



The Role of Legal Uncertainty and Regulatory Gaps in Reducing the Effectiveness of Venture Capital Investment Agreements for Startups in Iran: Practical Challenges and a Proposed Legislative Framework

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Abstract

Venture capital, as a driving force of the knowledge-based economy, represents a financing model in which investors assume the substantial risks associated with early-stage startups in exchange for equity ownership and participation in corporate governance. Nevertheless, the effective implementation of venture capital investment agreements within the Iranian legal system faces fundamental legal challenges. The principal issue addressed in this study concerns the extent to which traditional legal rules and regulatory deficiencies undermine the effectiveness of contractual mechanisms such as preferred shares, veto rights, and exit mechanisms thereby increasing transaction costs and contributing to higher rates of contractual failure. This research adopts a descriptive-analytical methodology based on documentary analysis of Iranian statutory law, particularly the Commercial Code and the Civil Code, to examine the inconsistencies between modern venture capital agreements and the existing legislative framework. The identified research gap demonstrates that the Iranian legal literature has predominantly focused on the theoretical dimensions of venture capital agreements while paying insufficient attention to their practical enforceability and the challenges arising before domestic courts. The rationale for selecting this topic lies in the pressing need to enhance judicial certainty for investors and to prevent capital flight from the technology sector. The findings indicate that the absence of formal legal recognition for several key venture capital contractual mechanisms under Iranian commercial law, together with their potential conflict with mandatory legal rules, has significantly weakened the enforceability of venture capital agreements and diminished their effectiveness in dispute resolution. The study further demonstrates that the current legal framework lacks the flexibility required for efficient risk allocation and management within startup financing transactions. Accordingly, it recommends the enactment of a dedicated Venture Capital Act, the establishment of specialized technology arbitration institutions, and the adoption of standardized model agreements approved by competent regulatory authorities in order to enhance legal certainty and strengthen mutual confidence between investors and entrepreneurs.

Keywords: Venture capital, startups, legal uncertainty, regulatory gaps, contractual effectiveness, legislative framework.

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1. Introduction

In the contemporary global economy, the transition from resource-based development toward a knowledge-based economy has firmly established startups and emerging enterprises as principal drivers of innovation, entrepreneurship, and employment (Sadeghi, 2023). However, the inherently high-risk nature of these enterprises, coupled with the absence of tangible assets suitable for collateralization, has rendered conventional bank financing increasingly ineffective, thereby highlighting the necessity of alternative financing mechanisms, most notably venture capital investment.

Venture capital constitutes a specialized financing model in which investors contribute not only financial resources but also managerial expertise, strategic guidance, and professional networks, while simultaneously assuming entrepreneurial risk in exchange for equity participation (Izanlou, 2021). Despite its growing economic significance, this financing model encounters substantial structural obstacles within the Iranian legal system. Venture capital investment agreements are inherently sophisticated, multidimensional, and future-oriented, whereas Iran's Commercial Code, enacted decades ago, was not designed to accommodate modern corporate concepts such as preferred shares with enhanced voting rights, compulsory exit mechanisms, or sophisticated preferential rights.

The principal objective of this study is therefore to examine how legal uncertainty arising from the interaction between contractual autonomy and the mandatory provisions of Iranian commercial law, together with existing regulatory deficiencies, undermines the effectiveness of venture capital investment agreements and weakens judicial protection for investors. Where venture capital investors are unable to manage investment risks because of uncertainty surrounding the judicial interpretation of statutory provisions or concerns regarding the potential invalidation of contractual clauses, transaction costs inevitably increase and incentives for investment decline substantially. This phenomenon ultimately constitutes a significant obstacle to the sustainable development of Iran's entrepreneurial ecosystem (Esmaili, 2022).

A review of the existing literature reveals that, despite numerous scholarly discussions concerning the legal nature of venture capital agreements, a significant research gap remains regarding their practical effectiveness within the Iranian judicial system. Previous studies have largely confined themselves to theoretical analyses of statutory provisions, while comparatively little attention has been devoted to examining the relationship between legal uncertainty and the practical failure of startup investment agreements. Accordingly, this research seeks to bridge that gap by identifying the principal legal obstacles affecting venture capital transactions and proposing an appropriate legislative framework to address them.

The study employs a descriptive-analytical methodology. It first provides a comprehensive description of the structural components of venture capital agreements and the current Iranian legal framework before critically evaluating the impact of regulatory gaps on the practical effectiveness of these contractual instruments. Based upon this analysis, the research develops recommendations for legislative reform. The principal research question may be formulated as follows: How do legal uncertainties and regulatory deficiencies within the Iranian legal system affect the effectiveness of venture capital investment agreements during the stages of contract formation, performance, and exit. The central hypothesis of this research is that the rigidity of the provisions governing joint-stock companies under the Iranian Commercial Code, together with the absence of judicial recognition of modern venture capital contractual mechanisms, renders contractual outcomes unpredictable, increases legal risk, and significantly diminishes the protective function of contractual arrangements. The significance of this research is underscored by the increasing number of disputes between startups and venture capital investors that have produced inconsistent judicial decisions due to the absence of clear statutory provisions. Such inconsistency has substantially undermined confidence in the domestic investment environment. Furthermore, following the enactment of the Knowledge-Based Production Leap Act, there is an urgent need to clarify the legal framework governing venture capital transactions to facilitate the effective implementation of national innovation policies (Shokouhi, 2022a). By adopting an interdisciplinary perspective that integrates legal and economic analysis, this article argues that contractual effectiveness extends beyond the mere drafting of contractual provisions; rather, it fundamentally depends upon legal predictability and the existence of effective enforcement mechanisms within a coherent regulatory framework. Accordingly, the analysis first explores the nature and sources of legal uncertainty, subsequently critiques existing legal approaches, and ultimately proposes a legislative model aimed at transforming

venture capital agreements from purely formal legal instruments into genuinely effective mechanisms for risk allocation and management. More specifically, the subsidiary hypothesis maintains that, unless contractual autonomy in venture capital transactions receives meaningful legal recognition and Iranian courts abandon their traditional interpretation of the Commercial Code of 1932 in addressing contemporary investment agreements, the anticipated economic benefits of venture capital financing will remain unattainable, and the gap between market realities and the existing legal framework will continue to widen. Accordingly, through a descriptive-analytical approach grounded in documentary legal research, this study seeks to formulate a practical roadmap for aligning Iran's legal system with the evolving requirements of an innovation-driven economy.

2. Conceptual Challenges and Structural Tensions Between Venture Capital Agreements and the Existing Legal Framework

By their very nature, venture capital investment agreements constitute a sophisticated hybrid of contract law and corporate law, designed to allocate risk efficiently and regulate the legal relationship between investors and entrepreneurs. The primary conceptual challenge in this area arises from the tension between the principle of freedom of contract (embodied in Article 10 of the Iranian Civil Code) and the mandatory provisions governing corporate law. Whereas venture capital agreements are founded upon contractual flexibility and highly customized contractual arrangements, the Iranian Commercial Code of 1932 and its 1968 Amendment adopt a rigid and formalistic corporate structure that is ill-equipped to accommodate modern investment mechanisms (Nasiri, 2021). This structural conflict becomes particularly evident when the parties seek to confer rights that exceed the proportion of their equity ownership, an approach that appears inconsistent with the traditional principle of equality among shareholders in Iranian joint-stock companies. Moreover, venture capital agreements are fundamentally premised upon a shared-risk model and obligations of best efforts rather than guaranteed outcomes. Nevertheless, Iranian courts have generally tended to interpret such agreements through the lens of traditional nominate contracts or civil partnerships, thereby overlooking the sophisticated governance and investor-protection mechanisms embedded within these transactions (Nasser Katouzian, 2021). One of the most significant conceptual conflicts concerns restrictions on the transfer of shares. While international venture capital practice considers restrictions on founders' exit indispensable for preserving enterprise value and ensuring business continuity, Iranian law may regard contractual provisions that absolutely prohibit the transfer of shares as legally problematic because they conflict with the doctrines of ownership and the principle of dominion (taslit) over property (Amiri, 2023). Furthermore, venture capital financing requires the use of hybrid financial instruments capable of granting investors preferential rights upon liquidation or exit. However, the restrictive statutory concept of preferred shares under Iranian commercial law does not clearly permit sophisticated non-financial privileges or multi-tiered liquidation preferences. This conceptual deficiency has compelled practitioners specializing in technology transactions to rely upon ancillary legal devices including lifetime settlement agreements and irrevocable powers of attorney to bridge these legislative gaps. Yet, because such mechanisms are inherently vulnerable to revocation or judicial invalidation, they ultimately exacerbate legal uncertainty rather than eliminate it (Sadeghi, 2023). Fundamentally, the conflict between the dynamic legal requirements of the digital economy and the static framework of Iranian commercial law has created an insecure investment environment in which contractual instruments, instead of facilitating investment, frequently become sources of legal disputes. Consequently, unless Iranian commercial legislation incorporates an autonomous legal framework governing startups and venture capital agreements, the effectiveness of these contracts will continue to be constrained by traditional legal doctrines and classical interpretations of corporate law.

2.1. Legal Characterization of Venture Capital Protective Provisions in Light of the Principles of Iranian Civil and Commercial Law

Venture capital agreements incorporate contractual provisions that appear unfamiliar and occasionally inconsistent with the classical doctrines of Iranian private law. To assess the legal validity of these provisions, they must first be examined within the framework of Article 10 of the Iranian Civil Code and the principle of contractual autonomy. Article 10 authorizes parties to conclude any agreement that does not expressly violate statutory law, public policy, or public morality. The legal challenge, however, arises where these contractual arrangements conflict with mandatory corporate law provisions or fundamental principles governing property rights. Clauses such as tag-along rights, drag-along rights, and equity vesting arrangements

constitute core components of venture capital transactions whose legal characterization requires careful doctrinal analysis (Shahidi, 2022). Among these mechanisms, equity vesting represents one of the most significant instruments for ensuring founders' long-term commitment to the startup. From the perspective of Iranian civil law, such a provision may be characterized as a contractual obligation (*shart-e fe'l*) whereby the definitive transfer of ownership is conditioned upon the passage of time or the achievement of predetermined milestones. Under this interpretation, vesting is broadly compatible with the general principles governing contractual obligations. The principal legal difficulty emerges, however, when vesting is compared with the traditional doctrine that ownership transfers immediately upon the conclusion of a sale contract. Under Iranian law, uncertainty regarding the timing of ownership transfer or its suspension upon future contingencies may render the transaction *gharar*-based (uncertain or speculative), thereby exposing it to invalidity under Article 190 of the Civil Code (Naser Katouzian, 2021a). Consequently, a traditional judicial approach may misconstrue a four-year vesting arrangement as an impermissibly speculative sale rather than recognizing its true commercial function as an incentive mechanism designed to secure founders' continued participation. Similarly, drag-along and tag-along rights, which regulate exit transactions, create tensions with the doctrine of dominion embodied in Article 30 of the Iranian Civil Code. Under this principle, every owner possesses unrestricted authority over his or her property. Consequently, where a venture capital agreement authorizes a controlling investor to compel minority shareholders or founders to sell their shares to a third-party purchaser, such a provision may initially appear incompatible with both contractual autonomy and proprietary freedom (Amiri, 2023). To justify these mechanisms within Iranian law, legal scholars frequently rely upon the doctrines of irrevocable agency granted within a binding contract or contractual provisions producing direct legal effects (*shart-e natijeh*). Nevertheless, given the legal fragility of agency relationships and the possibility of their judicial invalidation under certain circumstances, investors cannot rely upon these mechanisms with complete legal certainty. Furthermore, within the framework of Iranian commercial law, contractual provisions modifying voting rights or preferential shareholder rights in favor of a particular class of investors conflict with the rigid corporate structure established under the 1968 Amendment to the Commercial Code. For example, anti-dilution provisions, which enable investors to preserve their ownership percentage in subsequent financing rounds without contributing proportionate additional capital, appear inconsistent with Article 157 of the Commercial Code, which requires payment of the nominal value of newly issued shares (Shokouhi, 2022a). These tensions demonstrate that although such provisions may be defensible under Article 10 of the Civil Code as manifestations of contractual freedom, they encounter substantial obstacles when confronted with the specialized mandatory rules of corporate law, which prioritize capital maintenance principles over contractual autonomy (Pasban, 2021). Accordingly, this analysis demonstrates that merely incorporating these provisions into a private agreement is insufficient. In the absence of explicit statutory recognition, there remains a persistent risk that judges or arbitrators unfamiliar with venture capital practice may declare such provisions unenforceable. This legal uncertainty ultimately undermines the effectiveness of contractual risk-allocation mechanisms and substantially diminishes the practical utility of venture capital agreements.

2.2. *The Inadequacy of Preferred Share Mechanisms under Iranian Commercial Law to Meet the Strategic Needs of Venture Capital Investors*

Within the venture capital ecosystem, preferred shares serve as a fundamental instrument through which investors balance the substantial risks inherent in financing early-stage ventures against the governance and protective rights necessary to safeguard their investments. However, when this contemporary corporate mechanism is introduced into the framework of the Iranian Act Amending Certain Provisions of the Commercial Code (1968), it encounters structural constraints that significantly diminish its strategic effectiveness. Although Article 42 of the Amendment authorizes the issuance of preferred shares and permits their privileges to be specified in the company's articles of association, the underlying legislative philosophy reflects the economic realities of the late 1960s, emphasizing traditional financial preferences rather than the governance-oriented and exit-focused protections required in modern venture capital transactions (Askini, 2022). The foremost challenge concerns liquidation preference. Under standard venture capital agreements, investors typically require that, upon liquidation or sale of the company, their invested capital—and in some cases a multiple thereof—be repaid before any distribution is made to common shareholders. Although Article 42 permits preferential financial rights, the traditional principle of proportional

distribution of profits and losses according to capital contributions under Iranian corporate law constrains progressive interpretations of this provision. Many Iranian corporate law scholars maintain that any preference resulting in the complete deprivation of other shareholders' financial rights or fundamentally disrupting the equitable structure of a joint-stock company would be incompatible with economic public policy (Pasban, 2021). Consequently, investors cannot confidently rely upon the company's articles of association to guarantee capital recovery in downside scenarios involving startup failure.

The second challenge relates to governance and control rights. Venture capital investors commonly seek enhanced voting rights or veto powers over significant corporate decisions in order to prevent deviations from the startup's strategic growth trajectory. Articles 107 and the subsequent provisions of the Iranian Commercial Code vest the management of a company in a board of directors elected by the general meeting of shareholders. A legal conflict arises where an investor contractually demands the right to appoint a majority of board members or exercise veto power over shareholders' resolutions, notwithstanding that the 1968 Amendment requires directors to be elected by the general meeting according to the principle of majority voting (Askini, 2022). This tension between contractual autonomy and mandatory corporate governance rules creates a legal environment in which governance rights incorporated into the articles of association may either be rejected by the Companies Registration Office or subsequently invalidated by courts on the ground that they improperly restrict the statutory authority of the general meeting.

Furthermore, protective mechanisms such as anti-dilution provisions, when incorporated into preferred shares, encounter significant implementation obstacles within Iran's statutory and registration framework. In developed jurisdictions, preferred shares frequently include automatic conversion mechanisms permitting conversion into common shares based upon variable conversion ratios, thereby preserving the investor's economic interest when subsequent financing rounds reduce the company's valuation. Under Iranian law, however, any modification to the number or class of shares requires compliance with complex statutory procedures governing capital increases, including mandatory cash contributions and corporate registration formalities. The concept of automatic conversion without adherence to these statutory procedures finds no recognition within the Commercial Code (Izanlou, 2021). This technical incompatibility compels investors to rely upon ancillary contractual arrangements, which lack the enforceability against third parties and governmental authorities enjoyed by rights formally embedded in the company's constitutional documents.

Finally, the transferability of preferred-share privileges presents another significant legal uncertainty. In venture capital practice, the rights attached to preferred shares must accompany the shares upon transfer to subsequent purchasers during an exit transaction. Iranian law, however, provides no definitive answer as to whether the privileges associated with preferred shares are attached to the shareholder personally or to the shares themselves (Shokouhi, 2022a). The absence of legislative clarity on this issue significantly impairs the liquidity of preferred shares and undermines investors' exit strategies (Sadeghi, 2023). Collectively, these deficiencies demonstrate that the existing framework of Iranian commercial law was designed primarily for traditional industrial and commercial enterprises and is incapable of accommodating the dynamic strategic requirements of technology-based venture capital investment. This regulatory deficiency transforms venture capital agreements from reliable instruments of investment protection into legally uncertain documents whose essential provisions remain perpetually vulnerable to judicial invalidation.

3. Regulatory Gaps and Practical Obstacles Throughout the Lifecycle of Venture Capital Agreements

The successful implementation of a venture capital agreement depends not merely upon careful contractual drafting, but equally upon the regulatory and institutional environment within which the agreement operates. The lifecycle of a venture capital transaction begins with pre-contractual negotiations, continues throughout the monitoring and governance phase, and ultimately culminates in the investor's exit. Within the Iranian legal system, each of these stages is characterized by substantial regulatory deficiencies that impede the effective implementation of the parties' contractual intentions. During the negotiation stage, the absence of a comprehensive legal framework governing preliminary agreements, coupled with uncertainty regarding the enforceability of pre-incorporation confidentiality and non-competition obligations, exposes investors to significant risks of information disclosure and failed negotiations without adequate legal remedies (Sadeghi, 2023).

The execution stage during which investors exercise their monitoring and strategic support functions reveals even more pronounced practical obstacles. One of the most significant deficiencies is the absence of a flexible statutory mechanism permitting shared corporate governance. The traditional administrative practices of the Iranian Companies Registration Office recognize only a limited range of standardized constitutional documents, while innovative governance arrangements relating to board composition or the allocation of managerial responsibilities frequently encounter administrative resistance. As a result, governance provisions negotiated between investors and founders often remain nothing more than private contractual commitments, lacking enforceability against third parties or governmental authorities (Jafari, 2023). Moreover, Iranian labour and social security legislation, without recognizing the unique characteristics of startup enterprises, imposes substantial regulatory costs that are inconsistent with the economic realities of early-stage venture development (Esmaili, 2022).

The exit stage represents the most critical phase of the investment lifecycle and is where Iranian law presents its greatest regulatory shortcomings. Whereas initial public offerings (IPOs) and mergers and acquisitions (M&A) constitute the principal exit mechanisms in mature venture capital markets, investors in Iran encounter considerable barriers arising from the complexity of public market listings for knowledge-based companies and the absence of a transparent legal framework governing competition and large-scale acquisitions. Furthermore, the lack of a regulated secondary market for shares of privately held joint-stock companies substantially limits investment liquidity, thereby directly undermining the economic effectiveness of venture capital agreements (Rezaei, 2022).

Finally, the limited familiarity of the judiciary with the commercial realities and economic rationale underlying venture capital transactions constitutes a major practical obstacle. In contractual disputes, judges frequently interpret venture capital agreements through the traditional principles of Iranian civil law rather than according to the commercial practices of innovation-driven investment. The resulting judicial decisions often fail to reflect the realities of technology markets and entrepreneurial finance. Collectively, these deficiencies from incorporation to exit create an environment in which venture capital agreements, rather than functioning as reliable mechanisms for reducing investment risk, become themselves a significant source of legal uncertainty.

3.1. Uncertainty in Governance and Supervisory Mechanisms, Contractual Restrictions on Directors' Powers, and the Approach of Iranian Courts

Within the venture capital model, the investor is not merely a provider of financial resources but rather a strategic partner whose role necessitates active oversight and, where appropriate, participation in key corporate decision-making in order to safeguard the investment. Such oversight is typically exercised through contractual provisions restricting the powers of directors and establishing governance and monitoring mechanisms. The implementation of these provisions within the framework of Iranian commercial law, however, presents fundamental legal challenges. Pursuant to Article 118 of the Act Amending Certain Provisions of the Commercial Code (1968), the board of directors possesses all powers necessary for the administration of the company, and any limitations imposed upon those powers through the articles of association are effective only in the internal relations among shareholders and are unenforceable against third parties (Askini, 2022). This statutory rule gives rise to a significant legal question: where the managing director or board of a startup undertakes a substantial transaction or fundamentally alters the company's strategic direction in breach of the venture capital investment agreement, by what legal means can the investor effectively enforce its contractual protections. The uncertainty surrounding governance mechanisms becomes even more pronounced when the parties seek to grant the investor veto rights over board decisions. Venture capital agreements typically require the investor's prior written consent or that of its designated board representative for a broad range of reserved matters, including changes to the company's capital structure, transfers of intellectual property assets, or the appointment of senior executives. From the standpoint of Iranian corporate law, however, such provisions may conflict with the principle of managerial independence. Under the traditional doctrine of Iranian corporate law, directors are required to act in the best interests of the company as a whole and to exercise their fiduciary powers independently, rather than merely implementing the instructions of a particular shareholder (Pasban, 2021). Consequently, where contractual arrangements constrain directors to such an extent that they effectively become agents of the investor's will, Iranian courts may declare those provisions invalid or unenforceable on the grounds that they impermissibly undermine directors' independent judgment or interfere with their statutory duties (Shahidi, 2022).

The judicial approach of Iranian courts toward these governance provisions has generally been conservative and strongly anchored in the literal interpretation of statutory law. Owing to limited familiarity with the economic realities of startup enterprises, many judges analyze venture capital agreements not as integrated commercial arrangements but rather on a clause-by-clause basis under the general principles of contract law. For example, where an investment agreement provides that the chief executive officer may not execute contracts exceeding a specified monetary threshold without the investor's prior approval, yet the CEO nevertheless enters into such a transaction, Iranian courts are likely to uphold the validity of the transaction vis-à-vis the third party pursuant to Article 118 of the Commercial Code while merely preserving the investor's right to seek contractual damages. The practical difficulty, however, is that within the startup environment, an award of damages following the destruction of the company's enterprise value offers little meaningful protection and fails to preserve the commercial purpose of the investment arrangement (Shokouhi, 2022b). The absence of statutory recognition of the external enforceability of governance restrictions has therefore reduced many supervisory mechanisms to little more than moral commitments rather than effective legal safeguards.

Furthermore, with respect to inspection rights and access to corporate information, although Article 139 of the Act Amending the Commercial Code grants shareholders certain informational rights, these rights are narrowly circumscribed and generally limited to specific periods, such as immediately preceding the general meeting of shareholders. Venture capital investors, by contrast, require continuous access to monthly financial reports, operational metrics, and real-time management dashboards. The failure of Iranian commercial legislation to recognize this level of ongoing oversight and the absence of judicial recognition of such access as a fundamental contractual right means that where founders refuse to disclose information, investors possess no efficient legal mechanism by which to compel compliance. This regulatory deficiency generates severe information asymmetries and has emerged as one of the principal causes of failed investor-founder relationships in recent years (Sadeghi, 2023). Ultimately, the prevailing judicial philosophy, grounded in the principles of shareholder equality and majority rule, stands in marked contrast to the fundamental premise of venture capital transactions, namely, the protection of minority investors through negotiated governance rights. Unless Iranian courts distinguish between large public corporations and early-stage startup companies and recognize investor-protective provisions as legitimate and enforceable expressions of contractual autonomy under Article 10 of the Civil Code, the effectiveness of venture capital agreements during the governance and monitoring phase will remain inherently fragile (Shokouhi, 2022b). Put differently, uncertainty surrounding the judicial interpretation of governance restrictions significantly increases the systemic legal risks associated with venture capital investment, encouraging investors to rely upon costly and informal mechanisms of entrepreneurial control rather than transparent legal instruments an outcome fundamentally inconsistent with the sustainable development of the startup ecosystem.

3.2. *Legal Challenges Associated with Investment Exit and Practical Obstacles to the Enforcement of Share Acquisition and Modern Preferential Rights*

The exit stage represents the ultimate objective and principal economic driver of the venture capital investment cycle. It is at this stage that investors realize the financial return generated by assuming entrepreneurial risk through the monetization of their equity interests. Within the Iranian legal system, however, the exit process is burdened by significant structural deficiencies and practical impediments that undermine the enforceability of contractual exit mechanisms. The principal contractual tools designed to facilitate exit include tag-along rights, drag-along rights, and put options, each of which encounters distinct legal obstacles under Iranian law (Sadeghi, 2023).

The first major challenge concerns drag-along rights. Under such provisions, a controlling shareholder—or an investor satisfying specified contractual conditions—may compel minority shareholders to transfer their shares to a purchaser seeking to acquire the entire company. From the perspective of Iranian law, this mechanism conflicts with both the principle of contractual freedom and the doctrine of dominion (taslit) over property. Compelling shareholders to dispose of their shares in the absence of explicit statutory authorization has frequently been regarded by Iranian courts as either inconsistent with the essential nature of ownership or constituting an unlawful restriction upon proprietary rights (Shahidi, 2022). To overcome this obstacle, practitioners commonly employ irrevocable powers of attorney. Nevertheless, under Iranian law, an agency relationship terminates automatically upon the death or incapacity of either party, thereby seriously undermining the long-term

stability and reliability of contractual exit mechanisms in venture capital transactions (Naser Katouzian, 2021b). A second challenge concerns put options and contractual mechanisms permitting founders or the company itself to repurchase investors' shares. Venture capital agreements frequently provide that, if the startup fails to achieve specified milestones or enters liquidation, the investor may require the founders to purchase its shares at a predetermined valuation. Two significant practical obstacles arise in this context. First, founders often lack the financial resources necessary to perform such obligations, rendering judicial judgments practically unenforceable. Second, Iranian commercial law imposes strict limitations on a company's acquisition of its own shares. Unlike many advanced corporate law jurisdictions, the Iranian Commercial Code generally prohibits a company from repurchasing its own shares except under narrowly defined exceptional circumstances. Consequently, one of the most common exit mechanisms in international venture capital practice corporate share repurchases is effectively unavailable under Iranian law (Askini, 2022). Moreover, modern pre-emptive rights in connection with future capital increases, including preferential subscription rights and anti-dilution protections, encounter significant administrative obstacles. Venture capital investors commonly negotiate subscription rights exceeding those recognized under Article 166 of the Commercial Code in order to preserve their ownership percentage during subsequent financing rounds. However, both the Companies Registration Office and the Securities and Exchange Organization continue to adhere to the traditional statutory principle that pre-emptive rights must be allocated proportionately among all existing shareholders. Accordingly, contractual arrangements departing from this statutory allocation—even where expressly agreed upon by all parties—may be rejected during the registration of capital increases, thereby depriving such provisions of practical enforceability (Rezaei, 2022).

Finally, exit through an initial public offering (IPO) remains subject to stringent regulatory constraints within the Iranian capital markets. The admission requirements imposed by the Tehran Stock Exchange and the Iran Fara Bourse place considerable emphasis upon sustained profitability and operational continuity, criteria fundamentally inconsistent with the business model of early-stage startups, many of which operate at a loss during their initial years of growth. Consequently, contractual provisions obligating the company to pursue an IPO frequently remain aspirational rather than practically achievable (Izanlou, 2021). Similarly, in the context of mergers and acquisitions, the absence of a comprehensive legal framework governing the transfer of intellectual property assets and regulatory licenses to acquiring entities exposes exit transactions to substantial and often unpredictable legal and tax risks. The lack of a well-developed secondary market for privately held startup shares further exacerbates these difficulties. As a result, even where robust contractual exit provisions exist, investors continue to face substantial practical barriers to realizing liquidity the defining characteristic of venture capital investment (Rezaei, 2022).

Taken together, these structural deficiencies demonstrate that, unless an organic integration is established between contractual autonomy and Iran's corporate registration and capital market regimes, contractual exit mechanisms will remain largely theoretical, offering little practical protection to venture capital investors.

4. Proposed Legislative Framework and Strategies for Enhancing the Effectiveness of Venture Capital Agreements

Following the foregoing analysis of the conceptual and practical challenges, it becomes evident that the current Iranian legal framework requires a fundamental reform in order to effectively accommodate the complex nature of venture capital investment agreements. The effectiveness of contractual arrangements is largely contingent upon the predictability of the judicial system and the flexibility of the legislative framework. Accordingly, the first proposed reform is the enactment of a dedicated Venture Capital Act or, alternatively, the incorporation of a specialized chapter entitled Start-up Companies and Venture Capital Partnerships into the proposed new Commercial Code. Rather than emphasizing rigid corporate formalities, such legislation should recognize party autonomy as the governing principle and introduce carefully tailored exceptions to the general rules of corporate law such as the principle of absolute equality among shareholders where appropriate for venture capital transactions (Sadeghi, 2023). Such legislative reform should further confer independent legal recognition upon modern financing instruments, including convertible securities, thereby eliminating interpretive uncertainty regarding their legal status. Beyond structural legislative reform, another essential strategy for improving contractual effectiveness lies in the specialization of dispute resolution mechanisms. Given the traditionally formalistic approach adopted by ordinary courts, it is advisable that all venture capital agreements incorporate arbitration clauses referring disputes to specialized arbitral institutions, such as the

Arbitration Center of the Chamber of Commerce or specialized technology arbitration centers. Arbitrators possessing expertise in the economic realities of start-up businesses are considerably better positioned to preserve the commercial objectives of the parties and to avoid decisions based solely upon rigid interpretations of the Civil Code that undermine the commercial purpose of the agreement (Amiri, 2023). Likewise, judicial education concerning emerging legal institutions and innovative financing structures constitutes an indispensable prerequisite for strengthening legal certainty in this field (Nasiri, 2021). At the administrative level, modernization of the procedures governing the Companies Registration Office is equally imperative. The introduction of standardized articles of association incorporating, as default provisions, non-financial rights attached to preferred shares, exit mechanisms, and corporate governance arrangements would significantly narrow the gap between privately negotiated investment agreements and officially registered corporate documents. Such reform would not only reduce transaction costs but would also enhance the enforceability of contractual provisions against third parties (Jafari, 2023).

Ultimately, improving the effectiveness of venture capital agreements requires the integration of law, economics, and technology so that legal rules function as facilitators of investment and risk management rather than as barriers to innovation. Such an integrated legal ecosystem would substantially reduce non-commercial risks while simultaneously strengthening the confidence of both domestic and foreign investors in Iran's innovation economy.

4.1. The Necessity of Establishing a Comprehensive Venture Capital Regulatory Framework and Official Recognition of Standardized Investment Agreements

Over the past decade, Iran's innovation ecosystem has experienced remarkable growth, whereas its legal infrastructure has largely remained confined within the framework of the 1968 Amendment to the Commercial Code. The foregoing analysis demonstrates that the principal difficulty does not stem from the absence of contractual arrangements, but rather from the lack of legal recognition and the inconsistency of judicial interpretation. Accordingly, the foremost strategic recommendation for enhancing judicial and commercial certainty is the adoption of a comprehensive regulatory framework governing venture capital investment. Such a framework should not merely consist of non-binding recommendations; rather, it should be enacted as a superior regulatory instrument or statutory enactment redefining the relationship between private contractual autonomy and mandatory corporate law within the context of start-up enterprises (Sadeghi, 2023). The necessity of such regulation arises from investors' need for a legal environment characterized by maximum predictability a goal unattainable under legislation originally designed for conventional manufacturing companies. A central component of this regulatory framework should be the formal recognition of standardized venture capital agreements. In advanced economies, organizations such as the National Venture Capital Association (NVCA) have developed standardized contractual documentation that has gained widespread acceptance among investors, entrepreneurs, legal practitioners, and regulatory authorities. By contrast, the absence of officially approved model agreements in Iran endorsed by governmental institutions such as the Vice Presidency for Science and Technology or the Securities and Exchange Organization has resulted in each investment agreement functioning as an isolated legal instrument. Formal recognition of such standardized agreements by the Companies Registration Office could substantially reduce transaction costs. At present, numerous essential contractual provisions including vesting arrangements and tag-along rights cannot be incorporated into corporate charters because they are not recognized within existing administrative registration formats. Consequently, these provisions lack both official registration and governmental enforceability (Jafari, 2023). The adoption of standardized agreements would not only facilitate the registration process but would also promote greater judicial consistency. Once a model venture capital agreement has been officially promulgated by a competent authority, judges and arbitrators would be more inclined to interpret such agreements according to the specialized commercial principles governing venture capital transactions rather than relying upon the general rules applicable to contracts of sale or compromise. In effect, these agreements would gradually acquire the status of established commercial custom, which, pursuant to Article 225 of the Iranian Civil Code, may prevail in interpreting the parties' intentions (Nasser Katouzian, 2021). Such a development would encourage courts to regard provisions such as liquidation preferences not as oppressive or inequitable clauses but rather as legitimate mechanisms for allocating investment risk, which constitute an essential feature of venture capital financing (Shokouhi, 2022a). Furthermore, the proposed regulatory framework should expressly define the legal nature of emerging financing instruments. For example, instruments such as the Simple Agreement for Future Equity (SAFE) and convertible debt

instruments presently suffer from significant doctrinal uncertainty within Iranian law regarding their legal characterization. The proposed framework should clearly define these instruments and establish corresponding registration and taxation rules, thereby preventing inconsistent administrative interpretations (Nasiri, 2021). Such legislative clarity would substantially improve contractual effectiveness by preventing either founders or investors from exploiting regulatory ambiguities to evade their contractual obligations.

Finally, the official recognition of standardized venture capital agreements would establish a common legal language among lawyers, entrepreneurs, investors, and regulatory authorities. This shared framework would substantially reduce the duration and complexity of contractual negotiations while accelerating capital formation within Iran's innovation ecosystem. Accordingly, this study proposes that the Securities and Exchange Organization, in cooperation with the Vice Presidency for Science and Technology, issue standardized subscription and investment documentation applicable even to private joint-stock companies. Reliance upon officially recognized contractual models would significantly strengthen the enforceability of negotiated provisions against both third parties and judicial authorities (Amiri, 2023). Undoubtedly, such a comprehensive regulatory framework represents the missing component necessary to reconcile the traditional principles of Iranian corporate law with the modern requirements of venture capital financing, thereby transforming investment agreements from merely formal legal documents into effective instruments for economic development.

4.2. *Establishing Specialized Arbitration Institutions and Reforming Judicial Practice in Innovation and Technology Disputes*

Even the most carefully drafted agreements and the most comprehensive legislative framework cannot ensure contractual justice if the adjudicating authority lacks an adequate understanding of the underlying commercial relationship. One of the principal challenges confronting venture capital agreements in Iran is the referral of disputes to ordinary civil courts. Owing to heavy caseloads and their traditional orientation toward classical private law doctrines, judges frequently analyze sophisticated technology investment agreements through the conceptual framework of conventional contracts such as sale or lease. Consequently, concepts such as start-up valuation based upon future cash flows or vesting arrangements may be characterized as uncertain or unconscionable contractual provisions and therefore declared unenforceable (Shokouhi, 2022b). Judicial reform and the specialization of dispute resolution mechanisms have therefore become indispensable. The first proposed measure is the establishment of specialized arbitration institutions within innovation centers and science and technology parks. Arbitration is particularly well suited to venture capital disputes because of its expertise, confidentiality, and procedural efficiency. Unlike judges who are bound by the rigid procedural requirements of civil litigation, specialized arbitrators possess the ability to interpret contractual provisions in light of established commercial practices within the technology sector and thereby give effect to the parties' genuine commercial intentions. Nevertheless, merely including an arbitration clause is insufficient. Institutional arbitration centers should be established with dedicated panels composed of arbitrators possessing expertise in technology law, corporate finance, and the digital economy (Nasiri, 2021). Judicial recognition and enforcement of arbitral awards pursuant to the Iranian International Commercial Arbitration Act and Articles 454 et seq. of the Civil Procedure Code would substantially strengthen investor confidence (Askini, 2022).

A second essential reform concerns the specialization of the judiciary through advanced judicial training and the establishment of specialized commercial divisions. The Judiciary, in cooperation with the Vice Presidency for Science and Technology, should implement specialized educational programs introducing judges to emerging legal institutions and innovative financial instruments. Unless judges appreciate the distinction between a company's registered capital and its valuation in successive investment rounds, they are likely to misinterpret disputes involving anti-dilution mechanisms and equity financing. Specialized judicial divisions dedicated to knowledge-based enterprises, supported by economic and technological experts, would promote greater consistency in the interpretation of venture capital agreements (Pasban, 2021). Such specialization would significantly reduce interpretive uncertainty and strengthen the enforceability of investment agreements.

Moreover, judicial interpretation should gradually evolve from a purely formalistic methodology toward a purposive and economically informed approach. In contemporary contract law, contracts should be viewed not as static legal texts but as instruments facilitating commercial cooperation. If Iranian courts prioritize preserving contractual arrangements and

interpreting ambiguous provisions consistently with the legitimate commercial objectives of the parties, many existing enforcement difficulties would be substantially alleviated (Nasser Katouzian, 2021). For instance, when reviewing non-compete provisions, courts should evaluate their reasonableness and necessity for protecting the viability of the start-up rather than invalidating them categorically on grounds of occupational freedom. Such a paradigm shift necessarily requires judicial recognition of established start-up commercial customs as a supplementary source of legal interpretation (Sadeghi, 2023). Finally, the establishment of a comprehensive database of judicial and arbitral decisions concerning venture capital and start-up disputes would significantly enhance legal transparency. By enabling investors and entrepreneurs to examine how similar disputes have previously been resolved, such a database would reduce contractual uncertainty and facilitate more sophisticated risk allocation during negotiations. Greater transparency would discourage frivolous litigation while simultaneously contributing to the maturation of Iran's innovation law jurisprudence. Ultimately, the combination of efficient specialized arbitration and a professionally trained judiciary would complete the institutional framework necessary for effective venture capital investment, ensuring that investment agreements are protected from the risk of judicial non-enforcement. Such institutional reform is an indispensable complement to legislative reform, for even the most sophisticated legal framework cannot achieve its intended objectives if applied by adjudicators unfamiliar with the commercial realities of venture capital financing.

5. Discussion of the Findings: Examining the Relationship Between Legal Certainty and the Dynamism of Venture Capital Investment

A comprehensive analysis of Iran's innovation ecosystem reveals a profound paradigm gap between law in its traditional sense and the modern innovation-driven economy. Venture capital investment is inherently characterized by uncertainty, risk, and probabilistic outcomes, whereas legal systems are fundamentally designed to promote stability, predictability, and certainty. The central challenge arises when attempting to accommodate the inherently dynamic nature of start-ups within the rigid framework of commercial legislation enacted decades ago. The findings of this study demonstrate that legal certainty should not be understood as limiting contractual freedom, but rather as providing a protective legal framework for the parties' autonomy. Unfortunately, under the current legal structure, this protective framework remains fragmented and inadequate.

The first major issue concerns the legal enforceability of contractual autonomy. Within venture capital transactions, an investment agreement serves not merely as an instrument allocating contractual rights and obligations, but also as a sophisticated governance mechanism designed to shape the conduct of founders and corporate managers. When investors negotiate contractual restrictions on managerial authority, their objective is not to undermine managerial discretion but rather to safeguard investments that are often secured solely by intellectual capital and the execution capabilities of the founding team rather than tangible assets. Nevertheless, by emphasizing doctrines such as managerial independence and broad statutory managerial authority, the Iranian legal system whether intentionally or inadvertently subjects investment protection to bureaucratic constraints. Consequently, investment activity is adversely affected because investors who perceive the judicial enforceability of governance provisions as uncertain either refrain from investing altogether or significantly increase their risk premium, thereby imposing financial burdens that may ultimately impede the growth and sustainability of start-up enterprises.

Another significant issue concerns the distinction between legal ownership and economic ownership. Under Iranian corporate law, shares primarily represent proportional ownership of corporate capital and generally confer equal rights upon shareholders. In contrast, venture capital financing is founded upon the principle that equal financial contributions need not necessarily produce identical governance or economic rights. Instruments such as preferred shares, enhanced pre-emptive rights, and liquidation preferences are specifically designed to establish an equitable balance between the extraordinary risks assumed by venture capital investors and the returns to which they are contractually entitled. The findings indicate that the absence of formal recognition of these differentiated ownership structures by both the Companies Registration Office and the judiciary has effectively created an informal parallel legal regime. In practice, parties frequently negotiate sophisticated contractual arrangements that bear little resemblance to the corporate constitution formally registered with governmental authorities. This dual-document structure constitutes one of the greatest threats to legal certainty. When disputes arise, courts inevitably rely upon officially registered corporate documents that fail to reflect the commercial realities embodied in the

investment agreement, resulting in judicial decisions that may be legally sound from a formal perspective but economically detrimental.

With respect to exit provisions, the findings reveal the existence of what may appropriately be described as an exit bottleneck within the Iranian legal system. Successful exits constitute the principal driving force behind venture capital investment. Unless investors possess confidence that their equity interests can ultimately be liquidated, they will have little incentive to participate in early-stage financing. The practical unenforceability of contractual mechanisms such as drag-along rights, coupled with statutory restrictions on corporate share repurchases, has effectively confined investment capital within portfolio companies. This creates a fundamental paradox. On the one hand, public policy consistently emphasizes the promotion of innovation and productive investment; on the other hand, the legal mechanisms necessary to facilitate investor exit are frequently invalidated on grounds such as inconsistency with the essential nature of the contract or unlawful restrictions upon property rights. Genuine market dynamism depends upon the free circulation of investment capital rather than its immobilization through inflexible rules governing ownership and share transfers.

One of the study's most significant findings concerns the decisive influence of judicial mentality upon the development of the innovation ecosystem. Iranian judicial practice continues to be deeply rooted in the analytical framework of traditional nominate contracts developed over centuries. From the perspective of a conventionally trained judge, it may appear difficult to accept arrangements whereby a shareholder possesses economic ownership without voting rights or whereby one shareholder may contractually compel another to transfer his or her shares. This conceptual gap has substantially limited the practical effectiveness of even well-designed legislative reforms. Consequently, any meaningful discussion of legal certainty must necessarily encompass the modernization of judicial reasoning. The legal system requires judges who appreciate that, within technology-driven markets, time often represents a more valuable asset than property itself, and that judicial proceedings extending over several years may effectively destroy both the start-up enterprise and the investor's capital—even where the ultimate judgment is rendered in favor of the investor.

The policy recommendations emerging from this analysis raise an important question: should reform be pursued through deregulation or through modern legislative intervention. The findings suggest that the appropriate solution lies between these two approaches. Rather than expanding mandatory regulation, the legal system requires facilitative legislation. The proposed comprehensive venture capital regulatory framework and standardized contractual documentation may function as an intermediary legal language capable of translating privately negotiated agreements into forms readily recognizable by governmental authorities and judicial institutions. Once a standardized investment agreement receives official recognition, its legal validity is effectively endorsed in advance by public authorities, thereby significantly reducing the risk of inconsistent judicial interpretation. It is precisely at this point that legal certainty directly contributes to economic dynamism by restoring investor confidence in the legal system. The study also addresses the relationship between contractual fairness and freedom of contract. Critics occasionally argue that sophisticated investor protections may result in the exploitation of entrepreneurs. However, the present analysis demonstrates that, within the context of venture capital financing, protecting investors who often possess superior financial resources but comparatively limited informational access ultimately benefits the innovation ecosystem as a whole. Without adequate legal protection, investors will simply decline to commit capital, thereby depriving entrepreneurs of the financial resources necessary to commercialize innovation. Accordingly, contractual justice in this context should not be interpreted through a formalistic conception of equal rights but rather through the broader objective of sustaining entrepreneurial activity and long-term business development. Another particularly significant finding concerns the role of specialized arbitration. The evidence suggests that arbitration should not merely function as an alternative forum for dispute resolution but rather as a specialized institution dedicated to preserving commercially viable contractual relationships. Arbitrators possessing expertise in venture capital financing understand that disputes concerning technical contractual provisions should not ordinarily result in the invalidation of an entire investment agreement. Instead, through commercially informed and purposive interpretation, they are capable of preserving both the continuity of the enterprise and the legitimate expectations of the contracting parties. In this respect, the relationship between legal certainty and commercial dynamism becomes particularly evident: specialized arbitration promotes legal certainty through expertise while simultaneously fostering commercial dynamism through procedural efficiency.

Ultimately, the findings indicate that the current difficulties surrounding venture capital investment agreements in Iran do not merely reflect technical deficiencies within existing legislation; rather, they reveal a more fundamental philosophical

challenge. The legal system has yet to fully recognize that start-up enterprises constitute a distinct category of commercial entity requiring a legal framework fundamentally different from that governing conventional corporations. Genuine legal certainty will be achieved only when legislators and judges recognize entrepreneurial risk-taking as an economically valuable activity rather than as speculative conduct requiring restriction through traditional legal doctrines. The continued development of Iran's innovation ecosystem therefore depends upon transforming venture capital agreements from legally fragile instruments into fully enforceable mechanisms of investment protection. Achieving this objective requires the establishment of a threefold institutional framework consisting of modern legislation, specialized judicial interpretation, and flexible corporate registration mechanisms.

Accordingly, this study concludes that the relationship between legal certainty and the vitality of venture capital investment is both direct and indispensable. As legal uncertainty surrounding governance mechanisms, managerial oversight, and investor exit strategies is progressively reduced, the circulation of investment capital will accelerate, thereby fostering higher levels of technological innovation and entrepreneurial growth. The reforms proposed herein including the adoption of a comprehensive venture capital regulatory framework and the establishment of specialized adjudicatory institutions should therefore be regarded not as optional policy choices but as indispensable prerequisites for sustainable economic development in the digital era. The Iranian legal system must evolve from serving as an impediment to innovation toward functioning as its principal facilitator. Only through such a transformation can the country's considerable human and technological resources flourish within a legally secure environment. Without this fundamental shift, venture capital agreements will continue to be constrained by traditional judicial interpretations, while investment capital will increasingly migrate toward safer and less productive markets. Ultimately, the future of Iran's innovation ecosystem depends not merely upon advances in software code, but equally upon the modernization of the legal code capable of accommodating the rapid pace and distinctive characteristics of the digital economy.

6. Conclusion

The present study examined the legal challenges surrounding venture capital investment agreements in Iran and demonstrates that the principal source of their ineffectiveness lies not in the parties' contractual intentions, but rather in the disconnect between classical commercial law and the realities of the innovation-driven economy. The findings indicate that the current framework of the 1968 Amendment to the Iranian Commercial Code, owing to its rigid and highly formalistic nature, is incapable of accommodating modern contractual mechanisms such as equity vesting, liquidation preferences, and tag-along rights. This structural incompatibility has created a state of contractual uncertainty in which venture capital investors are exposed not only to substantial commercial risk but also to significant legal uncertainty.

With respect to corporate governance provisions, the study concludes that traditional legal concepts such as the fiduciary duty to act in the company's best interests and the broad statutory authority granted to directors frequently conflict with the restrictive governance mechanisms commonly incorporated into venture capital agreements. As a consequence, directors of start-up companies are often placed in the difficult position of choosing between compliance with contractual obligations and adherence to mandatory corporate law requirements. This conflict undermines legal certainty and substantially increases agency costs. Furthermore, regarding investor exit mechanisms, the study demonstrates that the absence of an efficient secondary market and the statutory restrictions on corporate share repurchases create significant obstacles to investor exit, thereby disrupting the liquidity cycle that constitutes one of the fundamental characteristics of venture capital financing.

Based on these findings, the study proposes a comprehensive reform strategy operating on both legislative and judicial levels. At the legislative level, the adoption of a comprehensive regulatory framework governing venture capital investment, together with the formal recognition of standardized venture capital agreements by corporate registration authorities, represents the most critical step toward reinforcing the legal validity of privately negotiated contractual arrangements. Such reform would not only reduce interpretative uncertainty but would also establish a common legal framework capable of enhancing both the efficiency and legal certainty of venture capital transactions. At the judicial level, the study emphasizes the necessity of moving beyond ordinary civil courts toward specialized arbitration mechanisms, while simultaneously providing judges with specialized training concerning the economic characteristics of start-up enterprises. Unless judicial practice abandons its reliance on traditional civil law concepts developed for conventional commercial transactions and instead adopts an analytical framework appropriate for venture capital financing, the full potential of Iran's innovation ecosystem will remain unrealized.

Finally, it should be emphasized that legal certainty in the field of venture capital investment is not merely a technical legal issue but rather a fundamental prerequisite for sustainable economic development. The transition from law as an impediment to law as an enabler requires recognition that venture capital agreements are not ordinary commercial contracts but sophisticated strategic partnerships that demand dynamic, commercially informed, and supportive legal interpretation. Accordingly, this study ultimately recommends the establishment of an interdisciplinary working group composed of legal scholars, policymakers, economists, and technology specialists to prepare comprehensive amendments to the Iranian Commercial Code with a particular focus on knowledge-based enterprises and innovation-driven businesses. Such reforms would substantially narrow the existing gap between legal doctrine and commercial reality and would provide the institutional foundation necessary for the continued growth and international competitiveness of Iran's technology and innovation sectors.

Ethical Considerations

All procedures performed in this study were under the ethical standards.

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Conflict of Interest

The authors report no conflict of interest.

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