

Kluwer Arbitration Blog

The Effect of Bankruptcy on Arbitrations Seated in Iran: Practical Insights from a Recent TRAC Case

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Introduction

For the purpose of this article, there are some words and principles that shall be defined before raising the main issue.

Article 412 of the Commercial Code of Iran (CCI) defines the bankruptcy of an entity (natural or legal person) as the result of its cessation in payment of its debt. In this situation, the ceased entity, its creditor(s) or the prosecuting attorney can request the competent court to declare the bankruptcy of the company. Under Iranian law, it is particularly important to determine the exact date of cessation of the debtor in payment of its debts, because of the consequences and effects of such date. That is why, Article 416 of the CCI requires the court to determine the time of cessation, failing which, the date of the award will be deemed to be the date of the cessation.

The importance of the date of cessation is due to the fact that some major restrictions on the debtor will be triggered as of such date. Accordingly, Article 423 of the CCI introduces such transactions which are all common in one element: they could have damaging effects on the creditors' credits. For all other restrictions, the date of the bankruptcy award is the indicating date.

Iran's legal system differentiates between bankruptcy and other disputes that a bankrupt entity might have. Put differently, even if bankruptcy itself is not an arbitrable subject matter, the disputes that a debtor might have (including the disputes resulting from its bankruptcy) should be capable of being referred to arbitration.

The Arbitration Agreement and Bankruptcy

The crucial question is whether an entity whose bankruptcy is declared by the competent court is allowed to conclude any contract, including an arbitration agreement, with others or not. According to general provisions of the CCI, a bankrupt entity is prohibited from any action with regards to its properties, but the liquidator

should act as its successor. Although the scope of such legal incapacity is not clearly defined in the CCI, both practice and scholarship suggest that legal incapacity encompasses any action which might affect the rights of the creditors.

Although the CCI has no direct indication as to the arbitration agreement, considering the nature of bankruptcy and Iran's legal approach to centralize the process of liquidation (to the extent possible), one can gather that the bankrupt entity is not permitted to conclude an arbitration agreement. In addition, according to Article 454 of the Iran Civil Procedure Code (CPC), all persons who have the right to litigate should be able to refer their disputes to arbitration. However, this provision should be read in light of Article 84(3) of the CPC, which excludes those who are not capable of filing an action, among which a bankrupt entity is named. In conclusion, since the bankrupt entity is not able to litigate, according to the provisions of Article 454, it is not able to arbitrate either. Therefore, it is fair to suggest that such person is also banned from concluding an arbitration agreement.

According to Article 418 of the CCI, the liquidator is the successor of a bankrupt entity and has the required authority to act on its behalf, namely concluding any sort of contract, i.e. arbitration agreement.

The Effect of Bankruptcy on Arbitration Proceedings

Although the aim of an insolvency proceeding is to centralize the process of liquidation, there is always the possibility that an arbitration agreement was correctly concluded before such date, or the arbitration proceeding was initiated before the bankruptcy. In such situations and in regards to the legal capacity of the bankrupt entity for commencing or continuing the arbitration, two options might be envisaged. First, nullification of the arbitration agreement or termination of the arbitration proceedings and second, suspension of the proceedings until the succession of the liquidator.

Bearing in mind that Iran's legal system differentiates between the bankruptcy dispute and other disputes related to a bankrupt entity, termination of arbitration would not be an option. This approach is also supported by the fact that permission to terminate a proceeding (litigation or arbitration) due to the bankruptcy of a party does not exist in the written law.

Some practitioners and scholars, however, by invoking Article 481 of the CPC (which provides that the arbitration will be terminated as a result of the death or incapacity of one of the parties), suggest that bankruptcy should also be considered as a ground for termination.

This opinion, however, does not seem to be well-founded, because according to the CPC, bankruptcy is not considered a form of incapacity.

On the contrary, the provision of Article 419 of the CCI supports the second option, that is the suspension of the proceeding until succession of the liquidator:

“From the date of the bankruptcy award, any person who has any disputes, including movable or immovable disputes, against the bankrupt entity, it shall either file it or continue it against the liquidator. All the executive actions are included in this order.”

This provision has a general wording and is not limited to pending litigations against the bankrupt entity. Therefore, the same would apply in a pending arbitration or in an arbitration which has not yet been initiated.

All in all, while the bankrupt entity is not allowed to take any action affecting the rights of the creditors, the liquidator, as its successor, is permitted to conclude arbitration agreement on its behalf or initiate or continue arbitration.

A Review of a Recent Case under TRAC Rules

In a recent arbitration case under the Rules of [Tehran Regional Arbitration Centre \(TRAC\)](#), some issues of bankruptcy arose which are helpful to better understand the above-mentioned arguments.

Background

In an arbitration case under the [TRAC Rules of Arbitration \(2018\)](#), one year after the initiation of the proceeding (including the exchange of statements and holding two hearing sections) on the 8th September, 2019, the Tribunal declared the closure of the proceeding and further started their deliberation. While the deliberations were ongoing, the Tribunal, through press reports, became aware of rumors regarding the Respondent’s bankruptcy. A few days later, the Respondent informed the Tribunal that it went bankrupt. The Tribunal requested the Claimant to comment on the Respondent’s submission. The respondent, in response, attached the judgment of the court of first instance, and stated that the award is not final yet, but it is under the appeal proceeding.

The Tribunal’s Evaluation of the Facts

Although the judgment of the court of first instance was not final, as soon as the Tribunal received it, it decided to derogate from its decision on the closure of the proceeding, and reopen it. Such decision was based mainly on the date of issuance of the court’s judgment which was before the closure of the arbitration proceeding. Immediately after such decision, the Tribunal requested the Centre to communicate a letter, notifying the Insolvency Bureau of Tehran (‘Insolvency Bureau’) about the present arbitration, and organize a hearing session with the presence of their representative. The Respondent, after several weeks, provided the Tribunal with a copy of the appeal court judgment overruling the decision of the court of first

instance. After such final judgment was submitted, the Tribunal once again declared the closure of the proceeding and proceeded to render its final award.

Analysis of the Tribunal's Decision

In the case at hand, the Tribunal correctly decided that the date of bankruptcy (and not the date of cassation) is critical for any action. Additionally, the Tribunal decided that the provision of Article 481 of the CPC should not apply, mainly for the reasons stated above. In addition, if the Tribunal was of the opinion that Article 481 of the CPC could apply, they would have been unable to derogate from their decision on the closure of the proceeding and accordingly, reopen it because the arbitration was simply terminated and they did not have the required mandate. That is, the Tribunal's derogation could only (and correctly) be construed in line with Article 419 of the CCI, which allows for the continuation of the proceeding with the presence of the liquidator.

From the documents provided by the Claimant (which seemed insufficient), the Tribunal was not able to find out the exact date of the "final and binding" award of bankruptcy. Therefore, two scenarios could have been assumed:

First, if the final award was issued before the date of closure of proceeding, the Tribunal, by virtue of Article 419 of the CCI ought to have suspended the proceeding and invited the liquidator. In the case at hand, the tribunal correctly contacted the Insolvency Bureau because the liquidator was not yet determined or he was unknown to the Tribunal.

Second, if the final award of bankruptcy was issued after the declaration of closure of the proceeding (in accordance with Article 32 of the TRAC Rules), there was no obligation to suspend the proceeding and invite the liquidator.

By virtue of this provision, when the closure of the proceeding is declared, the Tribunal should assure that the parties have had sufficient opportunity to present their positions, proof and documents. After such declaration, the Tribunal will start its deliberation and the parties would not have further inference in the proceeding. Therefore, no party, including the liquidator, as the successor of the bankrupt entity, are required to be present.

In the case at hand, although the final award of bankruptcy was not issued before the closure date, the Tribunal (perhaps for the sake of utmost caution), decided to reopen the proceeding by virtue of the power allocated in Article 32(2) of the TRAC Rules, and invited the liquidator to participate.

Conclusion

The bankruptcy of parties is not recognized as a ground for termination of an arbitration proceeding under Iranian law. Article 419 of the CCI specifies that after

the date of issuance of the bankruptcy award, all legal actions shall be filed and all pending lawsuits shall continue against the liquidator. Although this provision is dealing with court proceedings, by analogy, the same provision can be applied to arbitration. Therefore, arbitrators coming across a bankrupt entity, shall invite the liquidator to participate in the proceeding.

In the recent case under TRAC Rules, the tribunal suspended the proceeding (thus changing its previous decision to closure of the proceeding), and further invited the liquidator to the hearing session. The reason for such actions was the date of issuance of the bankruptcy award and the date of the hearing. Since the court's decision (of which the Tribunal was not aware) was issued before the closure of the proceeding, the Tribunal decided cautiously to reopen the proceeding and invite the liquidator.

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