Partnerships in Iraq

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Disclaimer: This Article expresses the opinions of the authors on partnerships in light of commercial needs and the absence of a detailed legal framework in Iraq. This Article only provides a general insight into the nature of partnerships in Iraq and should not be viewed as a substitute for tailored legal advice.

Introduction

Partnerships are one of the most successful models of establishing and managing business between different kinds of entities ranging from individuals to companies. This article discusses the legal nature of a partnership under Iraqi law and its advantages \ disadvantages; control of the business and liability towards third parties; fiduciary duties of the partners to each other; ownership of partnership capital and sharing profits and losses; some recommended partnership terms; and the importance of maintaining accurate business records.

The Legal Nature, Advantages, and Disadvantages of Partnerships

A partnership is an agreement between two or more parties. However, unlike a company's articles of incorporation, a partnership does not create a separate legal entity. There is no specialised law regulating partnerships in Iraq. Partnerships are pure creatures of contract that are governed by the general rules of the Iraqi Civil Code and the commercial necessities of running a successful business. Therefore, partnerships in Iraq offer more flexibility compared to other incorporated alternatives. Partnerships are quicker and cheaper to set up compared to companies because there is no need to make any filings. In addition, partnerships also have no minimum capital requirements.

Control of the Business and Liability Towards Third Parties

A partnership agreement can provide for a level of control that does not strictly align with ownership stakes in the business. However, enforcing the terms of the partnership regarding control of the business, which is often a necessity for commercial success, requires all partners to be involved in dealings with third parties. Shared control of the business can only be achieved through a mutual authorisation between the partners who must become agents of each other when dealing with third parties. The direct consequence of mutual agency between the partners is that there can be no limitation of liability towards third parties who deal with the partners in common.

If some or all partners do not participate in the running of the business and do not wish to share control of the partnership operations, then the partnership may be structured to limit the liability of such silent (and by consequence limited) partners who will not be part of dealings with third parties. However, it may be argued that limitation of liability towards third parties does not limit the partner's obligation to contribute to losses in accordance with their share of the partnership because of the long-standing Iraqi accounting principle that losses must follow profits. The authors of this Article are not aware of any established judicial practice in this regard in Iraqi courts. In addition, structuring a partnership to limit a partner's liability towards third parties by limiting their interactions with said third parties cannot affect the partners share in capital losses because partners who do not share in capital losses may be viewed as mere creditors.

Fiduciary Duty of the Partners to Each Other

The nature of partnership, the mutual agency between the partners, and the necessities of doing business in common prohibits any partner from benefiting secretly or openly from partnership capital without sharing with the other partners. In light of the absence of a detailed legal framework, the partnership should expressly define the fiduciary duty of the partners and call for infringing partners to compensate the other partners on the basis of the benefit derived from breaching the fiduciary duty.

Ownership of Partnership Capital and Sharing Profits and Losses

The Iraqi Civil Code regulates common property in Articles 1061 to 1097. The Civil Code regulates the management of common property, distribution of income, dissolution of the common ownership, and dealings with third parties. All partners frequently own the partnership capital as common property and the rules of common ownership are thus often invoked in partnership disputes. However, despite the context provided by the default rules of common ownership, it is still necessary for the parties to carefully consider the terms of their partnership because the rules of common ownership do not address all the needs of a partnership. In addition, the nature of the partnership capital may present obstacles to common ownership by all partners. These obstacles often arise from nationality ownership restrictions or other requirements to hold certain assets such as licenses. The partnership agreement needs to account for such obstacles preventing some partners from holding an ownership stake in partnership property.

Recommended Partnership Terms

The lack of a defined statuary legal framework to provide default rules makes it necessary to address some issues in a partnership agreement. A partnership does not need to be a long and detailed document but the it should address the following at a minimum:

- Responsibility for preparation of partnership accounts;
- Accounting periods and distribution of profits and losses;
- Third party liability;
- Definition of the partnership term and business;
- Fiduciary duty of partners to each other and obligation not to compete with the partnership business;
- Partners shares of profits \ losses and partnership capital;
- Ownership of partnership property;
- Limits of authority of individual partners when acting on behalf of the partnership;
- Exit of partners and dissolution of the partnership.

The Importance of Maintaining Accurate Business Records

Partnership disputes are often resolved by what is known as "accounting lawsuits" in Iraq. An accounting suit is a request for the court to appoint experts to prepare or audit the partnership accounts and make a distribution of capital, profits, or losses. For this reason, it is important that partnerships maintain accurate commercial records particularly in the absence of the usual audit and accounting requirements of companies.

Conclusion

Partnerships offer more flexibility in comparison to other incorporated models of doing business. In addition, partnerships are easier to set up. However, effective shared control of the partnership business requires mutual agency between the partners which in turn practically exposes all partners to joint liability to third parties. The nature of partnership and established accounting principles in Iraq mandate sharing profits and losses in the same proportions.

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