporation' and its brief legal history

The word "*sherkat*" has two different meanings in Persian language: It refers to both 'partnership' and 'corporation'. This dual use of the term stems from the fact that the concept of 'corporation' is a relatively recent phenomenon while the concept of partnership has deep roots in the Islamic and even in the pre-Islamic law.

Concept of '*sherkat*' (partnership) and its legal ramifications are discussed in detail in the Islamic law books. The Civil Code of Iran that is heavily influenced by the Islamic law has 36 sections (or Articles) about this subject. Articles 571 to 606 of the Code are divided into two subsections covering the general rules and the division of property. The basis of all the rules is the concept of partnership that is defined in section 571 of the Code: "- A partnership is defined as the combination of the rights of several proprietors in one single thing by way of undivided shares." A partnership is therefore composed of four essential elements: a) a single thing; b) several proprietors; c) combination of the rights; and d) undivided shares of proprietors. Most of these elements are present in the definition of corporation.

The first contact of Iranians with foreign corporations dates back to Safavid era in 17th century when the British East India Company (BEIC) developed more interest in establishing trade relationship with Iranian merchants. During the 17th and 18th

centuries, the commercial relations between Iran and the Great Britain was controlled and managed by the BEIC. In the second half of the 19th century, when British and Russian companies entered into – mostly - concession agreements with the government of Iran, the concept of '*sherkat*' found its way to the vocabulary of the public. Significant number of agreements signed with British and Russian counterparts covered a vast array of subjects including operating of telegraph lines, fishing in Caspian Sea, establishing banks, transportation and insurance, transfer of oil, construction of railroads, operation of oil rigs, printing of money, and construction of lighthouses. The concessions granted to Baron Julius de Reuter and the tobacco régie (monopoly) granted to Talbot opened the way for vaster presence of foreign companies in Iran.

Starting from the second half of the 19th century, Iranian tradesmen established their own "*sherkats*" in Tehran, Shiraz, Mashad, Isfahan and Bushehr. For the Iranian tradesmen, perhaps, these '*sherkats*' were the same as the foreign corporations because they started with a certain amount of capital divided into a certain number of shares owned by famous merchants of each of the above cities. In one instance, '*Sherkate Omumi Iran'* that was established by 17 merchants of Tehran, sold its 'shares' to almost 20,000 shareholders. Later this '*sherkat*' bought shares of another partnership that was involved in constructing roads in west of Iran. After four years of mostly successful operation, the partnership was dissolved due to its failure in maintaining trust of its shareholders.

These partnerships did not own legal personality. As a result, they could not be qualified as corporations. At the same time, their founders tried to make them resemble their foreign competitors in the Iranian market. Their efforts were doomed to fail due to the fact that the Iranian traditional legal system had neither a law nor a corporate registry to enable the Iranian tradesmen to incorporate their partnerships.

The concession agreements signed in the second half of the 19th century created a close link between two concepts of 'company' and 'concession' in the mind of Iranian lawyers. For this reason, Iran's 1906 Constitution tried to put an end to this unpleasant link and experience. Article 23 of the Constitution prescribed that without the approval of the National Consultative Assembly (*Majlis*), no concession for the formation of any public company of any sort shall, under any plea whatsoever, be granted by the State. Article 26 added that construction of railroads or chausses, whether at the expense of the Government or of any Company, whether Iranian or foreign, shall depend on the approval of the National Consultative Assembly.

More than two decades later, Article 3 of the Act on Registration of Companies (1932) stated that all foreign companies interested in carrying out commercial, industrial or financial activities in Iran through a *branch* or a *representative office* were required to register at the Deed Registry of Tehran. Article 6 of the same Act exempted the companies that had obtained concessions from the State from the duty of registration at the Corporate Registry. The latter group, in fact, somehow got the status of chartered

companies while the former group received the same treatment as the one received by Iranian private companies.

Later, Article 1 of the Act on Attraction and Protection of Foreign Investment (1955) opened the way for new forms of activities of foreign corporations in Iran. Under this Article, foreign private persons, companies and establishments that by permission of the Iranian government and in accordance with Article 2 of the Act brought into Iran their capital in the form of cash, factories, machinery and their parts, equipment, patent rights, expert services and the like, for the purpose of development and rehabilitation and productive activities in the areas of industry, mining, agriculture, and transport, could enjoy the facilities set out in the Act. They could also enter into *joint venture* or business agency agreements with their Iranian partners. Foreign corporations could also start an investment project directly, i.e. without any need to establish a branch or a representative office or to establish an *equity joint venture company* in Iran.

After the Islamic Revolution of 1979, the new Constitution of Iran imposed new restrictions on the activities of foreign companies in Iran. Article 81 of the Constitution states that granting the concession of formation of companies and institutes to foreigners in the fields of commerce, industry, agriculture, mining and services shall be strictly forbidden. As explained before, an inextricable link between two concepts of ‘concession’ and ‘company’ dominated the legal paradigm of Iran since the second half of the 19th century. In this context, Article 81 was nothing but a reiterated prohibition of granting concession to foreign legal and physical persons. In practice, however, the Corporate Registry of Iran prohibited involvement of foreign persons in any activities related to establishing a company in Iran, including registration of branches and representative offices of foreign companies at the Corporate Registry of Iran. This strict prohibition put an end to any collaboration between Iranian corporations and their foreign counterparts. Finally, the Prime Minister of Iran at that time sent a letter to the Guardian Council on March 27, 1981, requesting the Council to find a more practical interpretation for Article 81 of the Constitution. On April 2, 1981, the Guardian Council opined that "foreign companies that have concluded legal contracts with Iranian governmental entities may register branches of their companies in Iran according to Article 3 of the Act on Registration of Companies in order to carry out their legal obligations and conduct their businesses within the limits set forth in the contracts concluded by them. Such registration shall not be in contravention of the provisions of the Constitution of the Islamic Republic of Iran."

In 1997, the Act Permitting Registration of Branches and Representatives Offices of Foreign Companies authorized the foreign companies legally registered in their own countries of origin to set up branches and representative offices in Iran to carry out the businesses authorized by the government of Iran in due compliance with the Laws of Iran. This authorization depends on reciprocal treatment of foreign States, as far as activities of Iranian companies in respective foreign countries are concerned.

By and large, foreign corporations are now authorized to conduct business and economic activities in Iran in at least six different forms: a) directly; b) through a branch; c) through a representative office; d) through an equity joint venture; e) through a contractual joint venture; f) as a result of merger, amalgamation, or division.

Authorized activities for foreign corporations in Iran

a) Direct activities of foreign corporations: Under concession agreements, foreign corporations could directly carry out certain economic activities, especially in the fields of petroleum exploration, development, and exportation from Iran to other countries. Grantees of concession rights were not required to establish a branch or representative office in Iran. Contrary to generally accepted idea, concession agreements are being concluded all over the world, especially in developed countries. Article 2(c) of Foreign Investment Promotion and Protection Act (FIPPA) opens the way for concluding modern concession agreement by providing that concession means special rights which place foreign Investors in a monopolistic position. This means that a concession (service) agreement that is devoid of monopoly shall face no legal impediment.

In our view, after removing the existing misunderstandings concerning concession agreements, foreign corporations can sign concession (service) agreements with their government counterparts to start their economic activities directly, without any need to go through the unnecessary procedure of establishing branch and representative offices in Iran.

b) Activities of branch offices: As the name shows, branch offices are like branches of a trunk because they do not have a separate legal identity. By establishing branches in Iran, foreign corporations graft one or more of their branches to a new trunk in a new environment. In this way, branches grow and develop in a new environment in order to produce goods or services similar to those produced in their country of origin.

Branch offices are mirror images of their mother company. Therefore, any changes in the name, type, address, nationality, and capital of a foreign corporation or in the position or status of the branch office managers must be first registered at the Corporate Registry and then published in the Official Gazette. Failure in meeting this requirement may result in making the managers liable in tort.

Registration of a branch office in Iran also means that the foreign company accepts that its branch office, as well as all of those who work for the branch office, shall be subject to the mandatory laws of Iran. However, domestic laws that apply to foreign companies shall not violate the international, regional or bilateral treaties concluded between Iran and the respective countries.

c) Activities of representative offices: By definition, a representative is a trade agent of the company that it represents. As such, a representative gets all of his or her authority from the agreement or the letter of appointment that explains the scope, the period of validity, and the termination date of his or her authority. Article 23 of the

Regulations on Registration of Companies confirms that a representative is an individual who has obtained sufficient authority from a foreign company for representing it. As a result, all obligations and commitments undertaken by a representative shall be considered as obligations of the foreign company, as long as activities of the representative are *intra vires*. Two principles of correctness (*sehat*) or apparent control (*yad*) may be used to justify this understanding.

d) Activities of contractual and equity joint ventures: A foreign and an Iranian partner may get into an agreement to create a joint venture (JV). They enter into a venture – a business activity whose purpose is gaining of benefit – jointly so that the benefits earned or the losses incurred could be divided among them according to their agreement. This is the first step in the JV process. It is clear that the JV agreement is a partnership (*sherkat*) agreement with the difference that in a partnership agreement, it is not required that the parties seek benefit. In other words, partnership is essentially a joint ownership while a joint venture is one step ahead: partners create a joint ownership with the objectives of seeking benefit and avoiding losses.

The second step in the JV process is to establish a new corporation in which the partners have joint shares. During the 90s, when a new wave of investment incentives attracted foreign investors to Iran, the normal ceiling for ownership of foreign corporations was 49%. The Iranian partner who owned 51% of the shares in principle could control the joint venture company through its majority shares although the parties could include specific legal mechanisms in their JV agreement to strike a balance between the parties' interests.

Both the contractual and the equity joint ventures are established for investment purposes. Article 2(a) of the Foreign Investment Promotion and Protection Act (FIPPA) requires that equity joint ventures involve themselves in activities that bring about economic growth, upgrade technology, enhance the quality of products, and increase employment opportunities and exports. More importantly, they must not be implicated in activities that may pose a threat to the national security and public interests, or may cause damage to the environment, or may disrupt the country's economy, or may jeopardize the production by local investments (Article 2(b)). The policy guidelines included in Article 2 of FIPPA may be interpreted in a restrictive or expansive way, depending on the interpretation attributed to them by the Iranian government authorities or courts. In practice, the authorities have normally adopted a flexible approach in order to encourage and promote foreign investment in Iran.

e) Activities resulting of merger, amalgamation and division: Concepts of merger, amalgamation and division are newcomers to the legal system of Iran. They have rarely been discussed or interpreted by the Iranian legal authors due to almost complete silence of the laws of Iran on these legal concepts. The New Commercial Code opened the way for new forms of collaboration between a foreign and an Iranian entity. An example of this new potential for economic cooperation is when one or more foreign corporation and one Iranian corporation fuse together to create a new entity. As a result

of this process, one or more entities involved in this process lose their identity. Another example is when two business entities, one of which is an Iranian and the other a foreign corporation, enter into a fusion process as a result of which, both lose their identity and a new separate entity is born. Legal ramifications of merger, amalgamation and division will be discussed in one of our future numbers of News & Analysis.

Meaning of 'foreign' as an adjective for foreign corporations

Article 1 of the Act on Registration of Companies (1932) states that any company that is established in Iran and its head office is located in Iran shall be considered an Iranian company. If we use the terms that are applicable to physical person, we can say that an Iranian corporation must be born in Iran and also must have its center of interest in this country. What would be the status of a corporation that is established in Iran but its head office is located out of Iran? The two requirements of Article 1 are cumulative. Therefore, if one of the requirements is missing, then the corporation must be considered non-Iranian. This does not mean that the corporation is necessarily a foreign one.

It is also crucial to make a distinction between the adjectives of 'foreign' and 'Iranian' used to qualify a corporation, on the one hand, and the control that is applied to a corporation by its shareholders, on the other hand. Some laws determine a ceiling of 49% for foreign ownership in a corporation in order to ensure that its Iranian shareholders or partners maintain their control over decisions of the corporation. In a recent law, a distinction is made between an Iranian, a foreign, an Iranian-foreign, and a foreign-Iranian corporation. It appears that the two categories of Iranian-foreign (with 51% Iranian and 49% foreign ownerships) and foreign-Iranian (with 51% foreign and 49% Iranian ownerships) refer to corporations in which the Iranian or the foreign shareholders or partners hold their control over the corporation respectively. These terms, in other words, do not define companies of dual nationality.

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