JOINT VENTURE & THE LAW OF IRAN

Executive summary

Where two or more persons, whether natural or juridical, put together their assets to start a business activity in order to reap the benefits and to avoid the losses, they form a joint venture. Due to complexity of joint ventures, on the one hand, and strong desire of the partners to a joint venture to agree on every aspect of their venture, on the other, it is necessary that the partners found their relationship on a well-drafted and sufficiently detailed joint venture agreement.

The next step is to choose the type of their joint venture partnership. They may opt for a simple, contract-based, and limited form of partnership. Two parties to the joint venture agreement cooperate in the framework of a joint venture agreement that sets up their objectives, plans, joint properties, as well as the method of calculation and payment of their profits.

Simplicity of this legal structure might not match the complex activities that the parties intend to initiate. In that case they provide for detailed procedure of establishing a joint venture company (JVC) that will function as their common pool of interest. Parties to the joint venture contract become shareholders or partners in a company. As a result, they have to agree on name, capital, head office, shareholders, types of shares, general meetings, and many other aspects of establishing a company in their shareholders agreement as well as in the Articles of Association (AoA) of their JVC. All the agreements related to their common interests, especially those related to transfer of technology, intellectual property rights (IPRs), purchase and sale of realties, etc. must be annexed to the joint venture agreement too.

Appropriate drafting of the above agreements require a thorough understanding of the legal context of Iran. The recently passed Commercial Code of Iran is one of the laws that must be studied and analyzed carefully before starting negotiations on establishing a joint venture in Iran. Impact of the sanctions imposed on Iran is another major issue of concern for every foreign investor in Iran. We will discuss this latter issue later.

Definition of Joint Venture

The term 'joint venture' refers to joint involvement of at least two persons in a venture, i.e. a profit-bearing activity that is fraught with some risk of losing the seed money too. To understand legal consequences of getting into a joint venture, therefore, we need to look at two main aspects of a joint venture: partnership (*sherkat* or *mosharekat*) of at least two persons; and their commitment to put their capital, knowledge, energy and intention into making money while accepting that in this process, they may also lose their initial capital.

Joint ventures can also be recognized by looking at their functions. They work as hinges that connect two or more parties together, ideally in a flexible and efficient way. Parties to a joint venture change during the life-time of their partnership. If the hinge that connects them cannot adapt itself to the changes, it will break and the partners will divorce. A business divorce may have disastrous ramifications for the partners.

Joint ventures also function as vehicles for a successful venture. Partners to a joint venture must take all the required measures in order to reduce the tension that results from their eventual business failure, or even success. Their relationship must be smooth and stable. At the time of drafting their joint venture agreement, therefore, the parties need to think about all the ups and downs of their relationship to avoid unpleasant surprises.

Legal bases of joint ventures

Joint ventures are subject to two sets of rules: a) contractual rules included in joint venture agreement, shareholders' agreement, articles of association, transfer of technology agreement, intellectual property agreement, and so on; b) rules that are prescribed by the Acts, regulations and by-laws of Iran.

Parties to a joint venture try to regulate their legal relationship through the provisions that are set out in their agreements. The first and the most basic agreement for the parties is the joint venture agreement. This text is the blueprint of the plan that the parties draft carefully because the marriage between business interests of the parties depend heavily on comprehensiveness and efficiency of this agreement. Two main issues are normally explained in full detail in joint venture agreements: 1) information-sharing through transfer of technology, or training, and so on; 2) mechanisms defined and devised by the parties to ensure their effective collaboration in the framework of the projects to be carried out jointly by them.

Another major issue is the control that the parties apply to the activities of a joint venture. A main instrument that can guarantee an efficient control is a full-fledged accounting system that may either be internal or external to the joint venture. In the former case, a regular external auditing will also be necessary to avoid, as far as possible, occurrence of misrepresentation. External accounting entities are less vulnerable to managerial influences but they may lack deeper knowledge of an insider accountant

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Partnership as the basis of a joint venture

As soon as joint venture partners agree on the essence of their partnership under the laws of Iran, their agreement becomes subject to the provisions of the Civil Code of Iran on partnership (sections or Articles 571-606). The main consequences of their partnership under the Civil Code are:

1) **Creation of a partnership**: Under Article 573 of the Code, a voluntary partnership may arise from any form of contract. In practice, the parties include provisions in their joint venture agreement concerning their joint properties, activities and objectives. A main issue to be handled in this phase of their collaboration is the value of the contribution made by each of them. Normally the partners avail themselves of the services of official evaluation experts who are internationally renowned.

The parties may enter into a joint venture agreement with different objectives: A foreign partner may a strong marketing and sale network in Iran. The Iranian partner, on the other hand, needs a foreign partner that can open the way for presence of the joint venture in international markets. It is advisable that before entering into a joint venture agreement, parties to the agreement avail themselves of a fact-based market analysis that may assist them to effectively reach their target market.

2) **Administration of partnerships**: A joint venture is a partnership that is directed towards profit-making goals. Partners agree on the method of administration of the joint property by including detailed conditions on it in their joint venture agreement (Article 576 of the Code). Depending on whether they establish a joint venture company or not, the mechanisms devised by the parties take two distinct forms:

A - In equity joint ventures, the parties agree on a corporate structure that normally takes one of the following four corporate forms: 1) joint stock companies; 2) limited liability companies; 3) limited partnerships; and 4) general partnerships. In all of these corporate forms, one can observe a general meeting of the shareholders or partners that decides about overall policies and strategies of the joint venture company. At a second level, there is a board of directors that makes general managerial decisions. Finally, at the peak of the pyramid, we have a CEO that is responsible for day to day management of the joint venture company.

B - A similar structure is normally devised for contractual joint ventures. The first layer is composed of all of the partners. According to Article 577 of the Civil Code, every partner under the contract of partnership is entitled to perform any act which is necessary for administration of the joint venture. This entitlement may be assigned by the partners to a board of directors that forms the second layer of administration. Assignment of entitlement may be made under an irrevocable contract so that as long as the partnership lasts, the partners shall have no right of withdrawal (Article 578 of the Code). Finally, the third layer is composed of one or more directors or administrators who carry out duties similar to those of CEOs. They may perform the acts which are necessary for the administration of the partnership either singly or jointly. In the latter case, the director who acts alone and has no written authorization from the other partners will be a guarantor in relation to the partners, even if it is at that moment impossible for other partners to intervene in the administration (Article 580 of the Code).

As far as partnership property is concerned, a partner who has possession of property belonging to the partnership is in the position of a trustee and will not be a guarantor in

respect of the destruction or damage of that property, except in cases of negligence or excessive use. Partners who act without authority are responsible to the person with whom they have traded, and claimants have the right to refer to those partners only (Articles 584 and 585 of the Code).

3) **Profit-sharing in partnerships**: The general rule is that partners share in the profits and losses in proportion to their share except where one or more persons, in consideration of their services, are allotted greater shares.

4) **Termination of partnership**: Involvement of partners in a joint venture comes to an end through one of the following ways stated in Articles 586, 587 and 589 of the Civil Code:
a. Expiry of the period specified for the partnership in a joint venture agreement;
b. On a share-out;
c. If the property of the joint venture is totally destroyed; and
d. By a demand of the division of the jointly-owned property, unless a division in accordance with the provisions of the Code is forbidden or the partners have bound themselves in an irrevocable manner not to divide the property.

Venture as the driving force of joint venture

1) Types of business ventures: Partners enter into a joint venture with two objectives: earning of benefit, and avoiding of losses. Legally speaking, under Article 1 of the New Commercial Code, any activity for earning of benefit and avoiding of loss is a commercial activity. The same Article of the Code divides commercial activities into four types:

a. In the first type, an element of intention or objective is part and parcel of the commercial operation (sections 1, 2, 10 and 11 of Article 1). This means that acquisition of property rights with the intention of transferring them to another person to earn a benefit is a commercial operation.

b. In the second type which may be called as absolute commercial operation, the Code only requires a certain legal form in order to characterize it as a commercial operation (sections 3-9 of Article 1). This group covers those operations that by definition comprise a benefit-seeking intention.

c. The third type covers operations that are considered commercial due to the legal structure adopted for conducting the activity. Establishing a company is the only legal way of involvement in these operations (Article 2 of the Code).

d. Finally, all operations that result from joint actions of two merchants are considered commercial.

2) Legal ramifications of business ventures: All four types of commercial operations include an element of venture. Consequently, when parties to a joint venture accept to

start a venture, they initiate a commercial operation. Consequences of being involved in a commercial operation are:

a. All mandatory laws of Iran shall apply to commercial operations that are conducted in Iran.

b. To start a partnership, the partners must put together their properties. This requires that foreign partners transfer their capital into Iran in order to be combined with the capital of their Iranian partners. By definition this activity is a foreign investment. Specific rules of Iranian law, especially those included in the Foreign Investment Protection and Promotion Act (FIPPA) shall apply to the joint venture.

c. If the parties opt for an equity joint venture, their joint venture shall be subject to the specific rules that regulate activities of corporations in Iran.

d. Under Article 105 of the Direction Taxation Act of Iran, the aggregate profits of companies, and the profits from the profit-making activities of other legal persons, derived from different sources in Iran or abroad shall be taxed at the flat rate of 25%. This rate shall be applied after levying the losses resulting from non-exempt sources and after having deducted the exemptions as prescribed. As far as joint ventures are concerned, the 25% rate applies only to equity joint ventures. Article 131 of the Act determines the rates that apply to natural persons, including partners of equity joint ventures.

Note 5 of Article 105 of the Act adds that natural and juridical persons shall not be liable to any other taxes in respect of the dividend or the contribution they may collect from the companies requesting investment.

3) Scope of business ventures: An interesting question to be raised is that whether foreign partners are allowed to be active in every field of business activities in Iran or not. It is evident that certain sensitive fields of activity are exclusively open to public or semi-public Iranian entities. The question, however, remains that whether presence of a foreign partner in a joint venture agreement or company makes the partners or the joint venture company disqualified for any business activities or not. Here we need to make a distinction between the Iranian entities that are active in the private sector of the Iranian economy and those that are authorized by law to operate in its public sector. Under Article 44 of the Constitution, the public sector includes all large-scale and mother industries, foreign trade, major minerals, banking, insurance, power generation, dams and large-scale irrigation networks, radio and television, post, telegraph and telephone services, aviation, shipping, roads, railroads and the like. It is added in the same Article that "all these will be *publicly owned and administered by the State*." Involvement of a joint venture company, even if is established in Iran and its head office in Iran and therefore must be considered as an Iranian company, in the activities that fall in the scope of the public sector, is therefore prohibited.

The words “publicly owned and administered by the State” draw our attention to two main criteria: ownership and administration (i.e. control). Both of these terms are matters of degree. If the State keeps ownership of 51% of a public company and transfers 49% of it to a joint venture company, one may argue that the company is still publicly owned and administered by the State.

Control of a company is a complex issue that requires further studies. We will come back to this issue in one of our coming reports concerning foreign investment.

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