

I N S I D E T H E M I N D S

Bankruptcy Law Client Strategies in the Middle East and Africa

*Leading Lawyers on Examining Local Bankruptcy
Systems, Analyzing Recent and Proposed Changes to
Laws, and Preparing Successful Client Strategies*



ASPATORE

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Investor Protection in Iran: A Bankruptcy Approach

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Introduction

Iran, a member of the Organization of Petroleum Exporting Countries (OPEC), ranks among the world's top three holders of both proven oil and natural gas reserves. Iran is OPEC's second-largest producer and exporter, after Saudi Arabia, and in 2008 was the fourth-largest exporter of crude oil globally after Saudi Arabia, Russia, and the United Arab Emirates.

In recent years, Iran has been placed in the spotlight by the international media and has dominated the major news headlines for its controversial nuclear activities. The international community under the leadership of the United States of America has imposed a series of financial and economic sanctions to force Iran to abandon its nuclear ambitions. The rigorous sanction regime and the threat of war by Western powers not only have deterred Iran from pursuing a nuclear program, but also have made it more determined to be recognized as an active player in the regional affairs and politics.

The geographical location of Iran in the Middle East and close proximity to Europe could make it a strategic partner for the European Union (EU) and the West, which is currently dependent on Russia for gas supply. Iran could provide an alternative route for the transit of energy from the Caspian Sea and the Persian Gulf to the EU and the West that is cheaper and safer than the existing pipelines transported through the hostile and unstable Caucasus region. The abundance of natural resources and mineral wealth makes Iran an attractive location for foreign direct investment (FDI) activities for multinational oil companies. Countries from different corners of the globe—in particular the so-called BRIC (Brazil, Russia, India, China)—have expressed interest to invest in the lucrative Iranian energy market.

The focus of this chapter is investor protection in Iran. It will provide an overview of the Iranian bankruptcy system, which is an important component of a market economy. The aim is to determine whether the Iranian laws protect foreign investors against commercial risk of bankruptcy. This will be achieved by highlighting the current trends and developments in the Iranian legal system to see what remedies are available to investors in case their investment project is subject to bankruptcy and insolvency proceedings.

Today's Bankruptcy Environment in Iran

Economic Development Plan

The Iranian economy has suffered in the past from a decade-long war with neighboring Iraq (1980–1988), international sanctions, and the petroleum-based exports. Therefore, Iran has missed great opportunities to attract the flows of foreign capital, technology, and management skills that are needed to foster economic development and growth, as compared with other countries of the world.

The Iranian economy is mainly centrally planned and state-controlled. The government, rather than the marketplace, determines prices of the goods and services. The Iranian government has implemented a series of five-year development plans that set forth the guidelines for macroeconomic and fiscal policies reform, privatization programs, liberalization, and opening-up of the economy to foreign investors. The focus of the fifth development plan (2010–2015) includes subsidy, banking, taxation, currency, infrastructure, social justice, and productivity. The ambition of the government is to reach self-sufficiency by the end of 2015. The fifth economic plan is part of the “Vision 2025,” a plan for long-term sustainable growth. The fifth plan, like its predecessors, has allocated financial resources for the development of the oil and gas fields, which is the primary source of foreign exchange earnings for Iran. A successful economic development depends on the certainty, predictability, stability, and transparency of the legal system.

Law Reform

The existing Iranian Commercial Code was adopted in 1932 and is based on the combination of the 1807 French Code de Commerce and precepts of Islamic law. The Iranian Commercial Code is divided into four parts—merchant and trade activities, trade companies, negotiable instruments, and contracts and bankruptcy. The bankruptcy provisions have remained intact since the inception of the Commercial Code, meaning that it no longer meets present-day business needs. The legal system of the countries from which Iran borrowed its Commercial Code has undergone reform and development in response to the rapid acceleration of trade and investment

flows and integration of financial markets. Undoubtedly, Iran as a member of the international community must adapt to the changing economic conditions by reforming its laws and regulations on business transactions.

The recent change of the government policy, which is shifting away from the protectionist and closed economy to a liberalized, open-market economy, has laid the foundation for the law reform program. This includes setting up a commission in the Ministry of Justice for revision and update of the existing commercial code, including the bankruptcy provisions. During the fourth economic plan (2005–2010) the governments approved a bill on a new commercial code to replace the existing code and sent it to the parliament for ratification, which is still pending.

The new commercial code envisages broad and improved definition of trader and commercial activities, the rights and obligations of traders, commercial contracts, guarantees, trade documents, natural persons and trading companies, and reconstruction and bankruptcy. Once entered into force, it will provide many benefits to the business community, including new provisions on electronic trading and free competition.

Unfortunately, the reform process in Iran has been slow and in some cases non-existent because the development goals of the government have mainly concentrated on expansion of the production industries, including the energy and petroleum sectors, which are regulated by the public and administrative laws. Therefore, the need for creation of private laws did not materialize until the government started the privatization program.

The pursuit of a successful law reform will depend on the long-term development objectives, including broad and clear private law rights, including contract and property laws required for conducting market transactions. There must be adequate regulation of secured transactions and protection and remedies in case of non-payment of a debt. Until the parliament ratifies the new commercial code, the loopholes will remain in terms of the scope of and definition of permitted commercial transactions and the structure of economic enterprises. The existing Iranian commercial laws are antiquated and outdated and must be reformed to address the new developments in international business transactions.

New Privatization Act

For years, the government had been the dominant force in the operation of major industries, including oil, gas and petroleum, telecommunications, banking and insurance, automotive and transport, and construction. Despite the approval of privatization program in the first (1990–1995), second (1995–2000) and third (2000–2005) plans and in every annual national budget law that has been adopted since 1993, the ministries had failed to identify the names of state-owned companies for privatization, dissolution, or consolidation.

In July 2006, the Supreme Leader issued a directive for the implementation of general policies on privatization of industries under Article 44 of the Iranian Constitution by requiring the transfer of the bulk of governmental assets to the private sector by the end of the Fourth Plan. The “Law Amending some Provisions of the Fourth Economic Development Plan and Implementing General Policies of Article 44 of the Constitution,” titled the New Privatization Act, was approved by the parliament on January 28, 2008, and ratified by the Expediency Council on July 21, 2008.

The New Privatization Act has removed the ambiguity surrounding the scope of activities in each economic sector—public, private, and cooperative. The government is required to cede 80 percent of the share value in the economic activities contained in Article 44 of the Constitution to non-state actors by the end of fourth plan. The methods through which state companies may be ceded to non-state actors are sale of shares through public offering in domestic or foreign stock exchanges, sale of shares to domestic or foreign markets through tendering, and sale of shares through tendering.

Under the act, the ownership and management of most major industries, including upstream oil and gas, banking and insurance, power distribution, radio and television, aviation, harbor, water distribution, and military production, will remain with the government. The privatization of the economy and acquisition of public assets by private investors will undoubtedly require a robust bankruptcy and insolvency regime entailing the rights and obligations of creditors and debtors.

Lending Practices by the Iranian Banks

Access to credit and cash flow is an important aspect of doing business. Generally, in Iran, banks and financial institutions advance cash and credit to businesses and factories by taking security over the land and tangible assets. Therefore, in case of default by the borrower, the collateral protects the creditor's rights by allowing it to take possession of the asset or estate.

In recent years, the government handed out loans to startups or small-sized enterprises, but most of them went out of business before even becoming operational because of lack of adequate business plans or institutional support to kick off their investment projects. The private sector activities in Iran have always been limited to small-sized, family-owned business units that are not connected to the country's production chains. The collapse of these companies due to financial hardship or economic crisis does not usually make it to the evening news, as they are insignificant to the economic output. The bankruptcies of Enron, WorldCom, and investment banks, such as Lehman Brothers, rattled the economies of the West because of their sheer size and the number of people they employed around the globe.

In Iran, borrowers rarely file for bankruptcy because there are not many creditors involved, and the quickest and cheapest way for a single lender to recover the monies owed to him is by selling the secured asset. Financially distressed companies usually have no liquid assets to distribute to creditors who pursue their claim against debtors through contractual arrangement, such as security, collateral, mortgage, or pledge, rather than through bankruptcy proceedings. This is because the bankruptcy route does not provide adequate remedies to banks and lending institutions, and because there are cumbersome procedures for filing bankruptcy petitions against defaulters.

The procedures for bankruptcy will be outlined in the following sections. The enforcement of secured transactions is relatively straightforward and involves fewer formalities. At present, only persons (natural and legal) involved in business can apply to the court for bankruptcy, and individuals cannot file for bankruptcy for failing to make credit card payments.

International Sanctions

For years, the Iranian economy has suffered from international isolation for pursuing a nuclear program, and the international community, including the United Nations (UN), the United States, and the EU, has imposed severe economic and financial sanctions against Iran.

On June 9, 2010, the United Nations Security Council passed Resolution 1929, the fourth sanction against Iran. Member states are prohibited from providing financial and insurance services to Iranian banks and companies that are engaged in nuclear proliferation activities. The UN sanctions also targeted transfer of goods by Iranian ships and cargo planes. The UN sanction regime allows member countries to inspect any ships bound to or coming from Iranian ports that are suspected of carrying illicit goods, such as nuclear weapons, and must seize the cargo.

On July 29, 2010, the EU adopted restrictive measures against Iran. The EU sanctions restrict European companies from investing in the development of the Iranian oil and gas fields and liquefied natural gas (LNG). European companies cannot enter into joint-venture agreements with, purchase shares of, or give technical assistance to Iranian companies or nationals for the purpose of exploration and exploitation of oil and gas sectors. Also, providing banking, financial, and insurance services to Iranian companies is prohibited.

On July 1, 2010, the United States enacted the Comprehensive Iran Sanctions, Accountability, and Divestment Act (CISAD), giving non-US companies the option: trade with Iran and lose access to the US capital market, or sever any ties with Iran and avoid US sanctions. The American sanctions also prohibit the export of refined petroleum products by US and non-US companies to Iran.

The international sanctions have insulated the Iranian banks from exposure to the global financial crisis that erupted in September 2008. However, the UN, US, and EU sanctions had a profound impact on the Iranian private sector. Many Iranian companies became bankrupt because of the rising costs of doing business and the inability to export goods to international markets. Furthermore, Iranian businesses could not access foreign currency

or open letters of credit that are needed for conducting everyday banking transactions. In sum, many factories and production units have ceased operations, and Iranian businesses have suffered setbacks from the international sanctions.

Governance and Regulation of Foreign Investment: FIPPA

The Foreign Investment Promotion and Protection Act (FIPPA) 2002 is the law governing foreign investment in Iran. FIPPA and its implementing regulations set forth provisions on:

1. The scope of application (requirement for investment license)
2. Conditions and procedures for admission and establishment of investment and investor (admission provision)
3. Definition of foreign investor (natural and legal persons) and investment (subject-matter)
4. Forms of investments (equity and debt investments)
5. Dispute resolution options

The main guarantees offered by FIPPA to foreign investments are national treatment and non-discrimination standards, monetary transfer, compensable expropriation, export license, and access to dispute resolution. FIPPA provisions do not cover the organization structure of the business enterprise, registration of company, or bankruptcy and liquidation. The aforesaid matters will be subject to the Iranian Commercial Code, which will be outlined later.

Approving Authority

The Organization for the Investment, Economic, and Technical Assistance of Iran (OIETAI) is the responsible body for supervision, registration, and issuance of investment licenses pursuant with the provisions of FIPPA 2002 and implementing regulations. Generally, foreign investment activities do not require authorization from the government; therefore, individuals and corporations are free to undertake investments subject to the municipal laws and regulations in all fields of activities except national security and defense. However, by registering and obtaining an investment license from the OIETAI, investors are provided with a set of privileges, incentives, and protections.

Scope of Application

The FIPPA applies to investments that have been admitted in accordance with its provisions and prevailing laws and regulations. The investor must obtain an investment license from the OIETAI to be covered by FIPPA protection against political risks, expropriation, and inconvertibility. The investment must be for the purpose of development and promotion of producing activities in industry, mining, agriculture, and services. The implementing regulation contains a positive list of the sectors and subsectors of activities in which investment is allowed.

Conditions for Admission of Investment

FIPPA sets forth the conditions and procedures for admission and establishment of foreign investment and investors. The investment must satisfy the following conditions to be admitted into Iran:

- The investment should lead to economic growth, upgrade technology, enhance the quality of products, or increase employment opportunities and exports.
- The investment should not threaten national security and public interests, cause harm to the environment, interrupt the country's economy, or jeopardize production by local investments.
- The investment should not involve the granting of concession or special rights by the government to foreign investors resulting in the creation of a monopoly.
- The proportion of goods and services produced by foreign investments should not exceed 25 percent in each economic sector, and in each branch shall not exceed 35 percent.

FIPPA contains stringent conditions for admission and entry of foreign investment. The investor must show that the investment will increase exports from the Islamic Republic, supply the domestic productions market, or increase competition through enhancing the quality of goods and services. The requirements that the investment should not be a threat to the national security and public interest or harm the environment are recognized by international law and all legal systems around the world. Neither the act nor its implementing regulations clarify what it means by

“interruption of national economy” and “distortion of domestic production.”

A shortcoming of FIPPA is prohibition of foreign investment activities based on concession contracts, so foreigners cannot exercise ownership rights over natural resources or enter into production-sharing agreements (PSA). The last requirement imposes quantitative restriction on the market share of the foreign investor. The investment license cannot be for an amount more than the specified ratio of the market in each economic sector and sub-sector, unless the product of the investment is going to be completely exported. The ceiling on the percentage applies only at the time of the issuance of the investment license, and thereafter no limitations are placed on foreign investors for their market shares. In conclusion, it is impossible for the investor to meet all the above requirements, and the restrictions and limitations contained in FIPPA will pose as an obstacle for admission of foreign investment into Iran.

Definition of Investor (Individual and Corporate)

FIPPA defines foreign investor based on the foreign nationality of the capital, rather than the nationality of the individual or enterprise. The definitions provision refers to Iranian and non-Iranian natural and legal persons using capital with foreign origin who have obtained an investment license. Therefore, any natural and corporate investors, regardless of the place of residence or the seat of corporation and management, can cover their investments with FIPPA protection. The qualification of nationality of the foreign capital suggests that FIPPA envisages protection of the investment, rather than the investor.

Definition of Investment

FIPPA defines the protected investment in terms of the business organization of the investment through an enterprise (“enterprise-based model”). Foreign investment is defined as utilization of foreign capital in a new or existing economic enterprise after obtaining the investment license. Foreign capital is defined as various types of capital, whether in cash or in kind, imported into the country by the foreign investor. It then provides a list of capital transfers, including foreign currencies, machines, factory

equipment, accessories, operational facilities and tools, raw materials and individual parts of factory equipment, complete-knock-down (CKD) parts, foreign patents, technical know-how, and trademarks. FIPPA adopts the “transaction-based model,” which protects the underlying capital transfer, rather than the assets owned or controlled by the investor. FIPPA does not recognize an “asset-based model,” which contains a broad range of specified assets that can be protected under the law or agreement in question.

There are major flaws in the FIPPA definition of foreign investment. An “asset-based model” should be adopted similar to that contained in international investment agreements that include company stock and shares, other forms of equity, bonds, debentures, and other forms of debt interest in a company, contractual rights, tangible property, intellectual property rights, and rights conferred pursuant to law, such as licenses and permits.

Forms of Investments

FIPPA recognizes two types of investments—foreign direct investment (FDI) and non-equity-based contractual arrangements, so both types of equity and debt investment are accepted.

Equity Investment (FIPPA Art. 3(a))

The first category is direct investments in fields of activities that are open to the private sector. Foreign direct investment (FDI) activities involve the acquisition of ownership in Iran through:

1. Incorporation of a new company
 2. Purchase of shares of an existing Iranian company
 3. Registration of a foreign branch or representative office
 4. Participation in a joint venture with a local partner
- Incorporation of a wholly foreign-owned Iranian company

FIPPA guarantees investors the right to set up an Iranian company without any restriction as to the percentages of shareholding.

Therefore, investors with an investment license are authorized to establish a company in Iran with majority ownership, management, and control. The Iran Commercial Code specifies seven different forms of business enterprises. Only the private joint stock company (PJSC) and limited liability company (LLC) are relevant for the purpose of foreign investment.

- Private Joint Stock Company (PJSC)

The PJSC is the most common form of commercial enterprise in Iran. The founding members are subscribers to the entire capital, which is divided into shares. The liabilities of the shareholders are limited to the amount of capital contributed to the company. There must be at least three shareholders to form a PJSC and a minimum amount of capital of 1 million Iranian rials. The establishment of PJSC involves rigorous corporate governance, disclosure requirements, and compliance with company procedures under the Iranian Joint Stock Companies Act. The formalities and procedures include holding regular shareholders meetings, holding board of directors meetings, and filing and registering the resolutions and minutes of the meetings.

- Limited Liability Company (LLC)

The LLC is suitable for a privately run family business. Two shareholders are required to establish an LLC. The liabilities of the shareholders are limited to the amount of capital contributed. Incorporation of an LLC involves very simple procedures, as specified in the articles of association of the company. The LLC has a basic structure and has no minimum capital requirement. The emphasis is placed on each individual shareholder. The LLC is mostly used by small local businesses, and it is extremely difficult to transfer the shares of the company. In practice, few foreign companies have formed an LLC.

- Investment in Existing Iranian Company (FIPPA Art. 7)

Foreign investors who have already invested in Iran without the benefit of coverage of FIPPA may, upon completion of the admission procedure, benefit from FIPPA's coverage for the principal investment already made. Subsequent to the issuance of the investment license, the investor will be entitled to benefit from all privileges of FIPPA including, *inter alia*, the right to transfer profits. This type of investment will be generally considered an existing investment, to which the general criteria for admission of foreign capital are applicable. Foreign investments in existing enterprises by way of purchasing shares, capital increase, or combination of the two, subject to the completion of the admission procedure, will benefit from the privileges of FIPPA, provided such investment creates added value. The added value so created may result from an increase in investment in the existing firm or the achievement of certain objectives, such as enhancement of the management, increase in the exports, or improvement in the technology level of the existing firm.

- Foreign Branch Office

The Law Authorizing the Registration of Branches or Representative Offices of Foreign Companies, enacted in 1997, authorizes foreign investors to establish their branches or representative offices in Iran. The branch of the foreign company is the local unit subject to the principal company that directly undertakes the project and responsibilities of the principal company in Iran. The activities of the local branch are under the name and responsibilities of the principal company. The locally registered branch office of the foreign company has the following obligations and responsibilities:

- Closing of the company's branch in case of revocation of the operation permit by the competent authorities
- Disclosure of the annual report of the principal company containing the audited financial reports by independent

auditors resident in the home country to the relevant organization

- Disclosure report on operation of the branch or representative office in Iran, accompanied by audited financial statements, within four months after the end of the fiscal year to the relevant organization
- Administration of the affairs of the branch or representative office by one or two natural persons resident in Iran

Both foreigners and locals can be appointed as general managers of branches or representative offices. Foreign investors are not allowed to engage in export or import activities through a branch office. For establishing the branch office, the following documents are required:

- Articles of incorporation of the principal company
- Certificate of incorporation
- Corporate resolution for establishment of the branch office in Iran and power of attorney
- Justification report (for registration in Iran)
- Last certified financial report of the company
- Power of attorney for registration of the branch office
- Completed declaration form for registration

All the above documents should be prepared by the company, duly notarized by a notary public, attested by the foreign ministry, and, finally, legalized by the consular section of the Iranian embassy in the home state of the investor.

- Joint-Venture Companies

Foreign investors may establish joint-venture companies with the participation of Iranian investors based on a joint-venture agreement for engaging in economic and industrial activities in Iran. The parties to a joint-venture arrangement may be foreign individuals or private corporations with participation of Iranian individuals or corporations. There are two basic forms of joint

ventures—contractual (civil partnership) and equity joint-venture (company). The contractual joint ventures are mostly used for certain projects for a limited period of time; they will be outlined in the following subsections. The equity joint ventures are the most common form of companies with participation of a foreign investor in the equity capital of an existing company or incorporation of a new company in which the foreign shareholder and the Iranian partner each hold certain portions of the equity capital. Iranian law allows both types of joint ventures, but establishment of joint companies is the most common type of joint venture. The joint venture company can be formed by PJSC or a LLC.

Debt Investment (FIPPA Art. 3(b))

The second category is non-equity contractual investments within the framework of civil partnership (joint venture), buyback, and build-operate-and-transfer (BOT) arrangements. The investor can enter into any of these financial agreements to fund large and capital-intensive infrastructure projects. Debt investments are permitted in economic sectors that are under the exclusive control and monopoly of the government, such as upstream oil and gas. The executive cabinet decree that was passed on July 30, 2003 (cabinet decree on investment contracts), regulates the investment contracts in the form of civil partnership, buyback, and BOT arrangements.

- Government Guarantees

According to FIPPA, the return of capital and profits in civil partnership, buyback, and BOT contracts should not be guaranteed by the government, state banks, or entities (FIPPA Art. 3(b)). The government guarantees foreign investment projects against only non-commercial risks. The Ministry of Economic Affairs and Finance will provide the necessary guarantees covered under the FIPPA and implementing regulations to foreign investors undertaking investments in the form of civil partnership, buyback and BOT contracts. The government of the Islamic Republic of Iran, to prevent any violation resulting from the obligation of this guarantee, will make all necessary arrangements for financial cover

for the possible occurrence of a breach of obligations. The cabinet decree stipulates that the guarantees of the government of the Islamic Republic of Iran for the underlying methods of investment under FIPPA shall not cover the following:

- The damages caused by the breach of the investor in fulfilling its contractual obligations
 - The responsibilities of the investor in operating the investment
 - The damages caused to the investor as result of *force majeure*.
- Adverse Legislative Changes

FIPPA affords non-equity-based investments (project finance agreements) with specific guarantees that are not available to FDI activities. If due to alteration of the laws, the foreign investor incurs losses, the government is under an obligation to pay the foreign investor compensation (FIPPA Art. 17 Note 2).

- Off-Take Guarantee

The government guarantees the purchase of the goods and services produced by the investment project, provided it is the sole purchaser and supplier of the goods and services (FIPPA Art. 11). In cases where the government companies are the exclusive purchasers of the products (goods or services) resulting from the investment, the purchaser on the side of guaranteeing the purchase of products and payment of their prices should envisage adequate monetary penalty for failure of the investor to produce the product (cabinet decree Art. 7).

- Privatization of State Entity

The cabinet decree on foreign investment provides that the privatization of state entities is regarded as a government act; therefore, the state entities continue to benefit from the guarantees provided by the government (cabinet decree Art. 4). The

guarantees provided by the government prior to privatization of the state entity remain valid and binding after acquisition of the state entity by private shareholders.

- Secured Transactions

The main concern for foreign investors when making an investment abroad is the availability of a sophisticated system of security devices for obtaining financial facilities for their investment projects. The concept of project finance is new in Iran. FIPPA 2002 is the first piece of legislation to refer to a BOT contract as a method of project finance agreements. There are many obstacles for foreign investors in obtaining funding for proposed investment projects in Iran. First, foreign investors cannot own real property in Iran. FIPPA authorizes the project company (Iranian company) to purchase and own land for the purpose of undertaking investment activities. In Iran, the issue of security interest is dealt with under the concept of a pledge. As a solution, the foreign investor could establish an Iranian company to serve as a special purpose vehicle (SPV), which can own land and create security interest over its assets, including plant and machinery.

According to the Civil Code, a pledge may be taken over fixed or immovable assets, such as plant and machinery (Civil Code Art. 774). This means that the grant of security interest in obligations such as accounts receivable and future profits is prohibited. The pledge conveys a lender preference over all other creditors regarding the asset that is subject to the security interest and cannot be canceled without obtaining the consent of the lender (Civil Code Art. 780). At the time of issuing the pledge, the asset should be in existence and delivered to the bank or lender, but the lenders are not required to have physical possession of the property (Civil Code Art. 772). This implies that the parties can agree to pledge assets that the project company will own in the future, such as finished goods and products. FIPPA authorizes the foreign investor to exercise ownership right over the remaining capital in the economic entity in which the investment is made, so long as the

investment and accrued profits in the BOT schemes are not amortized (Art. 3). In BOT contracts, the proprietary rights of foreign investors can be transferred to institutions providing financial facilities to the investment project upon the confirmation of the board (FIPPA Art. 10).

- The Right to Transfers Funds (FIPPA Art. 11–18)

FIPPA guarantees transferability and convertibility of foreign currency. The methods of transfer of foreign capital into Iran include the conversion of cash into rials, cash used directly for purchases related to the foreign investment project, and non-cash items (equipment, tools, machinery, etc). The foreign investor has the right under FIPPA to transfer abroad all capital and profits and to repay its borrowing, including principal and interest, after fulfillment of its obligations concerning payment of taxation. The applicable foreign currency exchange rate at the time of entry or exit of the foreign capital, as well as all foreign currency transfers, will be the rate prevailing in the official banking system in case of unified exchange rates; otherwise, the free market rate, as recognized by the Central Bank of Iran, will be the basis for the exchange rate. Transfers relating to principal, profit, and installment payments should comply with FIPPA Art. 3(b), which states that joint-venture, buyback, and BOT contracts should not depend on any guarantee by the government, banks, or state entities. In another words, the government does not guarantee a certain rate of return for the investment project. Rather, it guarantees the payment of compensation for the foreign investor as a result of government actions. The foreign currency required for the transfer of the principal, profits, and installment payments can be obtained by the purchase of foreign currency from the banking system, from the proceeds of the export of manufactured products, or from the provision of goods and services. The CBI is under the obligation to provide and make available to the foreign investor the equivalent of the foreign currency for the transferable funds required for the purchases of foreign currency from the bank

by the approval of OIETAI and confirmation of the Minister for Economic and Financial Affairs.

The transfer abroad of any part of the foreign capital admitted into the country within the framework of the investment license that is unused is exempt from all the foreign exchange and export and import laws and regulations. A shortcoming of FIPPA is that the ability of the foreign investor to transfer funds overseas depends on the approval of the Foreign Investment Board and the Ministry of Economic and Financial Affairs, which does not make it clear how long it will take for permission to be issued. The act does not specify the grounds for refusal of the permission.

- Protection against Expropriation and Payment of Compensation (FIPPA Art. 9)

FIPPA guarantees foreign investors against non-compensatory expropriation. The Iranian government can expropriate and nationalize foreign investment only on the condition that it is for the public purpose, in accordance with the due process of the law, in a non-discriminatory manner and against payment of “appropriate compensation,” which is based on the “actual value” of the investment immediately before the expropriation. A shortcoming of FIPPA is that the Iranian government is required to pay compensation only for direct expropriation, which is the transfer of physical ownership and title of the asset to the government-nominated state entity or a third party. It excludes protection against constructive, creeping, indirect, *de facto* and “measures equivalent and tantamount” to expropriation. Therefore, the foreign investor is not entitled to claim compensation for regulatory expropriation. This is where the government takes a series of measures, including raising taxation and revocation of the investment license, which may lead to the bankruptcy of the investment company. FIPPA does not protect the investor against such regulatory actions by the Iranian government. The only remedy available to investors is entering into a stabilization agreement with the government not to take measures with adverse effects on the investment or unilaterally

change the contractual terms, without payment of adequate and just compensation.

FIPPA requires payment of “appropriate” compensation based on the “real value” of the investment immediately before the expropriation. The applicable standard of compensation is “appropriate” compensation, and without further clarification, it suggests that the amount of payable compensation by the government will be less than the “full compensation,” as required under international law. Under international law, the standard of compensation payable to foreign investors for expropriation of their investment is prompt, effective, and adequate compensation determined by the fair market value of the investment before the expropriation. The “real value” of investment as specified by FIPPA refers to the “net book value” containing the assets and liabilities of the enterprise. This means that other kinds of losses incurred by the investor, such as “loss of value” and “loss of profits,” are not recoverable. The FIPPA provision on expropriation and the standard of compensation deviates from the international principle of “full fair market value,” which is employed by international tribunals as a common method of valuation of an investment as a going concern. In reality, what the investor can expect to receive from the Iranian government for taking its property is the actual price paid by it to set up the investment. The provision must be modified to make it compatible with international standards.

The application for compensation claims should be submitted to the Foreign Investment Board within one year from the date of expropriation or nationalization. The one-year time limit is a short period for preparation and submission of the case by the investor. The investor should have more time, given the complexity and difficulty of gathering evidence, which may take more than one year. The investor should be given the right to appeal the decision of the government authority in a court of law in accordance with the international principles of natural justice. FIPPA does not provide any remedy for the foreign investor to seek redress if the Iranian government violates the obligation to lawfully expropriate or nationalize (requirements for public policy, due process, non-discrimination, and compensation). All disputes arising out of

expropriation should be settled pursuant with the dispute resolution provision contained in FIPPA, which will be discussed in the following subsection.

Dispute Resolution (FIPPA Art. 19)

FIPPA set forth the procedure for the settlement of investment disputes between the foreign investor and the Iranian government. Investors should first settle disputes with the Iranian government through negotiations. If the dispute cannot be resolved amicably, the investor has the right to submit the claim to the Iranian courts. The government agency parties to the contract are required, to the extent possible, to designate Iranian law and domestic tribunals as the dispute resolution forums or arbitration in the qualified contracts (cabinet decree Art. 11). In case there is bilateral investment treaty (BIT) in force between the investor's home state and the Iranian government, the dispute will be submitted to the forum provided in the dispute resolution provision. FIPPA does not mention arbitration in the dispute resolution clause; therefore, it is imperative that the investment contract between the investor and the state or state entity stipulate an express arbitration clause.

Bilateral Investment Treaties (BITs)

Iran adopted its first BIT model in 2002 and currently has concluded more than fifty BITs with capital exporting and developing countries to promote and attract a flow of foreign investment. The majority of the investment treaties signed between Iran and other countries grant investors the option of referring their disputes to international arbitration pursuant with the ad hoc arbitration rules of the UN Commission on International Trade Law (UNCITRAL) or the International Chamber of Commerce.

Dispute resolution provisions in Iranian BITs set forth the procedures for establishment of the tribunal, appointment of arbitrators, place and language of arbitration proceedings, consent of parties to arbitration, applicable law, and enforcement of the arbitral award. Iranian BITs condition the application of substantive investment protection standards to the registration and approval of the investment with the OIETAI.

Therefore, the investor must obtain an investment license to benefit from the BIT protections.

The investor must meet the condition precedents before activating the dispute resolution procedure. The condition precedents are the requirement for negotiation and amicable settlement of dispute, a cooling-off period of three to six months, notification of claim, and waiver of local law remedies. In addition the investor must satisfy the jurisdictional requirements of consent to arbitration.

The scope of dispute resolution procedure covers any disputes arising out of an investment between an investor and the Iranian government. Treaties define an investment as any kind of investment, direct or indirect, and entailing a list of assets, including movable and immovable property, shares, stocks, and other interests in companies, contracts, and claims to money and intellectual property rights. Under the Iranian law, disputes arising out of bankruptcy proceedings cannot be referred to arbitration, so the Iranian courts are the competent authority to hear the cases. However, the investor can prosecute a claim against the Iranian government for violation of obligations contained in the applicable investment treaty.

Iranian treaties guarantee investors fair and equitable treatment standards, national treatment, most-favored-nation treatment, monetary transfer, compensation for expropriation, observation of commitments, and access to dispute resolution. A subset of fair and equitable treatment is the requirement of due process and natural justice. Therefore, if the investor is denied due process or a fair hearing in bankruptcy proceedings, the Iranian government is liable to pay compensation. This means that the investor must have access to court and have the right to appeal judicial decisions. The obligation to treat investors fairly and equitably extends to administrative decision-making and procedural fairness; therefore, the authorities in charge of liquidation and bankruptcy affairs must exercise due diligence when dealing with foreign investors. Other requirements of fair and equitable treatment are transparency, predictability, certainty, and stability of the legal system of the host state. Therefore, the Iranian government must ensure that the laws, regulations, and decisions are disclosed to the investor.

The New Bankruptcy Regime

There are currently no specific bankruptcy laws in Iran. The Iranian Commercial Code set forth the provisions on bankruptcy of individuals and companies. The existing provisions do not contain appropriate procedures for the restructuring and reorganization of an insolvent company.

The difficulty arises when an investor falls behind in the payment of debt installments. There are no remedies for the debtor to settle its debts through out-of-court arrangements. The implication of this is that the debtor is not given an opportunity to restructure its business and repay the debts owed to creditors. Bankruptcy law must balance the interests of both the creditors and debtors. A creditor should be able to recover the money owed to him or her, and the debtor should be able to start again by returning to society and contributing to the economy.

In 2006, the Ministry of Commerce issued a report that highlighted the shortcomings of the existing Commercial Code and made recommendations for reform of the bankruptcy provisions:

1. Allow the debtor to restructure the insolvent company without involvement of the court
2. Expand the jurisdiction of the office of administration of liquidation and bankruptcy affairs and transform it into an organization for restructuring
3. Establish a board as a specialist body to investigate the problems of trader and company
4. Envisage financial restructuring of the insolvent trader
5. Create governing rules for the natural and legal liquidation officer
6. Reform the criminal laws to provide punishments for offenders
7. Establish the commercial court

Cross-Border Insolvency

UNCITRAL has proposed the adoption of the Model Law on Cross-border Insolvency by member states of the UN. The purpose of the Model Law is to facilitate the settlement of complex cross-border insolvency proceedings where companies have assets in several jurisdictions. The Model Law allows

the foreign representative (receiver) in a foreign insolvency proceeding to apply to the domestic courts to be recognized. The court could impose a stay on creditor action against the assets of a foreign company if a showing of certain procedural and due process protection is made.

Iranian law does not recognize cross-border insolvency, meaning any bankruptcy proceedings started in another jurisdiction are not recognized by Iranian courts. For example, where a US company with a company in Iran files for insolvency protection in the United States, the company's creditors are not protected against asset-stripping in Iran. In such a scenario, the creditors must allocate the assets of the company in the foreign jurisdiction and instruct local counsel to protect its assets. However, such a situation is unlikely, as companies registered in Iran have separate legal personalities and cannot be held liable for debts of their subsidiaries or parents unless the direct link between two companies can be established. The adoption of the Model Law by Iran will allow companies that have filed for bankruptcy in a foreign jurisdiction to seek judicial assistance from Iranian courts.

Existing Bankruptcy Procedures

The bankruptcy regime applies to all traders, which covers individuals and companies carrying out commercial activities, including foreign traders who establish a local branch and subsidiary in Iran. There is no separate bankruptcy law; therefore, any articles stated are provisions of the Iranian Commercial Code, unless stated otherwise by the author. Iranian laws do not define bankruptcy. According to the Iranian Commercial Code, the trader or commercial company is declared bankrupt when it ceases to pay its financial undertakings (Art. 412).

Bankruptcy Declaration

The court, pursuant with Art. 415, can declare a trader bankrupt by petition of:

- The trader
- The creditors
- A public prosecutor

Petition by the Trader (Art. 413 and 414)

The trader should declare its bankruptcy within three days of the date of the suspension in the payment of its debts or other monetary obligations to the court office of the place of its residence, and submit the inventory of its assets, as well as the commercial books. The trader is required to submit an inventory to the court, which must be signed and dated and contain the following information:

- A detailed description of the amount, number, and value of the movable and immovable properties
- A statement of all debts and claims
- A statement of profit and loss account and personal expenses

The trader must file for bankruptcy within three days of the date on which it ceases to pay its debts. Failure to comply with the statutory time limit is a criminal offence of bankruptcy by negligence (Art. 542(2)).

Petition by the Creditors

Under the commercial code, any person who is owed money by an individual or company can petition the court to issue a bankruptcy order against the debtor. The legal action by the creditors is necessary for preservation of their rights and prevention of the disposition and removal of the remaining assets of the insolvent trader.

Petition by the Prosecutor

The public prosecutor, on behalf of the people, can petition the court to issue a bankruptcy order against the bankrupt trader or company when it has reasonable belief that an individual or company has committed an offense under the commercial code, including negligent and fraudulent bankruptcies.

Jurisdiction of the Court

Once the bankruptcy application is submitted, the court can make any order it deems necessary to protect the rights of the trader and creditors. The

bankruptcy order is declaratory, meaning that it is not limited just to the parties to the dispute, and it will affect all persons. The bankruptcy order is enforced provisionally (Art. 417). As the order is not a final award, its enforcement is generally limited to protective measures. If the public court does not have a liquidation office for the administration of the insolvency proceedings, it must appoint a receiver. The court will examine the case and, if satisfied with the evidence, issue a bankruptcy order against the trader. The court has the power to issue the following orders:

- Appointment of an official receiver
- Security measures
- Issuing an arrest warrant against the debtor
- Setting the date of insolvency
- Appointment of the liquidator

Appointment of Receiver (Art. 427–432)

The court, in declaring the bankruptcy of a trader, will appoint a person as the official receiver. The receiver is bound to supervise the administration and speed of the insolvency proceedings. The receiver will report all disputes arising out of bankruptcy to the court that has the jurisdiction to resolve them. The court can always change the receiver and replace him with another person. Appeals against the receiver's decisions should be made to the same court that appointed the receiver. Appeals to the receiver's decisions are possible to the extent permitted by the Commercial Code.

Security Measures (Art. 433, 434, 438, and 439)

The court in the bankruptcy order will mandate the sealing of the trader's assets. The receiver must immediately seal the trader's assets unless he or she believes that the preparation of the inventory of the trader's assets is possible within one day, in which case it should be started immediately. The warehouse, business office, safe, documents, books, notes, property, and furniture of the firm, as well as the residence of the trader, must be sealed. In case of insolvency of the general partnership, limited partnership, or proportional liability partnership, the personal property of the general

partners will not be sealed, unless the court declares them bankrupt as part of the company's bankruptcy or issues a separate bankruptcy order.

Issuing Arrest Warrant against the Trader (Art. 435 and 436)

If the bankrupt trader fails to comply with the provisions of Art. 413 (bankruptcy declaration) and 414 (submission of inventory), the court, when issuing the bankruptcy order, can also issue an arrest warrant against the trader. The above provision covers instances where the trader has committed bankruptcy by negligence. An order for the arrest of the trader will be issued by the court when the debtor conceals the whole or part of his assets or prevents the administration of the bankruptcy and liquidation.

Setting the Date of Insolvency (Art. 416 and 418)

The court must specify the trader's insolvency date, and if it is not specified, then the date of the bankruptcy order will be the date. The creditors can request that the court change the date of the insolvency before the expiration of the time limit set for the assessment and confirmation of their claims. The bankrupt trader, from the date of the bankruptcy order, is prohibited from any interference in its property, including financial gains accrued during the bankruptcy proceedings.

Appointment of Liquidator (Art. 418, 419, 440, 441, and 442)

The court will appoint one person as liquidator, either as part of the bankruptcy order or within five days after the bankruptcy order has been issued. The liquidator is the legal substitute for the bankrupt trader with all the powers and financial rights, the exercise of which is necessary to facilitate the payment of its debts, and has the right to use the said rights on her or his behalf.

Duties of the liquidator include preparing the list of claims by creditors, serving notice on creditors, and setting the time limit for them to present themselves. From the date of the bankruptcy order, any person who has a claim (movable or immovable) against the bankrupt trader must submit it to

the liquidator. The court will determine the amount of remuneration entitled by the liquidator for undertaking her or his duties to settle the trader's debts.

Working with the Liquidation Office

By virtue of Article 1 of the Law of the Administration of Bankruptcy and Liquidation Affairs, an agency called the Liquidation Office has been established in Tehran and other important cities under the supervision of the High Judicial Council of the Ministry of Justice. As the name suggests, the agency is responsible for overseeing the liquidation and dissolution of the bankrupt trader or company. In places where the Liquidation Office has not been established, the liquidator and the court-appointed receiver will carry out the underlying tasks of supervising the insolvency proceedings.

Responsibilities of the Liquidation Office

Article 3 of the above-mentioned act requires the Liquidation Office to record the date and number of the bankruptcy order against the trader or company in the registrar of directory of bankruptcies and inform the director. As soon as a person is assigned to the case, the liquidator must adopt security measures to protect the rights of the bankrupt trader. Other types of measures taken by the Liquidation Office include preparing an inventory of property of the bankrupt person, sealing the assets, and seizing the bankrupt trader.

The Liquidation Office is used to working through local agents, so foreign counsel involved in bankruptcy and liquidation proceedings should liaise with an Iranian attorney concerning lodging an appeal. The best communication with the officials is through close cooperation and compliance with the demands made by the Liquidation Office during investigation and inspection of the company records.

Composition Agreement with Creditors

The Iranian legal system allows the use of a composition agreement between trader and creditors. After the bankruptcy order has been issued against the insolvent trader, and once the real creditors have been identified,

a composition agreement can be prepared to assist in reaching a composition agreement between the trader and the creditors, pursuant to the legal requirements. According to this agreement, the creditors can waive a portion of their claims from the bankrupt trader and recover the remaining debt based on the specific arrangement. In addition, they give the qualified trader a time limit to restructure its business entity, and in case of profitability, pay the outstanding debt. The bankrupt trader should undertake to carry out its commitment pursuant to the above terms.

The implication of such an arrangement is that the decision to implement a composition agreement is reached after issuance of the bankruptcy order against the trader or trading company. If, because of economic hurdles and unforeseen circumstances, the trader is unable to pay its debts, before issuing the bankruptcy order, the judge should invite the creditors of the bankrupt trader to seek their consent and give the insolvent trader a time limit to restructure its company and repay its debts.

Qualification for Composition Agreement (Art. 476, 477, 480, 481, 483, and 484)

Within eight days from the date set by the office manager of the court that has issued the bankruptcy order, the receiver should invite all creditors whose claims have been verified and accepted for consultation on the conclusion of a composition agreement. The general meeting shall be held in the place and at the time and on the date set by the receiver and presided over by him. Creditors whose claims have been temporarily accepted, or their attorneys, may attend the meeting. The bankrupt trader should be invited and must personally attend the meeting.

For recognition of the above-mentioned meeting and decision-making, two types of majority are envisaged: numerical majority and value majority. This means at least one-half of creditors plus one, representing a minimum of three-quarters in value of the total amount of debt, verified and accepted. If at the meeting the creditors represent a numerical majority but not three-quarters in value, they cannot proceed with the composition agreement. Therefore, during the general meeting, the creditors must have both numerical majority (half plus one creditor) and value majority (three-quarters of claims) to qualify for the composition agreement.

In the meeting, the liquidator presents its report, and then the bankrupt trader can inform the attendants on the debts and continuing the business and the possibility of repaying its debts. When the required majority for reaching the agreement is achieved, the bankruptcy proceedings will end, and the trader can continue his trade. A trader found guilty of bankruptcy by fraud cannot conclude a composition agreement, as the trader has inflicted loss to creditors by committing fraud. In the case of negligence bankruptcy, it is possible to conclude a composition agreement.

Ranking of Creditors

In bankruptcy proceedings, the priority of claims of creditors is as follows:

- Secured creditors (movable and immovable property)
- Preferred creditors
- Unsecured creditors

Secured Creditors (Movable and Immovable Property) (Art. 514, 515, 516, and 518)

Creditors secured by a mortgage are listed among other creditors for the purposes of the record only. This means that they are allowed to recover their entire claims that have been verified from the assets of the bankrupt trader, and there is no need for them to be mixed with the unsecured creditors. The liquidator can, at any time, with the permission of the receiver, redeem the mortgage by paying the debts to the creditors and releasing the mortgaged property, and list them as part of the assets of the bankrupt trader. If the mortgage is not released, the liquidator should sell it under the supervision of the public prosecutor, and the mortgagee must be invited for this purpose.

Creditors with a pledge over immovable property (land) will have priority over the underlying property, and their claims cannot be excluded. Therefore, from the proceeds of the sale of the immovable properties first, the debts of the creditors who have collateral over immovable property must be paid. If the proceeds of the sale of the immovable property are not sufficient to settle the claims, the secured creditors will be treated as ordinary creditors in regard to the outstanding claims and are entitled to receive a share from the amount allocated for the ordinary creditors, provided their claims have been verified.

Preferred Creditors

Art. 58 of the Law of Administration of Liquidation Affairs divides the creditors with preferred rights into four classes:

- Class A includes the salaries of housemaids for the duration of the last year before the insolvency, salaries of employees of the bankrupt entity for the duration of the last six months before the insolvency, and wages received by employees daily or weekly for three months before the insolvency.
- Class B applies to the claims of persons whose assets are administered by the bankrupt as guardian, in proportion to the amount in which the bankrupt is in debt because of the guardianship.
- Class C relates to the claims of doctors and pharmacists and claims consumed by medications of the debtor and its family during the year before the insolvency.
- Class D covers the wife's alimony, according to Civil Code Art. 1206. The wife's dowry up to 10,000 rials, on the condition that the marriage is entered into at least five years before the insolvency, and the surplus will be considered as other debts.

Unsecured Creditors

Ordinary creditors are persons who have no security rights or preferred rights in relation to the property and assets of the bankrupt trader. The claims of the said creditor will be settled after the submission of claims of secured and preferred creditors from the remainder of the assets of the bankrupt, in proportion to their respective claims.

Personal Bankruptcy of the Company Director/Shareholders/Partners

Commercial Code Art. 412 talks only about the bankruptcy of a trader or trading company that has discontinued payment of debts and monetary obligations undertaken by them, and does not mention anything about bankruptcy of the directors and partners of the company. Commercial Code Art. 439 stipulates that in case of insolvency of a general partnership, limited partnership, or proportional liability partnership, the court has the

discretion to declare the general partners bankrupt, either as part of the company's bankruptcy or in a separate order.

In the case of an LLC or a PJSC in the event of the liquidation of the company, the personal property of the directors/shareholders/partners is not protected against insolvency proceedings, even though the liability of each member is limited to the amount of shares held in the company. If the company does not have enough assets to distribute, the judge will order seizure of the personal property of the directors or shareholders.

Transactions Liable to be Set Aside

After a declaration of bankruptcy has been made, certain transactions may be set aside and annulled.

- Transactions with the intention of avoiding debt
- Sham transactions or collusion
- Gratuitous transfers

Transactions to Avoid Debt (Art. 424 and 425)

If the bankrupt trader enters into a transaction before the date of insolvency to avoid repayment of debt, it is deemed invalid. If, as a result of a lawsuit by the liquidator or a creditor against those persons who have been a party to a transaction with the trader, or against their legal successors, it is proved that the trader who has ceased payment of its debts has made transactions to avoid his liability or to inflict loss on the creditors, such transactions can be annulled unless the other party to the contract pays the price difference before an annulment order is issued.

An action for the annulment will be accepted in the court within two years from the date of the transaction. The law specifies the method of payment of the transaction price by the losing party. Where the court issues an order for the annulment of the transaction, the losing party must deliver the goods subject to the matter of the transaction to the liquidator and receive the price of the goods at the time of the transaction before assets of the trader are distributed among the creditors. If the goods are not in her or his possession, he or she must pay the difference in price.

Sham Transactions or Collusion (Art. 426)

If it is established in the court that the nature of the transaction is a sham or due to collusion, the transaction will be null and void, and the goods, as well as the gains thereof, must be returned. If the other party to the contract becomes a creditor, he or she will be treated as an ordinary creditor.

Gratuitous Transfers (Art. 423)

During the bankruptcy proceeding, which is the date on which the trader is not able to pay debts until the issuance of the bankruptcy order by the public court, the trader may enter into transactions with a view of inflicting losses on the creditors or transfer some of its assets to others. Under the Commercial Code, the following transactions are deemed null and void if undertaken by the trader following the inability to pay his or her debts:

1. A gift or any kind of conveyance with no consideration concerning a movable and immovable property
2. Payment of any debt, whether it has a maturity date or reached maturity
3. Any transaction that involves a lien on the movable and immovable property of the trader and causes loss to creditors

Stay of Personal Claims (Art. 419)

From the date of the bankruptcy order, any person who has a claim (movable and immovable) against the bankrupt trader must submit it to the liquidator. All enforcement measures are also subject to this provision. The appointment of the liquidator or the Liquidation Office by the court means that all the personal claims and lawsuits against the bankrupt trader will be stayed, and the liquidator or the Liquidation Office, as the legal representatives of the creditors and bankrupt trader, will carry out the responsibilities that are entrusted to him or her by the law. On the other hand, it is possible to appeal the decisions made by the liquidator or the Liquidating Office to the court that issued the bankruptcy order.

Conversion of Future Debt into Present Debts (Art. 421)

As soon as a person is declared bankrupt, all debts with a maturity date will become due by taking this period into account, as far as reduction in the amount of debt is concerned. Initially, creditors who lend to the trader have confidence in the creditworthiness of the trader or trading company, and may grant him or her a time limit to repay debts. As there is a risk of deterioration of the financial status of the trader and its subsequent liquidation and the possibility that the creditors may not be able to recover their claims, the fixed-term loans become mature. This will avoid further losses to the creditors.

Additionally, the liquidating officer or Liquidation Office distributes the assets of the trader among the creditors with debt claims pursuant to their respective shares, and no property will remain for recovery by the owner of debt after the loan matures, so it will incur losses.

Criminal Liability

As long as the trader complies with the statutory requirements and files for bankruptcy within the set time limit, he will not be subject to prosecution. However, in two instances the trader will incur criminal liability:

- Negligent bankruptcy
- Fraudulent bankruptcy

Negligent Bankruptcy (Art. 541)

In the following instances, the trader is declared a negligent bankrupt:

- If it is established that the personal expenses or expenses of the dependants of the trader during the usual course have been proportionally excessive, as compared with his income
- If it is established that the trader has spent an enormous amount on transactions that are disproportionate to his capital and that are deemed fictitious by commercial practice, or it has made superfluous profits

- If the trader, with the intention of postponing his or her bankruptcy, makes a higher purchase or cheaper sale than the market price, or for the same intention of obtaining cash resorts to methods that are uneconomic, such as taking a loan or issuing a bill of exchange or other means
- If the trader, after the date of inability to pay his debts, prefers one of the creditors and pays his or her claim

In the above instances, the court can issue a compulsory bankruptcy order against the debtor.

Court Discretion to Issue Bankruptcy Order (Art. 542)

The trader may be declared negligent bankrupt in the following instances:

- If the trader has undertaken certain obligations on a third-party account with no consideration for the payment of money, yet when considering his or her financial status at the time of performance, these obligations are considered unusual
- If his or her commercial transactions are suspended and he or she has failed to observe the provisions of Art. 413 of this law [declaration of bankruptcy within three days of inability to pay debts]
- If the trader has no books or there are inaccuracies or irregularities in the books, or the inventory list does not clearly specify its real financial status, including debts and claims, provided that it has not committed fraud in any case

According to Islamic Penal Code Art. 671, the punishment of a person convicted of bankruptcy by negligence is imprisonment from six months to two years.

Costs of Proceedings in Negligent Bankruptcy (Art. 543–548)

Prosecution of the above crime will take place at the criminal court upon the request of any one of the creditors or the public prosecutor. The liquidator cannot prosecute the bankrupt trader as negligent bankrupt, nor can he or she defend the case on behalf of creditors unless approved and authorized by the majority of creditors. In case the public prosecutor

prosecutes the negligent bankrupt, the costs should not be borne by the creditors. The costs of proceedings instituted by the liquidator on behalf of the creditors will be borne by the creditors if the trader is acquitted by the court, and if the trader is convicted, the government will be responsible for the costs. The government will bear the costs of trial initiated by one of the creditors if the trader is found guilty, and if the trader is acquitted, the costs shall be borne by the claimant.

Fraudulent Bankruptcy (Art. 549)

A bankrupt trader who has lost his or her commercial books, concealed part of his or her assets, or wasted the assets through sham transactions, misrepresentation, or fraud with regard to capital, or makes false entries concerning amounts that in reality he or she does not owe, will be declared a fraudulent bankrupt and will be subject to punishment according to the criminal law. According to Islamic Penal Code Art. 670, the punishment of the person convicted of fraudulent bankruptcy is between one and five years' imprisonment.

Completion of Bankruptcy

In ordinary closing down and liquidation after the distribution of assets and completion of bankruptcy proceedings, the person in charge will submit a report concerning the conclusion of the bankruptcy proceedings to the director of the Liquidation Office. The report must set out the summary of dissolution procedures, the reason for bankruptcy, value of the assets, debts, and the outstanding amounts, including the amount deposited in the account of court in accordance with Article 47 of the Law of Administration of Liquidation and Bankruptcy Affairs. The director of the Liquidation Office will announce and publish the bankruptcy.

Conclusion

There are many shortcomings in the Iranian bankruptcy regime. There are no adequate remedies for creditors and debtors, including reorganization and restructuring. There must be separate bankruptcy legislation that distinguishes between corporate and personal insolvency. In sum, the Iranian laws must be updated and reformed to reflect the above-mentioned

changes. However, there are still many challenges ahead for Iranian government, in particular the adoption of the new Commercial Code, ratification of the UNCITRAL Model Law on Cross-Border Insolvency, and creation of commercial courts.

The shortcomings of the present bankruptcy provisions are summarized as follows:

1. The lack of personal security of the bankrupt person and his family
2. The lack of security of the investments of the trader
3. The lack of security of the business enterprise
4. No clear rule on the date of commencement of the bankruptcy
5. No adequate and effective structure for the composition agreements
6. No uniform rules and regulations on the administration of bankruptcy affairs
7. The incompatibility of the period for declaration of bankruptcy with modern business practices
8. No provision on reinstating the credit of the trader
9. Inconsistencies in the provisions containing criminal punishment for the bankruptcy

The above changes must be addressed by the new bankruptcy law to enhance investor confidence in the Iranian legal system. The lawyers practicing in Iran should make sure their clients are protected in bankruptcy proceedings and follow the aforementioned suggestions when approaching the issue. Foreign attorneys involved in cross-border insolvency proceedings should maintain close working relationships with the Iranian lawyers to protect the interests of their clients. In particular, the observation of the local legal culture and formalities is essential in conducting complex insolvency proceedings.

Additional Resources

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Iranian Legislation

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- Second economic plan (1995–2000)
- Third economic plan (2000–2005)
- Fourth economic plan (2005–2010)
- Fifth Economic Plan (2010–2015)
- Vision 2025
- Commercial Code
- Civil Code
- Law of Administration of Liquidation and Bankruptcy Affairs
- The Law on Authorizing the Registration of a Branch or Representative Offices of Foreign Companies enacted in 1997
- Iranian Joint Stock Companies Act
- Iranian Model Bilateral Investment Treaty adopted in 2002
- Foreign Investment Promotion and Protection Act 2002
- Cabinet decree on regulation of the investment contracts in the form of civil partnership, buyback, and build-operate-and-transfer (BOT) passed on July 30, 2003
- 2006 Report by the Ministry of Commerce on the reform of the Commercial Code
- Law Amending some Provisions of the Fourth Economic Development Plan and Implementing General Policies of Article

44 of the Constitution (New Privatization Act) ratified on July 21, 2008

Foreign Legislation

- United Nations Committee on International Trade Law (UNCITRAL) Model Law on Cross-border Insolvency
- United Nations Security Council Resolution 1929 passed on June 9, 2010
- European Union restrictive measure passed on July 29, 2010
- United States Comprehensive Iran Sanctions, Accountability, and Divestment Act (CISAD) enacted on July 1, 2010

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Dedication: *I would like to dedicate this chapter to Ali Atai (LLB, LLM), the senior partner at Atai Associates Law Firm, to whom I am indebted.*



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