

Piercing the Corporate Veil and Ambiguities in the Iranian Legal System: A Comparative Study with California Law

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Abstract

This paper focuses on the situation of doctrine of “piercing the corporate veil” in the current Iranian legal system especially in the Iranian Commercial Code and in the Iranian Civil Code. The author discusses the ambiguities and legal challenges which arise, directly or indirectly, from implementation of these challenges. There is also a comparative study of the doctrine with the common law system. The paper aims to highlight the defects of this doctrine in the Iranian law system and provides suggestions to improve it.

Keywords: Iranian Commercial code, Iranian Civil Code, doctrine of “piercing the corporate veil”, legal challenges

1. Introduction

Under both, common law and civil law countries, there is a basic concept in business law upon which the company has been recognized as a separate legal entity. The outcome of this concept is that there is a veil or mask between a company and its members including directors and shareholders. However, the courts, may in some circumstances and according to the law and some law principles, depart from the concept of separate legal entity, pierce the corporation veil and order that managers or directors be personally liable for debts and claims against corporation. The Iranian legislator has provided some provisions in the Iranian legal system, especially in the Iranian Commercial Code that may help to protect the doctrine of “Piercing the corporate veil”. Also, there are other laws which have been, directly or indirectly, applied to this purpose. However, there are some legal challenges and ambiguities in the laws relating to this doctrine which frustrate the impacts of such laws. This paper outlines bases of the doctrine of pierce of the corporation veil and circumstances upon which the doctrine may be applied. After this, the paper examines the situation of the doctrine in the Iranian legal system and then evaluates legal challenges of the application of the doctrine in the legal system.

2. Brief Overview to the Doctrine of “Piercing the Corporate Veil”

The doctrine of “Piercing the corporate veil” or “lifting the corporate veil” is mostly well known in the Common legal system. The doctrine is used as an exception to acknowledge civil liabilities for shareholders, managers or directors of a commercial corporation, if the circumstances are appropriate. It is noteworthy that the doctrine of “Piercing the corporate veil” must be distinguished from the Latin doctrine of “Respondeat superior” or “let the master answer” upon which liability may impose on persons who were not principal persons to commit a crime, but they were in a position to control the perpetrator. This doctrine is also called “Master servant rule”. The doctrine is studied in the Law of Securities (Ferrara and Sanger).

Basically, establishment of a commercial corporation usually contains complicated process through which several persons decide to make a business or render some services. Such a corporation (in most legal systems) is recognized as an independent legal entity or separate legal person. Shareholders of a commercial corporation usually make a financial investment in the corporation that entitles them to elect the directors. Shareholders are not normally being involved directly in company management and their connection to company management is typically via the Board of Directors. If shareholders are not satisfied with the performance of the directors, or if the directors are disqualified to work for any reason, shareholders may remove the directors or refuse to re-elect them. Managers and directors of a commercial corporation must act according to the instructions of its statute and based on the commercial governing laws. Managers’ duty is, indeed, based on some basic law principles

relating to good faith, stewardship and accountability which have been confirmed both by common law system as well as Roman law system.

Generally, the presumption, (in Common law system and Roman law system) is that there is no responsibility for the managers and shareholders of a corporation, and they do their duties properly, unless some situations and facts justify the courts and convince them to use the doctrine "Pierce the corporation veil. The rationale justification for the usage of doctrine "Piercing the corporate veil" is simple. According to Clausen, "When shareholders use a corporate entity for illegitimate purposes, American courts attempt to do justice by ignoring the distinction between the shareholders and their corporation. A classic statement of the legal standard is "that a corporation will be looked upon as a legal entity as a general rule, and until sufficient reason to the contrary appears; but when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons"(Clausen).

Some academic writers have argued that "doctrine of piercing the corporate is not a doctrine at all. It is a remedy. Like any good remedy, of course, the corporate veil is pierced in order to achieve discrete, specific policy objectives"(Macey and Mitts, "Finding Order in the Morass"). To justify the doctrine "piercing the corporate veil" it is sometimes referred to the doctrine "alter ego which is the base justification of the enforcement the doctrine of piercing the veil of corporation"(Minton v. Cavaney)". "Moreover, courts often use a variety of interesting words and phrases, such as, "alter ego," "dummy" and "sham" in announcing their decisions"(Gelb).

Some academic writers have classified the basic situations which justify the usage of the doctrine as remedy into three categories. The first category includes the situation that courts use the doctrine to reconcile the behaviour of corporate managers with statutory plans of the government. The second category is used where the courts realize that there is fundamental trick which makes personal liability rather than a corporate debt. The third category is used as an alternative to prevent fraudulent conveyances and preferential transfers. This category is a good tool to increase the worthiness of an insolvent company and for the interest of all of the creditors. Indeed, the main aim of this category is to solve corporation's creditors issues(Macey and Mitts, "Finding Order in the Morass").

In practice, however, there are some situations and facts that can convince the courts (without consideration any theoretical base issue) to use of the doctrine of 'piercing the corporate veil', and we now look to them in brief.

2.1 Where There Is no Real Disjunction between Activities in the Corporation and Managers' Personal Activities

A corporation is formed based on commercial laws and must adapt its activities according to commercial and banking laws and it must protect of its corporate personhood. It must act like a corporation in its activities. Therefore, if the managers of a company, for example, mix their personal accounts with business bank accounts, or, pay personal bills from the business bank account, they have, in fact, ignored fundamental business functions and put the corporation at the risk of piercing the corporate veil. Also, any corporation must follow the formalities of related laws and make the regular minutes of meetings. In brief, all functions of a corporation including expenses and income and all bank accounts must follow the structure of the corporation, and managers of a corporation must never guarantee payment of a corporation's debts, otherwise it may give the impression that the corporation is established to serve the managers' personal activities. As a matter of fact, there mustn't be a unity of interests between the company activities and its owners.

In a landmark case ("Minton v. Cavaney"), the Seminole Hot Springs was a Company which had operations on a public swimming pool in California in 1954. The pool had been leased by its proprietor. The claimants' daughter was sunk in the pool and the claimant filed a lawsuit against Seminole corporation on June 24, alleging that the death of his daughter was caused for wrongful. The claimants could obtain a judgment to be paid 10000 dollars. Nevertheless, the claimants were not satiate with the judgment and filed another lawsuit against Mr Cavaney alleging that he was personally liable for wrongful operations. Since Mr. Cavaney died on May/ 28/1958, his widow, who was his executrix of his estate, had to defend as defendant. The facts in the case indicated that Mr Cavaney acted as an attorney, director, secretary and treasurer for Seminole corporation. Moreover, Seminole corporation had never acted like a legal entity. The corporation had never issued shares of stock, or it had never owned assets. The facts clearly illustrated the fact that Seminole didn't work like a corporation and it was established to abuse of advantages of a legal entity. The defendant tried to show that although there were some ties of interests between the corporation and Mr Cavaney's activities, the real separation between the corporation and Mr Cavaney had never happened. The case was referred to the court of appeal and it refused to enforce against the defendant the earlier judgment. The court of appeal argued that claimants had not brought sufficient evidences to show that the corporation had committed negligence, and the amount of damages was also insufficient. The case

shows that how keeping the personality of a corporation is important and damaging this personality may result in personal liability of directors of the corporation.

It is noteworthy that in such cases, the type of business is not important. Where a corporation has any type of business, whether small or big, it must comply with the commercial laws and regulations that administered by legislative bodies. As a matter of fact, large corporations and small corporations are not immune from losing their limited liability status and both must observe corporate formalities.

2.2 *Where the Activities of a Company Were Unlawful, Incorrect and Deceitful*

There are some laws in most common law systems which apply against fraud and wrongdoing in a corporation¹. In general, a corporation must act in the way that can prove there is no fraud or misrepresentation in its transactions and activities. This is a type of issue that can be studied in business law, contract law and consumer law. To prove that there is wrongdoing or fraudulent in a corporation activity, some criteria may be considered as follows. First, the company must have misrepresented some facts regarding the transaction which were critical to the other party of the contract. Second, the intention of the company was that encourage the other party of the contract to agree to the terms and conditions of the contract. Third, the other party of the contract must have relied upon misrepresented facts and acted upon them. Fourth, if the other party of the transaction or contract was aware of false facts, he or she didn't agree and rejected that transaction.²

The wrongful conduct or misrepresentation may be made through wrong transfer of some corporation assets. In a case from Florida (*Broward Marine, Inc. v. S/V Zeus*,) the plaintiff sued the defendant (Yacht Corporation) alleging foreclosure of its mortgage by the corporation. While judgment process, the plaintiff found that Yacht corporation had transferred all his assets to other corporations which were under control of Yacht corporation. The plaintiff requested to hold the transferee-corporation, and the sole shareholder, liable for the underlying judgment against the Yacht Corporation. The U.S. District Court for the Southern District of Florida pierced the corporate veil; hold that the corporation's dominant shareholder should be personally liable for the torts of his corporation.

2.2.1 Fraudulent Misrepresentation can be considered as the Key Element

In contract law (Common law), there are some main factors to prove fraudulent misrepresentation exists. Such main factors may be used while a corporation is one party of the contract, and as a result, the other party uses such factors to prove misrepresentation made by corporation, and if the court sees fit, it may pierce the corporation's veil. The two majors important of those factors are:

- The intention of the party who is making false statements to induce the other party to enter to a contract or getting out of a contract. Indeed, the aggrieved party has a difficult task to prove that there has been intention of the misrepresentation. Every statement of the party which is not correct may not be considered as misrepresentation. The statement must be statement of fact and not a mere opinion or future intentions. In one case (“Robert Hugh Bisset v Thomas Vernon Wilkinson”), it was held that a mere misstatement of opinion cannot be considered as misrepresentation.
- The false statement must be relied upon by the other party. In (*Redgrave. V.Hurd*), statements made about income misled a solicitor into believing that a place in a partnership was worth more than documents produced to him showed. Sometimes silence can be amounted statements of fact and one can be liable for misrepresentation even if he or she says nothing. When completing a proposal for life insurance, for example, if one is silent about his or her heart attacks, it may be assumed as misrepresentation. Such contracts are called *ubberimac fidei* (of the utmost good faith), and there is a duty to disclose all relevant facts in such contracts. In (*Iatomasi v. Conciatori*) the Court of appeal held that when, during the pre-contractual negotiations for the sale of a building, a vendor delivers plans to a purchaser, there is no implied representation that the building was built according to the plans. The court held, however, that the vendor is liable in fraudulent misrepresentation for statements that there had never been

¹ See for example, California Corporation Act 1949, Section 25401 that states: “It is unlawful for any person to offer or sell a security in this state, or to buy or offer to buy a security in this state, by means of any written or oral communication that includes an untrue statement of a material fact or omits to state a material fact necessary to make the statements made, in the light of the circumstances under which the statements were made, not misleading”.

² In one California case (“Engalla v. Permanente Medical Group, Inc.”) it was shown that fraud generally requires a misrepresentation, knowledge of falsity, intent to defraud, justifiable reliance by the victim, and resulting damage. Another case (“Hauter v. Zogarts”) indicates that whenever a customer is impressed by a salesman, this cannot be considered as misrepresentation and there must be an actual affirmation (or concealment) of a fact. Therefore, “sales talk” for example is generally considered to be an opinion only, unless it involves a representation of product safety.

problems with the basement of the house, notwithstanding the “entire agreements” clause. The court awarded damages³.

Other factors that are relating to misrepresentation include the relationship of the parties, the details of the agreement, and the nature of the misrepresentation. In most cases, the most difficult part is proving the intent of the misrepresentation.

2.3 Where Creditors or Customers of a Company Suffered an Unjust Cost

A “corporation” is indeed a legal entity which is apart from the people who have created it; and one of the reasons that founders of a corporation choose to form a corporation is that they won’t personally be liable should the business unable to pay off its debts, and should the creditors sue against the corporation. However, there are many corporations which use this advantage to make unjust costs to creditors. As a matter of fact, there are legal challenges between corporations that do not pay off the debts and claim for insolvency and their creditors who ask the courts to pierce the corporate veil and hold the owners liable⁴. Here, examining the type of obligations and contracts that corporations have made are important facts that the courts may take into consideration. This is because corporations may impose some risks that creditors or customers may not have agreed to bear them. Therefore, corporations must have reasonable grounds to justify their obligations and contracts. Any use of limited liability in a corporation, whether deliberately or recklessly, to impose liabilities and unjust costs to investors, creditors and customers without insurance and compensation may open the way of pierce the corporation veil for creditors⁵. It may even open the way to sue for the corporate veil to impose personal liability on a corporate insider who is not a shareholder, officer, or director⁶.

2.4 Where There Is Improper or Gross Under-Capitalization

Capitalization is the process that is usually performed in corporations by converting capital to new stocks. However, under-capitalization usually occurs in situations where a corporation faces lack or shortage of capital, as the result of unexpected increasing costs or increasing significant amount of debts, and it is not able to provide sufficient financial sources to pay to its creditors and pursue its normal business activities and plan. Therefore, such a corporation usually opts out the process of under-capitalization as a mechanism to adjust and improve its financial capability and in order to conform its financial situation to its market⁷. However, if the insufficiency of capital is so critical as to constitute a “gross under-capitalization,” then the courts may consider it as enough evidence and allow the creditor to request pierce the corporate veil. There are not certain criteria to determine

³ Legal scholars (DeMott) have commented that a clients must disclose all the facts relating to their situation while negotiating with finance companies such as insurance companies.

⁴ It is worthy of note that collection of debts by creditors must be arranged according to Fair Debt Collection Act (FDCPA) which was approved in 1977. The Act protects consumers from being mistreated by debt collectors and they are legally not allowed to harass or mislead any debtor in any way.

⁵This point has been illustrated in two interesting cases(“Sheffield Services Co. v. Trowbridge”) (“Martin v. Freeman”) where the corporations were eventually held responsible.

⁶ In a case Colorado (“McCallum Family LLC v. Winger”), in which Marc Winger was managing Manitoba Investment Advisors, a Wyoming corporation that had permission to do business in Colorado. While Manitoba's corporate was doing its business, Marc Winger got married to Vicki Winger, who was a director, 50% shareholder, and president of Manitoba. Also, Marc Winger's mother, Karen Winger, was a director, 50% shareholder, vice president, and secretary of Manitoba. Marc Winger was not officially a shareholder, officer, or director of Manitoba, however, he was managing and controlling the entire business." Marc Winger also used corporation funds to pay his personal bills. He used \$95,400 of corporation fund to pay to the State of California because he was convicted for a felony for failure to pay sales taxes.

On the other side, Manitoba concluded a contract leasing with McCallum as lessor, for real property in Grand Junction, Colorado, from which it ran a mobile home sales operation. However, Manitoba did not pay Mesa County property taxes as required by the lease for 2003, 2004, and part of 2005, and it vacated the property seven months before the end of the lease term, defaulting on the remaining rent. McCallum could obtain a sentence against Manitoba for \$76,224.

The fact was that the Manitoba was insolvent beginning in September 2004 and was administratively dissolved on May 31, 2006. McCallum sued a claim to pierce the corporate veil and hold Marc Winger personally liable for the debt owed by Manitoba. McCallum contends the trial court erred in applying a clear and convincing burden of proof, rather than a preponderance of the evidence burden, to this claim.

⁷ There are two types of undercapitalization that Iranian corporations may follow. 1- Optional undercapitalization which can be performed through the request of board of directors of a company from extraordinary general meeting. This occurs when capital of a company is not sufficient and cannot cover its debts and costs. 2- Obligatory undercapitalization that is anticipated in the Iranian Commercial Code, article 141 which states:

“In the case of the loss of a minimum of half the company's capital, the board of directors is bound to call an extraordinary general meeting immediately, with a view to deciding whether the company shall be wound up or shall continue its operations. If the said general meeting turns down the winding-up of the company with observance of the regulations laid down in Article 6 of this Act, the company's capital will be decreased. If, contrary to the foregoing article, the board of directors have not called a general meeting or if the meeting is not convened in conformity with the regulations, any interested person may apply to the competent court for the winding-up of the company “.

which decreasing of capital of a corporation can be considered as gross and which one cannot be considered as gross; and so it may differ in every case. Courts usually look to the manner of similar corporations and examine the capital and cash flow that those corporations may need for the same businesses. Overall, if the financial needs for running a business is low, decrease of capital in a corporation must be low; and if financial needs of a corporation to expand a business are reasonable and vast, then the under-capitalization may be justifiable, and the court may not permit the plaintiff to pierce the corporation veil.

In (“Walkovszky v. Carlton”), the defendant owned a Taxi company. He also established ten separate corporations which were under control and supervision of the main company. Each of ten separate corporations was holding the minimum amount of liability insurance of \$10,000 per taxi which was required by law, and William Carlton was stockholder of ten corporations. Although the companies were separate legal entities from the main corporation, they, indeed, were hold and run by Carlton and each corporation owned one or two taxis. As a matter of fact, all the corporations were operated as a single enterprise. One of corporation’s taxis negligently injured plaintiff (John Walkovszky) who was a pedestrian. Walkovszky sued against Mr Carlton alleging that Mr Carlton was personally liable for his damages because the multiple corporate structures constituted an unlawful attempt to defraud members of the public. So, the issue before the court was whether Carlton could be personally liable for the injury to a pedestrian because of under-capitalization and attempting to "defraud the members of the general public". The New York court of appeals refused to pierce the corporation’s veil because of undercapitalization alone. Judge Fuid held that Carlton could not personally be liable. He argued that if the corporation was used purely for personal benefits and not for the benefit of the corporation then that would be a basis for making the shareholder liable. However, as the judge pointed out, this is not the case here. A corporation even with a minimum amount of assets is a valid one and this point cannot be ignored.

In another law case (“DeWitt Truck Brokers v. W. Ray Flemming Fruit Co.”) Flemming’s company was operating as a broker between farmers and buyers of fruit. Flemming ordered a trucking company (plaintiff) to transport some fruit and assured the trucking company about its payment. He went further and stated that he would pay even if the company fails. However, Flemming didn’t act according to his promise and the disappointed trucking company sued Flemming and asked the court to hold him personally liable. Flemming argued that he was acting on behalf of the company and thus the corporation was liable and not him. However, the facts in the case showed otherwise. Firstly, Flemming owned most of the corporation stock; secondly, Flemming never had a shareholder meeting, and he was the only real director, thirdly, no one except Flemming ever got paid by the corporation and he kept withdrawing whatever money the corporation had for his personal use. Fourthly, the corporation basically had no capital of its own. Therefore, the district court found it was appropriate to “pierce the corporate veil” and make Flemming liable for the debts of his corporation. The case shows that a justifiable amount of risk of capital must be exist to the corporation and if the corporation is not properly capitalized, the personal liability to shareholders may be held⁸.

3. Recognition of Independent Legal Entity in the Iranian Legal System

Basically, the Iranian legal system, as other legal systems in the world, treats a corporation as a legal entity and has recognized independency of legal entity of a company from its shareholders and directors. Iranian Commercial Code has stated in this regard:

“All companies mentioned in this law, have legal entities⁹”

Independency of legal entity brings some legal effects. Firstly, a legal entity will have legal rights as well as legal duties. It has the power to sue and it is responsible for its actions and it can be sued, distinct from its stockholders¹⁰.

Secondly, the legal independence of a corporation supports shareholders from being personally liable for corporate debts¹¹. The independency of legal "person" status of corporations also causes perpetual life for the corporation which deaths of officials or stockholders do not alter the corporation's structure.

⁸ There are two more cases that illustrate this point in more detail and can be of interest to reader (“Juniper Investment Company v. United States”) (“Woodruff Construction, Llc v. Clark”)

⁹ Iran Commercial Code 1932, article 583

¹⁰ See Iran Civil Procedure 2000, articles 22 and 23 relating to how to bring actions against a company

¹¹ This point may have some exceptions relating to different types of companies. For example, article 94 of the Iranian Commercial Law 1932, relating to definition of a Joint Stock Company states: “A joint stock company is a company whose capital is divided into shares and the liability of its shareholders is limited to the par value of the shares respectively held by them”. Or article 94 of the Iranian Commercial Law, defines a Limited Liability Company (LLC) as private company which is formed by two or more people for trading purposes, and liability is limited to the payment of what is owed for shares.

The independency of legal entity of a corporation has also been recognized by some verdicts of the Iranian courts. In *S. T v. GH.M & Cooperative Company 2013*, the plaintiff who had paid some money to a cooperative company to build apartment for him, sued against directors of company and claimed his principal and interest payment because the company couldn't act upon its promise. The civil primary court held directors were responsible for this payment. However, the court of appeal reversed the verdict and held that the payment had been made to the company's account which has independent legal entity; and the action must be brought against the corporation and not the directors of the company¹². In other words, the court of appeal recognized the independency of legal entity of a corporation for bringing the action against it and not against its shareholders.

4. Duties and Liabilities of Corporations' Managers and Directors Provided in the Iranian Commercial Code

Having considered the Iranian Commercial Code, some duties and liabilities have been defined for directors of a company. Most of such duties are based on the statute of a company as well as law principles. If the director performed the duties in compliances with the statutory standard of conduct or in compliances with his or her fiduciary duties, the corporation will be protected by law and it will be treated as a legal entity. The Iranian Commercial Code has dedicated many rules (articles 107- 143) to directors' responsibilities, terms and requirements that they must hold to carry out such position. According to the said laws, directors must be from shareholders and in public companies there must be no less than five directors¹³. Directors must be appointed at general meetings and length of directorship must be determined in the articles of association¹⁴. A director or directors must have an appropriate number of shares to let them vote in the meetings. The shares act, indeed, as security in situations where shareholders need to claim against director for breaching duties¹⁵.

Regarding director's duties for diminution of capital, the Iranian Commercial Code provides:

"In the case of the loss of a minimum of half the company's capital, the board of directors is bound to call an extraordinary general meeting immediately, with a view to deciding whether the company shall be wound up or shall continue its operations"¹⁶.

"The directors and the managing director of a company are responsible either individually or jointly, as the case may be, vis-a-vis the company and third parties in respect of any infringement of legal regulations or the provisions stipulated in the articles of association or the minutes of general meetings. The court shall determine the scope of responsibility of each individual for indemnity purposes"¹⁷.

Director of a company will not be able to obtain any personal loans from the company or use security of the business to gain a personal loan. The Iranian Commercial Code provides has explicitly forbidden directors' act that may result in ambiguity in the activities of a company. The Iranian Commercial Code states in this regard:

"The managing director and the directors-with the exception of legal entities-will not be allowed to obtain any loan credit facilities from the company; the company will not be allowed to guarantee or assume the obligation of payment of their debts. Such transactions are void, ipso-facto. In the case of banks and financial and credit companies, the transactions mentioned in this article are permissible provided, however, that they are performed under prevailing normal terms and conditions. The prohibition mentioned in this article shall be applicable to the natural persons who represent legal entities at board meetings, moreover, the said provisions shall be applicable to the spouse, father, mother, ancestors, children, grandchildren, brothers and sisters of the persons mentioned in this article"¹⁸.

Even in the case of bankruptcy of a corporation, the Iranian court may hold director or directors liable. The Iranian Commercial Code provides in this regard:

"In the case of the loss of a minimum of half the company's capital, the board of directors is bound to call an extraordinary general meeting immediately, with a view to deciding whether the company shall be wound up or shall continue its operations. If the said general meeting turns down the winding-up of the company with observance of the regulations laid down in Article 6 of this Act, the company's capital will be decreased. If,

¹² Tehran Court of appeal branch 1, decree number 9209970220101581, date of issue Feb/2/2014

¹³ Iran Commercial Law 1932, article 107

¹⁴ Ibid, articles 108 & 109

¹⁵ Ibid, article 114

¹⁶ Ibid, article 141

¹⁷ Ibid, article 142

¹⁸ Iran Commercial Code 1932, article 132

contrary to the foregoing article, the board of directors has not called a general meeting or if the meeting is not convened in conformity with the regulations, any interested person may apply to the competent court for the winding-up of the company”¹⁹.

The director can only act within the scope of authorities conferred on him or her by the board of directors and he or she is considered to be a representative of the company and is authorized to sign on behalf of the company²⁰. Therefore, if a director of a corporation is authorized to sign contracts by limitation amount of \$10000, he or she can only act within that limitation and in the case of any violation of that limitation; director will be liable for the further amount.

Overall, it seems that the Iranian Commercial Code considers the role of director as an agent and trustee of shareholders. The director is obliged to safeguard the shareholder’s assets and must act according to the statute of the corporation as well as instructions applied in the general meetings. He or she is, indeed, is an agent who must act based on duties of an agent in the law, and in the case of doing any act of contravene the law and the statute of company, will personally be liable for his or her acts. In addition, the corporation will be at the risk of being pierced by the court decree.

5. Piercing the Corporation’s Veil in the Iranian Legal System

The Iranian Commercial Code has not directly considered the subject of piercing the corporation’s veil. However, there are other legal principles that may be considered while investigating cases in which the claimant claims the legal entity of a corporation has been misused and has caused damages to him or her. The basic principle which can be relied upon is fraudulent misrepresentation if director or manager of a company has used the corporation in a false way to induce another party. In this case, the party that is the victim of the misrepresented material may get out of a contract and may sue for pierce the corporation’s veil and claim any damages that may have occurred. However, there are some challenges and ambiguities to use of laws regarding the principle of fraud misrepresentation.

Basically, a corporation may be created either superficially or genuinely. Companies are created superficially if they don’t comply with legal requirements. For example, if companies do not file the necessary paperwork, or if they do not hold initial and annual director and shareholder meetings. If a corporation has been created superficially, it is a clear sign to prove that partners had no intention to create a real corporation, and this will be considered as misrepresentation, and therefore, the court can void corporate credential.

However, if a corporation has been created based on legal requirements and then it continues its works intentionally with some deviations and misuse from its legal requirements, this may be considered as a type of misuse of the law or fraud misrepresentation. Basically, proof of intention of fraud can be a legal challenge for plaintiffs. The intention can be inferred from statements, conducts and acts of defendants. Sometimes testimony of victims or witnesses as to how they have been misled by directors of a company can be admissible, and sometimes there are some correspondence between directors of a company and plaintiffs which show that despite the defendants knew victims were being misled, they continued operation of the business. There is no specific law in the Iranian Commercial Code relating to the outcome of conducts and behaviors of directors of a company who are intentionally misleading others, but it seems that some other laws may be referred for this purpose.

5.1 Voidness of a Contract for Misrepresentation

A contract may be voided with intention of evading from debts. Iran Civil Code states in this regard:

“If it is known that the contract has been made with the intention evading formally some liability, the contract will be null and void²¹”.

Typical grounds for a contract being void²² include coercion, undue influence, fraudulent misrepresentation²³, fraud or deviation of requirements that must be used in a specific contract, and such grounds may be made by a

¹⁹ Iran Commercial Code 1932, article 143

²⁰ Ibid, article 125

²¹ Iran Civil Code 1928. Article 218

²² The terms “void” and “voidable” and unenforceable contracts have common law origin and are used to show the degree of defect in contract. But there is, in contract law, distinction between void and voidable. A contract is considered void if it is against the law at every time of the doing and the law holds to be no contract at all as if the contract was never formed. A voidable contract, thus, is a ‘sick contract’ that may be “cured or killed” depending upon the option that may be exercised by the victim of the defective agreement. This distinction between void contracts and voidable contracts have been researched by (Nadew) and (Schaefer)

²³ In tort law, there are three types of misrepresentation that may be made fraudulently, carelessly or innocently. Fraud misrepresentation, that may lead to voidness of a contract, is a false statement that is made by someone who knows that it is a lie or disregards evidence that it is

natural person or a legal person. A contract that has been made by directors of a company with the intention evading formally some liability is indeed a voidable contract and the other party of such a contract can directly claim against such directors and demands from the court to void the contract. In *Azarbayejan Company v. East Azarbayejan Saderat Company Bank* (2016), court of appeal admitted the argument of plaintiff relating the contract that had been made between the plaintiff and the defendant (company bank). The plaintiff argued that the contract between the bank and the plaintiff didn't observe necessary requirements of the Law for Usury (interest) Free Banking²⁴, and therefore according to the Iran Civil Code²⁵, demanded the court to void the contract. The primary court held that the contract was made according to the Law for Usury Free Banking, but the Supreme Court reversed the decree and remanded the case to the primary court for reinvestigation and issuing the proper decree²⁶. In *Palic Company v. Qom Tejarat Bank* (2017), the plaintiff presented the similar argument and demanded for voidness of the contract. The primary court didn't issue order to void the contract but ordered that the plaintiff had paid its debts and the bank was not entitled to be paid extra payment²⁷. The cases show that if a financial corporation makes a wrongdoing in its contract, the proper decree can only result in the voidness of a contract or its amendment. Indeed, the Commercial Code has not provided a solution for such challenges and the courts have to refer to the Civil Code and the basic principles of law to judge.

5.2 Check Law

Iranian Check law has considered liability for anyone in a corporation who issues a nonsufficient fund check (NSF) and states:

“In the case that check has been issued by agent or delegation of holder of a bank account, whether natural person or legal person, both person issuing check and holder of bank account are jointly liable to pay the amount of check, and executive order and court judgment of compensation will be issued against both of account holder and person issuing check. In addition, person issuing check will bear criminal liability according to Check Law provisions unless proves that nonpayment of the check is subject to the act of account holder or the next agent, that in such a case, the person who has caused nonpayment of the check, will bear criminal liability²⁸”.

According to the above article, if a manager of a corporation signs a corporation check which has no fund in the bank account, he or she, and the corporation will jointly be liable, and creditor can file a lawsuit against them. In such case, the court will hold both corporation and manager jointly liable to pay the amount of check and pay prevailing party compensation. The rationale behind the above article is that the manager must have been certain of existing the money in the bank account while signing the corporation check²⁹. In other words, the manager of a company must observe and act according to the law of Check while doing his or her job in the company. Another article of Iran Check Law states in this regard:

“The person issuing the check must have sufficient fund in the bank and mustn't take out the entire amount or part of the amount of the bank account that he has issued his check based on that amount, and also he mustn't regulate

a lie. It occurs in a situation where an individual or entity has taken deliberate steps to intentionally deceive one or more parties. The deception may be involved issuing statements that are known to be untrue or to deliberately omit relevant facts or information that ultimately lead to some types of damages.

²⁴ Iran Banking system is based on the principles of Islamic law. There are two basic principles protect Islamic banking including sharing of profit and loss and, significantly, the prohibition of the collection and payment of interest. Collecting interest is not permitted under Islamic law. In September 1983, the Act for Usury (interest) Free Banking was approved by the parliament and then by the Guardian Council.

²⁵ The Plaintiffs referred to article 190 of the Iran Civil Code which provides: [For the validity of a contract the following conditions are essential: 1 - The intention and mutual consent of both parties to the contract....]. The plaintiffs in the said cases believed that their intention was to make partnership contract based on the Iranian Civil Code and the Law for Usury (interest) Free Banking while the bank financial company intended to obtain interest without any activity on specific area of work.

²⁶ Primary court Case number 940381, Tabriz Civil court branch 4, 2016

²⁷ Primary court Decree number 00969/96, Qom Civil Court branch 4, 2017

²⁸ Iran Check Law 1976 with amendments, article 19

²⁹ It is worthy of note that Not sufficient funds (NSF) may be applied, in most western countries, in two situations. First, there may be an issued check that a bank does not pass it because the checking account on which the check was drawn does not contain sufficient funds. The second situation may be applied where a person purchases with a debit card but there is not sufficient funds available in the checking bank account to pay the purchase price.

The corporation that issues a non-sufficient check (NSF) may be charged a big amount of fee by its bank. Sometimes, the bank has an overdraft agreement with its customer upon which if the customer writes a non-sufficient check (NSF), the bank will accept the check and pay its amount, and then the bank charges the customer an overdraft fee.

the check so that the bank, for noncompliance of signatures or scrawlings in the context of the check, or discrepancies in the contents of the check, and so on, withholds to pay³⁰.

Therefore, if a manager of a corporation issues a non-sufficient fund check (NSF), it means that he has been careless to observe the regulations of issuing the check. This is a reason that the court can pierce the corporation veil and give permission to the plaintiff to attach personal assets of a manager who has issued a non-sufficient fund check carelessly³¹. In a case of Packing Company A v. Mr H.T and company T, the plaintiff claimed that Mr H.T was liable for paying the amount of a check that was issued by him and his company. The plaintiff had, for 17 years, many transactions with Mr H.T who acted under cover of his company and indeed in all transactions Mr H.T was the principal party of the transaction. The court pierced the company's veil and held that Mr H.T was liable to pay the amount of the check. The decree was confirmed by the court of appeal³².

The above case shows that the pierce of the corporation is only applicable where a company has issued a nonsufficient fund check (NSF), and if a corporation issues other documents, there is no other law to rely on to pierce the corporation's veil.

5.3 Tax Law

Iranian Tax law has recognized liability of managers of corporations who have not paid corporation's tax. This law has stated in this regard:

“Managers of dissolved corporations, individually or jointly, for payment of legal entities tax income and taxes that legal entities are bound to deduct and payment and were related to their period of their management, have joint responsibility³³”.

Also, Iran tax law has also expressly stated that Iran Ministry of Economic and Finance, as well as Iranian National Tax Administration can prevent managers' exit from the country for debt tax during time of their management in the corporation³⁴. It is worthy of note that the Court of Administrative Justice³⁵ has issued a decree under which only the managers who have permission to sign the obligatory documents and checks may be liable for the corporation's tax³⁶.

6. Conclusion

While some other laws in the Iranian legal system have recognized liability for directors and managers relating to specific wrongdoings, the Iranian courts have to use the doctrine of pierce the corporation's veil if there has been serious misconduct and in a very specific situation. In addition, courts usually apply other legal tools, particularly those in the law of check and tax law and interpret the law broadly to include liability for directors or managers when they knowingly or intentionally use the corporation for their personal interests. However, lack of appropriate laws relating to application of the doctrine of pierce the corporation's veil in the Iranian Commercial Code may cause misapplication of the doctrine in cases and determining how to attribute liability to managers or directors of a corporation is a fact-specific inquiry which must be clarified by law.

³⁰ Iran Check Law 1976 with amendments, article 3

³¹ The problem, regarding joint liability of persons who issue a non-sufficient check, can be studied from another point of view, i.e. the nature of a check when it is issued. Check is a commercial negotiable instrument, i.e. unconditional promise or order to pay a fixed amount of money. The amount written on the document is a notation as to the specific amount promised and must be paid in full either on demand or at the specified time. A negotiable instrument can be transferred from one person to another. Most legal systems have provided provisions to give enough power to the holder of this type of document even if it is issued by two or more persons. In such a case, two or more persons who have signed check will have the same liability. (see Uniform Commercial Code, UCC,1952, 3-116). Also see French Monetary and Financial Code 2005, article 131-80)

³² Tehran Civil Court branch 35, Decree number 92000965, date: March/3/2014, confirmed by Court of appeal branch number 1, Decree number 9209970220101717

³³ Iran Tax law, article 1980. It is also worthy of note that, in Iran, like other countries, corporate tax imposed on the profits of companies which are trading and registered in the country. Corporation's taxable income can be classified in three groups: 1- Iranian companies that are resident in Iran, and they are taxed on their income derived from worldwide. 2- Iranian companies that are not resident in Iran and they are taxed in Iran on their income derived from Iran.3- If a foreign company registers a branch in Iran, such a branch will be taxed in Iran only on the profits derived from the work that has been done inside the country.

³⁴ Iran Tax Law, article 202

³⁵ According to the Iran Constitution Law, principle 173, “A court to be known as the Court of Administrative Justice will be constituted under the supervision of the Head of the Judiciary in order to investigate the complaints, grievances, and objections of the people in respect of government officials, organs, and statutes.

The jurisdiction, powers, and mode of operation of this court will be determined by law”.

³⁶ Case number: 91/139, Decree number 1909, date: 16/Feb/2015

It seems that the doctrine of veil piercing has been clearly adopted in most legal systems by their commercial laws which obviously determine the application of the doctrine in different situations. Since the foundation of corporations are similar in most countries and they follow similar legal base in their establishment, the notion of directors' misconduct and abuse of corporation need to be strictly clarified by commercial laws in order to protect corporations from other irrelevant laws. In addition, the methods that how the courts must apply the doctrine are important factors that may influence the area of commerce. Currently, we may see that how the doctrine is used, and arguably with different methods which may be misused. However, veil piercing needs a strong instrument in the Commercial Code to achieve justice as well as the right economic policy.

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