

At a Glance *Series*

BANKRUPTCY UNDER IRANIAN LAWS

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In the MENA region, there are different approaches when it comes to insolvency. Some countries have specific laws and regulations dealing with insolvency and some others, including Iran, Yemen and Iraq lack such means. Countries like Qatar, UAE, Palestine and Saudi Arabia have very minimal usage of their respective bankruptcy laws. Issues such as inefficiency, immaturity, and none-enforceability compared to regulations of Islamic *Fiqh* are among the main reasons preventing most MENA countries' insolvency and bankruptcy laws and regulations to be of more use and updated according to the needs and the fast-changing ambience of the world of modern commerce. In this note, we are going to review the key aspects of bankruptcy laws in Iran.

- **What Rules Govern Bankruptcy in Iran?**

The primary law in this field is the Iran Commercial Code enacted 1932, section 11 which sets the basic conditions of bankruptcy. According to Articles 549, 541 and 412 of the Commercial Law, there are three types of bankruptcy which has been defined below. This code is supplemented by the Law on Management of Bankruptcy Affairs Liquidation of 1939 which addresses the liquidation procedure. Some bankruptcy types are also ruled by the Islamic Penal Code of 2013 that outlines the penalties of the bankrupt's fault and fraud.

- **Who Is a Bankrupt?**

According to the Iranian Commercial Code, Bankruptcy does not in principle apply to non-merchants. However, both natural and legal persons can be subject to bankruptcy. The bankruptcy of a merchant or of a commercial company arises upon payment suspension of due debts. Nevertheless, the mere state of inability to pay one's debts does not *per se* render the individual or the company legally bankrupt. For a person to be recognized as a bankrupt under Iranian laws, certain legal procedures must be taken.

The state of bankruptcy must be declared by the competent court upon the request of competent persons. The assets of the company do not need to be valued less than the company's debts for it to be deemed insolvent. If the company is incapable of payment due to lack of access to its assets or inability to sell its service and products, it will be deemed as insolvent. Insolvency date, which is determined in the bankruptcy judgement is the date on which the merchant becomes unable to pay its dues.

Within three days after the merchant has ceased payment of his debts or other liabilities, every merchant must declare his insolvency to the Office of the Court of First Instance in the place where he resides and deliver to the office of the court his balance sheet and all his books.

If the court, for any reason, fails to determine the exact time of insolvency, the date of the issuance of the award shall be considered as the date of the occurrence of insolvency.

The company can be declared insolvent by the court of first instance through the declaration of the company itself or by the request of any of their creditors or the public prosecutor of the court of first instance.

The order of bankruptcy is a declaratory order and is to be published in the official gazette. The competent court is court of the of company's place of residence.

Bankruptcy disputes are not arbitrable; in addition to this, bankruptcy of a company results in the annulment of any commercial arbitration agreement they are a party to.

- **Appeal of a Bankruptcy Judicial Decision**

A judgment declaring a state of bankruptcy as well as a judgment fixing the date of insolvency prior to the time when payment was actually suspended may both be appealed against. Appeal must be lodged by the bankrupt person within 10 days, and by any other interested party within one month, if the party resides in Iran. In case the involved person is residing abroad, this period extends to up to two months. These periods will begin to run from the date of announcement of the bankruptcy judgment.

- **Bankruptcy Types**

Under Iranian Commercial Code,¹ three types of bankruptcy are recognized which each entail their individual specific legal effects and consequences, as follows:

1. Normal Bankruptcy

When the bankruptcy happened due to factors out of the merchant's control and unforeseen events over which the bankrupt has no power such as economic crises, recession etc. In this case, the merchant has

¹ Art 412, 541, 549

not caused bankruptcy through fraudulent action or by fault and therefore, he has limited responsibility compared to the two other cases of bankruptcy.

2. Bankruptcy by Fault

A merchant is considered bankrupt by fault in three different scenarios:

1. if the personal and family expenses have been extraordinary in comparison to his income in ordinary times.
2. If it is established that in proportion to his capital the bankrupt has used large sums either in transactions considered to be fictitious by commercial practice, or in mere chance speculations.
3. If with the object of delaying his bankruptcy, the bankrupt has affected purchases above or sale below current prices, or if for the same purpose, he has indulged in ruinous practices to procure funds, either by borrowing or by issuing bills of exchange or by any other means.
4. Finally, if after stopping payment the bankrupt has given an undue preference to one of the creditors.

3. Fraudulent Bankruptcy

Any bankrupt merchant who has lost his books, or concealed part of his assets, or has embezzled the same by means of an agreement with an accomplice or by fictitious transactions as well as any bankrupt merchant who, either by means of documents or through his balance sheet, declares himself to be indebted for sums he does not actually owe, will be declared a fraudulent bankrupt and punished with the penalties laid down in the Penal Code.

▪ Who Is a Liquidator?

In the order of bankruptcy, or at latest within five days from the order, the court will appoint a person to act in the capacity of Liquidator. The official receiver is to be appointed in the same order. The official receiver is bound to supervise and expedite the settlement of the affairs of the bankrupt and report to the court disputes related to the bankruptcy that fall within the court's jurisdiction. Liquidator main obligations are as follows:

1. Requesting the sealing of the bankrupt's assets from the official receiver.
2. Selling of the perishable commodities and those likely to deprecate in value.

3. Working with what is left of the bankrupt's capital with the permission of the official receiver
4. Recovering outstanding debts
5. Verification of the claims

- **Bankruptcy Orders Issued Outside of Iran**

The legal weight given to an order of bankruptcy issued by a foreign court is not expressly addressed in Iranian laws. However, from a theoretical point of view, two approaches can be discussed:

First, the theory of unison of bankruptcy (*unite de la faillite*) according to which there is only one court competent to issue the order, the court of the main center of business for companies and it will encompass (effect) all of the creditors and the bankrupt's assets inside or outside of the jurisdiction of this court.

The second theory, "multiple bankruptcy" or "territoriality of bankruptcy" implies that the order of bankruptcy can be issued from the competent court in all of the places in which the bankrupt has assets or creditors.

The latter is the approach taken by Iranian courts since it is accepted that decisions made by courts in Iran in this regard are not final and binding in other jurisdictions. Therefore, if a foreign court were to issue an order of bankruptcy concerning a merchant with assets and creditors residing in Iran, Iranian courts still have the power to issue another order of bankruptcy that they deem to be fit.

Post-Bankruptcy

- **What Happens to a Company Post Bankruptcy?**

1. Dating from the order of bankruptcy, the bankrupt person is deprived of all his property and of any property which devolves upon him as long as he is in a state of bankruptcy. The Liquidator is vested with the rights and powers of the bankrupt and can exercise them in his name and place particularly for the payment of his debt.

2. Any person contemplating proceedings in respect of movable or immovable property against the bankrupt, after declaration of bankruptcy, must notify the Liquidator or bring his action against him. The same rule applies to the execution of a judgment.
3. As soon as a person is adjudged bankrupt, debts due by him which have not yet matured become payable, but an allowance by way of discount will be made for the period the debt has to mature.
4. Any transaction relating to movable or immovable property prejudicial to the interests of the creditors, if conducted by the bankrupt itself is considered null and void.

- **Company Directors and Scope of their Liability**

Principally, bankruptcy of the partners of a company does not necessarily lead to the bankruptcy of the company or its shareholders. The Company's directors are not considered as merchants and they cannot be declared as bankrupt due to their directorship position in the company.

In principal, directors will not be held responsible for bankruptcy of the company as in most cases. However, if the court is convinced that bankruptcy can be attributed to the directors of the company through their negligence or violation of law and regulations, it can condemn them to pay certain portions of liabilities that cannot be recovered from the company's assets. The bankruptcy of all the partners in a joint stock partnership company will result in the bankruptcy of the company and its dissolution.

AFTERWORD

Elite Pars closely tracks legal developments in order to advise and support clients in the best possible way. Our experts are available to update you on all related questions in this regard to assist you in bankruptcy and liquidation of your companies in Iran.

DISCLAIMER

It is to be kindly noted: the current publication does not necessarily deal with every aspect of the topic nor is it legal advice in any manner or tantamount thereto. For exhaustive and fully reliable consultation regarding your questions, please do feel free to contact us at (+9821) 22 016 586 or info@elitepars.com

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