INTERNATIONAL COMMERCIAL CONTRACTS

New development

The number of international companies that are either negotiating, or planning, or at least considering a return to the Iranian market is increasing. Sooner or later, foreign companies need to initiate the process of negotiating an agreement with their Iranian counterparts. In that case they have to respond to few difficult questions: What are the crucial issues of concern during the negotiation process? Later, when the parties start the process of drafting their agreement(s), what are the key issues that the foreign party must take into consideration? What are the legal sources of international commercial contracts in the Iranian legal system? Is there any specific law that determines the limits of the contract law of Iran? How the laws of Iran interact with its jurisprudence? Would it be necessary for a foreign party to learn about Sharia rules, as far as international commercial contracts are concerned?

International companies must raise their issues of concern with their lawyers to enhance their understanding of the legal system of Iran. They are informed and sophisticated business persons. As such, they need to make head or tail of their eventual commercial activities in Iran before initiating a negotiation process with their Iranian counterparts.

The legal and business environments of Iran are changing constantly due to the fact that the policy-making structure in Iran has gone through a complex process since 1989, i.e. when the Expediency Discernment Council (EDC) was established in Iran. During the last 25 years, the EDC as well as other policy-making entities have tried to define and clarify legal policies of Iran, especially those policies related to international trade activities of the public and private sectors of Iranian economy.

Another challenge for international companies in Iran is to understand the *sui generis* legal system of Iran. Two main steps in this direction must be taken: First, to understand basic terms that may enable them to communicate with their Iranian partners; and second, to discern several sources of contract law of Iran in order to put each legal concept or legal rule in its proper place. These two steps may provide them with a compass that shall guide them through negotiation, conclusion, performance, interpretation, and termination phases of international commercial contracts in Iran.

Definition of international commercial contracts

International commercial contracts have three tenets, each worthy of careful analysis:

International: In line with the UNIDROIT Principles of International Commercial Contracts (2010), the concept of “international” contracts is given the broadest possible interpretation in Iran. This means that this term defines situations in which an international element is involved. If all the relevant elements of a contract are connected with Iran, then the contract is not international. Weighing the elements of a contract, including its place of conclusion, place of performance, currency unit of payment or

calculation, all and all, helps us to qualify a contract as international or local.

Commercial: The law of Iran distinguishes between “civil” and “commercial” parties and/or transactions. Two elements in a contract may help us to determine whether it is a commercial contract or not: its subject, and profession of the parties that conclude it. The list of subjects included in section 2 of the Commercial Code is not exhaustive. It may be extended to new fields of activity depending on the interpretation that Iranian courts will attribute to it.

The list of commercial activities in section 2 includes the following activities:
1. Acquisition of any immovable property, whether tangible or not, for sale, rent or any other transaction, whether the property has been subject to any possessive actions or not;
2. To rent an immovable property in order to rent it out or any other transaction that results in transfer of beneficial rights or establishing usufruct, whether it has been subject to any possessive actions or not;
3. Brokerage, commissioning and commercial representation and agency;
4. Any financial and credit activities including banking and exchange activities;
5. Any insurance operations except for social insurance;
6. Any transactions involving securities;
7. Issuance, endorsement, and guarantee of cheques, promissory notes, and bills of exchange and accepting them;
8. Carrying out through an enterprise any service activities including:
- Road, air and sea transportation of goods and or passengers;
- Issues related to employment and labor services;
- Sale of goods through bidding;
- Management of public exhibitions;
- Management of public warehouses;
- Loading, unloading or delivery operations of goods;
- Management of facilities for well-being, enjoyment or sporting activities;
- Management of conference centers for holding ceremonies, conferences, or exhibitions;
- Management of printing and publication, typing or translating firms;
- Management of news and broadcasting enterprises;
- Rendering postal services;
- Rendering of publicity or technical services;
- Managing facilities for transfer of water, gas or electricity;
- Issues related to information and communication technology including national or public domains, services related to access to communication or computer networks; hosting services, rendering services concerning provision of electronic data or computer software;
- Construction works in development affairs such as construction of buildings, roads or water channels.
9. Any mining activities;
10. Establishing factories or workshops or operating them, where it is not for personal use;

11. Establishing slaughterhouses, freezing spaces, agro-industry corporations, insect farming centers, animal farming or husbandry centers for different types of animals where these centers are not established for personal use;
12. Ship-building, sale and purchase of ships, local or international shipping, and transactions related to them.

As mentioned before, the above list is not exhaustive for the clear reason that no list can cover all the commercial activities. In practice, courts and merchants will add other needed activities to this list to make it as comprehensive as possible.

Under section 13 of the New Commercial Code, all of the transactions between the merchants are presumed to be commercial transactions. It is therefore necessary to clarify the exact meaning of the term “merchant” in the New Commercial Code. The Code guides us that in two ways a merchant can be recognized: First, a merchant is a person who has got the required document to prove his status as a merchant. These documents include commercial card and commercial certificate indicating that the merchant has registered his or her name in a commercial book. Using the title of merchant or tradesperson in publicity or in commercial documents also indicate that those who benefit from the publicity or those who use the documents consider themselves as merchants. Secondly, the legal format used for commercial activities is also an indicative element. A commercial company or enterprise by definition shall be treated as a merchant because the legislator informs everybody through its laws and regulations that it is forbidden to carry out commercial activities except through these special legal format.

Contracts: In the commercial context, the concept of contract has few differences with civil contracts. First, at the time of concluding their contracts, the parties to a commercial contract think about their commercial benefits. Objective of the parties distinguishes commercial contracts from civil ones because in the latter type, parties to a contract may have objectives other than personal benefit. Agreements concluded for charity purposes are clear examples of the civil contracts. Secondly, in commercial contracts, the parties are eager to go through the conclusion and performance processes as rapidly as possible because they want to reap their benefits as soon as possible. Thirdly, commercial contracts are subject to trade usages which are different from usages that are applied in civil contracts. Finally, due to rapid development of business law, and especially trade international law, commercial contracts are more inclined to adapt themselves to the globalization process while civil contracts are more influenced by the local legal culture and practice.

It must also be noted that commercial contracts in Iran are subject to different levels of laws and regulations. At the most fundamental level, the Civil Code of Iran as well as the doctrinal interpretations of it define the concepts, rules and principles that apply to commercial contract. The next level is occupied by the New Commercial Code of Iran as well as all the laws and regulations that are related to it. Finally, on top of this regulatory pyramid appear specific laws and regulations that prescribe and proscribe

commercial activities.

Civil Code of Iran

Sections 183 to 300 of the Civil Code of Iran set out the concepts, rules and principles that shape the foundation of the contract law of Iran. They are expected to cover five main phases of a contract's life:

A – Negotiation

It is interesting that the Civil Code is almost completely silent about the negotiation phase of the process of concluding a contract. It may be argued that the Code has left this matter to the customs and trade usage that are applicable to each type of contract. Article 225 of the Code may support this argument: "If certain points that are customarily understood in a contract by customary law or practice are not specified therein, those points are nevertheless to be considered as mentioned in the contract."

Customary law or practice covers all and every aspect of a contract, starting from the moment that the parties initiate the negotiation process until the time that the contract comes to an end, and even after that, when the parties are sometimes bound by obligations that live longer than the contract itself.

It must also be noted that under the Civil Code, there is no need to conclude a contract under a certain form or format. This means that the Code considers each preliminary agreement resulting from the negotiation process as a proper contract. In this process, the final contract, therefore, is composed of few or many mini-contracts that are put together to shape an overall and final agreement between the parties.

B – Conclusion

Four basic requirements of conclusion of a contract are stated by section 190 of the Civil Code:
"I - The intention and mutual consent of both parties to the contract;
2 - The competence of both parties;
3 - There must be a definite thing which forms the subject-matter of the contract; and
4- The cause of the transaction must be lawful."

It may be an interesting idea to compare the above section of the Civil Code with section 3.1.2 of the UNIDROIT Principles of International Commercial Contracts (2010) that provides:
"A contract is concluded, modified or terminated by the mere agreement of the parties, without any further requirement."

Comment 2 of section 3.1.2 adds that:
"This Article also excludes the requirement of 'cause' which exists in some civil law systems and is in certain respects functionally similar to the common law 'consideration'."

Article 3.1.1 moves one step further by providing that: "This Chapter does not deal with

lack of capacity." This tacitly means that capacity is a sine qua non of each contract but the Principles leave this issue to domestic legal systems.

The next element is "a definite thing which forms the subject-matter of the contract". Sections 214 to 216 of the Code explain that subject-matter of a contract must be some property or act which both the parties agree to deliver or execute. It must be capable of being owned and must embody some reasonable and legitimate advantage. It should not be ambiguous except in special cases where a general knowledge of the matter would be sufficient. By and large, two main requirements of the subject-matter are "being reasonably beneficial" and "parties having reasonable information about it".

The final, and the most important, requirements of a contract are "intention and mutual consent". Under section 195, lack of intention results in a contract becoming null and void. On the other hand, lack of consent or obtaining consent as a result of mistake or duress will make a contract unenforceable (section 199 of the Code). Section 209 adds that a transaction ratified after the removal of any undue force is binding.

Again it would be interesting to make a comparison between the provisions of the Code and those of the Principles, especially its Article 3.2.2 that allows avoiding a contract for mistake:
1) "If, when the contract was concluded, the mistake was of such importance that a reasonable person in the same situation as the party in error would only have concluded the contract on materially different terms or would not have concluded it at all if the true state of affairs had been known, and
(a) the other party made the same mistake, or caused the mistake, or knew or ought to have known of the mistake and it was contrary to reasonable commercial standards of fair dealing to leave the mistaken party in error; or
(b) the other party had not at the time of avoidance reasonably acted in reliance on the contract (emphasis added)."

Apart from reasonability issue, that returns us back to our discussions about customary law and trade usage, the real difference between the Principles and the Code is that the former text, contrary to the latter one, puts more emphasis on different degrees of committing a mistake. Iranian lawyers have developed their comments on the relevant provisions of the Code in the same direction. As a result, the actual difference between the Code and the Principles has been reduced.

C – Performance
Section 220 of the Civil Code states that: "A contract not only binds the parties to execute what it explicitly mentions, but both parties are also bound by all consequences which follow from the contract in accordance with customary law and practice, or by virtue of a law." Performance of a contract, in other words, is influenced by customary law and practice.

What will happen to the party who fails respecting her obligations? Section 221 gives

the following response to our question:
"If any party undertakes to perform or to abstain from any act, he is responsible to *pay compensation* to the other party in the event of his not carrying out his undertaking *provided the compensation* for such losses is specified in the contract or is understood in the contract according to customary law or provided such compensation is by law regarded as guaranteed (emphasis added)."

Again we need to have a comparative look at the Principles. Article 3.2.4 is the relevant provision: "A party is not entitled to avoid the contract on the ground of mistake if the circumstances on which that party relies afford, or could have afforded, a remedy for non-performance." There is a clear resemblance between "a remedy for non-performance" and "compensation".

Another important point concerning performance is that obligation of the parties are of two types: main obligations resulting directly from the subject matter of a contract, and conditions included in a contract. They are of three types as explained in section 234 of the Code: 1) conditions of description; 2) conditions of collateral events; and 3) conditions about the performance of a contract. The first category refers to the quantity or quantity of the object while the second provides for the fulfillment or the happening of some extraneous event. The last category arises when a condition is made as to the performance or non-performance by one of the parties or by a tierce.

It is necessary to clarify a matter before it results in a misunderstanding. The term "condition" is similar to the word "clause" or "term" in common law. It must be distinguished from the general term "condition" as explained in Article 5.3.1 of the Principles:
"A contract or a contractual obligation may be made conditional upon the occurrence of a future uncertain event, so that the contract or the contractual obligation only takes effect if the event occurs (suspensive condition) or comes to an end if the event occurs (resolutive condition)."

D – Interpretation
The Civil Code is silent about the rules and principles that apply to interpretation of contracts. The purpose of interpretation, as explained by the Iranian legal authors, is to find the real intention of the parties to a contract. Article 4.1 of the Principles agrees with this approach but the Principle adds few other rules that need to be studied carefully:

1. Article 4.4 of the Principles cover an interesting rule: "Terms and expressions shall be interpreted in the light of the whole contract or statement in which they appear." This is a logical and reasonable rule that is accepted and applied by the law of Iran.

2. *Contra proferentem* rule in Article 4.6 raises a serious issue because under this Article: "If contract terms supplied by one party are unclear, an interpretation against that party is preferred." There is no similar rule in contract law of Iran. The question, then, is that whether this rule is compatible with basic concepts and rules of the contract law of Iran or not? Under the general rule of '*eghdam*', if a person carries out an activity,

she must accept the risks of her action. One may argue that the *contra proferentem* rule is a sub-division of '*eghdam*' rule because it warns the party who drafts an agreement, either totally or partially, of the rule that in case the terms provided by her are unclear, the interpretation against her interests shall be preferred.

E – Termination

Under the Civil Code, a contract may be null and void (*batel*), avoided (*ebtal*), cancelled by action of a party (*faskh*), or cancelled without action of a party (*monfasakh*). It is also argued that under the law of Iran, contracts may not be classified as voidable. This issue is open to discussion.

The Principles use the term 'termination' to explain cancellation of a contract by one of the parties (sections 235 and 239 of the Code in comparison with Article 7.3.1 of the principles). However, it is difficult, and perhaps impossible, to find a concept similar to '*monfasakh*' in the Principles.

Legal doctrine based on the Civil Code of Iran

It is clear that the Civil Code is just a text composed of a limited number of words, sentences and phrases. Despite its limited scope, such a text becomes part of a system, standing on its own cultural foundations. The Iranian laws, especially the Civil Code of Iran, is founded on the Islamic law, both in its Sunnite and Shiite understandings, that has been transformed to its new shape less than one century ago. The Iranian authors have made it clear that under Article 167 of the Constitution of Iran: "All judges are bound to endeavor to judge each case on the basis of the codified law. In case of the absence of any such law, judges must deliver their judgments on the basis of authoritative Islamic sources and authentic fatwa. They, on the pretext of the silence or deficiency of law in the matter, or its brevity or contradictory nature, cannot refrain from admitting and examining cases and delivering their judgment". The main point of concern in this Article is the phrase "authoritative Islamic sources and authentic fatwa". It is argued that this phrase covers also the writings of the civil law authors because it is not possible to find all of the needed legal answers in the writings of the Islamic law authors.

New Commercial Code of Iran

In our introduction to the Persian translation of the UNIDROIT Principles, the legislator of Iran was reminded of the opportunity of including the Principles in the New Commercial Code of Iran. Unfortunately, like its predecessor, the New Commercial Code of Iran does not include any provisions concerning general rules and principles of international commercial contracts.

The reason for this silence, perhaps, is that the general understanding of the Iranian lawyers is that the Civil code accompanied by the civil law doctrine can meet all the theoretical and practical needs of international commercial contracts of Iran. This presumption stands against the approach adopted in major legal systems of the world

where by either adopting a special law or by adopting the Principles, a solid basis is prepared for the international commercial contracts.

Specific laws applicable to international commercial contracts

International commercial contracts are of mixed nature. They may cover vast panoply of issues including investment, banking and finance, labor and employment, insurance, export and import, etc. As a result, the regulatory system in each of the above fields may have a saying in negotiation, conclusion, performance, interpretation, and termination of an international commercial contract.

Investment law

Under section 3(b) of the Foreign Investment Promotion and Protection Act (FIPPA), at least three legal frameworks are available for foreign investment in Iran: a) civil partnership; b) buy-back; and c) build-operate-transfer (BOT). It is clear that an investment process comprises conclusion of few other agreements to rent, supply, transfer technology, get a loan or financial assistance, sell or export the products, etc. In our experience, the legal basis of an efficient collaboration between a foreign investor and its Iranian partner is a joint venture agreement. In both forms of joint venture agreements, namely the equity and the contractual JVs, foreign investors need to be clear about the legal basis of their partnership. It must be remembered that a partnership in Iran is based on sections 571 to 606 of the Civil Code. Partnership in investment context takes place when partners put together their property and services to get a reasonable benefit out of their toil. At the end of this process, the partners share their eventual benefits or losses.

Two provisions of the Code concerning liability of a partnership administrator and transfer of share to a tierce are of concern. According to section 577 of the Code: “A partner who in the contract of partnership is permitted to administer the property of the partnership is entitled to perform any act which is necessary for the administration, and will in no case be liable for losses suffered as the result of his actions, except in case of negligence or excessive use.” Limiting the causes of liability to negligence or excessive use may be against the interests of partners who may intend to have a more restrictive control over the actions of the administrator. It is not forbidden, under the Code or the Islamic law, to increase the causes of liability of an administrator in a partnership agreement.

Section 583 raises another issue of concern: “Each one of the partners may, without the consent of the other partners, transfer to a third person the whole or a part of his share.” Again the partners may limit and curb this right in their partnership agreement.

Banking law

The usury-free banking law of Iran allows foreign persons to be involved in the following activities:

1. Providing bailment;
2. Providing interest-free loans;
3. Engaging in civil partnerships;

4. Engaging in corporate partnerships;
5. Making direct investments;
6. Engaging in forward purchasing;
7. Offering installment plan purchases;
8. Offering hire-purchase services;
9. Building and selling low-cost housing;
10. Engaging in lease and sale;
11. Engaging in agricultural development;
12. Engaging in irrigation project development; and
13. Rewards.

The legal ramifications of these 13 banking law contracts are discussed in books about Islamic banking law. Here it is necessary to add that these contracts are based on Islamic law teachings that are adapted to banking and financial needs of the economic system of Iran.

Free zones and international commercial contracts

International commercial contracts are subject to special laws and regulations that apply in the free zones of Iran. For example, under section 13 of the Regulations on Investment in the Free Trade Zones of Iran, payments that are related to intellectual property rights of foreign partners must be made after informing the Free Zone Authority about them. Section 14 of the Regulations adds that transfer of shares from one investor to another also requires authorization of the Free Zone Authority.

Foreign investors must also be aware of the fact that the employer-employee relationship in free zones is subject to special laws and regulations. Under section 50 of the Regulations on Employment of Workforce in Free Zones:
"Rules and guidelines governing the determination of per capita insurance premiums for foreign nationals, the manner of establishing a fund or funds and regulations governing thereof; the relations between the funds and the Social Security Organization of Iran and/or other insurance companies, the manner of transferring the insurance record of foreign nationals to the mainland, and other related issues shall be prepared by the Secretariat of the High Council and the Social Security Organization of Iran and approved by the majority of the Ministers who are members of the High Council of the Free Zones."

Perhaps it is of more interest to foreign corporations that offshore banking units are authorized to be established in free zones of Iran if they carry out their banking operations in currency units other than Iranian Rials. These units are allowed to use the term offshore along with their names under the Note of section 2 of the Regulations on Monetary and Banking Operations in Free Trade Zones. They may establish their offices in free zones as banks or institutes or branches of foreign banks or institutes. Whatever legal format that they adopt, they will be allowed to conclude their banking or financial contract under the terms defined by the Regulations on Monetary and Banking Operations in Free Trade Zones.

Foreign investors may even get the chance to establish their offices in joint Iran-Qatar free trade zones that are currently under discussion between the two countries. A similar plan for establishing a joint Iran-Turkey free trade zone has been under consideration since December 2013.

Executive summary

International commercial contracts are cornerstone of all international trade activities around the globe. Those who involve themselves in these activities need to avail themselves of legal services of astute lawyers. New opportunities are getting available in Iran for foreign corporations and entities that are interested in starting up new business activities in Iran, either alone or in partnership with Iranian investors. After finding a partner, the parties need to start their negotiation process in order to prepare their joint plans for their partnership activities. In negotiating and drafting their agreements, they have to act as informed and sophisticated businesspersons. Understanding the legal language and the legal paradigm of Iran requires that they familiarize themselves with the main legal texts of Iran, including the Civil Code, the new Commercial Code, as well as the specific laws of Iran on different aspect of international trade activities including investment, banking, insurance, employment, and entrance and exit of foreign citizens.

They also need to learn about the laws and regulations that apply to negotiation, conclusion, performance, interpretation and termination of international commercial contracts in free trade zones and special economic zones of Iran.

It is evident that a major source of international trade law in Iran, as well as in any other place in the world, is the legal policy that defines, manages, delimits, and controls the entrance, activities, and exit of foreign entities to and from Iran. International companies have to take legal policies of Iran into consideration before, during and after conclusion of their international commercial contracts. Legal policies have opened the way for conclusion of a contract when it seemed impossible to conclude during the initial phases of negotiation. They can also make performance of contractual obligations very difficult or even impossible. Foreign companies need to take special measures based on up to date information from inside Iran in order to be prepared for handling policy-related challenges.