

LEGAL RAMIFICATIONS OF ARTICLE 968 OF THE CIVIL CODE OF IRAN

Executive summary

The interpretations of article 968 of the Civil Code of Iran (CCI) can be subdivided into two groups. Under the first one that is supported by few lawyers, article 968 is a mandatory provision of the CCI. This means that all obligations arising out of contracts are subject to *lex loci contractus*, wherever they are concluded. The only exception to this rule is where both of the parties are foreign citizens who have explicitly or implicitly declared that their contract shall be subject to a law other than *lex loci contractus*. The second interpretation is a more liberal and more popular one. Under this interpretation, article 968 is a facultative provision of the CCI authorizing the Iranian as well as the foreign citizens to subject their contracts to any law that they deem appropriate.

It is evident that the first interpretation ties the hands of Iranian juridical and natural persons because if they conclude their international commercial contracts inside Iran, the law of Iran shall apply to the contracts without any exception. On the other hand, they can adopt any law as the governing law of their contracts that are concluded outside Iran. However, if a party brings a case before an Iranian court, the judge who believes in mandatory nature of article 968 may impose the law of Iran on all aspects of the dispute. This normally happens where Iranian parties to international commercial contracts find it beneficial to have their disputes decided by an Iranian judge under the law of Iran.

The second interpretation leaves the Iranian juridical or natural persons free to choose the most appropriate law under the circumstances of each case. It removes the protective cover of the Iranian law, exposing the Iranian contractors to the benefits and risks of contractual freedom.

Both of the interpretations have their advantages and disadvantages that must be taken into account before opting for any of them. Whatever be the final decision of those who intend to enter into an agreement with Iranian companies, firms, foundations, or individuals, they need to be aware of the legal ramifications of article 968 of the CCI.

Article 968 and its different interpretations

Article 968 of the CCI reads as follows:

Obligations arising out of contracts are subject to *lex loci contractus* except where both of the parties are foreign citizens who have explicitly or implicitly subjected the contract to another law.

The *prima facie* consequences of the above article are:

- a. Only the laws of the place of concluding a contract shall apply to it if at least one of the parties to the contract is Iranian.
- b. Where both of the parties are foreign citizens, they are free to subject their contract to a law other than *lex loci contractus*.
- c. The intention of the foreign citizens to avoid application of *lex loci contractus* must be declared by the parties explicitly or implicitly.

These consequences are based on an interpretation of article 968 that considers it a mandatory provision of the CCI. Under a more liberal interpretation, article 968 is a facultative provision allowing the parties to adopt any law as the governing law of their contract.

The arguments raised by the supporters of each of the above interpretations deserve to be analyzed carefully because of the important role that this article plays in defining the legal contours of the international commercial contracts concluded by the Iranian juridical or natural persons.

Article 968 as a mandatory provision

The historical origin of article 968 helps us to understand the *raison d'être* of this provision in the context of the legal system of Iran in the 19th and early 20th centuries. Before adopting the CCI by the Consultative Assembly of Iran, the governing law of the international commercial contracts entered into between an Iranian and a foreign citizen was always a foreign law. The reason for this exclusive application of foreign laws was clear: Iran did not have a law that could be applied to international commercial contracts. The first step, therefore, was to adopt a set of rules that could open the way for application of the law of Iran. Hence, having a Civil Code was a necessary but insufficient step in this direction. The next step was to “encourage” the foreign citizens to choose the law of Iran as the governing law of the contracts that they concluded with their Iranian counterparts. The legislator of Iran needed to include a provision in the CCI that would make the law of Iran the governing law of any international commercial contract concluded in Iran by the Iranians. Therefore, it would defeat the main purpose of the legislator if article 968 of the CCI was interpreted as a facultative provision.

Another argument that supports the mandatory nature of article 968 is that the legislator has gone a long way to define the exception to the general rule: a) both of the parties must be foreign citizens; and b) they must express their intention of choosing a law other than *lex loci contractus* explicitly or implicitly. If the general rule stated in the first part of article 968 was facultative and the parties were authorized to adopt any other governing law even where one of the parties was an Iranian citizen, why should the legislator bother to include detailed explanations about the exception to a facultative general rule?

The final argument is that the language of article 968 shows no sign of facultative nature of the general rule. It is direct, clear, and straight forward: Obligations arising out of contracts are subject to *lex loci contractus*. If the rule was facultative, the legislator

would use words such as “may” to indicate that the parties can adopt a law other than *lex loci contractus* as the governing law of their contract.

Article 968 as a facultative provision

In the legal literature concerning article 968, two arguments could be found that support facultative nature of the provision.

First argument

The mandatory or facultative nature of the conflict of law rules stem from the mandatory or facultative nature of the field of law to which the rules apply. For example, the rules that apply to contracts are normally facultative to enable the parties to adopt the rules that are most appropriate for their contractual needs. Following the same line, article 968 that determines the governing law of contracts must be interpreted as a facultative provision.

It can be counter-argued that conflict of law rules of every legal system have a gate-keeping function. They protect the domestic law against undesired application of foreign laws. By qualifying article 968 as a facultative provision, doors of the domestic contract law are opened towards uncontrolled entrance of foreign laws that leaves the Iranian contractors completely defenceless.

Another counter-argument is that the rules that apply to every field of law are neither completely mandatory nor wholly facultative. Depending on their importance to public order, legislators decide how to qualify them. Protecting the Iranian contractors against stronger bargaining power of their foreign counterparts has always been a major public-order concern of the legislator of Iran. This means that article 968 was drafted and adopted as a mandatory provision of the CCI. It remains as such for the same reason.

Second argument

Iranian contractors would be deprived of adopting the law of Iran as the governing law of their contract when they conclude their contracts outside of Iran if article 968 was a mandatory provision. Three main counter-arguments are put forward:

I. Mandatory nature of laws are sometimes limited to geographical limits of a country and sometimes follow citizens of the country even when they are out of their country of nationality. For example, personal status provisions are applicable to Iranian citizens even when they live outside Iran while many criminal law provisions of Iran are only applicable in Iran. In some occasions even two different domestic laws claim application. For example Iranian bi-nationals are considered Iranian by the Iranian government while they are considered foreign citizens by their respective countries of citizenship.

The conflict of law rules are of *sui generis* nature. As mentioned before, their gate-keeping function requires that each legal system apply only its own conflict of law rules. At the same time, if at the time of applying a rule, the judge finds that the rule requires application of a foreign law, then the foreign law must be applied (*single renvoi*). In exceptional cases, the conflict of law rule of a foreign law refers the case back to the law of the first legal system (*Double Renvoi* or the *Foreign Courts Doctrine*). Simply put, if the law of Iran (A) refers to a foreign law (B), then $A \rightarrow B$. If the foreign law refers the case back to the law of Iran, then we have the following process: $A \rightarrow B$, then $B \rightarrow A$. It is evident that this ping pong shall not be continued forever. The easy way out is to say that in the second part of the process, the foreign law (B) refers the case back only to the substantive law of Iran (substantive A). Simply put: $A \rightarrow B$, then $B \rightarrow$ substantive A. As a result, the conflict of law rules of A shall not be applied again.

It must be noted that mandatory application of article 968 differs where a contract is concluded between an Iranian and a foreign citizen inside or outside of Iran:

A. Inside Iran - Iranian citizens (and their foreign counterparts) shall apply article 968 at the time of drafting and concluding their contract because mandatory provisions of the CCI must be respected inside the boundaries of Iran in all circumstances. It is clear that if article 968 is considered facultative, then the above rule shall not apply.

B. Outside Iran - Where the parties conclude their contract outside Iran, their freedom to choose the governing law of their contract may only be limited by the conflict of law rules of the place of concluding the contract and not by article 968 of the CCI. However, if they get into a dispute and one of the parties lodges a case against the other party before an Iranian court, the court shall apply article 968 to the case in hand if the judge considers it a mandatory provision of the CCI. If he opts for facultative nature of the provision, then the result shall be different.

II. Place of concluding a contract is the place of adding the last signature to a contract. Iranian parties are completely free to add their signature to their contract in Iran after all of the parties have done their part of signing it. They can keep sufficient evidence concerning signing of the contract in Iran to use it in court, if and when needed.

III. The role of governing law clause in contracts is sometimes overrated. For example, if an Iranian concludes an agreement with a foreign citizen in France and the parties adopt French law as the governing law of the contract but the place of performance of the contract is Iran, then all of the mandatory laws of Iran shall apply to the performance of the contractual obligations. This means that from the moment that an international trade operation passes the Iranian borderlines, the banking, customs, export-import, labour, insurance and many other operations shall be subject to the laws of Iran. In other words, although at the time of conclusion of the contract outside of Iran, *lex loci contractus* takes the upper hand but in the phase of performance, the laws of the place of performance (*lex loci executionis*) shall take the front seat. It is evident that performance of a contract covers almost its whole life. During this period, the governing

law (i.e. *lex loci contractus*) shall only apply to those fields that are not already occupied by mandatory provisions of the *lex loci executionis*.

Study of a special case under Article 968

What would be the decision of an Iranian judge concerning the governing law of a contract if an Iranian and a foreign citizen conclude a contract outside Iran in country X but adopt the law of country Y as the governing law of their contract? In such a case, two distinct circumstances are recognizable:

- a) One of the parties may directly bring a case before an Iranian court to benefit from the decision to be rendered by the Iranian court; or
- b) After lodging a case before a foreign court, the party who has benefited from the court's decision may request an Iranian court to enforce the decision in Iran.

Each of the above two options must be studied separately.

A. In the first case scenario, two options are available:

- a) If the judge adopts the approach of considering article 968 as a mandatory provision of the CCI, then *lex loci contractus* of country X must be applied. It has been argued that under article 10 of the CCI, the parties are allowed to opt for any law that pleases them. This argument faces a major criticism because it ignores the conflict of law rules of Iran by applying substantive provisions of the CCI directly.

After deciding in favour of applying the law of country X, the judge needs to consider conflict of law rules of this country. If they refer to the law of country Y, then the governing law adopted by the parties matches the law to be applied under the decision of the court. However, if the conflict of law rules refer to law of any country other than country Y, then there shall be a discord between the court decision and the governing law clause of the contract. The party who has lodged the case have two options: a) To waive the court decision in order to get into an agreement with the other party to apply the law of country X because it is more favourable to both of the parties; or b) to ask the court to enforce its decision.

B. In the latter case, the Iranian court shall go through the following process:

- 1) In the first step, under article 971 of the CCI:

Claims and lawsuits follow, in matters of competency of the court and of laws of procedure, the laws of the place where they are instituted. The fact that the same case or claim is already being decided by a foreign court cannot nullify the competency of the Iranian court.

- 2) If the judge considers that article 971 is a mandatory provision of the CCI, then he needs to look at whether the foreign court before which the case was instituted applied

its own law to determine its competency and to apply its laws of procedure or not. If the answer is positive, then the court shall move to the next phase.

3) In the last phase, the Iranian court shall decide whether it has and has had the exclusive competency to consider the case or not. If the response is positive, it will look into the matter and shall decide accordingly. If not, then it shall confirm the validity of the decision issued by a foreign court under the conditions stated in the Act on Enforcing Civil Court Decisions by issuing the required order. Article 972 of the CCI states that:

Effect cannot be given in Iran to judgments issued by foreign courts and official documents recognized as being enforceable by law in a foreign country unless an order to do so is issued in accordance with Iranian laws.

In arbitration cases, the arbitration tribunal shall apply article 27 of the International Commercial Arbitration Act that enables the parties to adopt the governing law that they deem appropriate.