DIRECTOR'S DUTIES TO COMPANIES IN IRAN: WHAT IMPERFECTIONS EXIST AND WHAT COULD BE DONE BY WAY OF IMPROVEMENT?

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ABSTRACT

This thesis comprises a study about directors' duties in Iran, and examines whether they are in an acceptable state, whether there is any potential need to modify them and if so how could they be improved.

After providing an introduction to the study in Chapter 1, Chapter 2 provides a background to directors and their duties. There is an explanation of the different types of directors and an analysis of the nature of duties that can govern them and this is considered in relation to various jurisdictions. Chapter 3 focuses on Iran, explaining the types of directors' duties, the legislation in place for companies and apparent weaknesses of the current law on duties. The thesis includes an extensive empirical study, which is documented in Chapters 4 and 5. In Chapter 4 the process of the empirical research is set out, detailing the selection of semi-structured interviews, the process of selecting the interviewees, the development of the questions, the ethical review and the data collection process. Chapter 5 presents the core points of discussion from the interviews. Each point of discussion contains the various views of the interviewees to provide a complete sample of what the different groups of interviewees think about each subject matter. Chapter 6 considers the shortcomings of the law on duties in Iran and it does so by drawing on the doctrinal analysis in Chapter 3 and the empirical research data from Chapter 5. One of the aims of the chapter is to see whether any of the alternative practices from other countries researched could resolve Iran's problems. Recommendations are then suggested for potential reforms of

Iranian company law that could improve directors' duties. Chapter 7 completes the thesis with a series of concluding remarks.

The study concludes that the law on directors' duties in Iran has many flaws and that in order to ameliorate the state of the law there needs to be reforms to the legislation so that there is a comprehensive set of directors' duties, an introduction of the Business Judgment Rule and greater ease for minority shareholders to enforce breaches of duty.

Directors' duties are required, as duties are currently not adequately provided for in either or both of statutory law and Islamic sources. This has led to companies being expected to make up for this shortfall in law by including their own set of duties in their articles of association.

The inclusion of a duty of care is also advocated and to be accompanied by the introduction of a Business Judgment Rule. The introduction of the duty of care alone would be a substantial improvement, as it would allow for a greatly needed subjective and objective approach for assessing breaches. The utility of the Business Judgment Rule comes in to effect when directors need to defend themselves in circumstances where the company has suffered damage due to a decision they made with good intentions.

Developments to permit greater enforcement of breaches of duty are equally necessary as duties are only effective if there is suitable enforcement in place. Currently there are substantial barriers that prevent many actions being brought. These barriers, when removed would greatly enhance the ability of minority shareholders to bring actions against directors.

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CHAPTER ONE

INTRODUCTION

1.1 General Background

The existence of companies is a fundamental prerequisite to all economies around the world. Apart from fulfilling a service or providing a product, companies need to manage all elements of their businesses including finances, employees and often business premises in order to successfully navigate from one day to another. Behind the scenes of every company there are shareholders.[1] These are people who have paid in capital and have a financial interest in a company as well as often having a personal desire for a company to succeed. Apart from the shareholders there is also a director or a board of directors who are responsible for making all the important decisions on the company's behalf and deciding in which direction the company will be driven.[2]

Appointing directors is a task carried out by the company shareholders. The director occupies the most authoritative and powerful post in a company and appointing an individual with suitable qualifications, experience, skills and personality is often key to whether companies flourish or fail. A board of directors will be in charge of formulating strategic plans for a company and selecting the best use of the company's labour and financial

[1] P. Davies, *Introduction to Company Law* (Oxford: Oxford University Press, 2010), 60.
[2] A. Keay, *Board Accountability in Corporate Governance* (Oxford: Routledge, 2015), 189.

resources to promote the success of the business and provide benefits for its shareholders.[3]

Ensuring that directors are executing their role correctly is a concern that all shareholders have to face. In smaller companies shareholders may rely on their own vigilance to monitor directors. Larger companies in contrast will usually rely on non-executive directors to monitor the executive directors in jurisdictions with one-tier boards.[4] The main aid at the shareholders' disposal is the law in place in the relevant jurisdiction that imposes duties on directors. These duties stipulate how directors are to act in the course of discharging their role and they also prescribe the obligations that directors must meet. The company is owed these duties by both the executive directors and the non-executive directors.[5] These duties are often found in legislation, case law or religious law and they set out guidelines that must be complied with by directors.[6] Every jurisdiction differs to some extent in the way that they include directors' duties in their law.[7]

This thesis is dedicated to the study of directors' duties in Iran, a jurisdiction which is regarded as having a less than adequate provision for directors' duties. The selection of directors' duties as the subject of the thesis is due to the importance of the role that directors can play in aiding a country to improve their corporate governance and also in contributing to developing the economy. In regard to Iran, aspects that will be considered are the

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[3] A. Keay, *The Enlightened Shareholder Value Principle And Corporate Governance* (Oxford: Routledge, 2013), 11.
[4] R. Tomasic et al, *Corporation Law in Australia* (Sydney: Federation Press, 2002), 270 – 271.
[5] D. Kershaw, *Company Law in Context: Text and Materials* (Oxford: Oxford University Press, 2012), 319.
[6] Ibid.
[7] Ibid.

provision of the duties, the enforcement of the duties, the efficacy of the courts as far as commercial cases are concerned and the standards of practising directors. The purpose will be to consider the extent to which directors' duties are achieving their objective of ensuring that directors are executing their role correctly.

Selecting Iran was based upon its unique company law and its unique economic circumstances in the world.[8] The distinctiveness of its company law is due to the mixture of sources of law that it is comprised of, the fact that Iran is the only Shi'a country in the world and the lack of developments that have contributed to the law that exists today.[9] The uniqueness of Iran's economic circumstances are a result of years of isolationism in a world where globalisation has occurred, and this has, to a degree, left Iran behind. There are indications already that certain elements of duties require attention. Firstly, the company law that exists is not sufficiently extensive or comprehensive especially in terms of the statutory legal code for directors and their duties. Furthermore the researcher's experience leads her to the opinion that directors and shareholders often lack the necessary awareness of the law surrounding company activities. Moreover, there is a general understanding that the courts are not dependable due to too much governmental involvement.[10]

Through this study the researcher seeks to systematically address all the doctrinal sources that relate to directors and their duties. Empirical

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[8]A. Rehan, *The Iranian Revolution of 1979: Theoretical Approaches and Economic Causes* (Washington DC: The American University, 2008), 35 – 39.
[9] *Iran Company Laws and Regulations Handbook Volume 1 Strategic Information and Basic Laws* (Washington: International Business Publications, 2016), 26.
[10] Sh. Ilias, *Iran's Economic Conditions: U.S. Policy Issues* (Washington: Congressional Research Service, 2010), 11-19.

research will also be conducted in order to achieve a more thorough understanding of the situation that exists in the law and it's practical application in Iran. By acquiring a complete understanding of the situation the researcher will be able to identify the weaknesses that exist as well. When armed with these data, one can begin to understand the problems and ergo start to consider what mechanisms are required to ameliorate the situation.

The research will be directed towards an analysis in Chapter 6, which will detail the findings of the study. With the key weaknesses of Iranian Company Law exposed, the chapter will propose changes to the law. These suggestions that will be put forward by the researcher will be based on all the doctrinal and empirical research carried out. The findings and proposals in this analysis are the contributions offered by this piece of work to the existing literature on directors' duties and company law. The findings will serve as a reference for future students and legislators when considering potential reforms to Iranian directors' duties. It is hoped that the proposals might be taken into account in any reform of Iranian law.

The piece is a much-needed contribution to the current stock of literature on Iranian Company Law. There is a shortage of research on company law that needs to be addressed for Iran to be able to make informed decisions about advancing its legislation. Whilst company law research conducted in many jurisdictions is plentiful, research on Iranian company law is almost non-existent. In terms of directors' duties in Iran, this will be the first substantial piece written on the subject.

An additional reason why a greater stock of literature on Iranian Company Law is needed is due to the fact that the timing of this piece coincides with the removal in 2015 of the economic sanctions that had been applied to Iran.[11] This event more than any other in the last 40 years will ask questions of Iranian company law as international businesses weigh up the benefits and the risks of investing in this new market. The prospect of opening a business in Iran will require companies to consider the corporate governance practices of the country, the involvement of the State in companies, the law in place to protect shareholders, the judicial procedures for settling disputes and the enforcement of company law.

1.2 Research Question

The matters referred to in the previous section of the chapter leads me to pose this research question:

- Should directors' duties in Iran be modified and, if so, in what way?

In examining this issue I will explore to what extent factors inherent in a country, and Iran in particular, can be taken into consideration in regulating the duties of directors.

1.3 Aims

The first aim of this study is to explain the nature of directors and their duties. The second is to articulate and analyse the existing company law in Iran as it applies to directors' duties. Thirdly, the study endeavours to ascertain what the position is, as far as directors' duties are concerned, in practice in Iran. A major aim is to seek to identify weaknesses and problems

[11] C.A. Mokri & H. Biglari, 'A Windfall for Iran? The End of Sanctions and the Iranian Economy', *Foreign Affairs* (2015). Available online: https://www.foreignaffairs.com [Accessed 04/12/2015].

associated with the way that Iran tackles directors' duties and to suggest improvements or solutions to ameliorate the existing imperfections. In the course of the study the researcher aims to evaluate potential solutions to Iran's problems that might be offered by other jurisdictions, namely the UK, Australia, Hong Kong and China. The reasons for considering these jurisdictions are articulated in Chapter 2.

1.4 Contribution To Knowledge

There is an ample amount of literature that addresses directors' duties in many jurisdictions. This is the case in western countries with established legal systems where much academic research is carried out. In Iran however, and as mentioned earlier, there is a shortage of published material on company law and there is almost no literature that explicitly addresses directors' duties. Certain company law editions only contain sections on directors' responsibilities in companies. The principal texts are 'Company Law' by Mohamad Reza Paseban and 'Commercial Law (Company Law)' by Rabia Skinny and 'Commercial Law' by Hasan Hassani. These texts address directors' duties, however they lack depth to their coverage of the material. Their purpose in discussing duties is to provide an overview for the reader rather than a meaningful analysis.

Moreover, a lack of academic publications on Iranian directors' duties has resulted in a lack of knowledge on the subject inside and outside of Iran. More research carried out on this subject would work to address this problem. With the study being addressed from an empirical perspective and not solely through a doctrinal lens, new useful material will be provided on duties that can be referred to by future researchers. The value in the work is predominantly in Chapters 3, 5 and 6. Chapter 3 provides some new insights into the state of the law in Iran. Chapter 5 provides the findings from the empirical work and offers new first hand accounts of the views of professionals concerning duties. Chapter 6 contains an analysis of problems and weakness of the law, followed by suggestions as to potential solutions.

Iran has the status of a significant country on the global stage with a population of 77 million people and a considerable amount of trading capability.[12] It has some of the largest oil and natural gas reserves globally. As international trading becomes more common after the removal of the sanctions the requirement of having functional company law will increase.

1.5 Methodology

The study will implement a qualitative approach to explore the research question that has been presented and within this approach two methods will be utilised. Initially a doctrinal method will be adopted to research the law that exists at present in Iran, how that law came to be and what issues have emerged as a result of it. A doctrinal method will also be utilised to examine the legal practices of other jurisdictions. The method will involve the consultation of a variety of sources including journals, books, government reports, legislation, case law and periodicals. The empirical study is the second method to be employed and it will be used to enable the researcher to ascertain how the present law is functioning in Iran. It provides primary data about the current state of directors' duties in Iran. This will involve the use of semi-structured interviews conducted with law scholars,

[12] S. Kamali, 'Iran aims to ban vasectomies and cut access to contraceptives to boost births', theguardian.com (2015). Available online: https://www.theguardian.com/world/2015/mar/11/iran-ban-voluntary-sterilisation-contraceptive-access-block-boost-population [Accessed 10/09/2015].

judges, company directors of public, private and governmental companies, commercial lawyers, and company shareholders.

1.6 An Outline Of The Study

The study will commence with an analysis of directors and their duties. **Chapter 2** will begin this analysis by considering the various types of directors that are present in a company and their role within the company structure. The chapter will progress on to duties, examining the rationale behind them and what form they take. Reference will be paid to the law that is applied in the UK, Australia, Hong Kong and China in order to understand alternative applications of directors' duties. **Chapter 3** will focus solely on Iran, initially detailing the types of companies in Iran and how they sit within the broad spectrum of Iranian commerce. The chapter will detail the sources of company law in order to explain the origins of the current law on duties in Iran. Following on from this, it will be possible to highlight and itemise some of the various weaknesses in the law regarding duties. The empirical research will commence in **Chapter 4**. Beginning with an appraisal of the type of empirical research method, the chapter will move on to examining the theory of semi-structured interviews. Each interview question will be explained and rationalised. Following this and prior to providing an account of the research itself, the planning process will be discussed, a description of the communication with all the interviewees will be made and an account of the scheduling of interviews will be documented. Finally the chapter will detail the results of the research along with any issues that occurred during the process. **Chapter 5** will contain the presentation of the data collected in the empirical research. The data will be presented to show all the major issues that are present in the law on directors' duties. The chapter will explain how the data was analysed and coded. Point by point, each weakness that the data highlights will be presented along with the interviewees' comments on it. **Chapter 6** will provide an assessment of Iranian law in light of the doctrinal and empirical studies. The chapter will endeavour to put forward arguments for amendments to the law that could be introduced. These suggestions will be based primarily on the lessons learned from the jurisdictions considered in Chapter 2 and from any other source that might be appropriate. Finally, **Chapter 7** will conclude the results of the studies and it will explain the analysis as well as providing some recommendations for future research.

CHAPTER TWO

DIRECTORS AND THEIR LEGAL DUTIES

2.1 INTRODUCTION

Having set out the intentions for the thesis in Chapter 1, it is now necessary to begin the doctrinal research by exploring the role of the director within companies and the duties that accompany the position. It is important to develop an understanding of this material prior to moving on to discuss the Iranian position, which we begin to do so in Chapter 3.

In order to establish an understanding of the material and in particular the issues concerning the nature and importance of duties, the chapter will refer to various countries' law on duties and the basis for that law as examples. These examples have varying practices in place and possess different approaches to law and companies. The jurisdictions covered are two western countries with developed legal systems and two Asian jurisdictions that have recently introduced legal codes on duties. The UK was selected due to its prominence as having such highly regarded directors' duties. Australia was also selected due to it having a successful code that varies from that of the UK in certain facets as will be mentioned in the course of the chapter. The selection of Hong Kong was made based on its status as a jurisdiction that has transplanted directors' duties and has since had to regularly update it. Moreover, much like Iran, it has many large family companies. China was selected for similar reasons in that it has recently transplanted duties into its law. Furthermore, the example of China is useful in that it has, like Iran, a civil law system and it provides us with an example of how a civil law system had dealt with duties. Again it has another similarity to Iran in that it has many large state owned companies. It offers a contrast to the UK, Australia and Hong Kong, which are all common law jurisdictions, which have predominantly privately owned companies.

The chapter develops in the following way. After this introduction, directors are the focus of section 2.2 as there will be an expansion on the definition of directors, followed by an explanation as to the various types. Once a definition is in place, the types of directors will be the central consideration in this part of the chapter, with the greatest consideration given to the two principal types: executive and non-executive directors.

Having explained in detail the intricacies of who directors are, the study then proceeds to discuss theoretical frameworks relating to the relationship between directors and shareholders. This study will address briefly the two major theories in section 2.3 dealing with an explanation of how directors operate and what is their motivation. Agency theory (section 2.3.1) sets out the dilemma of personal interest set against professional interest and how directors can deviate from their duties by putting their own interests first. Stewardship theory (section 2.3.2) is based around allowing directors to apply their skills as professionals and to do the best job they can without destroying their motivation with constant monitoring from the board of directors or shareholders.

The study then proceeds to consider duties. There will be an examination of the rationale behind directors' duties, with an explanation as to exactly why directors have duties placed upon them and the consequences that would exist should they not be in place. Next there is a consideration of the issue of to whom do directors owe their duties. Following this there is an examination of the types of duties that exist and what they are designed to achieve. In this section the jurisdictions mentioned above are considered.

Having established the types of duties, the following three sections will consider three individual elements that form part of general duties. Consideration is given to the two broad duties of care and loyalty. First, the duties of loyalty are discussed. After that there is an examination of the duty of care, skill and diligence and in this context there is discussion of the Business Judgement Rule. Each of these sections will consider the basis for duties and the practices and legislation that relates to the duties in the four countries mentioned earlier.

Finally, there will be a discussion of the enforcement of breaches of duty. Many scenarios exist where directors can be accused of breaching their duties. Within this section both public and private enforcement mechanisms will be considered.

Following on from our analysis of directors and their duties, a conclusion (section 2.9) will tie together all seven sections of the findings providing an overview of the research and a foundation from which Chapter 3 can build upon where directors and their duties will be considered in regards to Iran.

2.2 THE MEANING OF DIRECTORS

Despite a company's identity existing as a unique legal entity, its existence is dependent on the actions of humans. Directors are those beings that are principally involved in the running of a company where they act as either a board, individually or in committees.[13]

Directors are considered by some to be the agents of the shareholders, however this is not a theory universally accepted as others regard directors as agents of the company entity, on whose behalf they act.[14] Directors are in a unique position in that they receive most of their instructions from the board of which they are members. The law has recognised this unique position and in many circumstances it will require the directors of a company to behave towards the company and its property in a manner that is similar to trustees and their trust.[15] For this reason, a director can be considered a fiduciary agent.[16]

2.2.1 Definition of Director

There is no universal definition of a director. In order to obtain an understanding of the meaning of a title that can encompass so much, it is necessary to refer usually to a relevant jurisdiction's legal code for a complete definition. For instance, in section 250 of the Companies Act 2006 (UK) a director is defined as,

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[13] *Re Baring plc* (No 5) [2000] 1 BCLC, 523.

[14] *Automatic Self-Cleansing Filter Syndicate Co Ltd v Cuninghame* [1906] 2 CH, 34. See also A. Keay, *The Corporate Objective* (Cheltenham: Edward Elgar Publishing, 2011), 105. See also A. Keay, *Directors' Duties* (Bristol: Jordan Publishing, 2014), 7. See also D. French et al*, Mayson, French & Ryan on Company Law* (Oxford: Oxford University Press, 2016), 629-632. See also L. Sealy & S. Worthington, *Cases and Materials in Company Law* (Oxford: Oxford University Press, 1996), 211-212.

[15] *Charitable Corporation v Sutton* [1742] 2 ATK, 400 & *Re Exchange Banking Company, Flitcroft's Case* [1882] 21 CHD, 519. See also R. Tomasic et al, *Corporation law in Australia* (Sydney: Federation Press, 2002), 321-322.

[16] *Charitable Corporation v Sutton* [1742] 2 ATK, 400.

> "Including any person occupying the position of director by whatever name called.[17]"

However the definition is limited in the sense that it does not state who directors are, but rather generally describes them as the person who carries out the jobs of a director.[18] Perhaps, from this definition, it is possible to surmise that directors are defined by what they do as opposed to what their job title is.[19] It is also clear that without formal appointment of the title it is possible for a person to be a director as long as that person is carrying out the role of director.[20] Therefore, for a person to be legally regarded as a director it is not necessary for that person to be appointed as long as they are carrying out that role.[21]

As directors are defined by what they do, it is fundamental that persons in this role realise the range of responsibilities that they have and the duties that they owe in order for the company to be able to function from day to day and also for it to progress.[22] Directors must also be aware that they are responsible for the company's actions and in certain circumstances they might be liable for certain effects of company actions.[23] This will not always be the case as typically a company will be liable for its own actions

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[17] Companies Act 2006. *Section 250* (Norwich: The Stationery Office).
Companies Act 1985. *Section 741(1)* (Norwich: The Stationery Office). See also Companies Act 1963. *Section 2(1)* (Norwich: The Stationery Office). See also Companies Act 1985. *Section 741(1)* (Norwich: The Stationery Office). See also Companies Act 1963. *Section 2(1)* (Norwich: The Stationery Office).
[19] Companies Act 2006. *Section 250* (Norwich: The Stationery Office).
[20] Companies Act 2006. *Section 250* (Norwich: The Stationery Office). See also *HMRC v Holland* [2010] 1 WLR, 2793.
[21] Companies Act 2006. *Section 250* (Norwich: The Stationery Office). See also *Re Hydrodam (corby) Ltd* [1994] 2 BCLC, 189. See also *Re Canadian Land Reclaiming Colonizing Co* [1880] 14 Ch D, 660.
[22]*Re Westmid Packing Services Ltd* [1998] 2 All ER, 124.
[23]Ibid.

despite those actions being chosen by the director. As a company is a separate legal entity,[24] directors will not have any personal liability.[25]

The standard practice of appointing the first director is for the person to be mentioned in the articles of association for that company.[26] Following this step, directors are appointed by a notice and they are named in the annual returns[27] that have to be filed with the relevant government agency that oversee companies or the registration of companies. In the UK it is the Registrar of Companies.

2.2.2 The Different Types of Director

As the director has a different role in the board, the classification of a director becomes significant. It is often not possible to find these designations mentioned under legislation that regulate companies. The Companies Act 2006 (UK) is a prime example. In practice the types of directors are the 'executive or full-time' director and the 'non-executive or part-time' director. There is not any legal difference between executive and non-executive director, but they play different roles.[28] The company employs the executive director as a full-time director but occasionally this type of director might not occupy a full-time role.[29] Non-executive directors are

[24] *Salomon v Salomon* and Co Ltd [1897] AC, 22.
[25] A. Keay, *Company Directors' Responsibilities to Creditor* (Oxford: Routledge, 2007), 4-10.
[26] Companies Act 2006. *Section 254* (Norwich: The Stationery Office).
[27] Companies Act 2006. *Section 255* (Norwich: The Stationery Office).
[28] Companies Act 2006, 'The Model Article for Public Companies,' Article 2, *Companies House* (2014).
Available online: https://www.gov.uk/guidance/model-articles-of-association-for-limited-companies [Accessed 08/02/2015]. See also D. Kershaw, *Company Law in Context: Text and Materials* (Oxford: Oxford University Press, 2012), 258-264.
[29] Companies Act 2006, 'The Model Article for Public Companies,' Article 23, *Companies House* (2014).
Available online: https://www.gov.uk/guidance/model-articles-of-association-for-limited-companies [Accessed 08/02/2015].

appointed as part-time directors.[30] There are also shadow directors, de-facto directors and de-jure directors, however for the purpose of this study it is not necessary to examine these, as it is only the executive and the non-executive directors that will be focussed on.

2.2.2.1 Executive Directors (EDs)

The King III report on Corporate Governance in South Africa[31] has provided a clear definition of executive directors. It states that the position involves day-to-day management of the company or being in the full-time salaried employment of the company (or its subsidiary) or both.

An executive director, through his or her privileged position, usually has an intimate knowledge of the workings of the company, while the non-executive directors do not.[32] There can, therefore, be an imbalance in the amount and quality of information regarding the company's affairs possessed by executive and non-executive directors.

The executive director is a leadership role for a company and often he or she fulfils a motivational role.[33] Executive directors motivate and mentor members, volunteers, and staff, and may chair meetings of committees. [34]

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[30] Companies Act 2006, 'The Model Article for Public Companies,' Article 23, *Companies House* (2014).
Available online:
https://www.gov.uk/guidance/model-articles-of-association-for-limited-companies [Accessed 08/02/2015].

[31] A. Banik et al, *Corporate Governance, Responsibility and Sustainability: Initiatives in Emerging Economies* (Berlin: Springer, 2016), 83.

[32] *Street Pty Ltd v Cott* [1990] 3 ACSR, 54. See also W. Bewaji, *Insider Trading in Developing Jurisdictions: Achieving an Effective Regulatory Regime* (Oxford: Routledge, 2012), 160-172.

[33] *Street Pty Ltd v Cott* [1990] 3 ACSR, 54. See also A.J. Dignam & A. Hicks, *Hicks & Goo's Cases and Materials on Company Law* (Oxford: Oxford University Press, 2011), 254-257.

[34] *AWA Ltd v Daniels* [1992] 10 ACLC, 933. See also W.L. Charles & R. Gareth Jones, *Strategic Management* (Mason (OH):South-Western, 2010) 393-410.

The Chief Executive Officer or 'CEO' leads the organisation and develops its organizational culture.[35]

Executive directors have extensive powers delegated to them by the articles of association of the company and these powers are usually formalised by contracts.[36]

2.2.2.2 Non- Executive Directors (NEDs)

The role of the non-executive director has evolved over the last 30 years or so.[37] In previous years non-executive directors were not accountable for any directorial responsibilities, however since the early 1980[s] there has been a growing awareness of the important strategic role they can play (an argument supported by groups such as 'PRO non-executive directors,' 'the organisation dedicated to the promotion of non-executive directors').[38] The basis for the development of the role of non-executive directors is attributable to the report of the Cadbury Committee in 1992.[39] The non-executive director's role has since developed into a more prominent position in the company.[40] This type of director contributes significantly in providing objective judgment on issues facing the company.[41] Also the degree of responsibility expected of non-executive directors has increased

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[35] *AWA Ltd v Daniels* [1992] 10 ACLC, 933. See also W.L. Charles & R. Gareth Jones, *Strategic Management* (Mason (OH):South-Western, 2010) 393-410.

[36] Whitehouse v Carlton Hotel Pty Ltd [1989] 5 ACLC, 421.

[37] *Northside Developments Pty Ltd v Registrar-General* [1992] 10 ACLC, 933. See also, R. Lilley, *Welcome on Board: Non-executive Directors and Primary Care Trusts* (Oxford: Radcliffe Publishing, 2002), 85.

[38] The Sponsors of PRO-NED: Accepting House Committee; Bank of England; British Institute of Management; The Committee of London Clearing Bankers; The Committee of Scottish Management; The Committee of London Clearig Bankers; Confederation of British Industry, Equity Capital for Industry Limited; Finance of Industry Plc.; the Institutional Shareholders' Committee; The London Stock Exchange.

[39] The Cadbury Committee (1992) *Report of the Committee on the Financial Aspects of Corporate Governance* (Section 131). London: Kogan Page Publishers.

[40] *Australian Securities & Investments Commission v Rich* [2009] NSWSC, 1229. See also, S. Griffin, *Company Law: Fundamental Principles* (Dorchester: Dorset Press, 2005), 279-82.

[41] *Daniels v Anderson* [1995] 13 ACLC, 614.

since the late 1980s in a number of jurisdictions due to court judgments and provisions in legislation.[42]

In other words, non-executive directors whose main occupation lies outside the company, have the role of offering an independent view to, and a broader outlook on many facets of company activity. These include the company's strategy, performance, resources, appointment selection and its standard of the conduct.[43] They play an important part in the company's decision-making and they may assist company management with specialised expertise or knowledge.[44]

Also, in the case of larger companies and particularly listed public companies, non-executive directors are seen as being able to protect the interest of shareholders and have been treated as an essential element in the UK's system of corporate governance.[45] For instance, the UK's corporate governance code requires that non-executive directors must serve on the board committees for audits, remuneration (of the executive directors) and appointments (of directors).[46] They have an important role in monitoring the work and stewardship of the company's executives and managers.[47]

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[42] *Northside Developments Pty Ltd v Registrar-General* [1992] 10 ACLC, 933. See also M. Wright et al, *The Oxford Handbook of Corporate Governance* (Oxford: Oxford University Press, 2013), 282-285.
[43] The Cadbury Committee (1992) *Report of the Committee on the Financial Aspects of Corporate Governance* (Section 4.11). London: Kogan Page Publishers.
[44] M. Wright et al, *The Oxford Handbook of Corporate Governance* (Oxford: Oxford University Press, 2013), 282-285.
[45] *Equitable Life Assurance Society v Bowley* [2004] 1 BCLC, 180. See also B. Tricker & R.I. Tricker, *Corporate Governance: Principles, Policies, and Practices* (Oxford: Oxford University Press, 2015), 325- 330.
[46] Financial Reporting Council (2016) *UK Corporate Governance Code* (Provision A.4) London: FRC Publications.
[47] Ibid.

A non-executive director, once appointed, will hold office for a period of time determined by the company's articles.[48] Under the revised UK Corporate Governance Code (the code only applies to listed companies) a non-executive director of a public company should not ordinarily serve beyond a period of six years and may not serve for a period in excess of nine years.[49] The company must, at least, have two non-executive directors and half of the company directors should be the non-executive directors.[50] Moreover, the non-executive directors can be the executive directors of others companies.[51]

One important reason for appointing the non-executive director is the size of company.[52] When the company is very small or recently set-up and cannot afford appointing a full time director, the alternative is to have non-executive directors who can bring the experience and skill of that person by saving the cost of a full-time employee.[53]

2.3 THEORETICAL FRAMEWORKS

This section considers theories concerning corporate governance and particularly the relationship between the shareholder and the director. There are four broad theories on this subject: stakeholder theory, sociological theory, agency theory and stewardship theory. Out of the four theories, there are two that are more relevant to this study as they offer contrasting views on

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[48] Companies Act 1985, 'Table A', Article 73, *Companies House*, 1985.
[49] Financial Reporting Council (2014) *UK Corporate Governance Code* (Provision B.2.3) London: FRC Publications.
[50] Financial Reporting Council (2014) *UK Corporate Governance Code* (Provision A.3.2) London: FRC Publications.
[51] P. Mantysaari, *Comparative Corporate Governance: Shareholders as a Rule-maker* (Berlin: Springer, 2006), 95-101.
[52] A. Keay, *Board Accountability in Corporate Governance* (Oxford: Routledge, 2015), 13.
[53] Ibid.

the level of trust and supervision that shareholders are to bestow on directors and how directors are to discharge their duties. Agency theory and stewardship theory are theoretical perspectives that have been advanced to understand how directors operate and to examine the functions and structures of the vital participants and organisations in corporate governance.[54]

In the eighteenth century, Adam Smith, took a dim view of the corporate form proliferating,

> "The company director, however, being the director rather of other people's money than of their own, cannot well be expected, to watch over it with the same anxious vigilance with which the partners in a private company frequently watch over their own. Like the steward of rich man, they opt to consider attention to small matters as not for their master's honour, and very easily give themselves a dispensation from having it. Negligence and profusion therefore must always prevail, more and less, in the management of the affairs of such a company."[55]

Smith was suggesting that directors would not apply the same level of care concerning the affairs of the business compared with their concern for their own affairs and money. With it being someone else's money they will treat it as such and it is possible that this approach will lead to cases of neglect or some ill fate for the company.

[54] A. Fernando, *Corporate Governance: Principles, Policies and Practices* (Delhi: Dorling Kindersley, 2009), 46-49.
[55] A. Smith, *The Wealth of Nations* (Indianapolis: Hackett Publishing, 1937), 380.

2.3.1 Agency Theory

In the later decades of the twentieth century, during the period of financialisation of the Anglo-American corporation, a theory was established[56] for considering the relationship between shareholders and directors.[57] Originally the first utterings of the theory can be dated back to dialogue about corporate governance in the 1930s however it was Jensen and Mekling's pioneering paper that broached the subject of agency theory as we understand it today.[58] Agency theory is based on a relationship that arises when principals appoint agents to act on their behalf. The principal, through deciding that they do not have sufficient time or ability to take up the role, appoints an agent with the appropriate skillset who commits to carry out the role on their behalf.[59] The shareholders therefore act as guides and supervisors of the execution of the director's duties and responsibilities.[60]

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[56] T. Clarke, 'The Role of Agency Theory and Maximising Shareholder Value-Thomas Clarke-centre for Corporate Governance'*, Law and Financial Marketing Review*, 8.1 (2014) 39-51. See also A. Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (Oxford: Routledge, 2012), 133.

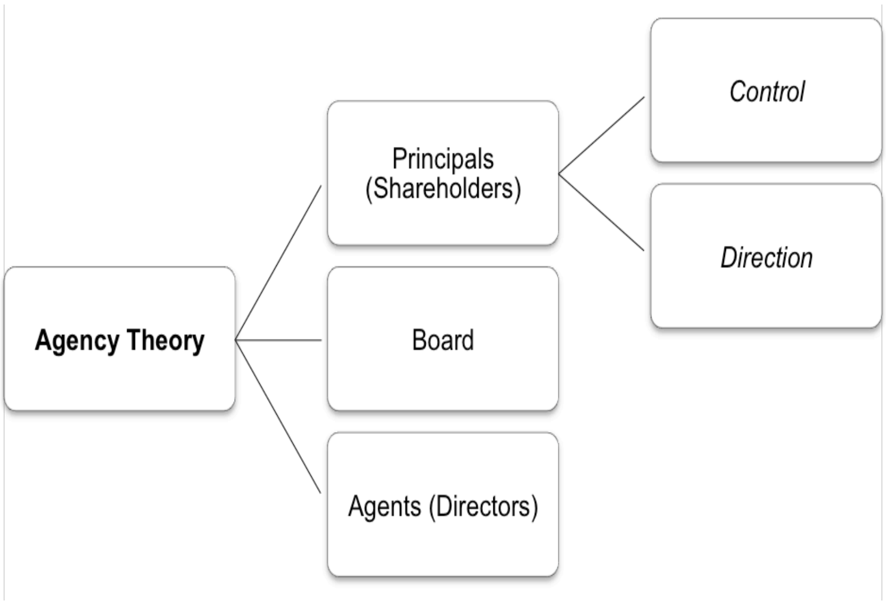
[57] O. Roche, *Corporate Governance & Organisation Life Cycle* (New York: Cambria Press, 2009), 12-13.

[58] M. Jensen & W. Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs, and Ownership Structure', *Journal of Financial Economics,* 3.1 (1976) 305. See also E. Fama, *Agency Problems and the Theory of the Firm,* Journal of Political Economy, 88.1 (1980) 228. See also E. Fama & M. Jensen, 'Separation of Ownership and Control', *Journal of Law and Economics*, 26.1 (1983) 301.

[59] J. Pratt & R. Zeckhauser, *Principals and Agents: An Overview,* in *J. Pratt and R. Zeckhauser, Principals and Agents: The Structure of Business* (Boston: Harvard Business School Press, 1985), 2.

[60] J. Matheson & B. Olson, 'Corporate Law and the Long-term Shareholder Model of Corporate Governance', *Minnesota Law Review*, 76 (1992) 1313-1328.

Figure 1: Agency Theory- Relationship



Jensen and Meckling understand the relationship to be,

> "a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some services on their behalf that involve delegating some decision-making authority to the agent."[61]

As the role of director is so broad in regards to the decision making and the actions that get made by the agent it is often not possible for a principal to be entirely aware of everything that the agent does. Thus there must be some control on the agent.

Since first broached, the theory has developed as more literature has been produced. In both practice and in research, agency theory is now regarded as the primary model within corporate governance.

[61] M. Jensen & W. Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs, and Ownership Structure', *Journal of Financial Economics*, 3.1 (1976) 305-308.

The conflict in the relationship of agent and principal can be reduced to two aspects. Firstly, principals can find it difficult to supervise directors. It can be expensive, time consuming and difficult to achieve this to a satisfactory level; this is known as agency cost. For this reason directors are made accountable for their actions and decision making to obligate them to execute their role as expected by the principals.[62] Secondly, directors cannot be trusted, as human nature dictates that they will always prioritise their own interests before the company's interests,

> "relying on reductionist assumptions of human motivation,[63] that directors, as they will know more about the details of the tasks that they are required to do,[64] and they are rational actors and self-interested utility maximisers, they will seek to benefit themselves, and so they cannot be trusted.[65] They will engage in self-dealing and/or shirking; they will have no incentive to maximise the interests of the shareholders,[66] and have no altruistic motives in anything that they do."[67]

This understanding of the relationship is a view shared by many. Keay states that despite both the director and shareholder being engaged in a

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[62] A. Keay & J. Loughrey, 'The Framework for Board Accountability in Corporate Governance', *Legal Studies*, 35 n2 (2015) 261. See also M Dooley *Two models of corporate governance*, Business Law, 47, 1992, 461-468.

[63] D. Pastoriza & M. Arinio, 'When Agents Become Stewards: Introducing Learning in the Stewardship Theory', *Journal of Business Ethics*, 118.1 (2013) 3-16.

[64] K. Kauppi & E. Raaij, 'Opportunism and Honest Incompetence – Seeking Explanations for Noncompliance in Public Procurement', *Journal of Public Administration Research and Theory*, 4.1 (2014) 4.

[65] J. Roberts, 'Trust and Control in Anglo-American Systems of Corporate Governance: The Individualising and Socialising Effects of Processes of Accountability', *Human Relations*, 54.1 (2001) 1547-1548. See also K. Eisenhardt, 'Agency Theory: An Assessment and Review', *Academy of Management Review*, 14 (1989) 57.

[66] A. Keay & J. Loughrey, 'The Framework for Board Accountability in Corporate Governance', Legal Studies, 35.2 (2015) 261. See also See also M. Dooley, 'Two Models of Corporate Governance', *Business Law*, 47.1 (1992) 461-468.

[67] J. Heath, 'The Uses and Abuses of Agency Theory', *Business Ethics Quarterly*, 19.1 (2009) 497-500.

cooperative venture, there will be conflict between both their interests. Another leading scholar[68] refers to agents as opportunistic actors given to self-interest seeking with guile.

When considering that the supervision of directors is often weak and also that directors are likely to pursue their own interests before the company's, it is not surprising that there are a host of situations that result in agency conflicts. Firstly, according to the Cadbury Committee's Code of Best Practice (1992),[69] agency problems can arise through directors pursuing their interests before those of the company. The solution put forward by the committee was for the accountability mechanisms in place to be as stringent as possible to ensure that there is no way for the directors to pursue such paths. The report also stated that the shareholders are considered as the company owners and they are the principals of the directors who act as their agents in operating the company's matters.[70]

Secondly, a great proportion of the responsibility for the financial crisis can be attributed to directors pursuing risky business ventures due to pressure exerted on them by shareholders.[71] A lack of supervision and a desire to generate fast returns for shareholders can encourage directors to take risks they otherwise would not pursue. Where long-term steady growth

[68]O. Williamson, *The Mechanisms of Governance* (Oxford: Oxford University Press, 1999), 171.

[69]The Cadbury Committee (1992) *Report of the Committee on the Financial Aspects of Corporate Governance* (Section 131). London: Kogan Page Publishers.

[70]R. Pilon, 'Capitalism and Rights: an Essay Toward Fine-Tuning the Moral Foundations of the Free Society', *Journal of Business Ethics*, 29 (1982) 31.

[71] B. Segrestin & A. Hatchuel, 'Beyond Agency Theory, a Post Crisis View of Corporate Law', *British Journal of Management*, 22.1 (2011) 484.

was perhaps the safe plan for the directors, pressure to succeed can lead them to pursue immediate results despite risky consequences.[72]

Directors as agents can also abuse their power by taking advantage of opportunities that come their way through their position as directors.[73] For instance if the chance to earn profit from an opportunity that was brought to their attention through their role as director arose, the director should decline it as it is a conflict of interest. However, they might pursue these opportunities if they are self-interested opportunistic agents that put their own interests before that of the company.[74]

A further issue that can often emerge between directors and shareholders is differences of opinion due to perspective.[75] The agent who is involved in the everyday dealings of the business has a different view to the principal who views things from afar and is kept up to date by the director periodically. It is arguable that there is an unbalanced access to information, as the director has a privileged role in understanding the business, which can lead to differences of opinion and also to the agent taking advantage. In fact, this means that the principals are at an unfair disadvantage when it comes to decision making since the agent will have more information. This is known as 'Information Asymmetry'.[76]

Having considered these three examples of how agency problems can occur, it is possible to see that they all involve situations where the interests of the agents and the principals are not aligned or when the agents operate

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[72] B. Segrestin & A. Hatchuel, 'Beyond Agency Theory, a Post Crisis View of Corporate Law', *British Journal of Management*, 22.1 (2011) 484.
[73] S. Wen, *Shareholder Primacy and Corporate Governance: Legal Aspects, Practices and Future Directions* (Oxford: Routledge, 2013), 59-61.
[74] Ibid.
[75] Ibid.
[76] C. Mallin, *Corporate Governance* (Oxford: Oxford University Press, 2013), 17.

without being controlled and monitored.[77] The result will be that the agents abuse their position through self-dealing or shirking.[78] In order to prevent these acts, the options are to have sufficient control over directors to prevent improper agency behaviour from occurring or alternatively to have sufficient accountability to act as a deterrent or to allow principals to claim against any agency behaviour that occurs. Increasing control over directors would come in the form of a board of directors being elected by the shareholders to assist the monitoring of the executive directors.[79]

Agency problems present a strong argument for why directors should be subject to duties. There are many scenarios in which companies can be impacted upon negatively due to the actions and decisions of directors. As previously mentioned, the job of the agent is to act on behalf of the principals. When an agent is not fulfilling his or her duties, the company is likely to suffer what is termed *'agency loss'* which means there will be a negative effect on the business.[80] When the agent returns to act in the interests of the principals, the *'agency loss'* will cease. A director being subject to duties allows for the company to be protected should any agency loss occur.

[77] S. Van Puyvelde et al, 'Agency Problems Between Managers and Employees in Non-profit Organisations', *Non-profit Management and Leadership*, 24 (2013) 63-64.
[78] M. Jensen, *Tests of Capital Market Theory and Implications of the Evidence*, (Bicksler: Handbook of Financial Economics, 1980), 305-360.
[79] A. Keay, 'Stewardship Theory, Directors and Board Accountability', *Unpublished Paper* (n.d) 1-15.
[80] J. Solomon, *Corporate Governance and Accountability* (Chichester: Wiley, 2007), 17-20.

2.3.2 Stewardship Theory

One theory that has been established to rebut agency theory in the last twenty years is stewardship theory, which is popular amongst many management scholars and some progressive corporate law scholars.[81] Unlike agency theory the principal concept of stewardship theory is that the directors will always place the interest of the company before their own.[82] As a steward, the director focuses on serving the company or the organisation, and in doing so subjugating his or her own interests.[83] When the director is appointed, there is the assumption that when the director begins their tenure, their objectives will be aligned with those of the principals.[84] Within the theory, the agent is regarded as reliable, trustworthy and consistently interested in performing to their highest potential.[85]

> "While agency theory posits individualism, stewardship theory adheres to collectivism."[86]

As the two theories both focus on the relationship between shareholders and stewards there are elements to the theories that contain similarities. Firstly, both theories regard agents as instruments to create and

[81] A. Keay, 'Stewardship Theory, Directors and Board Accountability', *Unpublished Paper* (n.d) 1-15.
[82] M. Huse, *Boards, Governance and Value Creation: The Human Side of Corporate Governance* (Cambridge: Cambridge University Press, 2007), 54-58.
[83] M. Hernandex, 'Toward an Understanding of the Psychology of Stewardship', *Academy of Management Review*, 37 (2012) 172-174.
[84] J. Davis et al, 'Towards a Stewardship Theory of Management', *Academy of Management Review*, 22.20 (1997) 29.
[85] A. Keay, 'Exploring the Rationale for Board Accountability in Corporate Governance', *Australian Journal of Corporate Law*, 29 (2014) 115.
[86] A. Keay, 'Stewardship Theory, Directors and Board Accountability', *Unpublished Paper* (n.d) 1-15.

increase shareholder wealth.[87] Also there is agreement that both theories attempt to explain the role and behaviour of the director in achieving firm goals.[88]

In contrast however, one difference is that stewardship theory is based on a model of managerial behaviour that departs from theories that are based on a conflict perspective of board organisation.[89] The theory holds that stewards' interests will not be based on promoting their own economic benefit but rather they will want to work to promote the best interests of the company. In working for the collective goal of the company's best interests they will be indirectly serving their own interests. Furthermore, it is considered in stewardship theory that the agent's interests are already aligned with those of the principal whereas in agency theory there is the constant need to monitor directors to measure the extent to which they are acting in the best interest of the company. The table below offers a comprehensive comparison between the two theories.

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[87] G. Davis, 'Agents Without Principals? The Spread of the Poison Pill Through the Interoperate Network', *Administrative Science Quarterly*, 36 (1991) 583-613.
[88] A. Keay, 'Stewardship Theory, Directors and Board Accountability', *Unpublished Paper* (n.d) 1-15.
[89] G. Maassen, *An International Comparison of Corporate Governance Models* (Amsterdam: Spencer Stuart, 2002), 72-77.

Figure 2: Comparisons of Agency Theory and Stewardship Theory.

Issues	**Agency Theory**	**Stewardship Theory**
Principles	- Reduce conflict of interest and Agency Costs. - Relationship between Principal and Agent is based on contract.	Agent works in the best interest of the company.
Scope	Narrow, External; focused on shareholder	Internal; Relationship between Principal and Agent.
Motivation	Personal	Selfless
Stakeholder	Shareholder	Directors
Outlook	External	Internal
Management Philosophy	Self-interested manager	The loyal Steward of asset
Discipline	Finance and Economic	Sociology and Psychology
Trust	Low; Employees are working averse and so they will shirk	High; Agents have an inherent partiality for loyalty
Time Frame	Short-Term	Long-Term
Theory Origin	1970	1990

Source: J. Davis, F. Schoorman and L. Donaldson, PETRANIX Corporate and Financial Communications AG, (2014). Available online: <http://www.petranix.com/en/index.php>, [Accessed 07/02/2015]. 'Toward a stewardship theory of management' (1997), The Academy of Management Review, 22 (1), 20-47.

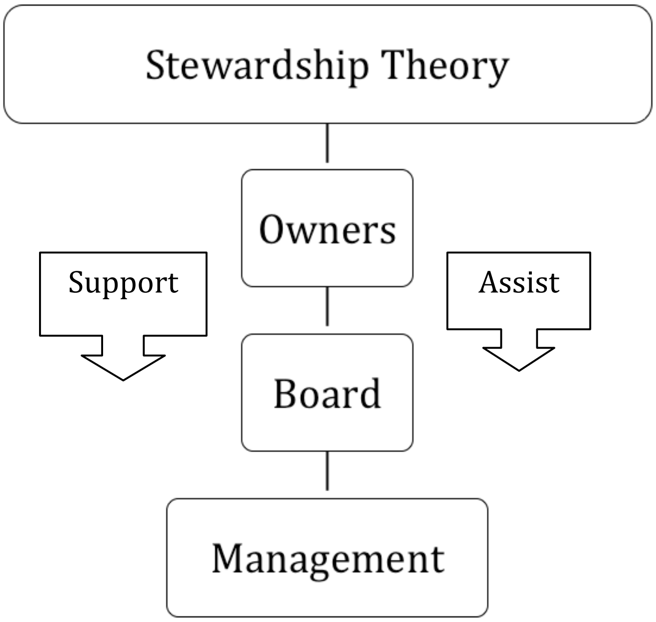
Having established the differences that set stewardship theory apart from agency theory it is necessary to elaborate further on this alternative non-economic premise for explaining relationships between shareholders and directors.

The idea of stewardship theory dates back to the 1930^s from the texts of debates between two leading law professors, Dodd and Berle.[90] Directors would consider themselves stewards of companies during the 1920^s to 1970^s, but it was only twenty or so years ago that organisational behaviour scholars have been credited with the development of stewardship theory.[91]

[90] A. Adolf & J. Berle, 'For Whom Corporate Managers are Trustees', *Harvard Law Review*, 44 (1932) 1365.

[91] L. Stout, 'On the Rise of Shareholder Primacy, Signs of its Fall, and the Return of Managerialism (in the Closet)', *Seattle University Law Review*, 36.1 (2013) 1169-1171. See also A. Keay, 'Stewardship Theory, Directors and Board Accountability', *Unpublished Paper* (n.d) 1-15.

Figure 3: The Principal Relationship of Stewardship Theory.



Trust is also a core ingredient of stewardship theory. Due to the director being regarded as a steward the principal will offer greater trust to the director/agent. The relationship between the agent and the principal will be based on collective goals and can develop in to long-term professional relationships built on trust.[92] When this type of relationship is created, loyalty is a common by-product.[93]

With the agent and the principal working in harmony the company can succeed as the organisation is being driven by one agenda that is in the company's best interest.[94]

The motivation for directors under stewardship theory is principally driven by their own standards to accomplish targets and take pride in their

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[92] R. Kluvers & J. Tippett, 'An Exploration of Stewardship Theory in a Not-for-Profit Organisation', *Accounting Forum,* 35 (2011) 275-277.

[93] R. Kluvers & J. Tippett, 'An Exploration of Stewardship Theory in a Not-for-Profit Organisation', *Accounting Forum*, 35 (2011) 276-277. See also A. Keay, 'Stewardship Theory, Directors and Board Accountability', *Unpublished Paper* (n.d) 1-15.

[94] S. Van Puyvelde et al, 'Agency Problems Between Managers and Employees in Non-profit Organisations', *Non-profit Management and Leadership,* 24.1 (2013) 63-65.

role. Their personal satisfaction is delivered through achieving results, improving in their role, developing skills, succeeding in challenging projects and gaining recognition from colleagues for their accomplishments. [95] Another motivational ingredient can be the responsibility the director has for the company's welfare and interests. Often this responsibility for the company's prosperity is the director's sole focus to the extent that its importance surpasses the director's own self-interest.[96] Personal sacrifice is a common feature for the director as their professional responsibility takes precedence over personal responsibilities.[97] From these motivations there is not a financial contributor that incentivises directors to adopt this approach. Instead of pursuing economic rewards, stewards are interested in performing their roles with honour and helping the company achieve its targets.[98]

Another incentive that is intrinsic to the motivation of the steward director is the association they see in their career progression being linked to the high standard execution of their roles. With this mentality, working for the

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[95] J. Davis et al, 'Towards a Stewardship Theory of Management', *Academy of Management Review*, 22.20 (1997) 20-47. See also K. Lambright, 'Agency Theory and Beyond: Contracted Providers' Motivation to Properly Use Service Monitoring Tools', *Journal of Public Administration Research*, 19 (2008) 207-210.

[96] M. Hernandex, 'Toward an Understanding of the Psychology of Stewardship', *Academy of Management Review*, 37.1 (2012) 172-186. See also T. Schillemans & M. Basuioc, 'Predicting Public Sector Accountability: from Agency Drift to Forum Drift', *Journal of Public Administration Research and Theory*, 25 (2015) 191- 208.

[97] J. Davis et al, 'Towards a Stewardship Theory of Management', *Academy of Management Review*, 22.1 (1997) 20.

[98] J. Davis et al, 'Towards a Stewardship Theory of Management', *Academy of Management Review*, 22 (1997) 20-28. See also D. Pastoriza & M. Arinio, 'When Agents Become Stewards: Introducing Learning in the Stewardship Theory', *IESE Business School* (2008). Available online: http://www.iese.edu/en/files/6_40618.pdf [Accessed 08/02/2015]. See also H. Tosi et al, 'An Empirical Exploration of Decision-making Under Agency Controls and Stewardship Structure', *Journal of Management Studies*, 40 (2003) 2053-2055. See also R. Kluvers & J. Tippett, 'An Exploration of Stewardship Theory in a Not-for-Profit Organisation', *Accounting Forum*, 35 (2011) 275-278; K. Lambright, 'Agency Theory and Beyond: Contracted Providers' Motivation to Properly Use Service Monitoring Tools', *Journal of Public Administration Research*, 19 (2008) 207- 221.

interests of the company will result in furthering the interests of the individual. It has been said that,

> "Their application in their roles and their loyalty cannot be considered as blind servitude but rather as their path to further their own best interests.[99]"

A prosperous company they direct is likely to reflect them as a competent and successful director.

It is arguable that duties are not needed within the context of stewardship theory, as the steward is not an opportunistic agent but rather an agent who will always work in the best interest of the company whilst also maintaining the business on an honest path free of conflict.[100] Duties principally exist for eventualities where directors fail to act to these standards so it is possible to question whether duties are needed should all directors act as loyal stewards. Whilst there is merit in this argument, stewards are not programmed to be perfect directors and the duties still have value in their role as a guide for directors to help them execute their roles as well as possible.

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[99] C. Daily et al, 'Corporate Governance: Decades of Dialogue and Data', *Academy of Management Review,* 28 (2003) 371-372.

[100] J. Plessis et al, *Principles of Contemporary Corporate Governance* (Cambridge: Cambridge University Press, 2010), 459-460.

2.3.3 Contrasting Theories

When applying the two theories to the practices of modern corporations I find that it is only agency theory that can create sustainable relationships between shareholders and directors across the broad spectrum of corporate structures.

The main objective in the relationship for shareholders is to have directors who do their jobs and pursue the best interest of the company. Agency theory sets out that the shareholder will monitor the directors and check that they are adhering to this guideline. Regularly checking up on directors is a sustainable model in that the shareholders gain regular information on the business, which should help them identify any issues from directors. Directors benefit as they will always be clear on their role and objectives as shareholders will intervene if they are doing anything they shouldn't be. Also the general knowledge of being monitored encourages directors to follow their guidelines and keep on a good path. In contrast, the freedom permitted by stewardship theory permits directors to stray from their course without it being noticed by the shareholders.

Secondly, an agency relationship is more suitable for dealing with breaches of duties should they occur. If a director does breach a duty then the breach is more likely to be noticed if there is regular supervision from the shareholders. Through regularly monitoring the directors, shareholders are better positioned to identify any potential breaches and they will be in the position to bring actions. If the directors have too much freedom as they would in stewardship theory then breaches can go unidentified and even covered up which is extremely damaging for companies.

In jurisdictions that do not have comprehensive duties in place, the benefits of agency theory are augmented. A director that is classed as a loyal steward who is not monitored and is also not subject to duties effectively is free to damage the company without liability. In jurisdictions that lack duties, it is especially important that directors are regularly and thoroughly monitored so that shareholders are aware of the decisions and actions being made by them.

Finally, a certain amount of trust has to be bestowed on a director because they are being empowered to run the company and direct it, but an appropriate degree of supervision is fundamental to ensuring that a director follows the guides of the shareholders and to safeguard against any miscreant actions or decision-making. Adopting a stewardship relationship of great trust on a presumption of loyalty from the directors is a practice that is more likely to result in damage to the company as directors can stray from their goals and responsibilities.

2.4 THE RATIONALE FOR DUTIES

Directors' duties are considered to be a fundamental element of company law. Duties are a set of obligatory legal guidelines designed to ensure directors do not act in a way that is not in the best interests of the company. A company's economic prosperity can be determined by whether directors execute their roles within the parameters of their duties. If they choose to not adhere to their duties it has an effect on third persons, not only shareholders but also constituents such as employees and creditors. The director's actions will not always be perfect as they are humans, however in their role they represent the company and the duties are also there to remind them of the approach that they must adopt.[101] Coupled with effective enforcement, the duties remind a director that they will face legal consequences should they not align themselves with the respective requirements of the law.[102]

Moreover, companies require certain things to happen constantly in order for their successful existence. They also need to be run in an honest way.[103] When someone is placed in the position of director they are placed in a position of power, trust and loyalty.[104] Without a strict list of duties, directors could allow their power to lead them along dishonest or unprofitable paths.[105]

The rationale is clear in that by having these duties in place, directors are incentivised to act properly and not to breach their duties, as they will be liable to the company for any such actions.[106] Now that it is clear why they would not want to breach their duties, it is also of significance why duties are needed in the first place.[107]

The shareholders are sometimes regarded as owners (and often creators) of the company and also the principals of the directors.[108] They

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[101] Companies Act 2006. *Section 170-177* (Norwich: The Stationery Office). See also D. Kershaw, *Company Law in Context: Text and Materials* (Oxford: Oxford University Press, 2012), 320-321.
[102] A.J. Dignam & A. Hicks, *Hicks & Goo's Cases and Materials on Company Law* (Oxford: Oxford University Press, 2011), 361-367.
[103] Companies Act 2006. *Section 172(2)* (Norwich: The Stationery Office). See also J. Honds, *Directors' duties in the Context of Insolvency* (Norderstedt: Grin, 2007), 3-5,21.
[104] Companies Act 2006. *Section 172(2)* (Norwich: The Stationery Office). See also J. Honds, *Directors' duties in the Context of Insolvency* (Norderstedt: Grin, 2007), 15-21.
[105] *Regentcrest plc v Cohen* [2002] 2 BCLC, 80.
[106] Companies Act 2006. *Section 171* (Norwich: The Stationery Office). See also A. Keay, *Company Directors' Responsibilities to Creditor* (Oxford: Routledge, 2007), 196-273.
[107]Ibid.
[108]S. McLaughlin, *Unlocking Company Law* (Oxford: Routledge, 2013), 40-43. See also A.J. Dignam & A. Hicks, *Hicks & Goo's Cases and Materials on Company Law* (Oxford: Oxford University Press, 2011), 309.

have the right to be comfortable in the knowledge that the business in which they have invested is in safe hands and will be run correctly.[109] When appointing a director they are employing a person to take care of an asset, which has a value. It is imperative that there are appropriate duties in place so that shareholders can know that the director is obliged to act appropriately and run the company properly.[110]

2.4.1 To Whom Do Directors Owe Their General Duties?

It is necessary to establish in this discussion to whom directors owe their duties, as it will impact upon the director's decision making and actions. The company, the shareholders, the majority shareholders and the creditors might all have different opinions in regard to how the company should be directed. The objectives of the director might differ depending on which one is owed the duties. For instance, if duties are owed to the creditors, they may require a director to pursue the avenue of returning the monies owed to them even if it may be to the detriment of the company's business. Alternatively, if duties are owed to the majority shareholder, then they might require a director to pursue an avenue that favours their interests over the interests of the shareholders collectively.

In reality, different jurisdictions have different approaches to defining to whom directors owe their duties. In the UK since the beginning of the twentieth century it has been established that duties are owed to the company, as can be seen from section 170(1) of the Companies Act 2006

[109] S. McLaughlin, *Unlocking Company Law* (Oxford: Routledge, 2013), 40-43. See also A.J. Dignam & A. Hicks, *Hicks & Goo's Cases and Materials on Company Law* (Oxford: Oxford University Press, 2011), 309.

[110] Institute of Directors, *The Director's Handbook: Your Duties, Responsibilities and Liabilities* (London: Kogan Page Publishers, 2010), 25-27.

(UK).[111] The usage of the term company in this section includes the collective shareholders within its meaning.[112]

Under common law, the notion of the duties being owed to the company was based on the decision of Swinfen Eady J. in 1902 in *Percival v Wright*.[113] Within this case the term 'the company' referred to the members of the company. In the case the directors failed to declare to the shareholders as a whole that certain shareholders had approached them offering the opportunity to purchase their shares at a time when secret takeover negotiations were going on. It was held that the directors were not in breach of any duty to the shareholders. The director owed their duty to the shareholders as a whole and the court took the view that premature disclosure of the takeover negotiations would have been damaging to the shareholders.[114] The position would have been different if the directors had made the approach to the shareholders, as it would have held that the directors were using their positions to pursue a cause in their own personal interest. As the court understood, however, the directors did not instigate this and in that moment they had no requirement to inform those shareholders of the undetermined takeover negotiations.

Since this approach came into being in the UK, it has also found acceptance in cases in different countries such as Australia and New Zealand.[115] Within the decision, it was also declared that directors do not

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[111] Companies Act 2006. *Section 171(1)* (Norwich: The Stationery Office).
[112] *Percival v Wright* [1902] 2 Ch, 421.
[113] *Percival v Wright* [1902] 2 Ch, 421. *Briess v Woolley* [1954] AC, 333. See also *Allen v Hyatt* [1914] 30 TLR, 444. See also *Esplanade Development Ltd v Drive Holdings Pty Ltd* [1980] WAR, 151.
[114] *Sharp and Ors v Blank and Ors* [2015] EWHC, 3220.
[115] *Coleman v Myers* [1977] 2 NZLR, 225. *See also Peskin v Anderson* [2001] 1 BCLC, 372. See also *Glandon Pty Ltd v Strata Consolidated Pty Ltd* [1993] 11 ACSR, 543. See also *Western Finance Co Ltd v Tasker Enterprises Ltd* [1979] 106 D.L.R, (3d), 81. See also

owe duties to the creditors, individual present or future shareholders and individual or collective employees of the company.[116]

The notion, captured in section 170(1), also can be seen in the case of *Multinational Gas and Petrochemical Co Ltd v Multinational Gas*.[117] In this case it was said that the directors do not owe any responsibilities to shareholders in order to act in the best interests of the company, as they owe only fiduciary duties to the company.[118] Also, Lord Cullen's view agrees with this point when he states that the company is the only master of the director.[119]

Whilst in the UK it is generally accepted that duties are owed solely to the company, there is also provision for specific cases in which the directors might owe their general duties to other persons besides to the company.[120] Take for instance the decision in *Peskin v Anderson*[121] which relates to shareholders. The Court of Appeal confirmed that special circumstances would be necessary to justify the imposition of fiduciary duties on directors to particular shareholders. Where a former member of the Royal Automobile Club Ltd (RAC) claimed that the director owed them a duty to disclose the details of a pending sale, the Court of Appeal dismissed the claim on the grounds that the directors only owed duties to the company. They furthered

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Esplanade Development Ltd v Drive Holdings Pty Ltd [1980] WA. See also *Brunninghausen v Glavanics* [1999] 46 NSWLR, 538.

[116] *Percival v Wright* [1902] 2 Ch, 421. See also *Boulting v Association of Cinematograph, Television and Allied Technicians* [1963] 2 QB, 606. See also *Re Neath Rugby Ltd (No 2), Hawkes v Cuddy* [2009] 2 BCLC, 427.

[117] *Multinational Gas and Petrochemical Co Ltd v Multinational Gas and Petrochemical Service Ltd* [1983] 3 W.L.R, 492.

[118] A. Dignam & J. Lowry, *Company Law* (Oxford: Oxford University Press, 2012), 403-415.

[119] Ibid.

[120] Ch. Shepherd & A. Ridley, *Company Law*, (Oxford: Routledge, 2015), 198-199.

[121] *Peskin v Anderson* [2001] 1 BCLC, 372.

the point stating that there needed to be special circumstances to justify the imposition of fiduciary duties on directors to specific shareholders.

Generally in common law countries, duties are owed to the company as a whole (including members) and it is only in the case of special circumstances where it can be held otherwise. It is not accepted that creditors are owed any duties by directors apart from in certain examples of insolvency in which the interests of creditors may replace the interests of the shareholders.[122]

In civil law countries there are various practices in place. Many countries follow the notion of the company as an entity being owed the duties, as can be seen in Germany and in France.[123] In the USA directors owe their duties to the corporation and its shareholders.[124] In Italy in contrast duties are owed to the company, the shareholders, the creditors and to third parties.[125]

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[122] C. Gerner-Beuerle et al, 'Study on Directors' Duties and Liability', *LSE Enterprise* (2013). Available online:
http://eprints.lse.ac.uk/50438/1/__Libfile_repository_Content_Gerner-Beuerle,%20C_Study%20on%20directors'%20duties%20and%20liability(lsero).pdf
[Accessed 20/01/2017].

[123] P. Davies, 'Board Structure in the UK and Germany: Convergence or Continuing Divergence?' *Journal* of *International and Comparative Corporate Law, 2* (2001) 435; C. Jungmann, 'The Effectiveness of Corporate Governance in One-Tier and Two-Tier Board Systems: Evidence from the UK and Germany' *European Company and Financial Law Review,* 4 (2006) 426.

[124] D. Polk & Wardwell, 'The Fiduciary Duties of Directors of Troubled U.S. Companies: Emerging Clarity', *Global Legal Group Ltd (*2008). Available online:
WWW.ICLG.CO.UK [Accessed 20/06/2008], 6-9.

[125] S. Triboldi, 'Italy: Pontecorvi Mannaerts & Triboldi,'. *PMT Studio Legale* (2015). Available online:
http://www.pmtlex.com/uploads/2012/10/Abstract-Directors-Liability_Italy.pdf
[Accessed 20/06/2008], 285-290.

2.4.2 The Types Of Duties

Directors' duties can generally be categorised as a duty of care and a duty of loyalty. The duty of care refers to the standard of care, skill and diligence a director is expected to apply in managing the company's affairs. The duty of loyalty refers to the directors' management of their personal interest alongside the interest of the company and in particular the prevention of jeopardising the company's interest through pursuing any conflicting personal interest they may have. When these duties coexist they are meant to ensure that directors act in the best interests of the company and that they act responsibly and carefully for the company's wellbeing. [126]

The duties are not necessarily different in their application between civil law and common law jurisdictions. In civil law countries the duties are often defined in broad terms with the duty of care having less specificity and the duty to avoid conflicts is less definitive.[127] In contrast in common law countries it is more common for a specific list of duties to be in place.[128] This is certainly the case for the duty of loyalty in the sense that it is specific in that it provides for many situations where the director's interests are in conflict or may potentially be in conflict with the interests of the company.

There are no clear divisions between the application of the duty of care between civil law and common law jurisdictions. In relation to both it is

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[126] A. Paolini, *Research Handbook on Directors' Duties* (Cheltenham: Edward Elgar Publishing 2014), 250-256.

[127] C. Gerner-Beuerle et al, 'Study on Directors' Duties and Liability', *ISE Enterprise* (2013). Available online: http://eprints.lse.ac.uk/50438/1/__Libfile_repository_Content_Gerner-Beuerle,%20C_Study%20on%20directors'%20duties%20and%20liability(lsero).pdf [Accessed 20/01/2017], 11.

[128] C. Gerner-Beuerle et al, 'Study on directors' duties and liability', *ISE Enterprise* (2013). Available online: http://eprints.lse.ac.uk/50438/1/__Libfile_repository_Content_Gerner-Beuerle,%20C_Study%20on%20directors'%20duties%20and%20liability(lsero).pdf [Accessed 20/01/2017], 9.

common to find a dual subjective and objective standard applied, however the comprehensiveness and the specificity does vary between jurisdictions.[129]

These two duties exist in different formats from one jurisdiction to another. It is useful to study the application of the duties in different jurisdictions and view the different approaches that are applied.[130]

2.4.2.1 United Kingdom

The Companies Act 2006 (UK) is the principal source of company law in the UK, and it is within this Act that the general directors' duties are located between sections 170 to 177. Previously being located in case law, the duties were moved to statutory law and organised into a codified scheme to present them in the most accessible way that the law allowed.

The duty of care, skill and diligence is in section 174 and it can be considered a detailed and specific version of the original duty of care. The duty of loyalty can be found within sections 171, 172, 173, 175, 176 and 177. These sections specify the core elements of the duty of loyalty. The diagram below sets out the general duties articulated in the Companies Act 2006 (UK) owed by the director to the company. [131]

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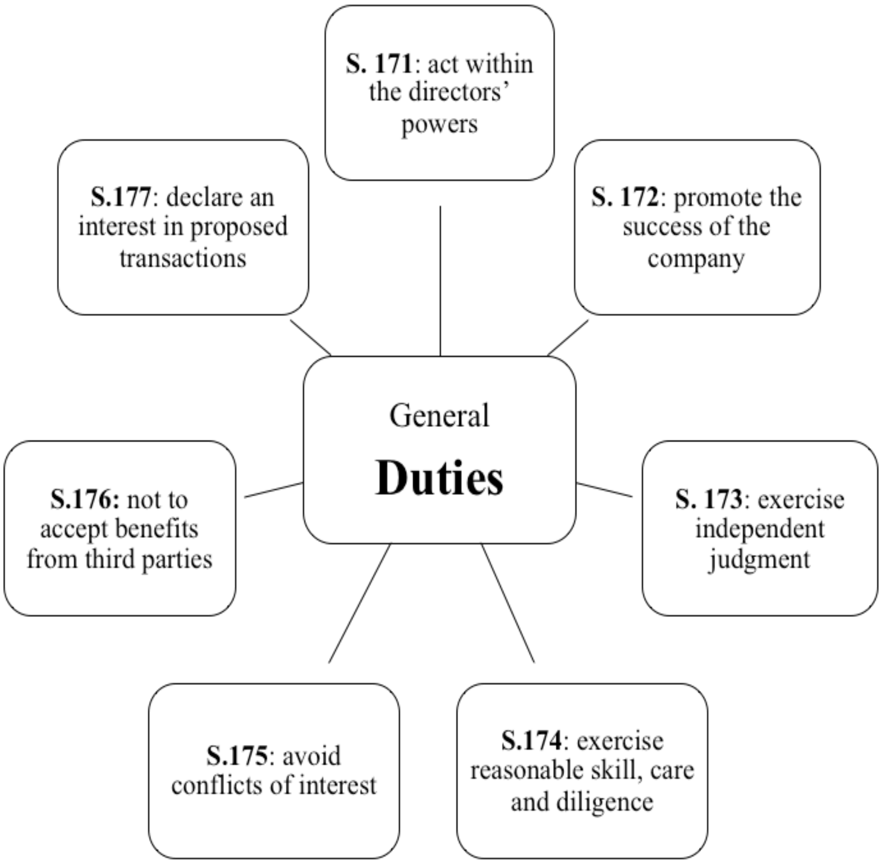
[129] C. Gerner-Beuerle et al, 'Study on directors' duties and liability', *ISE Enterprise* (2013). Available online:
http://eprints.lse.ac.uk/50438/1/__Libfile_repository_Content_Gerner-Beuerle,%20C_Study%20on%20directors'%20duties%20and%20liability(lsero).pdf
[Accessed 20/01/2017], 10.

[130] R. Dotevall, 'Is a Common Structure of Company Directors' Duties Evolving in the EU?' *European Business Law Review* (2016) 285.

[131] Companies Act 2006. *Section 170* (Norwich: The Stationery Office).

Figure 4: The General Duties of Directors according to the Companies Act 2006 (UK).



2.4.2.2 Australia

General duties in Australia are not too dissimilar to those found in the UK due to Australia being a former British colony and adopting English common law. Much Australian Company Law has mirrored the British pattern of legal development in respect of core legislation and concepts. Importantly Australian law has embraced most of the UK law on directors' duties.[132]

Australian Company Law is essentially contained in the Corporations Act 2001, and in company law rules and equitable principles. Directors' duties are provided for under both common law and statute, both operating

[132] Corporations Act 2001. *Sections 180 -185* (Canberra: Office of Parliamentary Counsel).

alongside each other. The statutory duties do tend to reflect those at common law. The Australian state 'Victoria' was the first Commonwealth jurisdiction to introduce statutory duties in 1958.[133] The other Australian states followed soon after.

The statutory duties were planned to give certainty to the law and also to impose a standard of criminality onto company officers. The duty of care is provided for in section 180 of Corporations Act 2001 and its application is no different to that in the UK. Within this section the Business Judgement Rule is also contained. The duty of loyalty again, in a similar way to the UK, is divided in to more specific duties, which can be found in section 181, 182, 183 and 184.[134] An overview of the duties can be seen in the table below.[135]

Figure 5: Sections 180 to 185 of Australian Corporations Act 2001.

Section 180	(1) Care and diligence. (2) Business Judgment Rule. (3) Business Judgment.
Section 181	(1) Good Faith and for the Proper Purpose. (2) Person involved in contravention.
Section 182	(1) Use of position; directors, other officers and employees.

[133] R. Baxt, *Duties and Responsibilities of Directors and Officers* (Sydney: Australian Institute of Company Directors, 2005), 81.
[134] Codification of directors' duties, first introduced into Australian legislation by The Company Act 1958 (Cth), was the first of its kind in English speaking world.
[135] This section was known as section 232 and was amended in 1992 to decriminalise its consequences and to make the standard of care objective for the courts and the regulators to enforce.

	(2) Person involve in contravention
Section 183	(1) Use of information; directors, other officers and employees. (2) Person involve in contravention
Section 184	(1) Good faith; directors, other officers. (2) Use of position; directors, other officers and employees. (3) Use of information; directors, other officers and employees.
Section 185	Interaction of Sections 180 to 184 with other laws ETC.

2.4.2.3 Hong Kong

The majority of the legal content and structure in Hong Kong was built during the period when it was a colony of the UK from 1842 to 1997.[136] It is no surprise that many facets of British law are reproduced within Hong Kong law.[137] Its company law legislation, since its early formation, was modelled quite extensively on the UK Companies Act,[138] and still continues to be so despite the fact that China now has jurisdiction over Hong Kong.[139]

[136] S. Shipp, *Hong Kong, China: A Political History of the British Colonies Transfer to Chinese Rule* (Jefferson (N.C): McFarland, 1995), 127-129.
[137] Y. Ghai, *Hong Kong's New Constitutional Order: The Resumption of Chinese Sovereignty and the Basic Law* (Hong Kong: Hong Kong University Press, 1999), 17.
[138] V. Stott, *Hong Kong Company Law* (London: Pitman Publishing, 1997), 6-10.
[139] T. Gomez & H.M. Hsiao, *Chinese Enterprise, Transnationalism and Identity* (London: Taylor and Francis Publisher, 2004), 130-133.

Company Ordinances that came into place in 1865, 1911 and 1932 in Hong Kong mirrored company law reforms enacted in the UK.[140] The changes established in the 1973 Second Report of the Company Law Revision, most of which were modelled on the UK 1948 Company Act, were implemented in the 1984 Companies (Amendment) Ordinance.[141] Following this the government established the Standing Committee on Company Law Reform (the SCCLR) to keep the legislation up to date.[142] The SCCLR's drive to update the law has led to the publication of the Companies (Amendment) Ordinance 2003.

Both the duty of loyalty and the duty of care are well provided for in the 2003 Companies Ordinance. The duty of care can be found in section 465 and the application of it is no different to that in the UK and Australia. The duty of loyalty again is spread between different sections. Article 33 is essentially the core duty of loyalty, however article 59 and article 60 are based around the duty of loyalty as well.

2.4.2.4 China

Directors' duties were first introduced in the PRC (the People's Republic of China) Company Law document of 1993 where duties were imposed on directors. The duties themselves were borrowed from German civil law and are as follows,[143]

- A duty of good faith

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[140] T. Gomez & H.M. Hsiao, *Chinese Enterprise, Transnationalism and Identity* (London: Taylor and Francis Publisher, 2004), 130-133.
[141] Ibid.
[142] T. Gomez & H.M. Hsiao, *Chinese Enterprise, Transnationalism and Identity* (London: Taylor and Francis Publisher, 2004), 130-133.
[143] Ch. Shi, *The Political Determinants of Corporate Governance in China* (Oxford: Routledge, 2013), 155.

- A duty not to divulge the company's secret information
- A duty not to engage in business that competes with the company
- A duty to misappropriate company information

As this set of duties was deemed to be inadequately comprehensive in terms of its provision on corporate governance and enforcement, the Chinese Securities and Regulatory Commission (CSRC) introduced further duties in the Code of Corporate Governance for Listed Companies. This code is derived from the OECD Principles on Corporate Governance and it is based around holding directors of listed companies to a higher standard.

The code includes,[144]

- A duty to diligently perform their duties for the best interest of the company and its shareholders.
- A duty to ensure adequate time and energy for the performance of their duties.
- A duty to attend board meetings in a diligent and responsible manner and express their opinion on the matters discussed.
- A duty to abide by the relevant laws, regulations, rules and the company's articles of association.
- A duty to fulfil the undertakings they make publicly.
- A duty to attend relevant training to familiarise themselves with rights, obligations and duties of a director, to know relevant laws, regulations, and professional knowledge required of a director.

China differs from other civil law jurisdictions in the specificity of its duties, as they can be considered quite precise in comparison. The formation

[144] Ch. Shi, *The Political Determinants of Corporate Governance in China* (Oxford: Routledge, 2013), 164.

of the Chinese duties was influenced by the existing duties in both the USA and the UK.[145] Regardless of this the Chinese duties are not quite as comprehensive as those of the UK or Australia and they can still be open to interpretation. As the enforcement mechanisms in place are not updated, again it is difficult for directors to be found in breach of these duties.

In terms of code surrounding liability for breaching duties the law fails to go far enough. Directors are only liable if their decisions are in violation of law as opposed to simply causing the company to suffer. This means directors can cause great damage to a company through breaching their duty of care, but they will not be liable.

The law was again modified in the 2005 Company Law amendment where a new chapter was introduced that set out qualifications and duties of directors. Articles 20, 21 and 149 deal with the shareholder and director relationship applying compensation laws should directors breach certain duties. The duty of loyalty and the duty of care exist in this edition, however it is considered that they are still not well defined and they are left open to interpretation. Additionally there are no enforcement mechanisms in place, which meant that directors could not be held accountable for breaches.[146]

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[145] Y. Wei, *Comparative Corporate Governance: A Chinese Perspective* (The Netherlands: Kluwer Law International, 2003), 114.
[146] Ch. Shi, *The Political Determinants of Corporate Governance in China* (Oxford: Routledge, 2013), 166.

2.5 Fiduciary Duties

The duty of loyalty, as already mentioned, exists in different formats in different jurisdictions. In the UK, Australia and Hong Kong, instead of the duty being a single duty, it has been separated into several more specific duties. These duties in many jurisdictions are not referred to as the duties of loyalty, but rather they form part of the fiduciary duties. This is the case in the UK, Australia and Hong Kong where the duties of loyalty have been included within the fiduciary duties catalogue. In other jurisdictions, fiduciary duties include all the general duties. In the USA, section 142 Delaware General Corporation Law for instance both the duty of care and the duty of loyalty are considered fiduciary duties.[147]

Loyalty is perhaps the most noticeable feature of fiduciary law.[148] It is often considered essential to fiduciary relationships, and within the fiduciary setting it has distinctive features. The loyal fiduciary will have the feeling that the well being of the object of his or her loyalty takes precedence over their own good.[149] A duty of loyalty obligates a director to subordinate his or her interest in order to promote the best interests of the company.[150] This is well demonstrated by the English Court of Appeal in both *Bristol and West Building Society v Mothew*[151] and *Item Software (UK) Ltd v Fassihi*.[152] As Millett acknowledged in the former case, a person is,

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[147] D. Block, N. Barton & S. Radin, *The Business Judgment Rule: Fiduciary Duties of Corporate Directors*, (Aspen Law & Business, 2002), chapter 2, Fiduciary duties of corporate Director.
[148] *Arklow Investment Ltd v Maclean* [2000] 2 NZLR 1, 4.
[149] Ibid.
[150] A. Keay, *Company Directors' Responsibilities to Creditor* (Oxford: Routledge, 2007),179-180.
[151] *Bristol and West Building Society v Mothew* [1998] Ch. 1, 18.
[152] *Fassihi and Ors v Item Software Ltd,* [2005] 2 B.C.L.C. 91, 104.

> "Not subject to fiduciary duties since he is a fiduciary; it is because he is subject to them that he is a fiduciary".[153]

In the case of Mummery LJ *in Tower v Premier Waste Management Ltd*,[154] the role of a director is defined in relation to their fiduciary commitments,

> "A director of a company is appointed to direct its affairs. In doing so it is his or her duty to use his or her position in the company to promote its success and to protect its interests. In accordance with equitable principles the special relationship with the company generated fiduciary duties on the part of a director. His or her fiduciary commitments to the company took the form of the duty of loyalty and a duty to avoid a conflict between his or her interests and his or her duty to the company."[155]

The first case of fiduciary duties can be traced back to the eighteenth century in the UK.[156] With the definition set out in *Tower* of the role, it is clear to see that even in the eighteenth Century the fiduciary position requires a director to 'promote the success of the company', 'protect the company's interests' and 'avoid conflicts of interests.' Since this moment fiduciary duties have been the core concept within Anglo-American law for addressing conflicts in the relationship of the directors and shareholders.

Apart from loyalty to the company another leading responsibility of directors in relation to their fiduciary role is to act *bona-fide* for the benefit of

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[153]In *Indata Equipment Supplies v. ACL* [1997] 2 WLR, 436, 18.
[154] *Towers v Premier Waste Management Limited* [2011] EWCA CIV, 923.
[155]*Bairstow v Queens Moat House plc.* [2001] EWCA CIV, 712, *Keech v Sandford* [1726] 25 ENG. REP, 223.
[156] *Leech v Sandford* [1726] Sel Case, Ch, 61.

the company.[157] As Davies has stated, the directors should act in the best interest of the company in terms of good faith.[158] That is, the directors must act the way that they honestly consider to be right.[159] As explained by the Appellate Division in South Africa,[160]

> "In common law, once a person accepts the appointment as a director, he becomes a fiduciary in relation to the company and is obliged to display the utmost good faith towards the company and in his dealing on its behalf."[161]

From considering the types of duties in the countries studied for this thesis, it is clear that China does not subscribe to the idea that fiduciary duties are a requirement of setting out duties. On the whole, it is possible to see that while fiduciary duties were not known to civil law systems, in many civil law and mixed civil and common-law jurisdictions, the idea of being a fiduciary[162] has in recent decades come into its own via legislation[163] and it is becoming increasingly common for them to be introduced.[164]

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[157] J. Parkinson, *Corporate Power and Responsibility*, Issue in the Theory of Company Law (Oxford: Oxford University Press, 1993), 73.
[158] Ibid.
[159] Ibid.
[160] *Howard v Herrigel NO and Ors* [1991] (2) SA 660 (A), 678.
[161] Ibid.
[162] A fiduciary is they who are bound to uphold the interests of the ultimate beneficiary or investor based on the idea of 'trust'.
[163] L. Smith, *The Worlds of the Trust* (Cambridge: Cambridge University Press, 2013), *304-310.*
[164] Ibid.

2.5.1 United Kingdom

The mid-nineteenth century was a critical period in the development of common law rules and equitable principles, and it was in this time that directors' duties first emerged.[165]

In the UK there are, as we have seen, provisions that cover six fiduciary duties.[166] These reflect the duties that are provided for in many jurisdictions around the world.

Figure 6: Section 171 to 177 (Fiduciary Duties)

Fiduciary Duties, The Companies Act 2006 (UK)	
SECTION 171	Duty to Act within Powers
SECTION 172	Duty to Promote the Success of the Company
SECTION 173	Duty to Exercise Independent Judgment
SECTION 175	Duty to Avoid Conflicts of Interest
SECTION 176	Duty Not to Accept Benefits from Third Parties
SECTION 177	Duty to declare interest in proposed transaction or arrangement

2.5.1.1 Duty to Act within Powers and to use Power for Proper Purposes

Powers are provided to a director to enable them to effectively execute their role and lead the company.[167] Without such a level of authority they would not be able to carry out the necessary management and running

[165] A. Keay, 'The Duty to Promote the Success of the Company: Is it Fit for Purpose', *SSRN* (2010). Available online: https://papers.ssrn.com/sol3/papers.cfm?abstract-id=1662411 [Accessed 12/06/2015].
[166] Companies Act 2006. *Section 170-177* (Norwich: The Stationery Office).
[167] Companies Act 2006. *Section 171* (Norwich: The Stationery Office).

of the company.[168] Whilst the purpose of entrusting the director with powers is to enable them, the duty to act within powers is there to make sure these powers are not abused.[169] Directors must not act or enter into any transaction, which is illegal or compromises the integrity of the company, and they must not, without the sanction of the members in a general meeting, do any act or enter into any transaction that is beyond the powers conferred on directors by the articles.[170] As it is apparent in section 171 of the Companies Act 2006 (UK), the two channels to the duty are that,

> "A director must-
> a) act in accordance with the company's constitution, and
> b) only exercise power for the proper purposes for which they are conferred."

This section is founded on an equitable principle.[171] Under section 171(a) the scope of the power given to the director is determined by the company's constitution. When the director acts outside of the constitution they are in breach of this duty and in simple terms they have overstepped the terms of their mandate.[172]

Additionally, under section 171(b) directors may not use their power in a way that can cause the company a loss. In particular cases, the execution of power that extended beyond the confinements of a company's constitution can be considered fraud on the part of the director.[173] This underlines the

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[168] *Re Sherborne Residents Co Ltd* [1987] BCLC, 82.
[169] *Ultraframe Ltd v Fielding* [2005] EWHC, 1638.
[170] See also *Selangor United Rubber Estates Ltd Craddock* (No 3) [1968] 1 WLR, 1555.
[171] See also *Selangor United Rubber Estates Ltd Craddock* (No 3) [1968] 1 WLR, 1555. See also *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC, 821.
[172] Companies Act 2006. *Section 171(a)* (Norwich: The Stationery Office). See also *Percival v Wright* [1902] 2 Ch, 421. See also B. Hannigan, *Companies Act* (Oxford: Oxford University Press, 2012), 159-163.
[173] *Spackman v Evans* [1868] LR 3 HL, 171.

importance of the company constitution in UK Company Law and its role in defining the extent of the director's power.[174] On the whole, the duty to act within powers defined in the company constitution does not feature greatly in common law cases.[175] An integral channel of the duty is that directors must use their power for a proper purpose.[176] As statutory law is not sufficiently extensive on this duty, the case law is relied upon for determining many cases.[177] If the articles stipulate that a director can use a particular power, the director can be challenged if when using the power, they use it for a purpose other than that which the articles intended it be used for.[178]

Also under the model articles of association,[179] the powers of management are vested for the purpose of directing the affairs and associations of the company.[180] Directors should not therefore use their authority to interfere with or undermine the shareholder's rights. Nor should they for instance, use their authority to issue shares to frustrate a takeover bid.[181] The duty imposed on directors to act *bona-fide* in the interest of the company is open to subjective interpretation by directors.[182] For this reason they must be aware to not employ their power to affect any improper purpose

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[174] *Spackman v Evans* [1868] LR 3 HL, 171.
[175] L. Smith, *The Worlds of the Trust* (Cambridge: Cambridge University Press, 2013), *306-315.*
[176]Ibid.
[177]Ibid.
[178]L. Smith, *The Worlds of the Trust* (Cambridge: Cambridge University Press, 2013), *306-315.*
[179] Companies Act 2006, 'The Model Article for Public Companies,' Article 3, *Companies House*, (2014). Available online: https://www.gov.uk/guidance/model-articles-of-association-for-limited-companies [Accessed 08/02/2015].
[180]Ibid.
[181]*Hogg v Cramphorn* [1967] Ch, 2542. See also *Harward Smith Ltd v Ampol Petroleum Ltd* [1974] AC, 821.
[182]*Hunter v Senate Support Services Ltd and Ors* [2004] EWHC, 1085.

under the guise of *bona-fide* action in the company interest, particularly where the director's personal interest stands to be enhanced.[183]

In scenarios in which it is claimed that directors have not exercised their power for legitimate managerial purposes, the courts will review the facts to identify their genuine purpose.[184] For instance, directors should not enter into long-term management contracts that are designed to reduce the shareholders' power to appoint new directors.[185] Moreover they should not enter into contracts that trigger improper obligations in the event of the takeover bid, the so-called poison pills, a strategy designed to discourage a takeover.[186] As typically the director will claim that their actions were made in the best interest of the company, the courts will consider whether their actions were so urgent that it prohibited them from acquiring authorisation from the board and forced them to act outside of their powers for the interest of the company.[187]

2.5.1.2 Duty to Promote the Success of the Company

The duty to promote the success of the company originates in the equitable principle that the directors must act *bona-fide* in what they consider to be the best interest of the company as a whole.[188] This requirement includes a broad definition of the company as a whole as directors have to make decisions factoring into account the following,

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[183] *Ashburton Oil NL v Alpha Minerals NL* [1971], 123 CLR, 614.
[184] *Teck Corp. v Miller* [1972] DLR (3d), 288.
[185] *Lee Panavision v Lee Lighting* [1992] BCLC, 22.
[186] *Criterion Properties v Stratford* [2004] UKHL, 28.
[187] *Re McCarthy Surfacing Ltd* [2009] 1 BCLC, 622.
[188] *Re Smith and Fawcett Ltd* [1942] Ch, 304. See also *Item Software v Fassihi* [2004] EWCA Civ, 1244.

> "(a) the likely consequences of any decision in the long term,
> (b) the interests of the company's employees,
> (c) the need to foster the company's business relationships with suppliers, customers and others,
> (d) the impact of the company's operations on the community and the environment,
> (e) the desirability of the company maintaining a reputation for high standards of business conduct, and
> (f) the need to act fairly as between members of the company."

It is only in the latest edition of the Companies Act that the meaning of the company was specified as the 'company as a whole' as previously the duty was to the company as a separate legal entity.

The duty itself can be considered subjective in that the director is making the decisions and it is they who are weighing up whether something is in the best interest of the company as a whole.[189] There is not an assessment of whether a decision was right or wrong as far as the interests of the company are concerned, but rather an assessment of whether the director believed they were making a decision in the best interests of the company.[190]

If directors are found to have made a decision that is not in good faith to promote the success of the business then their actions are open to challenge and they will also have to personally compensate the company and pay it for any loss.[191]

[189] *Scottish Co-operative Wholesale Society Ltd v Meyer* [1959] AC, 324.
[190] *Regentcrest plc v Cohen* [2002] 2 BCLC, 80. See also *Fassihi and Ors v Item Software Ltd,* [2004] EWCA Civ,1244.
[191] *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] A.C, 821.

2.5.1.3 Duty to Exercise Independent Judgment

Directors must use their own judgment managing the day-to-day running of a company and not execute actions based on the interests or desires of others.[192] The duty could be included as part of the general duty to act in good faith, as part of the duty to exercise care, skill and diligence or as a component of not pursuing conflicts of interest. It has been deemed as necessary to have it itemised as its own duty and that is how it is presented in the statute. Section 173 of the Companies Act 2006 (UK) states,

> 1. "A director of a company must exercise independent judgment.
> 2. This duty is not infringed by his or her acting—
>
> a) in accordance with an agreement duly entered into by the company that restricts the future exercise of discretion by its directors, or
>
> b) in a way authorised by the company's constitution."

This duty reflects the equitable principle that fiduciaries must refrain from being influenced by other parties. In other words, directors should not allow external pressures to compromise their decision-making integrity.[193]

Directors may breach their duties by following the advice of external individuals rather than reaching their own decision.[194] Also, nominee directors representing a particular shareholder must not just follow the directions of their nominator, if to do so would not be in the best interests of

[192] *Fulham Football Club v Cabra Estates plc* [1992] BCC, 863.
[193] Companies Act 2006. *Section 173* (Norwich: The Stationery Office).
[194] *Bishopsgate Management v Maxwell* [1993] BCC, 120. See also *Re Simmon Box (Diamonds) Ltd* [2011] 1 BCLC, 176.

the company.[195]

Directors can act on the instructions of third parties despite the fact that the third party is not a shareholder. These situations can occur when a holding company appoints directors to the board of a subsidiary company. Alternatively when a class of shareholders or a debenture-holder is given the power to appoint a director. In these situations the appointed director must make the shareholders aware of the nature of their appointment and it must have the approval of the company.[196]

2.5.1.4 Duty to Avoid Conflicts of Interest

Directors may have conflicts between their own interests and the interests of the company. A conflict of interest can be articulated as a rule that forbids a director from misusing a company opportunity and/or assets directly or indirectly for his or her self-interest, which is covered in section 175(2) of the Companies Act 2006 (UK). A director is not to have a personal interest that is in conflict with that of the company. When circumstances arise where the director has a personal interest in a company relationship or transaction, he or she can disclose the interest to the other directors of the company and get the board to authorise the conflict.[197] This duty applies to the misuse of any asset, information or opportunity.[198] If the board authorises the director to pursue the course, then it will not be deemed to be in

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[195] *Selangor United Rubber Estates Ltd Craddock* (No 3) [1968] 1 WLR, 1555; *Kuwait Asia Bank v National Mutual* [1991] 1 AC, 187; *Hawkes v Cuddy* [2009] EWCA Civ, 291.

[196] *Scottish Co-operative Wholesale Society Ltd v Meyer* [1959] AC, 324. See also *Selangor United Rubber Estates Ltd Craddock* (No 3) [1968] 1 WLR, 1555. See also *Lonrho Ltd v Shell Petroleum Ltd* [1980] 1 WLR, 627.

[197] Companies Act 2006. *Section 175(2)* (Norwich: The Stationery Office).

[198] Companies Act 2006. *Section 175(2)* (Norwich: The Stationery Office).

conflict.[199] A director who holds a directorship in another company and particularly in an opposing company should seek the authorisation of the shareholders to retain that directorship on the basis set out in section 175(5) and (6).[200]

Business opportunities belong to a business until such moment as the company abandons the opportunity.[201] A director might find that their own interests would be favoured if they were to exercise their power in a certain way.[202] Directors who attempt to usurp a company's assets and affairs for their own secret profit or profit of some other parties will be subject to duties if an action is brought against them, as this would constitute a conflict of interest.[203] Any benefit achieved in breach of the business opportunity rule will be held in trust for the company.[204] Take for instance, the approach adopted by the House of Lords in the well-known case of *Regal (Hastings) Ltd v Gulliver*.[205] In this case the appellant corporation owned a cinema (Regal) theatre in Hastings. The company intended to acquire two other local cinemas. However, due to a lack of funds in the business account, the company received investment from the five directors and the company solicitor. Each personally invested a sufficient amount for the company to acquire leases on the two extra cinemas. Regal was eventually sold and the

[199] *IDC v Cooley* [1972] 1 WLR 443; *Gwembe Valley Development Co Ltd v Koshy* (No 3) [2004] 1 BCLC 131

[200] *London & Mashonalad v New Mashonalad* [1891] WN, 165. See also *Bristol & West v Mothew* [1998] Ch 1 (CA). See also *In Plus Group v Pyke* [2002] 2 BCLC, 201.

[201] A.J. Dignam & A. Hicks, *Hicks & Goo's Cases and Materials on Company Law* (Oxford: Oxford University Press, 2011), 390-399.

[202] Companies Act 2006. *Section 175* (Norwich: The Stationery Office). See also A. Paolini, *Research Handbook on Directors Duties*, (Cheltenham: Edward Elgar Publishing, 2014), at 105-106.

[203] Companies Act 2006. *Section 175* (Norwich: The Stationery Office). See also A. Paolini, *Research Handbook on Directors Duties*, (Cheltenham: Edward Elgar Publishing, 2014), at 105-106.

[204] Companies Act 2006. *Section 175* (Norwich: The Stationery Office).See also R. Tomasic et al, *Corporation Law in Australia* (Sydney: Federation Press, 2002), 352-358.

[205] *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC, 134.

directors' made a profitable return when they sold their shares. The buyers of the company's shares claimed against the directors for profiting personally from their position as directors.[206]

The House of Lords ruled that the directors had breached their fiduciary duty.[207] Despite the directors and the solicitor acting *bona-fide* in the circumstances in which they assisted the company financially to pursue its goal, they were required to account for any profit gained from acting as directors of the company.

In a separate case, *Industrial Development Consultants v Cooley,* the director of an architectural design company was unable to secure a contract with a local gas board for the company.[208] The board having made it clear that it did not wish to deal with the company offered him the contract privately. The director decided to pursue this offer and did not disclose the deal to the company and asked to leave his work as a director on the false grounds of poor health.[209] The court decided that he was liable for the earnings that he made through the contract with the gas board. The reason for this is that he should have informed the company of the offer and instead he pursued his self-interest by using a fake illness to release him from his contractual responsibility and duty to the company to pursue an offer that would benefit his self-interest.[210] Both these cases are evidence of a very strict approach to enforce breaches of conflict of interest in the UK.[211]

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[206] D. French et al, *Company Law* (Oxford University Press, 2011), 517-523.
[207] Ibid.
[208] *Industrial Development Consultants Ltd v Cooley* [1972] 1 WLR, 443.
[209] Ibid.
[210] Ibid.
[211] A. Cahn & D. Donald, *Comparative Company Law: Text and Cases on the Laws' Governing Corporations in Germany, the UK and the USA* (Cambridge: Cambridge University Press, 2010), 342-350.

2.5.1.5 Duty Not to Accept Benefits from Third Parties

The duty not to accept benefits from third parties is found in section 176 of the Companies Act 2006 (UK). If any benefit is being presented to them as a result of their role as director (whether that be in exchange for them doing something or not doing something), they must not accept it.[212]

The duty is only infringed however if through accepting the benefit it can rationally be considered that the director has given rise to a conflict of interest.[213] This duty covers bribes or secret commissions.[214]

2.5.1.6 Duty to Declare Interest in Proposed Transaction or Arrangement

Directors are obligated under section 177 of the Companies Act 2006 (UK) to disclose to the other directors any interest, no matter how minor, that they have in any transaction or arrangement the company is involved in. Sub-section (7) covers competing duties, which may include those owed to a third party as a trustee or director.

On occasions it is possible for a director to find that he or she has a private interest in a transaction that the company they direct is involved in.[215] Provided that this conflict of interest in unintentional, the director must disclose the information to the shareholders and allow them to make a decision.[216]

An interested director, directly or indirectly, may be removed from voting or being included in the quorum of a board meeting by the company's

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[212] Companies Act 2006. *Section 176(1)* (Norwich: The Stationery Office).
[213]Companies Act 2006. *Section 176(4)* (Norwich: The Stationery Office).
[214]Ibid.
[215]Companies Act 2006. *Section 177* (Norwich: The Stationery Office).
[216]Ibid.

articles.[217] Where the duty applies, the interested director should make full and honest disclosure of the nature and extent of its interest. After this has occurred the board are at liberty to decide what the solution should be to move forwards with the matter.[218]

Section 182 of the Companies Act 2006 (UK) has extended the duty of a director to declare an interest in existing transactions and arrangements on broadly the same grounds that are mentioned in section 177. The declaration must be made once it is reasonably practical and failure to do so does not affect the underlying duty to make the declaration.

The Privy Council decision in *Cook v Deeks*[219] demonstrates the application of the principle contained in section 177. In this case three out of the four directors of a company misappropriated corporate assets from the company, Toronto the Construction Company Ltd (TCC).[220] The three directors tried to exclude the fourth by using their voting powers to approve a decision that was in their personal interest as opposed to the interests of the company. They passed a motion to declare that the company had no interest in a project with a third party and then they entered into contracts personally with the third party. These three directors intentionally used their positions to vote against an opportunity in the company interest, to then go on and steal the business opportunity for their own personal gain. The court held that the directors were in breach of their fiduciary duties to the company due to the

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217 *Grant United Kingdom Switchback Ry* [1889] LR 40 Ch.D, 135.
218 *Gray v New Augarita Porcupine Mines* [1952] 3 DLR, 1. See also *Movitex v Bulfield* [1988] 1 BCLC, 104.
219 *Cook v Deeks* [1916] 1 AC, 554.
220 *Cook v Deeks* [1916] 1 AC, 554. See also D. French et al, *Mayson, French & Ryan on Company Law* (Oxford: Oxford University Press, 2016), 510-515.

fact that they knowingly acted against the company's best interest in order to further their own self-interest.[221]

2.5.2 Australia

Section 181(a) of Corporations Act 2001 includes 'the duty of good faith in the best interest of the company', which considers whether a director's motivation for the action/lack of action was for the benefit of the company. Section 181(b) of Corporations Act 2001 is about the duty to use powers for a proper purpose.[222] The provision combines the same sorts of duties that are contained in sections 171 and 172 of the UK legislation.

Section 182 is the duty not to make improper use of position, which is based around fulfilling their role for its intended purpose. A director, secretary, other officer or employee of a corporation is in breach of the duty when they use their position to benefit themselves, someone with whom they have a relationship or to damage the business. Also, if the company is financially not in a strong position and the director, secretary, other officer or employee of a corporation exercises their power on a risk that the company cannot afford; they can also be in breach of this duty.[223]

Section 183 of Corporations Act 2001 is the duty not to make improper use of information, which in essence is to use the information that they are privy to for its intended use, which is the company's interest. Through being a director, any information that he or she comes by, should not be used to benefit themselves, someone with whom they have a

[221] *Furs Ltd v Tomkies* [1936] 54 CLR, 583. See also *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC, 134. See also *Peso Silver Mines Ltd (NPL) v Cropper* [1966] DLR (2d), 58.
[222] Corporations Act 2001. *Sections 181(2)* (Canberra: Office of Parliamentary Counsel). See also Corporations Act 2001. *Sections 187* (Canberra: Office of Parliamentary Counsel).
[223] Corporations Act 2001. *Sections 182* (Canberra: Office of Parliamentary Counsel).

relationship or to damage the business.[224] Sections 182 and 183 are akin to the sections 175-177 of the Companies Act 2006 (UK).

According to a Senate Committee, the aim of directors' duties is to shield shareholders who trust their interests to the care of directors. It does this by imposing standards of conduct that give rise to liability when breached.[225] In other words, the directors' duties in the general law and the Corporations Act are in place to protect the company from the abuse of directors' powers.[226]

2.5.3 Hong Kong

According to a recent survey by the Hong Kong Institute of Company Secretaries, less than 40 per cent of directors in Hong Kong understand their fiduciary duties and legal responsibilities and the remainder give them low priority.[227]

In fact, many smaller company directors disregard the concepts of company law and directors' duties.[228] The role of a director is sometimes mixed up with that of a senior manager.[229] This is a common problem of many directors in Hong Kong.[230] Lack of knowledge of their own positions and therefore their duties, responsibilities and liabilities is cause for great concern. Carrying out the work of the business, decision making and risk taking without proper understanding of the gravity of who their duties are owed to and legal consequences of actions, directors might unknowingly

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[224] Corporations Act 2001. *Sections 183* (Canberra: Office of Parliamentary Counsel).
[225] Senate Standing Committee on Legal and Constitutional Affairs (1981) Report on the Social and Fiduciary Duties and Obligations of Company Directors (Section 45). Canberra: AGPS.
[226] Ibid.
[227] Companies Ordinance 2014. *Articles 33-60* (Hong Kong: Legislative Council).
[228] Ibid.
[229] A. Naciri, *Corporate Governance Around the World* (Oxford: Routledge, 2008), 212.
[230] Ibid.

breach their duties. In Hong Kong the legislation exists and the gaps in knowledge cannot be attributed to this cause. The following are a list of directors' duties and related provisions,

Figure 7: directors' duties and related provisions in Hong Kong

Article 33	Directors should act in the best interest of the company and the shareholders and have duties of honesty, loyalty and diligence.
Article 34	Directors must ensure they have sufficient time and commitment to discharge their duties.
Article 59	Directors must discharge their duties faithfully, uphold the interests of the company, and not seize a company's properties, etc.
Article 60	A director must not misappropriate company's funds or lend company's funds to a third party.

2.5.4 China

Chinese Company Law does set out fiduciary duties and the concept of good faith in the 2005 amendment. Directors, supervisors and senior managers all have the obligations of fidelity and diligence specifically owed to the company imposed on them.

The law is still not as clear as it could be regarding fiduciary duties. From the inclusion of the duty of good faith it can be understood that lawmakers intended for the duty to be interpreted based on the civil law doctrine as being equivalent to fiduciary duties.[231]

This articulation of fiduciary duties is insufficiently comprehensive and will need to be amended. The duty of faith can certainly be expanded upon in future legislation updates intended to improve fiduciary duties. In order for fiduciary duties to be updated, there needs to be an improved archive for judges to refer to and establish a more consistent basis for determining cases. It would be an improvement if each court could refer to rulings of other courts and a system of mutual citation could be developed. From this base, the legislature could then codify those common principles and techniques emerging from cases after consistent patterns have been identified.

There is also a need for fiduciary duties to contain greater protection for minority shareholders. At present there is one duty that touches upon the subject of minority shareholders, and that is the duty imposed to prevent controlling shareholders from prejudicing the interests of minority shareholders and the company. This duty is there to prevent shareholders

[231] J. Zhao, *Corporate Social Responsibility in Contemporary China* (Cheltenham: Edward Elgar Publishing, 2014), 141.

from taking advantage of the limited liability of the company to avoid paying debts. It does not however provide for prevention from controlling shareholders oppressing minority shareholders' involvement in decision-making. Particularly in Chinese listed companies this results in the powers of minority shareholders being limited as the state elects directly or indirectly 70 per cent of each company's board members. Having over 50 per cent of the board's voting powers means that the state will have control of the company and ability to disregard the views of minority shareholders.

2.6 DUTY OF CARE, SKILL AND DILIGENCE

The duty of care takes slightly different forms depending on the jurisdiction that applies it. The main difference between jurisdictions is the standard that is applied to judge the degree of care required of directors. The standard is broken down into two categories, whether a director should be judged subjectively or objectively.

The objective standard is based on a director exercising the care, skill and diligence that would be applied by a reasonable person in the same position as the director in question without taking account of any particular expertise that the director possesses.[232] That is to say, directors would be held liable through their failure to perform some required activity.[233] The subjective standard in contrast is based on the director exercising the care, skill and diligence that would be applied by a reasonable person having the

[232] J. Zhao, *Corporate Social Responsibility in Contemporary China* (Cheltenham: Edward Elgar Publishing, 2014), 141.
[233] CA. Riley, 'The Company Director's Duty of Care and Skill: The Case for an Onerous but Subjective Standard', *Modern Law Review*, 62.1 (1999) 697.

director in question’s precise knowledge and experience.[234] Under this assessment, as Riley notes, liability would be based on whether the actions of the director fitted within their particular skillset or whether, with their knowledge, they were able to avoid the particular failure in question.[235]

2.6.1 United Kingdom

In the UK considerations of the foundation of the duty of care, skill and diligence are dominated by the case of *Re City Equitable Fire Insurance Co Ltd*[236]. There has been a notable shift in standards when comparing case law that existed prior to and after this case. Much enhanced legislation places on directors a greater duty to always go about their work with care, skill and diligence.[237] Importantly section 174 of the Companies Act 2006 (UK) provides that directors’ actions will be tested objectively as well as subjectively.

This duty originated from both equity principles and the common law of tort.[238] This duty is not fiduciary as disclosed by section 178(2) when it states,[239]

> “The duties in those sections (with the exception of section 174 (duty to exercise reasonable care, skill and diligence)) are, accordingly, enforceable in the same way as any other fiduciary duty owed to a company by its directors.”

[234] A.J. Dignam & A. Hicks, *Hicks & Goo's Cases and Materials on Company Law* (Oxford: Oxford University Press, 2011), 385-394.
[235] CA. Riley, ‘*The Company Director's Duty of Care and Skill: The Case for an Onerous but Subjective Standard’*, Modern Law Review, 62.1 (1999) 697.
[236] *Re City Equitable Fire Insurance Co Ltd* in [1925] CH, 407.
[237] B. Hannigan, *Company Law* (Oxford: Oxford Press, 2012), 203-210.
[238] *Bristol and West Building Society v Mathew* [1998] Ch. 1,16. See also *Base Metal Trading Ltd v Shamurin* [2004] EWCA Civ,1316. See also, D. French et al, *Company Law* (Oxford: Oxford University Press, 2011), 490-492.
[239] *Henderson v Merrett Syndicates Ltd* [1994] 3 All ER, 506. See also *Bristol & West Building Society v Mathew* [1997] 2 WLR, 436.

The UK currently applies both a subjective and objective standard. This has not always been the case however, as cases in the late nineteenth and for much of the twentieth century, tended only to apply the subjective standard.[240] The subjective standard is based around placing liability on directors for breaches that occur when it can be demonstrated that directors are not 'doing their best' (what they should be capable of doing given their level of skill and/or experience) or they could have 'avoided the failure'.[241] The reason that directors have hardly been held liable using this standard of liability is that it was legally difficult to apply due to the terms being vague.

Let us consider the example of shirking responsibility. Shirking responsibility is a breach of duty of care. Through shirking tasks, the director has made a mental decision to deliberately not take action that they are aware that they are required to take. They have made a conscious decision to face the consequences as opposed to carry out their tasks. When this is considered in court through the subjective standard it will have to be proved that the director is aware of the responsibilities of the job and that they recklessly elected not to do them. Also it will have to be proved that not doing these actions resulted in a cost to the company.

The real issue however is that the law does not articulate particular activities of a director. The case will depend upon the action in question that caused the loss to the company being included in the contract or articles of association as part of the director's role. Without some evidence that the director is required to do the action then it is difficult for the breach to be applied.

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[240] CA. Riley, 'The Company Director's Duty of Care and Skill: The Case for an Onerous but Subjective Standard', *Modern Law Review*, 62.1 (1999) 697.
[241] Ibid.

In the 1911 case of *Re Brazilian Rubber Plantation and Estate Ltd*,[242] Neville stated that,

> "A director's duty has been laid down as requiring him or her to act with such care, as is reasonably to be expected from him or her, having regard to his or her knowledge and experience. He or she is, I think, not bound to bring any special qualifications to his or her office. He or she may undertake the management of a rubber company in complete ignorance of everything connected with rubber, without incurring responsibility for the mistake which may result from such ignorance.[243]"

This case is an example of how the subjective standard alone permits a varied standard of care in companies. In fact the standard is only likely to be used when a director with considerable experience breaches their duties, as it would be the only scenario when the shareholders will be able to attest that the director in question should have known better. For this reason, the Court of Appeal stated that,

> "Directors have, both collectively and individually, a continuing duty to acquire and maintain a sufficient knowledge and understanding of the company's business to enable them properly to discharge their duties as directors."[244]

[242] *Re Brazilian Rubber Plantation and Estate Ltd* [1911] 1 Ch, 425.
[243] *Re Brazilian Rubber Plantation and Estate Ltd* [1911] 1 Ch, 425. See also D. French et al*, Mayson, French & Ryan on Company Law* (Oxford: Oxford University Press, 2016), 496-499.
[244] *Re Brazilian Rubber Plantation and Estate Ltd* [1911] 1 Ch, 425. See also D. French et al*, Mayson, French & Ryan on Company Law* (Oxford: Oxford University Press, 2016), 535-536.

Reiterating this thought after several years, Romer in *Re Equitable Fire Insurance*[245] stated that a director needs to acquire a greater level of skill, knowledge and experience than others in order to fulfil his or her duties.[246] The judge said that subjective standards were the key element, although he did approve a degree of objectivity (something not recognised by most commentators and judges until the late 1980[s]).

This line of thought opened up the door to the objective standard and how it could be incorporated into the duty of care. Justice said that directors should have 'sufficient knowledge and understanding' which can be interpreted as his belief that all directors should be required to be of some minimum standard.[247] When considering the objective standard there is a need to balance the incentive for the director to carry out the role and the avoidance of liability for the actions and decisions that are outside their control.

With an objective standard there is the risk that stewards will be made more cautious of the liabilities associated with the role that they will refrain from taking legitimate risks.[248] It is necessary for directors to take certain risks, which are vital for the success of the business, and it is a problem if they are incentivised not to take these risks.[249] The strictness of the objective standard can be increased by courts judging with the benefit of hindsight and a lack of business experience.

In an objective standard there is the risk that the judge will misapply the standard. This can happen when the company has failed at something

[245] *Re City Equitable Fire Insurance Co Ltd* in [1925] CH, 407.
[246] *Re City Equitable Fire Insurance Co Ltd* in [1925] CH, 428.
[247] Ibid.
[248] *Rochefoucauld v Boustead* [1897] 1 Ch,196.
[249] *Lloyds Bank Plc v Rosset* [1991] 1 A.C, 107.

due to a director's decision and the judge assesses the director not on their decision making process or their behaviour but instead on the damaging result that emerged from their decision. It is the decision making process that should be the subject of the judge's assessment, considering if the director carried out their research and weighed up alternatives as opposed to assessing their commercial decision.[250]

At the end of the twentieth century, the court recognised that the law surrounding the duty of care, skill and diligence was insufficient and this led to the acceptance of the 'dual or twofold' objective and subjective standard that was taken from section 214(4) of the Insolvency Act 1986 (UK).[251] In 1999 the Law Commission presented the possible standards that could be applied with a duty of this kind.

As previously mentioned, in the revision of the Companies Act 2006 (UK), there is the specification that both an objective and a subjective approach be applied for the duty in section 174. That is to say that the duty should be considered in both those aspects. It can be expected that directors work should be executed by a reasonably diligent person with (1) the general knowledge, skill and experience that may be expected of any persons who carry out that function and (2) the general knowledge, skill and experience that the director has.[252]

The combination of both the subjective and objective standard is based on a director exercising the care, skill and diligence that would be exercised by a reasonable person in the same position and also that should

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[250] CA. Riley, 'The Company Director's Duty of Care and Skill: The Case for an Onerous but Subjective Standard', *Modern Law Review*, 62.1 (1999) 697.
[251] *Norman v Theodore Ltd v Shamurin* [2004] EWCA Civ, 1316.
[252] Companies Act 2006. *Section 174* (Norwich: The Stationery Office).

have been exercised by themselves when taking into account their knowledge and experience.

2.6.2 Australia

Section 180 details that a director of a company is required to exercise their powers and discharge their duties with the amount of care and diligence that a reasonable person would be expected to. Using the term 'a reasonable person' implies that an objective standard of care is to be expected.[253] The court will consider the potential benefit against the potential harm that could have come to the business through the decision. Also the court takes into account, the state the business is in and the subjective position of the director.[254] Section 180 includes the Business Judgment Rule. Apart from a reference to the Business Judgment Rule, the provision is very similar to section 174 of the Companies Act 2006 (UK).

The duty of care, skill and diligence sets out that a director or other officer must exercise their power and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they,[255]

> (a) were a director or officer of a corporation in the corporation's circumstances; and,
> (b) occupied the office held by, and had the same responsibilities within the corporation as, the director or officer.[256]

[253]Corporations Act 2001. *Sections 180* (Canberra: Office of Parliamentary Counsel).
[254]Ibid
[255]Ibid.
[256]Corporations Act 2001. *Sections 180(1)* (Canberra: Office of Parliamentary Counsel).

2.6.3 Hong Kong

The duty of care, skill and diligence in Hong Kong is found within the Companies Ordinance and greatly resembles that of the Companies Act 2006 (UK). There is both a subjective and objective test to determine the standard of care that should be adhered to by directors in their decision making practice. The objective test sets out a minimum degree of care, skill and diligence that a director must adhere to which is as follows,

> "the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company".

The subjective test judges directors on the level of decision-making ability that they professionally should possess. If a director is experienced and qualified to a high level, it can be expected that they will be judged to a higher standard than someone who has recently acquired the position and has no experience.

Within the Companies Ordinance there is a provision that extends this duty of care not only to executive directors and non-executive directors, but also to shadow directors.[257]

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[257] L. Chung, 'New Hong Kong Companies Ordinance: Directors' Duty of Care, Skill and Diligence', *Slaughter and May* (2013). Available online: https://www.slaughterandmay.com/what-we-do/publications-and-seminars/publications/newsletters-and-briefings/2013/new-hong-kong-companies-ordinance-directors-duty-of-care-skill-and-diligence [Accessed 20/09/2016].

2.6.4 China

The duty of care came in to place in the 2005 Company Law Amendment and is a transplant from the Anglo-American fiduciary duties of directors.[258] There is only one article that treats the duty of care in the PRC Company Law and it is article 48. The article sets out that,

> "The directors, supervisors and senior executives of a company shall comply with the laws, administrative regulations and the articles of association of the company, and bear the duties of loyalty and due diligence towards the company.
> -The directors, supervisors and senior executives of a company shall not, by taking advantage of their positions and powers, accept bribes or other unlawful incomes, nor may they misappropriate the property of the company."

Within this description there is not a clear standard of care that is articulated, which makes the duty difficult to enforce.[259] An updated duty of care will endeavour to balance an appropriate level of protection for shareholders against the retention of entrepreneurial endeavour and risk taking.[260]

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[258] Ch. Shi, *The Political Determinants of Corporate Governance in China* (Oxford: Routledge, 2013), 166.
[259]Ibid.
[260]F. Ma, 'Directors' Duties in China: The Corporate Opportunity Doctrine', *University of Portsmouth*, 35.11 (2014) 340-346.

2.7 THE BUSINESS JUDGMENT RULE

The Business Judgment Rule may apply in cases of directors' duties in certain jurisdictions. A director can claim that any poor decision/judgment that he or she has made which caused damage to the company was made in good faith and based on this logic they should not be liable.

The rule is actively used in the USA and several other jurisdictions, each with their own adaptation of the rule.[261] Reference will first be paid to the interpretation of the USA, as it is where the rule originated.[262]

The rule was first introduced in the decades following the Second World War.[263] The case of *Smith v Van Gorkom*[264] is the most controversial authority on the rule. Here the Supreme Court in Delaware believed that the defence of business judgment could not be deployed in circumstances where the actions of the directors could be characterised as completely negligent.[265] These statutes, as Steinberg indicates, resulted in a situation where, in practical terms, a plaintiff today must prove a minimum of reckless conduct to recover damages for breach of the duty of care, skill and diligence.[266]

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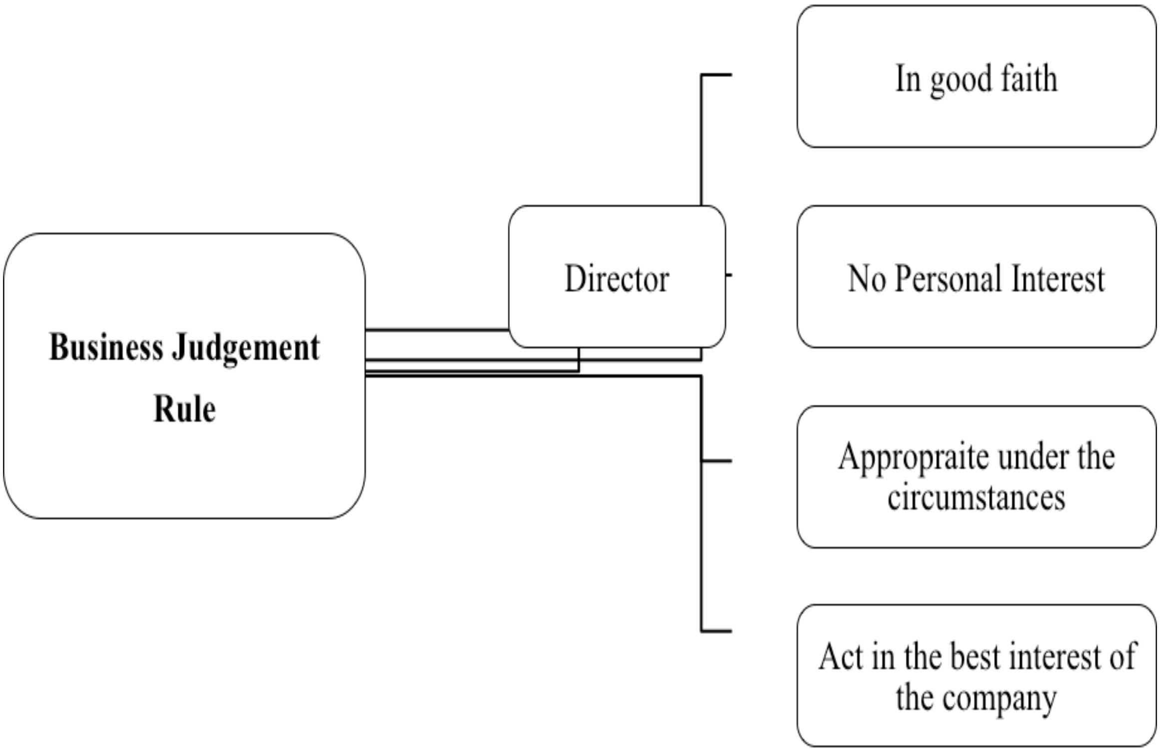
[261] A. Keay, *Board Accountability in Corporate Governance* (Oxford: Routledge, 2015), 252.
[262] P. Redmond, 'The Reform of Directors' Duties', *UNSW Law Journal*, 15 (1992) 86-113. See also P. Redmond, *Safe Harbours or Sleepy Hollows* in *Corporate Governance and the Duties of Company Directors* (Melbourne: University of Melbourne, 1997), 185.
[263] D. Milman, *Governance of Distressed Firms* (Cheltenham: Edward Elgar Publishing, 2013), 132-133.
[264] *Smith v. Van Gorkom* [1985] 488 A.2d, 858.
[265] D. Milman, *Governance of Distressed Firms* (Cheltenham: Edward Elgar Publishing, 2013), 132-133.
[266] Steinberg, 'The Corporate Law Reform Act 1992', *Australian Journal of Corporate Law*, 3 (1993) 153,161-162. See also Schipani, 'Defining Corporate Director's Duty of Care Standard in the United States and Australia', *Australian Journal of Corporate Law*, 27 (1994) 152-159.

The court acknowledged for years that the judgments made by directors involved a certain amount of risk, and that even an informed, good faith decision might result in an unfavourable outcome for the company.[267]

Since it would be inequitable for directors to be held personally responsible for poor outcomes of informed decisions made in good faith, the court has looked to the Business Judgment Rule in deciding such cases.

Figure 8: The Business Judgement Rule.



According to the Business Judgment Rule, the director's decision should be made once he or she is well informed, without personal interest, without corrupt motive, in good faith and in the honest belief that their choice serves the best interests of the company.[268] If directors do this they will be

[267]A. Schneema, *The Law of Corporations and Other Business Organisations* (New York: Delmar Cenage, 2013), 358-360.
[268]Ch. Mallon & S. Waisman, *The Law and Practice of Restructuring in the United Kingdom and US* (Oxford: Oxford University Press, 2011), 135-140.

safe from liability, whatever the result of their judgment. The rule recognises that not every decision will profit the organisation. The Business Judgment Rule protects directors from being held liable in certain respects but it does not protect directors against fraud, self-dealing, nor misconduct.[269] This rule protects directors from accountability for corporate decision making as can be seen from the above chart.[270]

2.7.1 Australian Law and the Business Judgment Rule

One of the primary areas in which Australian law differs from UK law is in relation to the provision of the Business Judgement Rule, which is arguably at the heart of corporate governance and directors' duties in Australia.[271] The rule was first proposed in the Corporate Law Economic Reform Program (CLERP bill) in 1997.[272] The grounds for its introduction were that it was to protect the authority of directors in the performance of their duties, as explained Stephen Bainbridge, when referring to the American equivalent,

> "the Business Judgment Rule reflects the need to reach a compromise between recognising the director's authority and discretion to decide, and the need for those directors to be accountable."[273]

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[269] J. Du Plessis, 'Company Lawyer, Open Sea or Safe Harbour? American, Australian and South African Business Judgment Rules Compared', *Springer Science & Business Media* (2011) Part 1. See also *Daniels v Anderson* [1995] 16 A.C.S.R, 607.

[270] Ibid.

[271] Corporations Act 2001. *Sections 180(2)* (Canberra: Office of Parliamentary Counsel).

[272] Australian House of Representatives, Corporate Law Economic Reform Program Bill, *The Parliament of the Commonwealth of Australia* (1998). Available online: https://www.legislation.gov.au/Details/C2004B00269 [Accessed 02/10/2016].

[273] S. Bainbridge, 'The Business Judgment Rule as Abstention Doctrine', *Vanderbilt Law Review*, 57.1 (2004) 83-84.

The Business Judgment Rule was introduced into the Corporations Act in March 2000. The Australian version contains all the same rules as the American version in that the rule is fulfilled if a director:

- Makes the judgment in good faith for a proper purpose.
- Does not have a material personal interest in the subject matter of the judgment.
- Informs himself or herself about the proper subject matter of the judgment to the extent they reasonably believe to be appropriate.
- Rationally believes that the judgment is in the best interests of the corporation.[274]

When directors have met the above criteria then the rule is there to prevent their decisions being judged unjustly.[275] As highlighted by D'Aloisio, there is a balance that must be found between on the one hand 'protecting shareholders' and on the other 'providing the freedom to the board to allow it to take risks without fear of liability'.[276] If there is a legal mechanism in place to bring actions against directors for poor business decisions then it will deter directors from risk taking entirely and they will even apply caution when taking necessary risks through fear of liability.[277]

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[274] Corporations Act 2001. *Sections 180(2)* (Canberra: Office of Parliamentary Counsel).
[275] Corporations Act 2001. *Sections 180(2)* (Canberra: Office of Parliamentary Counsel). See also J. Farrar, 'Corporate governance, Business Judgment and the Professionalism of Directors', *Corporate and Business Law Journal*, 6.1 (1993) 18.
[276] J. Plessis et al, *Principles of Contemporary Corporate Governance* (Cambridge: Cambridge University Press, 2010), 219.
[277] Ibid.

- **The Legal Basis Of The Business Judgment Rule In Australia**

The Australian Business Judgment Rule is similar to the American version in many ways. [278] The decision in *Australian Securities and Investments Commission v Rich*[279] explained the Business Judgment Rule in Australian Company Law, and indicated that this rule can provide a protection for actions in some cases that would otherwise amount to a breach of directors' duty.[280] The Business Judgment Rule in section 180(2) states that a director or other officer of a corporation will be protected from liability in relation to decisions made in the company's best interests unless the belief is one that no reasonable person in their position would hold.[281] More precisely, it is a defence for actions that may otherwise be in breach of section 180(1), which imposes an obligation on directors to exercise their duty of care and diligence when discharging their decision-making responsibilities.[282]

The subject matter of the Business Judgment Rule is included in section 180(2)(c) and it states that,

> "The director or officer must inform themselves about the subject matter of the judgment to the extent that they reasonably believe to be appropriate".[283]

[278] See also *Daniels v Anderson* [1995] 16 ACSR, 607.
[279] *Australian Securities & Investments Commission v Rich* [2009] FLR 1, 236.
[280] *Australian Securities & Investments Commission v Rich* [2009] FLR 1, 236. See also M. Legg & D. Jordan, 'Balancing Director Authority and Accountability', *Adelaide Law Review*, 34.2 (2013).
Available online:
https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2507059 [Accessed 20/05/2016], 406.
[281] *Talbot v National Roads and Motorists' Association Limited* [2000] 18 ACLC, 600.
[282] Corporations Act 2001. *Sections 180(1)* (Canberra: Office of Parliamentary Counsel).
[283] Corporations Act 2001. *Sections 180(2)* (Canberra: Office of Parliamentary Counsel).

Taken directly from US legislation, it requires directors to make informed but not necessarily flawless decisions.[284]

The rationality of the rule is that in order to make decisions the director needs to have done sufficient due diligence.[285] They require the time available for obtaining information, the costs relating to obtaining information, the director's confidence in exploring the matter, the state of the company's business at the time, the nature of the competing demands on the board's attention, and whether or not material information is rationally available to the director.[286] In the circumstances where the decision prompts an uncertain question of law, compliance with section 180(2)(c) involves the procurement of proper independent legal counsel.[287] In order for this section to function, there is the requirement for all four principles (they can be seen in the Business Judgment Rule diagram) to be present. Furthermore the drafting suggests that the onus of establishing the presence of those criteria is borne by the party who contends that section 180(2) applies (that is, the director or officer).[288]

Within Australian law culpability of the director lies in whether any alleged damaging decision was made in an honest, informed and sensible way. If this is the case then the director should be held not liable for any losses sustained by the company.[289] Therefore under the Business

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[284] R. Austin et al, *Company Directors: Principles of Law and Corporate Governance* (London: Butterworths, 2005), 242–3.
[285] Corporations Act 2001. *Sections 180(2)* (Canberra: Office of Parliamentary Counsel).
[286] *Australian Securities & Investments Commission v Rich* [2009] ACSR 1, 75. See also New South Wales Supreme Court, 1229, 2009, 7283.
[287] *Re HIH Insurance Ltd* [2010] 78 ACSR 405, 240. See also *Australian Securities and Investments Commission v Adler* [2002] 20 ACLC 576, 176.
[288] Australian Corporations Act 2001. Section 180(2) (Canberra: Office of Legislative Drafting and Publishing).
[289] Corporations Act 2001. *Sections 180(2)* (Canberra: Office of Parliamentary Counsel).

Judgment Rule, if all the factors in section 180(2) are fulfilled then the director is deemed to have acted with sufficient care and diligence.

Also, section 180(3) of the Australian Company Law defined a business judgment as any decision to '*take or not take'* action regarding '*a matter relevant to the business'* operations of the company.[290] Thus, a business judgment may be a decision to act or not to act. In this section, the language is used 'in respect of a matter relevant', that is to say that when a matter presents itself it might require a director's decision as opposed to simply a decision that the directors produced of their own accord. The language is however recognised as being broad and unspecific.[291] The courts have to give the definition of 'business judgment' a wide interpretation including, according to section 180(3). This provision states that *'business judgment'* means any decision to take or not take action in respect of a matter relevant to the business operations of the corporation.[292]

Figure 9: Section 180(3) Australian Law, the Business Judgment Rule

1. Decisions that are preparatory to the making of a business decision.
2. Decisions relating to corporate personnel.
3. Decisions relating to the termination of litigation.
4. The setting of policy goals.

[290]Corporations Act 2001. *Sections 180(3)* (Canberra: Office of Parliamentary Counsel). See also *Australian Securities and Investments Commission v Rich* [2009] 75 ACSR, 608.
[291]P. Redmond, *Safe Harbours or Sleepy Hollows* in *Corporate Governance and the Duties of Company Directors* (Melbourne: University of Melbourne, 1997), 195.
[292] AWA Ltd V Daniels (t/as Deloitte Haskins & Sells) [1992] 7 ACSR, 759. See also *Re HIH Insurance Ltd* [2010] 78 ACSR 405, 240.

5.	The apportionment of responsibilities between the Board and senior management.
6.	Decisions about planning, budgeting and forecasting.

2.7.2 United Kingdom

There has been no attempt to introduce the Business Judgment Rule in the UK as it is currently deemed that there is no issue that exists that the rule would be required to solve. The rule is predominantly to protect directors from liability for decisions made with good intentions based on their professional knowledge. In the UK, case law provides a similar level of protection for directors as a Business Judgment Rule would. Directors can be granted full or partial relief for a director's liability if it is satisfied that a director acted honestly and reasonably.

With this case law in place, even if it is clear that a decision is not the best decision the director could have made, English courts have on the whole demonstrated a position of standing by the business judgment of the director. This position of the courts coupled with the case law has meant that the UK has not had any requirement to introduce the Business Judgment Rule.[293]

2.7.3 Hong Kong

The Business Judgment Rule is not in place in Hong Kong for the same reason as the UK. The courts do not assume to question the decision making of directors unless it is clear that decisions are not made in good

[293] Simmons & Simmons, Time for a Business Judgment defense for United Kingdom Directors, *International Financial Law Review* (2002). Available online: http://www.iflr.com/Article/2027080/Time-for-a-business-judgment-defence-for- United Kingdom -directors.html [Accessed 25/08/2016].

faith. The case law from the UK also applies in Hong Kong, which means the position of Hong Kong regarding the Business Judgment Rule is no different to that of the UK.

2.7.4 China

At present China does not have the Business Judgment Rule and there are no signs of its intended adoption. That is not to stay however that legislation would not be improved through its adoption. At present when it comes to cases where damage has been caused to a company by directors' decision making, the judges consider whether the decision making process was reasonable or not in the circumstance. Judges are not businessmen and this approach can be far too subjective. The Business Judgment Rule has standards of review and it is up to the director to demonstrate that their decision was made with good intentions based on the information they had available at the time. The judge is then not allowed to question the reasonableness of the decision, but only whether the decision-making process meets the requirements of the standard or review.[294]

2.8 ENFORCEMENT OF BREACHES

A significant process that is required for the successful application of directors' duties is an effective enforcement of breaches. When a breach of duties has occurred, it first needs to be identified and secondly there needs to be a mechanism in place for an action to be brought. Enforcement of directors' duties is carried out by one of two methods, private or public

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[294] Ch. Xiao & Ch. Weng, 'Assessing the Applicability of the Business Judgment Rule and 'Defensive' Business Judgment Rule in Chinese Judiciary: a Perspective on Takeover Dispute Adjudications', *Fordham International Law Journal,* 34 (2010) 124.

enforcement. [295] Private enforcement involves actions brought by shareholders either on their own behalf or on behalf of the company against a director. [296] The most common form is derivative actions, which are actions brought by shareholders against directors on behalf of the company.[297] Public enforcement in contrast is less common and is currently only used in certain countries.[298] The identification of breaches and the process of commencing actions are both carried out by public authorities.[299]

When breaches are enforced and the director is found liable of profiting from the breach, they will be obliged to pay the company any money that they have made as a result of the breach.

2.8.1: United Kingdom

In the UK it is the company that must bring an action against a director believed to have breached their duties.[300] The company itself is empowered with the rights and ability to sue the director.[301] Section 178 provides that the consequence of a breach of any of the duties is the same as would have been applied under common law rules or equitable principles.[302]

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[295] Ch. Xiao & Ch. Weng, 'Assessing the Applicability of the Business Judgment Rule and 'Defensive' Business Judgment Rule in Chinese Judiciary: a Perspective on Takeover Dispute Adjudications', *Fordham International Law Journal,* 34 (2010) 124.
[296] V. Joffe et al, *Minority Shareholders: Law, Practice and Procedure* (Oxford: Oxford University Press, 2011), 65-69.
[297] Ibid.
[298] *Corporate Governance Supervision and Enforcement in Corporate Governance*, Section 38 (Paris: OECD Publishing, 2013).
[299] Ibid.
[300] *Companies Act 2006.* Section 178 (Norwich: The Stationery Office). See also B. Hannigan, *Company Law* (Oxford: Oxford University Press, 2012), 311-315.
[301] Ibid.
[302] *Companies Act 2006.* Section 178(1) (Norwich: The Stationery Office).

- **Derivative Action**

Derivative action is an exclusive scheme, which has existed in common law since the nineteenth century.[303] The actions permit an individual member of a company to bring an action that belongs to another. The courts, initially, and now the legislature, allow shareholders to bring a derivative action on behalf of the company in order to enforce the company's rights against the allegedly miscreant directors.[304] It is worth pointing out that the benefit from the action brought by the shareholder does not mean that that relief directly benefits the shareholder.[305]

Where a director or third party has committed the wrong done to the company, the directors in the exercise of their duty and power will decide whether the company should sue.[306] The directors should bring an action on behalf of the company, but they do not always do so for a variety of reasons. Then a shareholder may sue derivatively on behalf of the company to obtain a remedy for the company.[307]

In 1843, *Foss v Harbottle* [308] provided the legal foundations of the derivative action. From this case, derivate action as we understand it today has progressed considerably.[309] Several jurisdictions around the world provide for derivative actions in statutes. In 1997 the Law Revision

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[303] *Universal Project Management Services Ltd v Fort Gilkicker Ltd* [2013] EWHC 348 (Ch), 551. See also *Bhullar v Bhullar* [2015] EWHC 1943 (Ch). See also *Novatrust Ltd v Kea Investment Ltd* [2014] EWHC, 4061.

[304] J. Farrar & B. Hannigan, *Farrar's Company Law* (Oxford: Oxford University Press, 1998), 435-440.

[305] J. Plessis et al, *Principles of Contemporary Corporate Governance* (Cambridge: Cambridge University Press, 2010), 280-283.

[306] *Breckland Group Holdings Ltd v London and Suffolk Properties Ltd* [1998] BCLC, 100.

[307] *Burland v Earle* [1902] AC, 83.

[308] *Foss v Harbottle* 67 ER, 189. See also Wedderburn [1958] CLJ, 93.

[309] J. Farrar & B. Hannigan, *Farrar's Company Law* (Oxford: Oxford University Press, 1998), 435-440.

Committee made a recommendation for a revision of direction by assigning the litigation decision to the court.[310]

This recommendation was supported by the Company Law Review (CLR) and added to the Companies Act 2006 (UK), giving validity to the original reform recommendation by the Law Revision Commission.[311] The derivative action can be taken under the statute, which removes the need to use an exception to *Foss v Harbottle*,[312] save in limited circumstances, namely where there is a multiple derivative action sought.[313]

Accordingly, from 1st October 2007, derivative action[314] can be found in Chapter 1(11) of the Companies Act 2006 (UK). A shareholder must obtain the approval of the court for permission to bring the action.[315] The statutory definition for derivative action in section 260(1) of the Companies Act 2006 (UK) comprises three essentials. Initially, the action must be brought by a company member not by any other constituency.[316] Secondly, the action is in respect of a cause of action vested in the company and thirdly, the action obtains relief on behalf of the company.[317] Importantly, shareholders must first get approval of the claim before continuing a derivative action in court.[318]

There are instances however where a director has breached their duty where minority shareholders are not able to sue derivatively on behalf of the company. Breaches of duty can be ratified by a resolution of the

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310 Office of the Lord Chancellor 1997, *Shareholder Remedies*, Law Commission, Cm. 3769. See also A. Reisberg, *Derivative Action & Corporate Governance* (Oxford: Oxford University Press, 2007), 223-228.
311 Ibid.
312 S. Davies & P. Worthington, *Principles of Modern Company Law* (London: Sweet & Maxwell, 2012), 647-650.
313 *UPMS Ltd v Fort Gilkicker Ltd* [2013] EWHC, 348.
314 *Lesini v Westrip Holding Ltd* [2010] All ER (D), 108.
315 *Companies Act 2006.* Section 996(2) (Norwich: The Stationery Office).
316 *Companies Act 2006.* Section 112 (Norwich: The Stationery Office).
317 *Companies Act 2006.* Section 260(1) (Norwich: The Stationery Office).
318 *Companies Act 2006.* Section 263(2)(3) (Norwich: The Stationery Office).

shareholders.[319] This is achieved by over 50 per cent of the members voting in favour of ratification and it effectively releases the director of their breach and following this there is no wrongdoing that the company can sue them for. Following ratification of a breach, the company, the minority shareholders and any liquidator that is responsible for winding the company up, will not be allowed to sue the director over this breach as they will have been absolved from liability due to the ratification. The exception to ratification freeing the director from their breach is in circumstances where the breach is fraudulent. Fraud on the minority is therefore a circumstance where derivative action would still be an available tool for minority shareholders to claim against the director.[320]

2.8.2 Australia

It is possible to state that the regulatory model for the enforcement of directors' duties in Australia is distinctive from other nations. While private enforcement of duties plays a part in Australia, its regulatory model[321] for enforcing breach of directors' duties importantly includes a public enforcement model, reducing the regulatory burden on business and the community.[322] In contrast, the USA and the UK have their primary means for enforcing breach of directors' duties as private litigation.[323] Australian

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[319] CA. Riley, 'Derivative Claims and Ratification: Time to Ditch Some Baggage', *Legal Studies*, 34.4 (2014) 582.
[320] Ibid.
[321] J. Hill, *'Australia: The Architecture of Corporate Governance.'* in A. Fleckner et al, *Comparative Corporate Governance: A Functional and International Analysis* (New York: Cambridge University Press, 2013), 106-155.
[322] R. Jones & M. Welsh, 'Toward a Public Enforcement Model for Directors' Duty of Oversight', *V and J Transnat'l L*, 45.1 (2012) 343.
[323] J. Armour et al, 'Private Enforcement of Corporate Law: An Emperical Comparison of United Kingdom and the United States', *Emperical Legal Studies*, 6 (2009) 687.

Securities and Investments Commission act as the public enforcement tool and the process is supported by a civil penalty regime.

There has been a demonstration of a shift in balance between standards of conduct and standards of review shown by multiple cases brought forward by Australian Securities and Investments Commission alleging breach of directors' duties.[324]

In a speech on 27th November 2002 at a Corporate Governance summit, Berna Collier, a former commissioner of Australian Securities and Investments Commission and now a Federal Court judge, outlined the role of Australian Securities and Investments Commission in corporate governance.[325] In a description of their role in corporate governance and what they do on a daily basis to improve corporate governance, she itemised three points,

> 1. Monitoring, enforcing and administering compliance with the broad range of corporate governance provisions in the Corporations Act;
> 2. Carrying out a public education or advocacy role; and
> 3. Contributing to law reform in relation to corporate governance.[326]

It should be noted that Australian Securities and Investments Commission's role is as a regulator also instituting action against directors

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[324] *The Australian Securities & Investments Commission v Macdonald* (No 11) [2009] 256 ALR, 199. See also *Morley v ASIC* [2010] 274 ALR, 205. See also The Australian Securities & Investments Commission *v Hellicar* [2012] 286 ALR, 501. See also J. Armour et al, 'Private Enforcement of Corporate Law: An Emperical Comparison of United Kingdom and the United States', *Emperical Legal Studies*, 6 (2009) 687.

[325] B. Collier, 'The Role of Australian Securities and Investments Commission in Corporate Governance Summit', *ASIC* (2007).
Available online: http://asic.gov.au/about-asic/media-centre/speeches/#2007 [Accessed 07/10/2016], 5.

[326] Ibid.

to enforce the duties they owe towards the company, is one of the most distinctive aspects of the Australian corporate law and corporate governance model.[327] In other jurisdictions the task of directors' duties enforcement is left to the shareholders, and it has been shown in several jurisdictions that even with a statutory derivative action scheme available, legal actions against directors for the breach of their duties are few.[328] This is not so in Australia because of the Australian Securities and Investments Commission's active role enforcing these duties on behalf of companies.[329]

The Australian Securities and Investments Commission Act sets out all the powers and functions of the Australian Securities and Investments Commission, which must be applied with independence and objectivity.[330] They must also have to be aware of the government's policy framework as they address their role and responsibilities.

2.8.3 China

As already mentioned, public companies in China have a considerable state presence in the ownership structure and in terms of representative directors.[331] It is articulated in the Chinese Constitution that the government should be the principal shareholder in listed companies.[332] The government's shares in a public company are owned by the State Asset Supervision and Administration Commission and the chairman of the board of directors is

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[327] *Australian Securities and Investments Commission* v *Macdonald* (No 11) [2009] 256 ALR, 199.
[328] A. Keay, 'The Public Enforcement of Directors' Duties: A Normative Inquiry', *Common Law World Review*, 43 (2014) 89-119.
J. Plessis et al, *Principles of Contemporary Corporate Governance* (Cambridge: Cambridge University Press, 2010), 218.
[330] *Australian Securities and Investments Commission v Rich* [2009] 75 ACSR, 1.
[331] Ch. Shi, *The Political Determinants of Corporate Governance in China* (Oxford: Routledge, 2013), 143-152.
[332] C. Law & P. Wong, 'Corporate Governance: A Comparative Analysis Between the United Kingdom and China', *International Company and Commercial Law Review*, 16 (2005) 350.

usually a representative of the management of the State Asset Supervision and Administration Commission. The mandate of this Commission is to 'own' these listed companies and direct them in the interests of the public. This structure delivers a strong monitoring function over managerial performance.[333]

The official body of public enforcement is the China Securities Regulatory Commission.[334] This organisation carries out the regulation of public companies holding companies subject to government auditing and having to adhere to governmental standards in order to be approved both for national and international trade.[335]

In terms of private enforcement, the law does not stipulate exact specifications for penalties or mechanisms for enforcing directors' duties.[336] It is difficult for shareholders who are not the State Asset Supervision and Administration Commission members to bring actions against a director, as often they will be minority shareholders and the government involvement will prevent a case from being accepted.

2.8.4 Hong Kong

Much like the UK, Hong Kong's method for enforcing duties is private enforcement. Shareholders can bring derivative actions for any breach of duties committed by the director or any case of misconduct. Any shareholder can also equally apply to the court for an injunction against a director or

[333] Company Law of the People's Republic of China 2013. *Articles 108-116* (Beijing: Standing Committee of the National Peoples' Congress).
[334] J. Saee, *China and the Global Economy in the 21st Century* (Oxford: Routledge, 2012), 12.
[335] Company Law of the People's Republic of China 2013. *Articles 108-116* (Beijing: Standing Committee of the National Peoples' Congress). See also J. Saee, *China and the Global Economy in the 21st Century* (Oxford: Routledge, 2012), 12.
[336] Ch. Shi, *The Political Determinants of Corporate Governance in China* (Oxford: Routledge, 2013), 163.

individual for breaching the Companies Ordinance, fiduciary duties or articles of association.

2.9: CONCLUSION

This chapter has investigated directors and their duties in various jurisdictions to consider whether there is legislation and practices that Iran can learn from and potentially transplant to its own situation. The most important relationship a director has, besides his or her fellow board members, is with their shareholders. Agency theory and stewardship theory are the two main theories that consider this relationship. The former suggests that the agent requires constant supervision as left to their own devices they will follow their own self-interest as opposed to the company's best interest. Stewardship theory differs in that it presents the agents as trustworthy individuals who can be depended upon to lead a company honestly with some support and assistance where necessary. Duties are necessary for directors under both these theories because they help them know the scope of their role and how they should approach their decision-making.

Directors' duties exist to ensure a company's well being and without them a business could be taken advantage of by directors, as it is ultimately the director who is responsible for whether a business succeeds or fails. The duty of loyalty and duty of care are the two principal categories of directors' duties. All four jurisdictions considered have developed law in relation to both of these duties and offered varying insights into the basis and application of the duties.

The fiduciary duties in the UK, which encompass loyalty, have been updated periodically to suit the country's social and economic changes over time. For this reason they are specific in terms of their definitions of duties and they serve as a comprehensive guide for directors to adhere to. The duty of care in the UK has evolved in much the same way, having began with only a subjective standard of care to hold directors to, it now comprises of both a subjective and objective standard. The UK models for both these duties are useful to consider for any jurisdiction considering transplanting duties.

Australia's fiduciary duties and duty of care, being based on the UK model was not able to offer any unique contribution on these duties, save for consideration of the Business Judgment Rule. This rule emerged as result of the need to protect directors from being held liable for decisions that have had a detrimental impact on businesses but were made with good intentions. The rule is useful to consider for jurisdictions considering enhancing their duty of care.

Much like Australia, Hong Kong's duties are transplanted from UK law. The example of Hong Kong's transplantation is relevant to a study of the efficacy of replicating one jurisdiction's duties in another, particularly where the cultural and political situation is so different. The lack of awareness about fiduciary duties is a result of statutory duties being introduced in an environment that has no channel for directors to become aware of it. Any jurisdiction transplanting duties should take note of this example and consider possible solutions for avoiding such issues.

China is not as advanced as the other three jurisdictions in its provision of fiduciary duties. The law is less specific and it has been left too open to interpretation for judges. Its broad duties do not go far enough in defining the key duties and they may be too vague to be easily enforced. The duty of care is similar in that it is too broadly defined and it lacks a defined standard of care. The result is that it too is difficult to enforce it and attempts are being made to improve it.

In terms of enforcement, Australia and the UK offered the most successful examples. The Australian model of public enforcement of breaches of duties consists of having an independent body that holds directors accountable. The UK is an example of the application of private enforcement whereby the responsibility is held by shareholders to claim against their directors. An element of the Chinese enforcement system that would be useful to examine further is the involvement of the state in regulating public companies.

CHAPTER THREE

AN EXPLORATION OF DIRECTORS AND THEIR LEGAL DUTIES IN IRAN

3.1 INTRODUCTION

The previous chapter provided a consideration of the role of the director and the nature and purpose of directors' duties. The analysis provided was required prior to discussing directors and their duties in Iran, which is the subject of this thesis, as it provides the necessary background and acts as a basis for the more specific study of Iranian law. This chapter will now address Iran and discuss the features identified in Chapter 2 in the context of Iranian law through the use of doctrinal research.

As mentioned in the introduction to the thesis in Chapter 1, company law in Iran is unique in that there is no other law that resembles it. Since the 1979 revolution, Iranian Company Law has not been updated and it has stood still during a period when the rest of the world went through globalisation. The company law that exists has been moulded together by borrowing laws from the French Civil Code and Islamic sources. This melange is far from perfect and in terms of directors' duties there are gaping holes in the law that can be identified. By studying the law in Iran it will be possible to develop a picture of the weaknesses in directors' duties and how they fit into the larger picture of Iranian Company Law.

The chapter develops in the following way. After this introduction, the study will be divided into four main parts. Initially the chapter will provide an account of the various types of companies that exist in Iran and how they fit into the economy. Following on from this there will be a focus on company law and an overview will be provided of the two pillars that hold it together: Napoleonic code and Islamic law. Once an understanding has been provided as to how company law functions under these two pillars an analysis will be provided of the process for legal reforms. The third part of the chapter will focus on directors' duties in Iran with a consideration of the laws that exist and how the principal directors' duties are provided for. Reference will be made to the provision for fiduciary duties, the duty of care, the use of the articles of association and the mechanisms of enforcement. The final part of the chapter will address the weaknesses of law that exist in relation to directors' duties. The weaknesses are explained in terms of what duties are lacking in Iran and also what duties are omitted from Iranian Company Law. Following on from this study a conclusion will be developed that will draw together the principal lessons from the study covered in this chapter.

3.2 COMPANIES

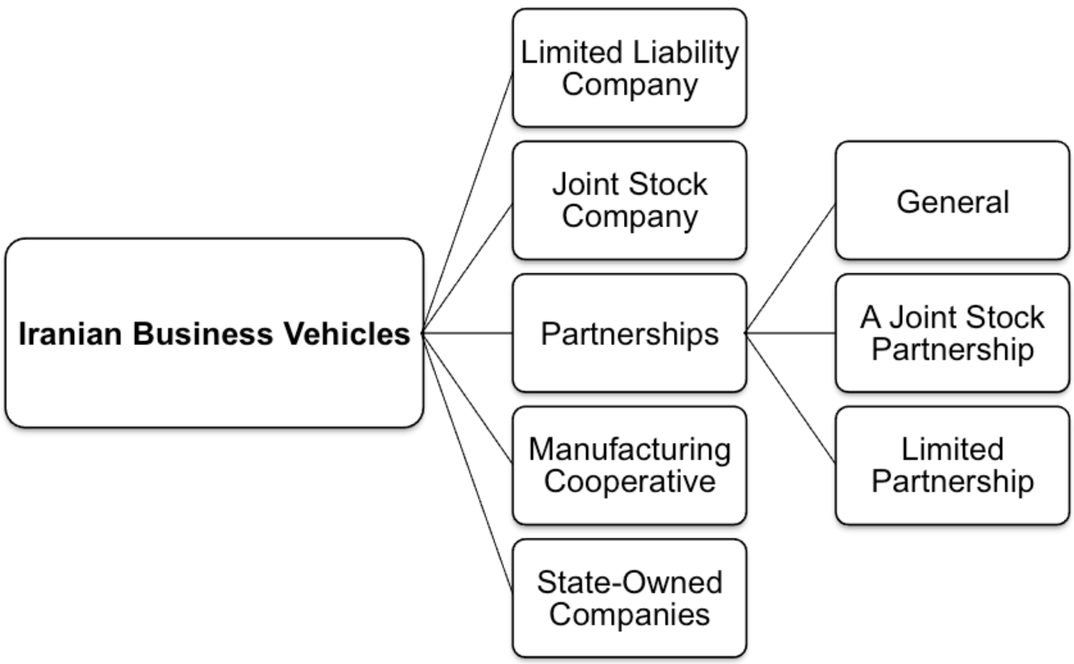
In Iran there are various different structures of companies to choose from when it comes to registering a new business.[337] There are several different types of business associations provided for under the Iranian Company Law, even if shares or stocks of the company belong to foreign natural or juridical persons.[338] In other words, Iranian law and regulations[339]

[337] Iranian Company Law 1933. Article 20 (Tehran: Didavar Book Publisher).
[338] Ibid.
[339] For instance, Iranian Company Law, Tax Code, Export and Import Regulations, Labor Law and Panel and Trade Mark Law for Registration of the Company.

generally control the legal relationship between company shareholders and directors.[340]

The incorporation of companies involves a similar procedure to that found in most countries. The type of company must be added to the name of the company on all company documents, papers, publications and all other paper and electronic documents published by the company.[341] Below is a chart detailing the various types of Iranian business vehicles that are available. These are very similar to those that are available in most jurisdictions, such as the UK.

Figure 10: Iranian Business Vehicles according to The Iranian Company Law, article 20 of Iranian Company Law 1933.



[340]For instance, Iranian Company Law, Tax Code, Export and Import Regulations, Labor Law and Panel and Trade Mark Law for Registration of the Company.
[341]Iranian Company Law 1933. Article 9 (Tehran: Didavar Book Publisher).

3.2.1 Limited Liability Company

A limited liability company[342] is defined in the Iranian Company Law as a private company formed by two or more people for trading purposes.[343] It does not prescribe a maximum number of shareholders but it does stipulate a minimum of two.[344] '*Liability'* is based on the direct contributions of the shareholders to the companies, meaning that liability is limited to the payment of what is owed for shares.[345] One or more directors could manage the limited liability company, however, if there is more than one manager, one of them must be selected as the company chairman.[346]

The formation of a limited liability company is deemed to have taken place when the capital in cash has been fully contributed and when non-cash contributions have been assessed and delivered to the company.[347] There is also no legal limitation on the nationality of shareholders and directors who may form a limited liability company.[348]

3.2.2 The Joint Stock Company

The private joint stock company [349] and the public joint stock company[350] are the most common forms of company in Iran possessing all of the fundamentals of modern, corporate business associations.[351] The joint stock company is described in the Iranian Company Law as a company that is formed where its capital is divided into shares and the liability of whose

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[342]Iranian Company Law 1968. Articles 94 to 161 (Tehran: Didavar Book Publisher).
[343]Iranian Company Law 1933. Article 94 (Tehran: Didavar Book Publisher).
[344] Ibid.
[345]Ibid.
[346]Iranian Company Law 1968. Article 104 (Tehran: Didavar Book Publisher).
[347]Iranian Company Law 1968. Article 102 (Tehran: Didavar Book Publisher).
[348]Iranian Company Law 1968. Article 114 (Tehran: Didavar Book Publisher).
[349]Covers in Iranian Company Law 1968 Articles 1 to 300 (Tehran: Didavar Book Publisher).
[350] Ibid.
[351]Ibid.

shareholders is limited to the par value of their shares.[352] Also, the number of members of a joint stock company must not be less than three people.[353] As is the case with limited liability companies, in joint stock companies there is also no legal limitation on the nationality of shareholders or directors.[354]

The important distinction between a private and a public joint stock company is that the shares and debt securities in a public joint stock company could be offered to the public whereas in a private joint stock company they could not.[355] In Iran, the private joint stock company is the more popular form of doing business and perhaps the most suitable as far as foreign investments are concerned.[356] Private joint stock companies must be formed with a minimum of three shareholders and public joint stock companies must be formed with a minimum of five shareholders.[357]

According to article 21 of the Iranian Company Law 1968, the liability of the shareholders is limited to the value or their shares[358] and in the absence of fraud, there is no recourse to shareholders as far as the liability of the company is concerned once they have paid up what is owed on their shares.[359] According to articles 583 and 588 of the Iranian Company Law 1968, the joint stock companies also have a separate legal standing with most of the same rights and duties as a person and it may be inferred from

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[352]Iranian Company Law 1968. Article 1 (Tehran: Didavar Book Publisher).
[353]Iranian Company Law 1968. Article 103 (Tehran: Didavar Book Publisher).
[354]Iranian Company Law 1968. Article 114 (Tehran: Didavar Book Publisher).
[355]Iranian Company Law 1968. Article 4 (Tehran: Didavar Book Publisher).
[356]Iranian Company Law 1968. Articles 3 & 4 (Tehran: Didavar Book Publisher). See also J. Westberg, 'The Joint Stock Company in Iran', *American Bar Association*, 23(1), 1967, 148-149.
[357]Iranian Company Law 1968. Article 3 (Tehran: Didavar Book Publisher).
[358]Iranian Company Law 1968. Article 21 (Tehran: Didavar Book Publisher).
[359]Iranian Company Law 1968. Article 6 (Tehran: Didavar Book Publisher).

these articles that a joint stock company may legitimately engage in all of the activities permitted for a person. [360]

The minimum Iranian share capital at the time of formation is one million Rials[361] for a private joint stock company and five million Rials for a public joint stock company.[362] Payment can be made either in cash or in kind for a public joint stock company and a minimum of 20 per cent of the share capital should be made available to the general public.[363] Management of a joint stock company is through a board of directors, who are elected by company shareholders. Should a board member reside abroad, delegation of power to resident board members is permitted, however the articles of association of the company must authorise such a delegation of power.[364]

Shareholders possess the usual rights held by their counterparts in other countries such as the right to attend shareholder meetings, receive financial reports, elect or replace the board of directors and vote on major company decisions.[365]

The joint stock company management is made the responsibility of directors who must be elected by the company shareholders at least once every two years.[366] According to article 107 of the Iranian Company Law 1968, a board of directors, appointed from among the shareholders, manages a joint stock company. In a public joint stock company there must

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[360]Iranian Company Law 1968. Article 588 (Tehran: Didavar Book Publisher).
[361]22.57 British Pound. A Pound is worth 41697.24 Rials.
[362]The Iranian Rial is the official currency in Iran and it is commonly expressed in written form as Rls.
[363] Iranian Company Law 1968. Article 6 (Tehran: Didavar Book Publisher).
[364]J. Westberg, 'The Joint Stock Company in Iran', *American Bar Association*, 23.1 (1967) 148-149.
[365]Iranian Company Law 1968. Article 72 (Tehran: Didavar Book Publisher).
[366]Iranian Company Law 1968. Article 107 (Tehran: Didavar Book Publisher).

not be less than five directors.[367] They are elected either at the statutory meeting at commencement or at the ordinary general meeting of shareholders.[368] The board at the first meeting should elect a chairman and a vice-chairman (If the chairman cannot perform his or her job, the vice-chairman should do these duties), both of whom must be members of the board of the directors.[369] Directors in public and governmental companies do not have to be a shareholder, while in private joint stock companies they must be. [370] In public and governmental companies the minister that represents the government's share in the business appoints a director.[371] A serving director of a governmental company whilst in their position cannot occupy any position or hold membership on the board of directors of any private company.

The board must appoint a person as the managing director of the company and specify clearly the scope of his or her duties, term of office and his or her remuneration.[372] The managing director cannot be the chairman in the same company unless three-quarters of shareholders confirm that.[373]

The directors and the managing director of a company are responsible either individually or collectively for the company, in respect to any infringement of legal regulations or provisions stipulated in the articles of association or the minutes of general meeting.[374] The court should determine

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[367]Iranian Company Law 1968. Article 107 (Tehran: Didavar Book Publisher).
[368]Iranian Company Law 1968. Article 108 (Tehran: Didavar Book Publisher).
[369]Iranian Company Law 1968. Article 119 (Tehran: Didavar Book Publisher).
[370]Iranian Company Law 1968. Article 110 (Tehran: Didavar Book Publisher).
[371]Iranian Constitution Law, Article 141 (Tehran: Didavar Book Publisher).
[372]Iranian Company Law 1968. Article 119 (Tehran: Didavar Book Publisher).
[373]Iranian Company Law 1968. Article 124 (Tehran: Didavar Book Publisher).
[374]Iranian Company Law 1968. Article 135 (Tehran: Didavar Book Publisher).

the scope of responsibility of each for indemnity purposes.[375] They do not have any personal liability for the company's wrongs.

3.2.3 Differences Between The Joint Stock And The Limited Liability Companies

There are some differences between the two types of companies and there are reasons why people would choose one over the other depending on what type of company they wish to operate and how they want it to be structured.

The first difference is the limit on the amount of shareholders that are allowed to be in the business. Whilst neither type of business has any limit on how many shareholders, both have limits on how few are permitted. The private joint stock companies must have a minimum of three shareholders and public joint stock companies must have a minimum of five shareholders,[376] whereas the limited liability companies must have a minimum of two shareholders.[377]

The second difference is the process involved in the registering of the company. For a joint stock company it is required to demonstrate that there is a minimum of five million Rials that will be invested in the company.[378] This has to be demonstrated with evidence from the bank.[379] However, in limited liability companies, whilst there exists the same financial requirement of five million Rials, it is possible to transfer an asset to the business that has the

[375]Iranian Company Law 1968. Article 142 (Tehran: Didavar Book Publisher).
[376]Iranian Company Law 1968. Article 3 (Tehran: Didavar Book Publisher).
[377]Iranian Company Law 1968. Article 94 (Tehran: Didavar Book Publisher).
[378]Iranian Company Law 1968. Article 5 (Tehran: Didavar Book Publisher).
[379]Ibid.

value of the share that the shareholder will have.[380] That is to say, if three shareholders wish to start a limited liability company, two agree to invest five millions Iranian Rials each and the other sells an asset worth five millions Iranian Rials to the company, they will all own an equal third of the business and their responsibility and liability will be proportional to this.[381] As mentioned, in the joint stock company the shareholders have to commit in cash to the total amount of investment they will invest in the company.[382]

Finally once private and public joint stock companies are registered the shareholders should inform the public of the registration of the company by publishing a notice in a widely read local paper.[383] This requirement is, however, not enforced.

Retaining directorships again is an area where differences are apparent. An appointed director of a joint stock company can be assigned their role for a term of two years before the shareholders must decide whether to reappoint them or to make a change of director.[384] In contrast in limited liability companies there is no limit to the duration of the term of the director.[385]

Moreover, when a company decides to have a board of directors as opposed to just a single director, there are practical differences in managerial terms.[386] In the limited liability company it is not necessary to have a shareholder on the board of directors and there is no requirement for the

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[380] Iranian Company Law 1968. Article 6 (Tehran: Didavar Book Publisher).
[381] Iranian Company Law 1968. Article 5 (Tehran: Didavar Book Publisher).
[382] Ibid.
[383] Iranian Company Law 1933. Articles 9 & 59 (Tehran: Didavar Book Publisher).
[384] Ibid.
[385] Iranian Company Law 1968. Articles 104 & 109 (Tehran: Didavar Book Publisher).
[386] Iranian Company Law 1968. Article 144 (Tehran: Didavar Book Publisher).

chairman of the board to be a shareholder.[387] In the joint stock companies, the board of directors should be comprised of company shareholders.[388]

The final difference that exists is the selection of the auditor. Private and public joint stock companies should select auditors for the company, however auditors are not a fundamental requirement for limited liability companies.[389]

3.2.4 State-owned Companies

State-owned companies play an important role in Iran. The general assembly regulates the state owned company's general policy framework, approves the annual cost, financial statements and balance sheets, and manages all functions.[390] The general assembly is made up of the President (Rouhanni), Vice President, Director General of the Management and Planning Organisation, Ministers of Oil, Energy, Industries and Mines, Labour and Social Affairs, Economy and Finance.[391]

The company's board of directors approves the operational schemes within the framework ratified by the general assembly. It also approves transactions and contracts and prepares annual budgets, balance sheets and reports for presentation to the general assembly.[392] The managing board oversees the operation of the general policy guidelines defined by the

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[387]Iranian Company Law 1933. Article 104 (Tehran: Didavar Book Publisher).
[388]Iranian Company Law 1968. Article 107 (Tehran: Didavar Book Publisher).
[389]Iranian Company Law 1933. Article 109 (Tehran: Didavar Book Publisher).
[390]UA, The Memorandum of the Foreign Trade Regime of the Islamic Republic Of Iran, *Ministry Of Commerce* (2009). Available online: http://www.ard.mimt.gov.ir//parameters/mimt/modules/cdk/upload/content/file_manager/9883/1425674255912bc50q3mech43nc6n3953sv4f22.pdf [Accessed 12/06/2015].
[391]UA, '*Iran Government*', Pars Times (2015). Available online: http://www.parstimes.com/gov_iran.html [Accessed 14/05/2015].
[392]Ibid.

general assembly, and pursues executive operations via the company's managing director.[393]

State involvement in business prior to the revolution of 1979 was minor as the private sector enjoyed great freedom.[394] An amendment was made to company law in 1968, which opened the door to state involvement in companies.[395] It was not until 1979 that the Islamic government nationalised many major companies in Iran with the operational principles of Islamic economics. This meant taking ownership of over 80 per cent of the economy including banks, insurance companies, dams and irrigation works, large-scale manufacturers, radio and television stations, transport companies and several companies in other sectors.[396] Also, the large part of economic and industrial capital stock was allotted to *Bonyad*.[397] This was a considerable reformation of the private sector converting an open market to a state controlled market.[398] This policy derived from the combination of Middle Eastern socialist ideology coupled with a desire to retaliate against commercial supporters of the Shah who had been deposed.[399]

In many instances the supreme leader Khamenei, the Army of Guardians and the government seized control of entire companies and in

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393 P. Clawson, 'National Iranian Oil Company', Beyond Oil Analytics,' *Washington Institute* (2011). Available online: http://www.washingtoninstitute.org/policy-analysis/view/iran-beyond-oil [Accessed 17/05/2015].

394 Iranian Constitution Law 1980, Article 44 (Tehran: Didavar Book Publisher).

395 Ibid.

396 Sh. Shahriari, A. Mashayekhi, 'Iran Investment Monthly', *Turquoise Partners*, 3(31) (2009). Available online: http://www.turquoisepartners.com/media/1163/iim-aprmay09.pdf [Accessed 20/06/2015], 2-9. See also P. Alizadeh, 'Iran's Quandary Economic Reforms and the 'Structural Trap', *The Brown Journal of World Affairs*, 1.2 (2003) 272.

397 Bonyad is a Farsi word for '*Foundation*' this is informal network; they are control by Iranian Government.

398 UA, 'Tracking Iran's Unconventional Weapon Capabilities', *Alphabetical List of Iranian Entities* (2008). Available online: www.iranwatch.org [Accessed 2016/08/01].

399 B. Mashayekhi & M. Bazaz, 'The Effects of Corporate Governance on Earnings Quality: Evidence from Iran', *Asian Journal of Business and Accounting*, 3.2 (2010) 71-100.

certain industries there are no longer any completely private businesses without any state ownership.[400] This seizure of Iranian business has provided the state with a major role in the national economy as owner and manager of a vast share of Iranian national companies.[401] This transition despite being swift was entirely smooth and unproblematic.[402] Since the revolution a lack of appropriate surveillance and monitoring systems allowed managers to abuse their power and steal from the businesses they ran.[403] Common offenses have been pocketing salaries from non-existent employees, setting up fraudulent sales contracts and transferring funds to favoured individuals.[404]

3.3 COMPANY LAW

In the Iranian legal system today it is possible to see two pillars of law married together, namely the Napoleonic code and Islamic law.[405] The Napoleonic code can be classified as the principal source that the legal system has been built upon.[406] Islamic law arrived later in Iran's history, and is now completely engrained in the legal framework.[407] Islamic law exists to ensure that the legal system reflects the religious principles of the Islamic

[400] S. Rubenfeld, 'Iran Business Prospects Complicated by Revolutionary Guard', *Wall Street Journal* (2015). Available online: http://blogs.wsj.com/riskandcompliance/2015/11/30/iran-business-prospects-complicated-by-revolutionary-guard [Accessed 01/04/ 2015].
[401] Ibid.
[402] Ibid.
[403] N. Bozorgmehr, 'Iran's Revolutionary Guards Wary of Threat to Business Interests', *Financial Times* (2015). Available online: https://www.ft.com/content/e88a1dae-2096-11e5-aa5a-398b2169cf79 [Accessed 20/09/2015].
[404] K. Crane & R. Lal, 'Iran's Political, Demographic, and Economic Vulnerabilities', *Rand Corporation* (2008). Available online: https://www.rand.org/content/dam/rand/pubs/monographs/2008/RAND_MG693.pdf [Accessed 21/09/2015].
[405] H. Enayat, *Law, State and Society in Modern Iran: Constitutionalism, Autocracy, and Legal Reform 1906-1941* (New York: Palgrave Macmillan US, 2013), 43, 62.
[406] Ibid.
[407] A. March, *Shari'a: Islamic Law* (Oxford: Oxford: Oxford University Press, 2010), 17-22.

regime.[408] The Napoleonic code and Islamic law, as they are applied in Iran, will now be discussed and analysed more extensively.

3.3.1 The Napoleonic Code

The Napoleonic code was introduced in Iran in 1927, during the reign of the monarch Reza Shah. At this point in Iran's history, the country was modernising following the 1905 revolution and required a legal system that would be able to fulfil the needs of a growing economy and modernising society.[409] The most sensible and achievable option for updating a legal system that would satisfy these requirements was to borrow frameworks already in existence in other parts of the world.[410] The principal models that could have been considered adoptable for Iran were the Anglo-American model of common law or the continental European model of the Napoleonic code.[411]

At that point in time, the Anglo-American model was not sufficiently popular around the world, or at least it was unfamiliar to the Iranian lawmakers and businessmen. Typically the nations that decided to pursue a common law system had some form of English influence or they had been British colonies.[412] Whilst the common law system includes statutes, historically it has granted the majority of power to judges as laws are provided for and applied most commonly as a result of judicial outcomes.

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[408] W. Spencer, *The United States and Iran* (Brookfield, CT: Twenty-First Century Books, 2000), 1900.
[409] C. Ghani & S. Ghani, *Iran and the Rise of the Reza Shah: From Qajar Collapse to Pahlavi Power* (New York: I.B.Tauris, 2000), 383-396.
[410] C. Ghani & S. Ghani, *Iran and the Rise of the Reza Shah: From Qajar Collapse to Pahlavi Power* (New York: I.B.Tauris, 2000), 392.
[411] D. Hilse Dwyer, *Law and Islam in the Middle East* (Westport: Greenwood Publishing Group, 1990), 124-126.
[412] V. Palmer & M. Mattar, *Mixed Legal Systems, East and West (Oxford: Routledge,* 2016), 225-229.

This type of system might be considered by some countries to be uncontrollable and their preference might be to ensure that law-making powers are only subject to government control.[413]

The Napoleonic model can be considered as more manageable from a political perspective as it permits the government a level of involvement in the economy and greater control of the private sector. The French civil code system contained elements of the common Iranian ethos that there should be a strong relationship between the state and the private sector.[414] The fact that the Napoleonic code preserved this relationship between private ownership and government control presented it as a less demanding alternative than a common law system.[415] Iranian statesmen for different reasons have always wanted to have a weak and controlled private sector.[416] Iran was not the first nation in the region to start on this path, as the neighbouring Islamic nation of Turkey had already begun to adopt the Napoleonic code model.[417]

The Napoleonic code, whilst being the principal code in Iran, always had to fit within the existing parameters of Islamic law of the Shia Jafari School.[418] In the years following the introduction of company law, law became increasingly secular and borrowed heavily from the French code of

[413] H. Liebesny, *The Law of the Near and Middle East: Readings, Cases, and Materials* (New York: University of New York Press, 1975), 270-283.
[414] C. Roberson & D. Das, *An Introduction to Comparative Legal Models of Criminal Justice* (Florida: CRC Press, 2008), 145-153.
[415] B. Cheffins, 'Using the Theory to Study Law: A Company Law Perspective', *The Cambridge Law Journal*, 58.1 (1999) 115-117. See also L. Bebchuk & M. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance* (Cambridge (MA): Harvard Law School, 1999), 11 to 22.
[416] R. Aeasteh, *Man and society in Iran* (Leiden: E. J. Brill, 1964), 150.
[417] T. Ansay & D. Wallace, *Introduction to Turkish Law* (The Hague: Kluwer Law International, 2011), 9-11.
[418] M.I. Zagday, 'Modern Trends in Islamic Law in the Near, Middle and Far East', *Current Legal Problems*, 1.1 (1948) 209.

laws. The Iranian Company Law brought in distinct legislation for companies in 1927 that allowed members of the general public to incorporate companies for the first time.[419] Iran utilised the company laws of France and Belgium as models, whilst also ensuring that the Iranian Company Law remained consistent with Islamic principles.[420] The Iranian Company Law was subsequently reviewed and upgraded in 1932.[421] This action was one of a number that was taken by Mohammad Reza Shah (the son of Reza Shah) to move Iran down the path towards westernisation.[422] As part of this process, in 1969 the Iranian government proposed to Parliament a new collection of 300 sections based on the Napoleonic code in order to address deficiencies of the Iranian Company Law in respect of the joint stock companies.[423] The new collection was passed and remains at the moment the primary source of company law with the joint stock legislation in Iran.[424]

Within Iranian Company Law, the latest version of the code exists in the joint stock company law 2009, sections 86, 87 and 88. This edition superseded the joint stock company law 1968 and is currently the active code on joint stock companies providing a true reflection of present Iranian law in this area.[425] The code however does not apply to limited liability companies, which still follow section 94 to 115 of Iranian Company Law. These sections are still broadly translated sections from the original code

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[419] K. Aghaie & A. Marashi, *Rethinking Iranian Nationalism and Modernity* (Texas: University of Texas Press, 2014), 19-24.

[420] W.B. Hallaq, *An Introduction to Islamic law* (Cambridge: Cambridge University Press, 2009),152-180.

[421] C. Ghani & S. Ghani, *Iran and the Rise of the Reza Shah: From Qajar Collapse to Pahlavi Power* (New York: I.B.Tauris, 2000), 390-398.

[422] S.A. Arjomand & N.J. Brown, *Rule of Law, Islam, and Constitutional Politics in Egypt and Iran* (New York: University of New York Press, 2013), 200-215.

[423] Iranian Company Law 1968. Chapter 1 (Tehran: Didavar Book Publisher).

[424] Iranian Company Law 1968. Articles 1 to 300 (Tehran: Didavar Book Publisher).

[425] Iranian Company Law 1933 (Tehran: Didavar Book Publisher).

that was included in 1933. The Iranian Company Law is an example of a piece of the Napoleonic code that has periodically evolved throughout Iranian legal history. From the arrival of the Napoleonic code in Iran, the company law was one of the first pieces heavily influenced by the Napoleonic code.[426] It was the first company law in Iranian legal history to introduce the concept of legal entity.[427] Nowadays it can be regarded as a piece of company law that has evolved throughout the varying transitions Iran has gone through. Each time it is updated, most of the company law provisions (articles) stay the same and minor changes are made where necessary.[428] In the late 1970s for example minor amendments were added to company law to bring it into line with the new Islamic values of the government.[429]

The way that the Act operates is, to a large extent, to address shareholder and director conflict rather than the conflict that might exist between the majority and minority shareholders.[430] It only confronts the issue of majority abuse of rights against minority shareholders in the circumstance of a wrongdoer director or shareholder wanting to vote in the general meeting to ratify their own misconduct.[431]

The issue of justification for majority rule is relatively new in Iranian Company Law and has rarely been considered by company law scholars.[432]

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[426]Iranian Company Law 1933 (Tehran: Didavar Book Publisher). See also E. Abrahamian, *Iran Between Two Revolutions* (Princeton, NJ: Princeton University Press, 1982), 250-260.
[427] Iranian Company Law 1933 (Tehran: Didavar Book Publisher).
[428]Iranian Company Law 1933. See also M. Tamadonfar, *Islamic Law and Governance in Contemporary Iran: Transcending Islam for Social, Economic, and Political Order* (Lanham, MD: Lexington Books, 2015), 41-55.
[429]Iranian Company Law 1933 (Tehran: Didavar Book Publisher).
[430]Iranian Company Law 1933. Articles 1-20 (Tehran: Didavar Book Publisher).
[431]Ibid.
[432]Iranian Company Law 1968. Article 107-143 (Tehran: Didavar Book Publisher). See also H. Tehrani, 'Trade Law', *Dehkhoda Publication Press*, 2.1 (1997) 175-176.

The existing literature on company law often either neglects the issue, or tends to merely explain the law as it stands rather than to examine, analyse and clarify it.

3.3.2 Islamic Law

The second source of Iranian Company Law is Islamic[433] law or Sharia law, as it is more commonly known. This law is based around original Islamic religious texts such as the Quran and Hadith.[434] The principles that exist in the raw text of these publications are identified and converted into law. This practice is not a science, but rather it is a subjective task that is open to interpretation.[435] Jurists with advanced linguistic competence carried out the task of interpreting the figurative lexicon and general language to enable there to be precise meanings in the texts.[436] Many principles are not always directly transferable as a legal article, especially not when they are applied to modern society and the legal context.[437]

According to Schacht J., a British-German professor of Arabic and Islam at Columbia University in New York, the origin of Sharia[438] law (Islamic Jurisprudence) is the theory that emerged as a result of a complex historical process spanning a period of some three centuries.[439] Nowadays, according to western scholars, a notable change can be seen in the commercial branch

[433]O. Leaman, *The Qur'an: An Encyclopedia* (Oxford: Routledge, 2006), 558-560.
[434]M. Mohammadi, *Judicial Reform and Reorganisation in 20th Century Iran: State-Building, Modernisation and Islamicisation* (Oxford: Routledge, 2007), 117.
[435]M. Mohammadi, *Judicial Reform and Reorganization in 20th Century Iran: State-Building, Modernization and Islamicisation* (Oxford: Routledge, 2007), 114-121.
[436]W. Hallaq, *An Introduction to Islamic Law* (Cambridge: Cambridge University Press, 2009), 19.
[437]Ibid.
[438]The Sharia word is derived from he Arabic root, 'Shara'a' in English that mean the direction that all Muslims should follow as a guide for life.
[439]N. Coulson, *A History of Islamic Law* (Miami: Transaction Publishers, 2011), 135, 149-155.

of sharia law, as social, economical and political factors have forced change upon what is seen as traditionally out of date legal codes.[440]

It must be understood however that the core component of its identity is that it is conscious about its character as a religious ideal.[441] Mohammad's aspiration as a prophet was not to make a new system of law; it was to teach his society how to act, what to do, and what to avoid in order to pass the reckoning on the day of judgment.[442] This leads to the result that consideration of good faith, equality, justice, truth and other moral rules play only a subordinate part in the system.[443]

Within Islamic law there are differences in its application amongst countries that incorporate it in to their legal systems. Certain countries practising Islamic law are greatly exposed to western legal codes and practices.[444] Turkey for instance, in an attempt to advance its integration into the European Union, has made efforts to westernise aspects of its legal system and steer it away from Islamic law. The European Union is Turkey's principal trading partner, a relationship encouraged by a free trade agreement due to Turkey's membership of the Euro-Mediterranean Partnership.[445] As Turkey currently seeks membership of the European Union it is in a position whereby reform of its legal code is necessary in order

[440] N. Coulson, *A History of Islamic Law* (Edinburgh: Edinburgh University Press, 1964), 5-7.
[441] J. Schacht, *The Origins of Muhammadan Jurisprudence* (Oxford: Oxford Clarendon Press, 1967), 320.
[442] J. Schacht, *The Origins of Muhammadan Jurisprudence* (Oxford: Oxford Clarendon Press, 1967), 10-11.
[443] J. Schacht, *The Origins of Muhammadan Jurisprudence* (Oxford: Oxford Clarendon Press, 1967), 206.
[444] Such as Afghanistan, Iran, Sudan, Iraq and increasingly Pakistan.
[445] UA, 'The Official European Union Website', *European Union* (2015). Available online: http://europa.eu/index_en.htm [Accessed 26/04/2015].

to meet the European Union's convergence criteria.[446] The Iranian theocratic government in contrast, following the 1979 revolution introduced certain measures to gain more control of the private sector.[447] Article 44 of the new Iranian constitution gave state protection to corporations on the condition that they contributed to the development of the Iranian economy.[448] In effect through this article it allocated a large portion of opportunity for economic activity to the government, even in areas that are, normally, by their legal definition regarded as private. As a result of this provision, the government controls business in many key sectors of the economy and can also involve itself in the private sector should it wish to do so.[449] From a non-Islamic perspective, control of the government over companies could also address the factionalism concern of the Islamic jurists.[450] Furthermore, article 22 approved the Islamic government's right to take constitutional measures to seize the assets and control of companies that fail to adhere to the objective of the public interest.[451]

Moreover, the branch of Islam that a country follows, whether that be Shia or Sunni, determines the religious texts that are used as raw legal

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[446] UA, 'European Neighborhood Policy and Enlargement Negotiation,' *European Commision* (2016). Available online: http://ec.europa.eu/enlargement/countries/detailed-country-information/turkey/index_en.htm [Accessed 20/06/2016].

[447] E. Abrahamian, *Iran Between Two Revolutions* (New Jersey: Princeton University Press, 1982), 510-530.

[448] Iranian Constitution Law 1980, Article 44 (Tehran: Didavar Book Publisher): "The economy of the Islamic Republic of Iran is to consist of three sectors: state, cooperative, and private … ownership in each of these three sectors is protected by the laws of the Islamic Republic, in so far as this ownership is in conformity with the other articles of this chapter, does not go beyond the bounds of Islamic law, contributes to the economic growth and progress of the country, and does not harm society …"

[449] Iranian Constitution Law 1980, Article 44 (Tehran: Didavar Book Publisher).

[450] N. Shirazi, *Descent of the Holy Quran* (Munich: Createspace Independent Publishing Platform, 2015), 99.12 – 99.19.

[451] Iranian Constitution Law 1980, Article 22 (Tehran: Didavar Book Publisher): The dignity, life, property, rights, residence, and occupation of the individual are inviolate, except in cases sanctioned by law.

sources.[452] The division between the two religious sects of Islam is due to a disagreement over the rightful successor to Mohammad in 632 AD (anno Domini).[453]

Both groups have an overall belief that adherence to Islamic law is a religious duty, and they believe that the totality of God's commands must control life in all its features.[454] There is the understanding in countries with sharia law that there is equality between worship, ritual and political and legal rules.[455]

Sunnis and Shias disagree over the delegation of power and authority within the religion.[456] The doctrine of the Imamat (Shia text) includes the idea that the successor of Mohammad is not merely a political leader but also must be a spiritual leader.[457] In Iran this theory is accepted, and the Supreme Leader occupies this role as a descendent of Mohammad. The determining of legal rules vests in the Shi'ite Imam, who speaks with the supreme authority of the divine legislator himself, namely God.[458] In Sunni countries there is not the same belief and whilst heads of states can have great power over law, there is not the same spiritual standing to their position.[459]

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452 B. Rubinpp, *The Middle East: A Guide to Politics, Economics, Society and Culture* (Oxford: Routledge, 2015), 325-327.
453 B. Rubinpp, *The Middle East: A Guide to Politics, Economics, Society and Culture* (Oxford: Routledge, 2015), 327.
454 J. Kitagawa, *The Religious Traditions of Asia: Religion, History, and Culture* (Oxford: Routledge, 2013), 157.
455 Ibid.
456 J. Hubbard-Brown, *Shirin Ebadi* (New York: InfoBase Publishing, 2007), 46.
457 G. Curtis & E. Hooglund, *Iran: A Country Study* (Washington: Government Printing Office, 2008), 120.
458 L. Rosen, *The Justice of Islam; Comparative Perspective on Islamic Law and Society* (Oxford: Oxford University Press, 2000), 185-190.
459 L. Rosen, *The Justice of Islam; Comparative Perspective on Islamic Law and Society* (Oxford: Oxford University Press, 2000), 191-190.

Behind many elements of the Shia faith is philosophical rationalism developed from Greek legal concepts.[460] However, in some cases when philosophy and the Quran appeared to be in conflict, the Quran was interpreted ‘allegorically’[461] by Shias to fit with the natural law theme of philosophy.[462]

3.3.2.1 Sources Of Sharia

In Accordance with the classical theory of Islamic Jurisprudence, Sharia law is made up of a range of primary and secondary sources. The leading primary sources, which are accepted universally by all Muslims around the world, are the Quran and the *Sunnat* (Hadith or Mohammad’s traditions). The leading secondary sources are Ijma (Consensus), Qiyas (Analogical Reasoning) and Ijtehad (the elaboration of new idea)[463] as is displayed in the diagram below.

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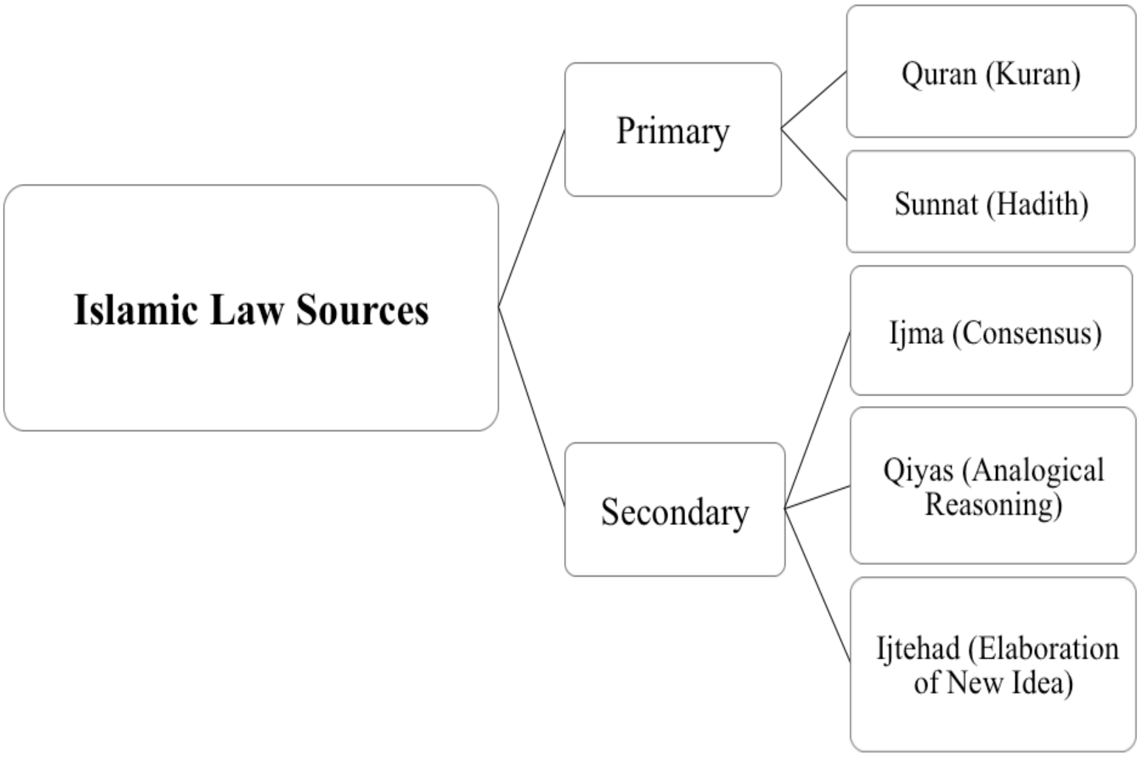
[460] O. Scharbrodt, *Islam and the Baha’i Faith: A Comparative Study of Muhammad ‘Abduh and ‘Abdul-Baha ‘Abbas* (Oxford: Routledge, 2008), 7-11.

[461] Allegories are used as literary devices that convey hidden meanings through symbolic figures, actions, imagery which together make the spiritual or political meaning the creator wishes to transfer.

[462] N. Keddie & Y. Richard, *Modern Iran: Roots and Results of Revolution* (New Haven: Yale University Press, 2006), 17-18.

[463] W. Hallaq, *An Introduction to Islamic Law* (Cambridge: Cambridge University Press, 20090, 21.

Figure 11: Sources Of Islamic Law



A. Primary Sources

A primary source is one that is accepted by all the Islamic schools. There are two sources that are considered to be primary, the Quran and the Sunnat (Hadith).[464]

I. Quran

The etymology of the word of Quran originates from the Arabic word 'Qurra' which is best defined as 'the reading' or 'that which ought to be read'.[465] Devout Muslims believe that the Quran is the word of God.[466]

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[464] W. Hallaq, *An Introduction to Islamic Law* (Cambridge: Cambridge University Press, 20090, 21.
[465] W. Graham, *Islamic and Comparative Religious Studies: Selected Writings* (Surrey: Ashgate Publishing Ltd, 2010), 130-132.
[466]Ibid.

The Quran contains a substantial amount of material that lends itself to the application of legal problems.[467] According to modern scholars and Muslim Jurists, there are approximately 500 verses with legal content.[468] Of these verses approximately 140 relate to moral obligations for Muslims concerning faith, prayer, charity, etc.[469] A further 70 verses are dedicated to marriage, divorce and family issues.[470] Around 140 verses refer to laws concerning commercial and economic transactions.[471] A further 30 verses relate to crime and punishment and the remainder treat issues about justice, fairness and responsibilities.[472]

Islamic law cannot be considered without studying the Quran since it is the primary source of law in more than 55 Muslim countries.[473] Iranian readers often find the Quran a difficult text to navigate, since the expression and rhythm of the Arabic words do not translate well to Farsi or other languages.[474]

II. The Sunnat (Hadith)

The Sunnat is regarded as an important text within Islamic law. It contains the spoken words and actions of Mohammad, the twelve Imams and Fatemeh, Mohammad's daughter.[475] The diverse range of issues, which Mohammad preached about are contained in the Hadith and are included in

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[467]N. Adam & A. Thomas, *Islamic Bonds: Your Guide to Issuing, Structuring and Investing in Sukuk* (London: Euromoney Books, 2004), 25-26.

[468]S. Goitein, 'The Birth-Hour of Muslim Law', *In The Muslim World*, 50.1 (1960) 23-29.

[469]Ibid.

[470] S.C. Vesey-Fitzgerald, *Nature And Source of The Sharia*, in The Law in The Middle East (Washington, DC: The Middle East Institute, 1955), 87.

[471] Ibid.

[472]Ibid.

[473] The Quran includes 114 chapters, 6,666 verses and 86,430 words.

[474] Ch. Knight et al, 'The Penny Magazine of the Society for the Diffusion of Useful Knowledge', *Harvard Collage Library*, 3.1 (1834) 435-442.

[475]H. Ramadan, *Understanding Islamic Law: From Classical to Contemporary* (Lanham (MD): Altamira, 2006), 12-14.

Islamic law.[476] In Iranian law, the Jurist must resort to the Sunnat only when he or she cannot find any applicable law in the Quran.[477] The primacy of the Quran over the Sunnat is partially a result of the fact that the validity of the Quran is not open to doubt.[478]

When the Quran and Sunnat are silent on the legal issue, the judge should refer to secondary Islamic sources,[479] as shown below.

B. Secondary Islamic Sources

Should the primary sources fail to cover the context of a particular legal dispute, then it is possible to refer to a range of secondary sources such as the Ijma, Qiyas and the Ijtihad. These sources are not universally accepted, with certain Islamic schools disregarding their legitimacy.[480] The schools that do accept them consider that their interpretations are in line with the primary sources.[481] These subordinate sources will follow in subsequent subsections.

I. Ijma (Consensus)

Ijma constitutes a secondary source of Islamic international law. It provides the Islamic community with essential tools to reach agreement,[482] as Mohammad said,

[476] A. Affi & H. Aff, *Contemporary Interpretation of Islamic Law* (Leicester:Troubador Publishing Ltd, 2014), 8-10.
[477] W. Hallaq, *A History of Islamic Legal Theories: An Introduction to Sunni Usul Al-fiqh* (Cambridge: Cambridge University Press, 1999), 89, 160.
[478] Ibid.
[479] M. Mattar et al, *Mixed Legal Systems, East and West* (Oxford: Routledge , 2015), 208 to 210.
[480] L. Zakariyah, *Legal Maxims in Islamic Criminal Law: Theory and Applications* (London: Brill Publication, 2015), 10-14.
[481] Ibid.
[482] J. Burns, *Introduction to Islamic Law: Principles of Civil, Criminal, and International Law Under The Shari'a* (New York: TellerBooks, 2014), 28-29.

> "My followers will never agree upon an error or what is wrong… God's hand is with the entire community."[483]

It is an important source that has been instrumental in the interpretation of the Quran and Sunnat.[484] Ijma literally means consensus, however it is interpreted differently by different Iranian Jurists.[485] As the interpretations of the source vary, there is still a serious question of whether consensus means a majority of opinion or common agreement.[486] In Iran, it is applicable if the majority of opinion is not against the principle of Quran and Sunnat (Hadith).[487]

II. Qiyas (Analogical Reasoning)

Qiyas is the second important subordinate source, or the fourth 'root' of Islamic law.[488] The idea is that, if a ruling is required on a situation not covered in the primary sources the Quran and the Sunnat, a comparison can be made with situations, which the Quran and the Sunnat did not provide for.[489] If, take for instance, the Quran forbids the use of wine, the use of other liquids, with similar influence, can be illegal as well.[490] However, Shiites do

[483] J. Rehman, *Islamic State Practices, International Law and the Threat from Terrorism: A Critique of the 'Clash of Civilisations' in the New World Order* (Oxford: Hart Publishing, 2005),13.
[484] U. Khaliq et al, *'Islamic State Practices, International Law and the Threat from Terrorism: A Critique of the Clash of Civilisations',* New World Order, 33.2 (2006) 324–330.
[485] J. Burns, *Introduction to Islamic Law: Principles of Civil, Criminal, and International Law Under The Shari'a* (New York: TellerBooks, 2014), 28-29.
[486] J. Burns, *Introduction to Islamic Law: Principles of Civil, Criminal, and International Law Under The Shari'a* (New York: TellerBooks, 2014), 29.
[487] N. Shirazi, *Descent of the Holy Quran* (Munich: Createspace Independent Publishing Platform, 2015), 2: 137 and 4:115.
[488] J. Burns, *Introduction to Islamic Law: Principles of Civil, Criminal, and International Law Under The Shari'a* (New York: TellerBooks, 2014), 29-34.
[489] Ibid.
[490] H. Visser, *Islamic Finance: Principles and Practice* (Cheltenham: Edward Elgar Publishing, 2013),10-15.

not accept analogical reasoning, but replace it with Human Reason (In Farsi called Aql).[491]

III. Ijtihad (The Elaboration of New Idea)

This source is considered as a supplementary source of Islamic law.[492] Ijtehad came from 'Jahad' meaning to try one's utmost.[493] In other words, it means the use of human reason in the explanation of Islamic law.[494] It covers a variety of rational processes, ranging from the interpretation of texts of the Quran and the evaluation of the validity of the Sunnat (Hadith).[495] Ijtehad, therefore, it is an exercise of one's reasoning to arrive at a logical conclusion on a legal issue undertaken by the Jurists, and to deduce a conclusion as to the effectiveness of a legal precept in Islam.[496]

Shia jurists maintain that if a solution to a problem cannot be found from the primary sources, then Aql or Ijtehad can be used to deduce a proper response from the primary sources.[497]

3.3.3 Legislation Reform

Iranian Company Law has undergone very few updates since its inception. Since the 1979 revolution, there has been a new body in charge of regulating legislation reform. The Islamic Consultative Assembly receives legislation updates from legislators and determines whether or not they are

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[491] J. Burns, *Introduction to Islamic Law: Principles of Civil, Criminal, and International Law Under The Shari'a* (New York: TellerBooks, 2014), 31-32.

[492] Ijtihad, which is six hundreds verses and two thousand Hadiths. J. Burns, *Introduction to Islamic Law: Principles of Civil, Criminal, and International Law Under The Shari'a* (New York: TellerBooks, 2014), 31-35.

[493] H. Visser, *Islamic Finance: Principles and Practice* (Cheltenham: Edward Elgar Publishing, 2009),13.

[494] A. Saeed, *Islamic Thought: An Introduction* (Oxford: Routledge, 2006), 52-57.

[495] A. Naqvi, *Shia Dissociation from Usuli School* (Milton Keynes: AuthorHouse, 2013), 193-200.

[496] B. Kettell, *Introduction to Islamic Banking and Finance* (New York: John Wiley & Sons, 2011), 7-15.

[497] Ibid.

beneficial and in line with the Islamic principles of the state.[498] With the Islamic Consultative Assembly in this role legislators have had very little success in gaining approval for legislation updates.[499]

Since the revolution, apart from installing Islamic law, no sections relating to directors' duties in company law have been updated. In 2002 a company law legislation update was submitted which included directors' duties, however it was refused on the grounds that it was deemed to not be sufficiently in line with the Islamic principles. There was no attempt to suggest amendments that would allow for a revision to be submitted that would be accepted.

Moreover, in 2011, a revision was made to the legislation that relates to corporate governance.[500] The reform began a test period that was meant to run for five years beginning in 2012. It was active for a period of two years before the Islamic Consultative Assembly removed it following a review.[501] The Islamic Consultative Assembly rejected the reform due to section 241[502], 28[503], 12 and section 43(2)[504] of Iranian Company Law and principle (article)

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[498] Iranian Constitution Law 1980, Article 4 (Tehran: Didavar Book Publisher).
[499] A. Taheri, *The Baloch in Post Islamic Revolution Iran: A Political Study* (Raleigh (N.C): Lulu.com, 2008), 44-48.
[500] B. Mashayekhi & S. Mashayekhi, 'Development of accounting in Iran', *The International Journal of Accounting*, 43 (2008) 66-86.
[501] Ibid.
[502] Iranian Company Law 2011 (Amendment). Article 241 (Tehran: Didavar Book Publisher): the certain amount of pure benefit of a year of company can go for the directors rewards, it should not exceed more than three percent of public joint stock companies' benefit and the six percent of private joint stock companies' benefit per year goes and that reward cannot be more than the salary of the whole year.
[503] Iranian Company Law 2011 (Amendment). Article 28 (Tehran: Didavar Book Publisher): People are free to choose whatever profession they wish as long as this profession is not against Islam, public interest, and the rights of others. In considering the needs of society for different occupations, the government is required to provide favourable circumstances for the equal employment of all persons.
[504] Iranian Company Law 2011 (Amendment). Article 43(2) (Tehran: Didavar Book Publisher): Nobody could be a director of more than one governmental or not-governmental company at the same time. The punishment for breaching this law is giving back all the money that earned by companies plus extra amount to punish that person.

85 of the Constitution of the Islamic Republic of Iran.[505] Essentially the reasoning provided is that the reform put forward is not in keeping with the religious principles of the regime.

3.4 DIRECTORS' DUTIES

Having now considered the Iranian legal system and the rules on company law, it is necessary to progress to the primary objective of the research, which is the duties of directors in Iranian Company Law'. This section is divided into general laws on directors, fiduciary duties, the duty of care, the articles of association and the law on enforcement. For both fiduciary duties and the duty of care, reference will be paid to both statutory law and Islamic law.

3.4.1 General Law on Directors

The principal source of law for directors' duties is the Iranian Company Law.[506] The Act was introduced in 1932 and the code on directors was included in this edition. Later in 1968 the act was amended and articles 21 to 93 were deleted to make way for the introduction of 300 new articles. Within this update, there were no changes to any articles (sections) relating to directors' duties. Still today Iranian Company Law is the source of law where the majority of rules relating to directors' duties can be found. The

[505] Iranian Constitution Law 1979 (Amendment), Article 85 (Tehran: Didavar Book Publisher): Membership in the Assembly is vested in an individual and cannot be delegated to another person. The Assembly cannot allocate the power of legislation to a person or a commission. However, in urgent cases it can assign to its own internal commissions the power to legislate certain laws, in accordance with Iranian Constitution Law 1979 (Amendment), Article 72 (Tehran: Didavar Book Publisher). In this case, the laws will be implemented experimentally for a period of time that is specified by the Assembly. Their final approval will be determined by the Assembly.

[506] Iranian Company Law 1968. Article 107-143 (Tehran: Didavar Book Publisher).

general rules on directors are located from article 107 to article 143. They dictate the appointment of directors, their terms and requirements.

Article 107 specifies that directors must be from shareholders and in public companies there must be no less than five directors.[507] Article 108 dictates that directors must be appointed at general meetings and article 109 states that length of directorship must be determined in the articles of association.[508] Articles 110, 111, 112 and 113 specify who can and cannot be a director and the process for replacing directors.[509] Article 114 dictates that directors must have an appropriate amount of shares to allow them voting rights in the meetings. It also mentions that the shares act as security in instances where the shareholders need to claim against directors for breaching duties. Article 115 sets out that a director must obtain the required amount of shares to be able to act as the director. Article 116 concerns the return of the shares of the director following their exit from the role of director. Provided that the shareholders approve the profit and loss accounts, then their shares are released. The role of the auditor is mentioned in article 117 stating that they must note any actions that deviate from the restrictions of the articles of association. Article 119 to 123 details items of the board of directors. Firstly the board must elect a chairman and vice chairman, who cannot be the managing director unless three-quarters of the shareholders' vote confirms the appointment.[510] The elected chairman must call the general meetings and the majority of the board must sign the minutes of the meetings. Moreover, the resolutions of the board are decided by majority

[507] Iranian Company Law 1968. Article 107 (Tehran: Didavar Book Publisher).
[508] Ibid.
[509] Iranian Company Law 1968. Article 124 (Tehran: Didavar Book Publisher).
[510] Iranian Company Law 1968. Article 124 (Tehran: Didavar Book Publisher).

votes. Articles 124 to 128 refers more to the role of the managing director detailing that they must be a natural person and a representative of the company with the ability to sign on behalf of the company. They are not allowed to be the managing director of more than one company at a time. When a managing director is appointed, a statement must be submitted to the registrar of companies that details the scope of their authority and responsibility.

Article 134 refers to the directors' remuneration stating that it should be detailed in the articles of association. Article 135 dictates that once a director is appointed and is making decisions, these decisions cannot be voided by the suggestion that formalities were overlooked at their appointment. Article 136 refers to the expiry of the director's term of office being located in the articles of association. Article 137 dictates that the directors are to prepare a report for the auditor every six months. Articles 138 and 139 state that the directors have to call an annual meeting to gain approval from the shareholders for the finances for the previous year. 15 days before the general meeting shareholders can get a copy of the profit and loss accounts and a report of operations of directors and auditors. Article 140 sets out that a company has to have a legal reserve fund of 5 per cent of the net profit for the company. In cases of liquidation, article 141 states that any interested parties can call the general meeting to begin the process of liquidating the company.

In terms of directors' duties, article 142 stipulates that directors are bound to abide by the restrictions set out in the articles of association. The article provides that all directors are individually or jointly responsible for any infringement of legal regulations or the provisions stipulated in the articles of association or in the minutes of general meetings.[511]

Article 143 explains directors' liability for breaches of their obligations. It is stated that should the company go into liquidation and there are not sufficient securities in the business to satisfy all the debts, then the director may be liable for debts if the reason for the damage to the company is caused by their violations of the legal regulations or the provisions stipulated in the articles of association or in the minutes of general meetings. This article demonstrates that statutory law does not cover duties. Should there be no provisions in the articles then directors have no liability at all. If duties are included in the articles with the exception of a duty to act in good faith then this will place the director in a position of liability for any damage regardless of any cause of the damage being made in good faith.

In addition to statutory law, Islamic law includes certain principles that relate, albeit very indirectly, to directors' duties. Specifically in the Fighh*,* it is achievable to examine the different roles of a director depending on different circumstances.[512] A director could be viewed as an agent '*Vakil*' of the shareholders and trustee '*Amin*' and manager '*Mudarib*' of the shareholders' assets.[513] According to these three descriptions of the director's role, they will have to fulfil their role as a manager, safeguard the shareholder's assets and act as agent of the shareholders.[514]

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[511] Iranian Company Law 1968. Article 104 (Tehran: Didavar Book Publisher).
[512] T. Harrison & E. Ibrahim, *Islamic Finance: Principles, Performance and Prospects* (Bern: Springer, 2016), 21-27.
[513] Ibid.
[514] Iranian meaning for Amin: 'Trustworthy person', Vakil: 'legal lawyer', Mudareb: 'advisor'.

3.4.2 Duties of Loyalty

Article 118 sets out the duty to act within powers. The limitations to the power of the director are set out in the articles of association and by way of resolutions at general meetings. The director will be liable if they act outside of this power remit.

Article 129 is the first article that is based around conflicts of interest. It states that any transaction of the company cannot be entered into with a party that the director is involved with directly or indirectly. [515] If the board permits such a transaction, then a report must be prepared for and delivered to the general meeting and the auditor must scrutinise the details of the transaction.[516] After receiving a report from the auditor they can vote in a general meeting in which the director in question will forfeit their vote. Should the board vote against allowing the director's involvement in the transaction, then a solution will be arrived at that prevents the director's involvement being allowed to occur. The solution might be to not proceed with the transaction, or find an alternative third party to complete a similar transaction with.

In article 130, it sets out that should the managing director approach the board of directors about a transaction in which they have a conflict of interest and the board of directors allow the director to proceed with it, then the liability for any loss to the company that results from the transaction will be attributable to the board members that approved the transaction as well as the managing director. [517]

[515]Iranian Company Law 1968. Article 129 (Tehran: Didavar Book Publisher).
[516]Ibid.
[517]Ibid.

Article 131 continues on the subject of the transaction stating that if the board are not made aware of the conflict of interest and the director proceeds with the transaction then the board has up to three years to rescind the transaction.

Article 132 sets out that directors will not be able to obtain any personal loans from the company nor will they be able to use security of the business to gain a personal loan. One scholar mentioned that in the banks, directors should follow that the director of any company is forbidden to do any deal for their personal interest. Before any agreement with their company the permission of the board of directors needs to be granted and it should be proven that the decision was in the interest of the company not in the personal interest of the director. Finally the decision needs to be revealed in the company's general meeting.

Article 133 relates to corporate opportunities stating that directors are not to be involved in transactions that compete with the transactions of the company.[518] Any transaction that is deemed to be in competition with the company that causes the company a loss, will result in the director having to indemnify the company for such losses.[519]

Directors' fiduciary duties and other duties can be derived from a general rule of agency under the Fighh. In particular the agent must act within the scope of his or her authority as an agent and in the best interest of his or her principal. An Iranian judge would decide agency related issues on a case-by-case basis relying on the general Fighh agency rule. This system

[518] Iranian Company Law 1968. Article 133 (Tehran: Didavar Book Publisher).
[519] Ibid.

however opens itself up to inconsistent judgments as similar cases may result in different decisions.

This is covered under principles of *Sharia*; take for instance, the following from the Quran,

> "-Do not take one another's property irrationally, nor bribe the judges, in order to misappropriate a part of other people's property, sinfully and knowingly.[520]
> -O you who believe! Betray not God and his Messenger nor betray knowingly your (trust you entrusted to).[521]
> …And if one of you deposits a thing on trust with another, let the trustee discharge his trust and let him fear God. Conceal not evidence: for whatever conceals it, his heart is tainted with sin and God knows all that you do.[522]"

The concept of trust is used in these principles and they can be applied in relation to the duty of loyalty. Also further Sharia principles are applied for setting out that a duty of loyalty involves considering all shareholders equally.[523] The Quran includes,

> "-Give back the trusts to their legal owners, and when you judge between people, judge with justice.[524]
> -Of those we created are people who guide by the truth, and by it act with justice.[525]

[520] N. Shirazi, *Descent of the Holy Quran* (Munich: Createspace Independent Publishing Platform, 2015), 2.188.
[521] N. Shirazi, *Descent of the Holy Quran* (Munich: Createspace Independent Publishing Platform, 2015), 8.27.
[522] N. Shirazi, *Descent of the Holy Quran* (Munich: Createspace Independent Publishing Platform, 2015), 2.283 & 9.4.
[523]Subject to anything specifically allowed to the contrary in the articles of association or shareholders' resolutions.
[524] N. Shirazi, *Descent of the Holy Quran* (Munich: Createspace Independent Publishing Platform, 2015), 4.28.
[525] N. Shirazi, *Descent of the Holy Quran* (Munich: Createspace Independent Publishing Platform, 2015), 8.180.

> -God commands justice and good-doing…. And he forbids indecency, dishonesty and insolence.[526]
> -Give just measure and weight, and do not withhold from the people the things that are their due.[527]
> …God does not love anyone who betrays his trust and its bereft of gratitude…[528]"

These latter principles are addressing honesty in general terms, which is linked to acting in a trustworthy manner with honesty. They take into account the Fighh principle that prohibits self-dealing by agents or employees (a director is under a duty not to benefit from a conflict of interest). The Fighh principle includes,

> "Honest businessmen will be raised on the Day of Judgment (According to Hadith from Mohammad). Truthful businessmen will be raised on the Day of Judgment together with the truthful and the martyrs (According to Hadith from Mohammad*)*.
> When you deal with each other in lending for a set period of time, put it in writing. Let a scribe write it down with justice between the parties.[529]
> A director authorised to buy or sell an item is not permitted to buy or sell to/from himself or herself.[530]"

The statutory code and the Islamic law exists side by side, however there is an unwritten rule that the Islamic law takes precedence over the

[526] N. Shirazi, *Descent of the Holy Quran* (Munich: Createspace Independent Publishing Platform, 2015), 15. 92.
[527] N. Shirazi, *Descent of the Holy Quran* (Munich: Createspace Independent Publishing Platform, 2015), 11.85.
[528] N. Shirazi, *Descent of the Holy Quran* (Munich: Createspace Independent Publishing Platform, 2015), 22.38.
[529] N. Shirazi, *Descent of the Holy Quran* (Munich: Createspace Independent Publishing Platform, 2015), 2.282.
[530]M. Kamali, *Principles of Islamic Jurisprudence* (Cambridge: Islamic Text Society, 2003), 323-350.

statutory code in instances where there is law from both sources that relates to a circumstance.

3.4.3 Duty of Care

The only articles in the code that are relevant are articles 141 and 114. Article 141 provides that the directors can be held to be negligent for failure to alert shareholders when a threat to the value of the company's shares arises. If the director is aware of the threat and fails to inform the shareholders, then they are considered negligent if the problem results in harm to the company's investment.[531]

Article 114 is particularly applicable in instances of breaches of the duty of care. The shares of the director (and it will be recalled that directors must hold shares in the company) act as a security against a director negligently damaging the company through making poor decisions on behalf of the company. If it is proven that a director has acted wrongly, then these shares could be seized by the court and returned to the shareholders as compensation for damage caused by the directors.[532]

A duty of care is imposed by the Fighh on people in the positions of liability or authority. In this case, it is likely that the Fighh would require a director to act within the scope of the powers vested in them (and not abuse those powers), and fulfil their duties. The principles of the Fighh provide effectively that directors are to act to the best of their ability in the best interests of the company and in a rational manner as responsible directors would act.

The writer in the interpretation of the Quran said: an agent allowed

[531] Iranian Company Law 1968. Article 141 (Tehran: Didavar Book Publisher).
[532] Iranian Company Law 1933. Article 52 (Tehran: Didavar Book Publisher).

to trade an item, must do so at the reasonable market price, if there is no price specified by the owner.[533]

Responsibility of the director is covered under principles of the Fighh*.* These responsibilities include improving one's own leadership qualities, taking responsibility for one's area of business, strengthening the finance of the organisation (Bait-Ul-Maal), helping the local community in the organisation's locality and having a good relationship with all Islamic personalities of the organisation's locality.[534]

A director ratified to buy or sell an item at a specific price is responsible to the shareholders for covering the discrepancy between the actual price at which he or she buys or sells and the price originally stated by the shareholders,[535]

> "Each one of you is a guardian, and each guardian is responsible for everything under his care."[536]

As Mohammad said above we can now say clearly there is a type of guardian role for directors because he or she has to take care of assets for others. It is also stated in the Quran that Muslims should not disregard their responsibilities and accountability and they can face punishment in this

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[533] M. Kamali, *Principles of Islamic Jurisprudence* (Cambridge: Islamic Text Society, 2003), 323-350.

[534]M. Ala, 'Principles Of Islamic Leadership', *Ibrahim.com* (2000). Available online: http://www.ibrahimm.com/ISLAM/Islamic%20Articles/PRINCIPLES%20OF%20ISLAMIC%20LEADERSHIP.htm [Accessed 10/09/2016].

[535]H. Elasrag, *Corporate Social Responsibility: An Islamic Perspective* (Munich: Createspace Independent Publishing Platform, 2015), 10-20.

[536] H. Elasrag, *Corporate Social Responsibility: An Islamic Perspective* (Munich: Createspace Independent Publishing Platform, 2015), 15.

world or in the hereafter (life after death).[537]

3.4.4 Articles of Association

The articles must contain the key attributes of the company such as the name, the subject, the location, the amount of investment, the price of shares, type of company, the names of the board of directors and the voting system.[538] Within the general rules from articles 107 - 143 there are several rules that refer to the articles of association. Article 109 stipulates that the length of directorship should be determined in the articles of association. Also, article 134 dictates that directors' remuneration should be detailed in the articles of association. Importantly article 118 dictates that limitations to directors' powers are set out in the articles and article 142 importantly notes that directors are bound by the provisions contained in the articles.[539]

This last article is especially critical as essentially it provides that directors' duties should be included in the articles of association.[540] This is a key rule as it relinquishes the responsibility from statutory law to provide a comprehensive set of directors' duties and instead defers that responsibility to the articles of association. Lawyers who seek to make up for this shortcoming will include duties in the articles and any shareholder aware of the lack of duties in statutory law will also endeavour to put duties in place.[541]

Either the shareholders or a solicitor carries out the task of producing the articles.[542] When it is the shareholders producing the articles, there is the risk that they will fail to include all the relevant and fundamental duties that

[537] H. Elasrag, *Corporate Social Responsibility: An Islamic Perspective* (Munich: Createspace Independent Publishing Platform, 2015), 10-20, 17-18.
[538] Iranian Company Law 1933. Article 37 (Tehran: Didavar Book Publisher).
[539] Iranian Company Law 1968. Articles 107-143 (Tehran: Didavar Book Publisher).
[540] Iranian Company Law 1968. Article 124 (Tehran: Didavar Book Publisher).
[541] Ibid.
[542] Iranian Company Law 1968. Article 124 (Tehran: Didavar Book Publisher).

are needed to protect them. Even with the assistance of a solicitor, articles of association can be brief and fail to cover all the duties in sufficient detail.[543]

Some companies that seek an extra level of security will include the *Sherkat Nameh* (company letter or document) in their articles. This is a document provided by the Judiciary which companies can include in their articles to give them an extra level of authority. The document contains a series of rules and regulations that companies can agree to or not agree to. The rules they agree to will exist as other provisions of their articles. Following the inclusion of the Sherkat Nameh, the articles are signed by the shareholders and sent to the office of the Ministry of Justice for their stamp of approval.[544] The purpose of this is to make clear the mutual agreement with the articles of all the shareholders.[545]

In cases where the duties set out in the articles are breached, the directors and the managing director of a company are liable either individually or collectively for breaking company rules.[546] Apart from duties on directors, there will be a host of other rules in the articles that apply to directors, shareholders, dealings with third parties and company protocol.[547] The court determines the scope of responsibility of each director for indemnity purposes.[548]

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[543]Iranian Company Law 1968 (Tehran: Didavar Book Publisher). See also Iranian Company Law 1933. Article 36 (Tehran: Didavar Book Publisher).
[544]Iranian Company Law 1933. Article 36 (Tehran: Didavar Book Publisher).
[545]Iranian Company Law 1933. Articles 36-38 (Tehran: Didavar Book Publisher). Iranian Company Law 1968. Articles 197.
[546] Iranian Company Law 1968. Articles 142 & 61 (Tehran: Didavar Book Publisher).
[547] Ibid.
[548] Ibid.

3.4.5 Good Faith

Islamic law imposes a general duty to act in good faith in all transactions. It requires parties to act in good faith during negotiations, contract formation and performance. Ghaedeye Ehsan is an Islamic principle of fairness found in the Haddith. It is not solely assigned to company law and there are instances where it is applied in civil cases. It is in effect a requirement to act reasonably and moderately and to not use the terms of a contract to abuse the rights of the other contracting party. It is a requirement to not cause unjustified damage to the other party.

> “a contract must be performed in accordance with its contents, and in a manner consistent with the requirements of good faith”.[549]

Good faith is also applied in Al’Amalo bel Niat, which is essentially a duty to act altruistically. This in effect is a requirement not to use the terms of a contract to abuse the rights of the other contracting party, not to cause unjustified damage to the other party and to act reasonably and moderately. For instance, a party that enters into contract negotiation in order to gain access to another’s’ confidential information violates the Islamic law duty to act in good faith. In addition, a creditor bears a duty to give his or her debtor a grace period if he or she is unable to pay the debt.[550]

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549 Interpretation of Hadith (sentence) from Mohammad, 630 CE (Common Era).

550 F. Akaddaf, ‘Application of The United Nation Convention on Contract for the International Sale of Good (CISG) to Arab Islamic countries: is the CISG compatible with Islamic Law Principles?’, *Pace International Law Review*, 13 n1 (2001) 1-58.

3.4.6 Enforcement

Iranian Company Law contains law on enforcement in the form of articles 276 and 277. These are the only two articles that deal with enforcement. The former states that only shareholders with shares that exceed 20 per cent of the share capital of the company can bring an action against the director and also that the shareholder must fund this action personally. Article 277 supports article 276 by stating that no provision can be added to the articles of association that conflict with article 276. For instance no rule could be added to the articles allowing any shareholder to bring an action regardless of their portion of share capital.

3.5 WEAKNESSES OF DIRECTORS' DUTIES

3.5.1 Sources of Law on Duties

The first weakness of the law on duties is that it is not straightforward enough due to there being too many sources and also due to the actual laws being ambiguous. Having duties spread between the articles of association, the Fighh and Iranian Company Law results in an unclear presentation of the duties that directors are bound by and a significant degree of uncertainty for all parties. Ideally there would be only one source of law that details duties. In terms of the duties being too ambiguous, statutory law has several duties that are vague and not clearly defined. The same is true of the duties in the Fighh. The articles of association of some companies are likely to be the source with a more precise series of duties, but these will be unique to individual companies and not employed across Iran in a consistent way.

For directors and shareholders there will be confusion and uncertainty over what duties directors are bound by. More importantly for judges the law on duties is spread across the articles of association, scattered articles in statutory law and scattered principles in Islamic law. As a result, judges have various sources to look through to find a relevant rule to determine a case, which instils uncertainty in them as well. As some of the laws are so dated judges are even harder pressed to interpret the law as they are referring to laws created 80 years ago, which might be completely irrelevant to today's modern business context. Islamic sources as well date back to the origin of the Quran in 1382.

If company law were continuously updated taking into account new cases that appear in Iran, then it would start to become more precise and relevant and easier for judges to make accurate decisions. Added to this is the fact that Islamic law is particularly difficult to interpret, as it is not designed for resolution of company law disputes and problems.

3.5.2 Duties in the Articles

Moreover, as already mentioned article 142 states that directors are responsible for any regulations that are prescribed in the articles of association.

> "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.[551]"

[551] Iranian Company Law 1968. Article 142. (Tehran: Didavar Book Publisher).

This deference of duties and regulations to the articles results in each company having its own unique set of duties in place as opposed to the jurisdiction having a universal set of duties. This is a considerable weakness to the law as it results in directors around the country being bound by varying levels of liability. Where a director might have liability for a decision in one company they might not in another. This variation in liability leads to many issues for shareholders and directors. Universal levels of liability are needed for companies having protection from directors and for judges to make consistent decisions.

3.5.3 Duties of Loyalty

The fiduciary duties are not adequately comprehensive in Iran and many key aspects to fiduciary duties are not included. Whilst there is a duty to act within powers it is not specific enough as it states that the scope of the power must be defined in the articles. By adding the dimension that the onus is on shareholders to specify the scope of the director's power will result in many cases of nothing being specified. The alternative would have been to specify in the law what the scope of the power would be.

Articles 129 to 133 relate to conflicts of interest however they are too specific on the scope of the duty. Instead of having a 'duty to avoid conflicts of interest' the duty is made up of descriptions of scenarios in which director would be liable. For instance in article 29 directors cannot,

> "Without the permission of the board of directors, be a party whether directly or indirectly, to a transaction consummated with or on account of the company, or share in the said transaction. Even if allowed, the

> board of directors shall be bound to inform the inspector(s) immediately of the transactions allowed by them and, simultaneously, submit a report to the next ordinary general meeting. A board member or managing director who has an interest in such transactions, shall not be allowed to vote at meeting of the board of directors and general meetings when such transactions are put to motion.”

Equally article 130 refers to article 129 clarifying that,

> “If, as result of such transactions, losses are inflicted on the company, then the board of directors and the managing director or the director or directors having an interest who sanctioned such transactions shall be jointly responsible to indemnify the company.”

Article 131 also refers to article 129 stating,

> “If transactions are performed in the absence of approval of the board of directors and the ordinary general meeting does not confirm such transactions, then they will be rescindable. The company shall be entitled to apply to the court and obtain an injunction of recision of such transactions within three years from the date of their conclusion and if concluded secretly, within three years from the date they were discovered. In any case, the responsibilities of the interested director or directors or managing director vis-a-vis the company remain intact.”

Moreover, article 132 considers a different scenario of liability where,

> “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."

A different scenario of liability is considered in article 133 where,

> "The directors and the managing director shall not be allowed to conclude transactions identical to the transactions of the company which are considered to compete with the company. If any director, acting in contradiction of the purport of this article, inflicts a loss to the company by his violation, he shall be held responsible to indemnify the company's losses. The losses mentioned in this article purport actual losses incurred or reductions in profit."

There is a lack of broadness to these articles and many conflicts of interest do not fall within these parameters. For instance, there is no provision to prevent third parties from influencing the decision making of the director. In a country where both family companies and public companies make up such a high proportion of the company stock, there is a need for a law that makes directors liable for allowing their decision making to be influenced at the detriment of the company.

3.5.4 Duty of Care

Whilst article 141 refers to a particular liability for negligence it is far too specific to be an all-encompassing duty of care. Without the law, directors are free to cause considerable damage to a company without any risk of liability. For the shareholders this is a serious concern as their interests are constantly exposed without any protection and at present they can only rely on trust or surveillance to protect their interest. Any shareholder who is aware of the danger would be prudent to include the duty in the articles of association however certainly there are many who do not do this.

3.5.5 Good Faith

Good faith exists only in Islamic law in Iran, as there is not any statutory law on the subject. Both Ghaedeye Ehsan and Al'Amalo bel Niat are broad versions of good faith law and they are not designed for company law applications, they are rather general laws that are applied to company law cases. Furthermore, the rules are rarely used in cases of breaches of duties (from articles). Directors need a level of protection against unjust cases of negligence being brought against them and at present this law is not comprehensive enough to be able to protect directors. Should the duty of care come into force, then a provision of good faith would be necessary alongside it.

3.5.6 Enforcement

A legislation update to enforcement was put forward in 2011. It contained a suggested reform of articles 276 and 277 to allow for the derivative action to be brought by any of the minority shareholders against the directors regardless of their portion of share capital. Furthermore the shareholders would be exempt from paying the fee for bringing the action. The proposal was rejected. The fact that this proposed update was submitted demonstrates that there is some acceptance of flaws in the enforcement of breaches of duties in Iran.

Apart from bringing actions against directors, there is a common practice of resolving issues internally in companies. Directors who have damaged companies might be well connected either as a family member or a politically connected individual. Punishments may take the form of fining a director or suspending them without pay. When a director does not have connections the typical solution is to dismiss them which is a considered the most useful tool for dealing with improper actions from directors. Needless to say dismissing a director does not compensate a company for damage incurred as a result of the director's actions.

3.6 CONCLUSION

This chapter has investigated company law and in particular directors' duties in Iran. The formation of companies in Iran is not that dissimilar to other jurisdictions. The private joint stock company and the public joint stock company are the two most common company vehicles.

The majority of Iranian law can be traced back to civil law for since its foundations the Iranian legal system has borrowed many sections that are now key points of legislation. This civil code has been placed within a rigid Shia Islamic framework, which demands adherence. The Islamic law is derived principally from religious scriptures, or secondary texts that refer to the scriptures.

Legislative reform of company law has been limited in Iran and there is clear preference from the Islamic Consultative Assembly to prevent updates coming through the system. Since 1932 directors' duties have not been updated despite a later update to the company law in 1968.

There is considerably more guidance on directors' appointments, share structures and the details regarding the formation of a company as opposed to on duties. Article 142 dictates that directors' duties will be contained in companies' articles of association.

There are several articles that refer to duties of loyalty within Iranian Company Law, however they fail to broadly cover the main properties needed in such duties. Whilst article 118 states that directors should act within their powers, it defers responsibility for setting out the scope of their powers to the articles. Specific conflicts of interest are mentioned in article 129 to 133 however there is no 'duty to avoid conflicts of interest' that would be broad enough to cover all examples of conflicts.

Equally the closest Iranian law comes to applying a duty of care is in articles 141 and 114 where there are provisions against negligent directors. These two articles do not set out any duty of care, skill and diligence' that directors can follow, but they do state that companies can bring actions against negligent directors.

The articles that exist can be classed as wholly inadequate in their provision of allocating liability to directors for damaging companies. Additionally, there is no form of protection in statutory law for directors in instances of actions brought against directors who have acted in good faith. The Islamic law that does provide for good faith is too broad and the principles that are applied to company law are too general in nature to the extent that they are also applied to many other fields of law.

The articles of association, as mentioned, are where shareholders are able to specify a comprehensive series of duties. In theory this is satisfactory as long as all shareholders provide adequate duties through the assistance of a qualified legal practitioner. In reality though, many shareholders do not seek legal advice when drawing up the articles of association and even those that do seek advice cannot be secure in the knowledge that their provision of duties will be adequate to cover all eventualities. Depending so heavily on companies developing their own articles of association is an unsatisfactory practice as it results in an inconsistent level of liability across the jurisdiction for directors.

The enforcement of directors' duties is also lacking in that article 276 and 277 limit directors who are minority shareholders with less than a 20 per cent stake in a company from bringing an action. Furthermore, the costs of bringing an action must be borne by the shareholder.

CHAPTER FOUR

THE PROCESS AND FORMULATION OF AN EMPIRICAL STUDY INTO DIRECTORS' DUTIES IN IRAN

4.1 INTRODUCTION

The previous chapter provided a detailed doctrinal account of the law in Iran and specifically it focused on the law relating to directors' duties. The doctrinal approach has been useful to understand many elements of the research such as the code that exists and the legal structures in place. Through carrying out empirical research on the subject matter the research has been developed by the acquisition of new data. This new data has made it possible to provide new findings on the subject, which have allowed for a more in depth understanding than previously existed.

Up until this point there does not appear to have been any other empirical research carried out in relation to directors' duties in Iran. Including empirical research in this project has provided a greatly overdue new insight into the state of directors' duties in Iran today.

The chapter considers the use of empirical research and how it has been included within the thesis. The subject matter is broken up into five sections that explain the stages of the empirical research process.

Section 4.2.1 discusses the method of empirical research and the reason for its selection of qualitative research in conducting this study. Section 4.2.2 explains the preparation undertaken for embarking on the empirical research. Section 4.2.3 details the organisation of the empirical research, including the communication with interviewees and the steps taken for the university ethics review. Section 4.2.4 accounts for the period during which the researcher was in Iran. The process of the one-to-one interviews, including the difficulties and problems that were experienced, is explained. Section 4.2.5 details the data collection process that took place after the research was concluded, describing the coding of the collected data.

4.2 EMPIRICAL RESEARCH

As examined in the methodology section in Chapter 1, this research aims to discover what are the problematic issues that exist under current Iranian Company Law relating to directors' duties and it also aims to make suggestions about potential reforms that could be considered. To obtain data that is relevant to the current state of directors' duties and how they affect practice in Iran, it was necessary to conduct empirical research.

Empirical research had to take the form of either a quantitative or a qualitative analysis. The target of quantitative methods is to acquire data from a random or representative sample in order to achieve objectivity in the responses and to be able to replicate the data.[552] A qualitative method however involves the acquisition of data from authoritative sources that can provide personal insight into the mechanics of the topic.[553] When comparing the two methods, it was clear that the quantitative method would not be able to provide the level of depth in the data reproduction that was required for this thesis. The qualitative approach, however, did have potential to produce

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[552] R. McQueen & Ch. Knussen, *Research Methods for Social Science: A Practical Introduction* (Gosport: British Library Cataloguing Publication Data, 2002), 196, 197, 200.
[553] U. Flick, *An Introduction To Qualitative Research* (London: SEGA, 2002), 11-15, 34-35.

data that would satisfy these requirements. For this reason it was considered that a qualitative approach was superior for the purpose of this study.

Having decided that a qualitative approach was the preferred strategy, the researcher had to select the type of qualitative approach to be undertaken. Interviews in the native language of the interviewees was chosen as the preferred means of obtaining data, as this would be substantially more useful than other approaches in being able to provide genuine insight into the subject material from authoritative sources.

4.2.1 Method of Empirical Research

Having established that the empirical research would be carried out through interviews it was necessary to establish what type of interview format should be implemented. When deciding between structured interviews, semi-structured interviews and unstructured interviews, the decision would be based on which would allow for the greatest extraction of useful data. It was concluded that structured interviews would be too limiting, as they would not permit the interviewer to probe interviewees for further information beyond the scope of set questions. Unstructured interviews were also deemed to be unsuitable, as all the interviews should cover the same material in order to get a response on the same issues in order for the data to be useful. Semi-structured interviews were selected as the most suitable type of interview technique as they would allow for a structure that would be repeated for all the interviews whilst at the same time permitting sufficient freedom for the interviewer to probe certain interviewees on certain topics where appropriate.

Semi-structured interviews involve the interviewer having a planned set of questions on particular topics but commencing the interview they are afforded the ability to deviate away from the questions in order to gain the most from the responses of the interviewee. On occasions there might be considerable deviation and on other occasions little deviation.[554] They are typically conducted one-to-one however they can be carried out in groups or in pairs.[555]

4.2.1.1 Semi Structured Interviews

Semi-structured interviews are considered to be the most common of the qualitative methods used to obtain data within social sciences.[556] From anthropology to philosophy to law the most effective means for extracting precise data is semi-structured interviews.[557] When reflecting on the use of semi-structured interviews, many researchers have considered the method and considered the various aspects including the selection of interviewees, the selection of questions to match the candidates, the interview location, the recording technique and the process for analysing the data.

In comparison with structured interviews, they can make better use of the knowledge-producing potential of dialogues by allowing the freedom to follow up on points that they deem important. The interviewer has the opportunity of engaging as a 'knowledge-producing participant' in the process itself, rather than hiding behind fixed interview questions.[558] Compared to unstructured interviews, the researcher has a greater control

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[554] R. McQueen & Ch. Knussen, *Research Methods for Social Science; a Practical Introduction* (London: British Library Cataloguing Publication Data, 2002), 196-200.
[555] R. Longhurst, *Interviews: In-Depth, Semi-Structured* (Oxford: Elsevier, 2009), 581-584.
[556] U. Flick, *An Introduction To Qualitative Research* (London: SEGA, 2002), 11-35.
[557] Ibid.
[558] P. Leavy, *The Oxford Handbook of Qualitative Research* (Oxford: Oxford University Press, 2014), 286-287.

over the discussion and extracting what they believe is vital information in relation to the research project.[559]

Semi-structured interviews allow the interviewer to be active and reflective in the process of the data generation rather than as a neutral data collector.[560] By engaging with the interviewee it is possible to further develop points and access a more profound level of response than would otherwise be possible. This also justifies the researcher's role as a participant-observer. As a method of primary data collection, interviews are the most efficient way of obtaining the information required in a trustworthy format. In comparison there is not another means for obtaining the same objectives. Asking experienced people for their accounts and talking and listening to the persons selected is the best way to ascertain the existing position in commercial life in relation to the law on directors' duties.[561] Also, according to Mason,[562]

> "It is better to try to understand the complexities of the interaction rather than pretend that the key dimension can be controlled."[563]

It is also important to distinguish between the two ways in which the term 'depth' is utilised. Researching a point in depth is to develop a more extensive knowledge of it.[564] Moreover, researching something in depth is to

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[559] P. Leavy, *The Oxford Handbook of Qualitative Research* (Oxford: Oxford University Press, 2014), 286.
[560] P. Cane & H. Kritzer, *The Oxford Handbook of Empirical Legal Research* (Oxford: Oxford University Press, 2012), 262-270.
[561] Ibid.
[562] A. Bryman & E. Bell, *Business Research Methods* (Oxford: Oxford University Press, 2011), *385-386.*
[563] Ibid.
[564] Ibid.

uncover the complex nature of something that initially seemed simplistic.[565] This research deals with the latter meaning of depth as it involves delving into the complex landscape of directors' duties in Iran.

The semi-structured interview offers great potential to attend to the complexity of a research project. It allows for the engagement of the interviewee with segments of the interview, with each segment progressively being more structured. It can be carried out in one sitting, or several and allows for considerable reciprocity between the interviewee and the interviewer.[566] This reciprocity or give and take creates space for the researcher to probe an interviewee's responses for explanation, meaning and critical reflection. It is thought that a great deal can be accomplished within the semi-structured interview, as long as one gives considerable thought to the preparation of the questions.[567]

The benefits to the semi-structured approach are many, the first of which is that the openness to the conversations allows the interviewer to explain any terms or points that the interviewee might not understand in the questions posed.[568] When subject material needs expanding upon, the format of the semi-structured interview allows for conversation between the interviewer and interviewee to clarify meanings.[569] Whilst the interviewees in this study had professional backgrounds, most in law, certain question topics seemed foreign and complex to certain interviewees. A glossary was

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[565] T. Wengraf, *Qualitative Research Interviewing: Biographic Narrative and Semi-Structured Methods* (London: SEGA, 2001), 6.
[566] C. Dawson, *Practical Research Methods: A User-Friendly Guide to Mastering Research Techniques And Projects* (Oxford: How To Books Ltd, 2002), 28-32.
[567] A. Galletta & W. Cross, *Mastering The Semi-Structured Interview and Beyond: From Research Design to Analysis and Publication* (New York: New York University Press, 2013), 24.
[568] D. Porta, *Methodological Practices in Social Movement Research* (Oxford: Oxford University Press, 2014), 228,255-260.
[569] Ibid.

provided to the interviewees with clear explanations of terms to aid them in the event that they were not familiar with any points.

The semi-structured framework allows for the interviewer to rephrase and simplify the point of the questions when it is necessary to avoid any misunderstanding of terms or concepts or if the interviewee asks for any parts to be clarified. This is important as it eradicates any margin for misunderstanding. The flexibility to converse and rephrase elements of the questions can be a much-needed tool to help simplify the intention of the questions in the interviewee's mind. Without being able to do this, they might have a poor understanding of the questions and respond with short answers that prove not to be useful.[570]

Another benefit to the semi-structured approach is the freedom it allows interviewees to expand upon their responses.[571] It is the preferred technique for achieving depth in the research, as it allows the interviewee to expand on and explore a thought or sequence of events.[572] When dealing with a complex subject that has many levels and has occurred over a length of time, the interviewee requires time and freedom to consider their response and elaborate.[573]

The method is also useful for exploring social process, changes and problems and to achieve depth and a complete understanding in these areas rather than a superficial broad understanding of surface patterns.[574] This is

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[570] L. Luton, *Qualitative Research Approaches for Public Administration* (Oxford: Routledge, 2015), 21-27.
[571] Ibid.
[572] I. Crow & N. Semmens, *Researching Criminology* (Berkshire: Open University Press, 2007), 118-120.
[573] Ibid.
[574] A. Galletta & W. Cross, *Mastering The Semi-Structured Interview and Beyond: From Research Design to Analysis and Publication* (New York: New York University Press, 2013), 45,74-75.

because interviewees will often be encouraged to elaborate when points are raised that are not fully expanded upon in answering prescribed questions.[575] The ability to ask the interviewee to clarify points allows the interviewer to gain an extended depth of response.[576]

For certain subject areas semi-structured interviews are fundamental and without the method it would not be possible to fully understand certain research projects.[577] Moreover, the third benefit to semi-structured interviews is the researcher's freedom to probe the interviewees for more information on points of interest that arise in the discussion.[578] Semi-structured interviews enable interviewees to expand on complex and specific issues, clarifying in detail how they understand certain subjects.[579] Researchers can probe exact points extracting the core information that is required and also permit the interviewee to open up and disclose information freely.[580]

Through probing and exploring subjects with the interviewee, greater depth of information is unearthed and it allows for the opportunity to gain from the professional experience and understanding of the reality of the subject matter.[581] As long as the questions are sufficiently open-ended the

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[575] A. Galletta & W. Cross, *Mastering The Semi-Structured Interview and Beyond: From Research Design to Analysis and Publication* (New York: New York University Press, 2013), 45,74-75.

[576] G. Sammut et al, *The Cambridge Handbook of Social Representations* (Cambridge: Cambridge University Press, 2015), 64-71.

[577] D. Golsorkhi et al, *Cambridge Handbook of Strategy as Practice* (Cambridge: Cambridge University Press, 2010), 313-317.

[578] J. Smith et al, *Interpretative Phenomenological Analysis: Theory, Method and Research* (London: SAGE Publications Ltd, 2009), 56,70.

[579] J. Smith et al, *Interpretative Phenomenological Analysis: Theory, Method and Research* (London: SAGE Publications Ltd, 2009), 60-66.

[580] J. Ritchie et al, *Qualitative Research Practice* (London: SAGE Publications Ltd, 2013), 77.

[581] J. Ritchie et al, *Qualitative Research Practice* (London: SAGE Publications Ltd, 2013), 78-79.

interviewee's real views and beliefs can surface.[582] Obtaining the thoughts of the interviewees in their own words is key to the process.[583]

Probing can result in needing to re-order the questions throughout the interview.[584] The semi-structured interview lends itself to reordering certain questions to help with the flow of the dialogue in instances where certain points are probed to extract more information.[585] Furthermore, it might also be seen as beneficial to add extra questions to probe significant points that arise.[586] What is fixed in the process of the semi-structured interview is the topic that is identified in advance along with the date, time and interviewee.[587] Apart from these core elements, interviewers are permitted to guide the interview as they wish.

The fourth benefit to semi-structured interviews is the added flexibility it permits in the flow of the discussion.[588] Whilst the series of questions are organised as a guide for the interview, the researcher is able to make changes to the order of the questions to best suit the progression of the discourse (see the questions by the researcher for example in this chapter). The questions can be more open ended in their approach than those in a structured interview schedule. Interviewees however are typically less keen on open-ended questions as they do not have any idea in advance that

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[582] M. Walsh & L. Wigens, *Introduction to Research* (Cheltenham: Nelson Thornes, 2003), 90-98.
[583] B. Klandermans & S. Staggenborg, *Methods of Social Movement Research* (Minnesota: University of Minnesota Press, 2002), 92,93.
[584] N. King & Ch. Horrocks, *Interviews in Qualitative Research* (London: SAGE Publications Ltd, 2010), 125-132.
[585] V. Braun & V. Clark, *Successful Qualitative Research: a Practical Guide for Beginners* (London: SAGE Publications Ltd, 2013), 85-89.
[586] V. Braun & V. Clark, *Successful Qualitative Research: a Practical Guide for Beginners* (London: SAGE Publications Ltd, 2013), 78-80.
[587] A. Galletta & W. Cross, *Mastering The Semi-Structured Interview and Beyond: From Research Design to Analysis and Publication* (New York: New York University Press, 2013), 45-75.
[588] G. Thomas, *How to Do Your Research Project* (London: SAGE Publications Ltd, 2013), 103-130.

these will be added. They might view them as more time consuming and place them in a position of reduced control. The flexibility to ask further questions probing the interviewee on specific points is an extremely useful tool for controlling and organising the interview whilst it is in progress.[589] For the purpose of this study, the researcher was flexible in terms of the order in which the topics were considered and, perhaps, more significantly they permitted the interviewee to develop ideas and speak freely on directors' duties and company law in Iran. The dialogue was more fluid and there was more emphasis on the interviewee elaborating points of interest. As a result of this, the researcher was able to follow up particularly interesting avenues that emerged in the interview and the interviewee was able to develop their thoughts more comprehensively. The semi-structured qualitative method was able to capture the richness of the themes emerging from the interviewees' speech rather than restrict the interviewee to quantitative categories.[590]

A fifth benefit to semi-structured interviews is the possibility that the interviewees might initiate new topics due to the open-ended questions being more likely to generate rich-in-depth responses.[591] In this study, with 21 questions prepared in advance there was already a clear structural framework for the interview that the interviewer was able to drop in and out of depending upon how the interview unfolded. The elite interviewees however with their professional experience were able to divulge information that the researcher might not have anticipated.

[589] A. Bryman & E. Bell, *Business Research Methods* (Oxford: Oxford University Press, 2011), 203.
[590] J. Smith et al, *Rethinking Methods in Psychology* (London: SAGE publication, 2005),18-30.
[591] J. Creswell & V. *Plano Clark, Designing and Conducting Mixed Methods Research* (London: SAGE Publications Ltd, 2011), 19-23.

A considerable benefit to semi-structured interviews is that whilst the researcher is primarily only intending to gain data regarding the questions that they are posing, the answers potentially can reveal new issues or useful information. If new information is revealed that is potentially useful, the interviewer has the flexibility to probe the interviewee and guide the flow of the conversation as they choose. Without the constraint of a fixed order of questions, new concepts can be brought into the discussion by interviewees.[592]

The final benefit of semi-structured interviews is that they allow high calibre interviewees to perform at their best and share as much as possible.[593] For this research the use of a standardised interview schedule was not appropriate due to the varied professional, educational and personal histories of the sample group.[594] The interviewees that were selected can be classified as '*elite interviewees*' due to their expertise on the subject matter covered by the questions.[595] A great deal of social research is aimed at the least well-off and least influential members of society, 'ordinary people'. When dealing with those who cannot be classed as ordinary, for instance: judges, magistrates, senior police officers, senior members of organisations, it is necessary to apply a more tailored approach that respects the interviewee's position.[596] This calibre of interviewee is most likely to consider the act of answering a mundane questionnaire as a less than productive use

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[592] J. Creswell & V. *Plano Clark, Designing and Conducting Mixed Methods Research* (London: SAGE Publications Ltd, 2011), 50-53.

[593] M. Denscombe, *The Good Research Guide: For Small-Scale Social Research Projects* (Berkshire: Open University Press, 2014), 303-307.

[594] K. Barriball, 'Collecting Data using a Semi-structured Interview: A Discussion Paper', *Journal of Advanced Nursing*, 19 n1 (1994) 328-230.

[595] K. Barriball, 'Collecting Data using a Semi-structured Interview: A Discussion Paper', *Journal of Advanced Nursing*, 19 n1 (1994) 331-332.

[596] K. Barriball, 'Collecting Data using a Semi-structured Interview: A Discussion Paper', *Journal of Advanced Nursing*, 19 n1 (1994) 332-335.

of their time.[597] Semi-structured interviews manage to balance the two aspects to the arrangement.[598] Firstly the interviewer can make the most of the opportunity to interact with powerful elites and secondly the interviewees are addressed with some elevated status in the research project.[599] This balancing act necessitates the interviewer managing the interviewees accordingly to achieve the best results for the project.[600]

Elite interviewees are extremely useful sources for interviews as their answers are those of authorities on the topics that are discussed.[601] Taking into account their positions, knowledge and influence, they can provide considerable input in terms of depth of understanding of social context and processes.[602] Methodological challenges do exist when the interviewer is dealing with elite interviewees, as whilst the process of developing interview questions and arranging the interviews is identical whether the interviewee is part of an elite or not, the actual discourse and debate between interviewee and interviewer can change considerably.[603]

The consensus amongst researchers is that when dealing with elite interviewees the semi-structured interview is the preferred approach.[604] An

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[597] I. Crow & N. Semmens, *Researching Criminology* (Berkshire: Open University Press, 2007), 118-120.
[598] D. Swetnam & R. Swetnam, *Writing Your Dissertation: The Bestselling Guide to Planning, Preparing and Presenting First-Class Work* (Oxford: How To Books Ltd, 2000), 64-69.
[599] Ibid.
[600] D. Swetnam & R. Swetnam, *Writing Your Dissertation: The Bestselling Guide to Planning, Preparing and Presenting First-Class Work* (Oxford: How To Books Ltd, 2000), 65-66.
[601] D. Swetnam & R. Swetnam, *Writing Your Dissertation: The Bestselling Guide to Planning, Preparing and Presenting First-Class Work* (Oxford: How To Books Ltd, 2000), 67-69.
[602] D. Swetnam & R. Swetnam, *Writing Your Dissertation: The Bestselling Guide to Planning, Preparing and Presenting First-Class Work* (Oxford: How To Books Ltd, 2000), 69.
[603] R. Harris, 'Accessing Elite Nurses for Research: Reflections on the Theoretical and Practical Issues of Telephone Interviewing', *Sage Journals* (2008). Available online: http://journals.sagepub.com/doi/pdf/10.1177/1744987107084671 [Accessed 01/05/2016].
[604] I. Crow & N. Semmens, *Researching Criminology* (Berkshire: Open University Press, 2007), 118-120.

unstructured interview format can give respondents too much control over the progression of discourse and the structured format can be limiting when trying to extract key information.[605] The semi-structured approach allows the interviewee to maintain control whilst also allowing them to probe for more complete answers when required.[606] Moreover, in the event that the interview has to be completed in a shorter time period due to unpredicted urgent matters or a shortage of time to complete the questions, the semi-structured approach allows for adaptability from the interviewer to prioritise certain questions over others to be sure of getting the most fundamental information from the interviewee.[607]

There are of course some negative aspects to semi-structured interviews. Utilising open-ended questions in interviews prevents the discourse from having clear scheduling boundaries for each subject that is brought up in conversation. The risk is that they will speak too much on certain topics without touching on the core point of the question.[608] The freedom of open-ended questions is that interviewees are able to direct the focus away from the question's subject matter if they so choose.[609] Another consequence of these responses that fail to answer the intended questions is that the coding of such responses is labour intensive and in some cases pointless.[610] Certain questions that are open ended can engender a high

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[605] I. Crow & N. Semmens, *Researching Criminology* (Berkshire: Open University Press, 2007), 118.
[606] Mayser & Wagstaffe, 'Research Methods for Elite Studies - G, Moyser, M. Wagstaffe', *Political Studies*, 35.4 (1987) 672-673.
[607] Ibid.
[608] M. Denscombe, *Research Proposals: A Practical Guide* (Berkshire: Open University Press, 2012), 91-101.
[609] Ibid.
[610] M. Hamid, *How To Write a Research Proposal and Thesis: a Manual for Students and Researchers* (North Charleston: CreateSpace Independent Publishing Platform, 2013), 49-51.

refusal rate as well if the topic area is too vast for them to provide a meaningful answer.[611] One of the lawyer interviewees, LAW3, for instance, refused to answer two questions due to the subject area being too large for him to provide a useful response.

Another negative aspect to semi-structured interviews is that by allowing the interviewee freedom to express themselves, their emotional state and the level of their awareness is able to impact on the data they provide.[612] If the interviewee is at the time for whatever reason at all anxious or worried they can allow these sentiments to affect their discourse.[613] In these moments it is up to the interviewer to retain their own composure and ability to control the environment and apply their knowledge allowing the interview to flow.[614]

The final negative aspect to semi-structured interviews is that they tend to be one of the more time consuming methods of data collection.[615] From recruiting interviewees, scheduling the appointments, organising places to conduct the interviews, carrying out the interviews, transcribing all the interviews to finally coding all the transcripts. The end result is the product of many hours of labour. [616]

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[611] M. Hamid, *How To Write a Research Proposal and Thesis: a Manual for Students and Researchers* (North Charleston: CreateSpace Independent Publishing Platform, 2013), 49-51.
[612] Ibid.
[613] K. Barriball, 'Collecting Data using a Semi-structured Interview: A Discussion Paper', *Journal of Advanced Nursing*, 19 n1 (1994) 328-235.
[614] J. Creswell & V. *Plano Clark, Designing and Conducting Mixed Methods Research* (London: SAGE Publications Ltd, 2011), 19-53.
[615] K. Barriball, 'Collecting data using a semi-structured interview: a discussion paper', Journal of Advanced Nursing, 19 n1 (1994) 328-235.
[616]R. Longhurst, *Interviews: In-Depth, Semi-Structured* (Oxford: Elsevier Ltd, 2009), 580–584.

4.2.2 Preparation for the Empirical Research

Having established that semi-structured interviews were to be the method of empirical research, it was thus necessary to make preparations for the process. The two fundamental ingredients required for the research were appropriate interviewees and an appropriate set of questions. Following on from this it was also necessary to consider a suitable period for the interviews and suitable locations for the meetings to occur.

4.2.2.1 Selecting Interviewees

The criteria for the interviewee selection were based on prospective candidates' knowledge and experience in the subject field of the interviews. The purpose of the criteria was to identify individuals who would be able to provide relevant and useful information from their genuine experience of having operated professionally in the field.

The candidates selected were Iranian government agents, judges, company directors of public, private and government companies, scholars, commercial lawyers, and company shareholders. It was felt that this mixture of professional expertise would allow the interviewer to gain first hand data about what the present situation in Iran was as far as directors' duties were concerned. Some interviewees had a strong understanding of directors' duties and others had less, however all had sufficient understanding to engage with the questions, which were outside the parameters of a casual discussion.[617] The method would be able to enhance the researchers' understanding of the current Iranian Company Law relating to directors'

[617] M. Denscombe, *The Good Research Guide: For Small-Scale Social Research Projects* (Berkshire: Open University Press, 2014), 173-189.

duties and how it is practised. Furthermore it had the potential to uncover issues that were not accounted for in doctrinal sources.

The types of professional people who were able to fill these criteria were professionals who worked in law and business. Professionals occupying different posts within the field of company law and company practice would be able to offer varying insights into the subject material. For this reason the researcher decided that if lawyers, legal scholars, judges, directors and shareholders viewpoints were all included in the study it would produce a broad spread of data for the research. These different groups of people were expected to offer different perspectives in the interviews. With different types of interviewees, there was a chance for the researcher to compare their views on the same topics. When selecting the quantity of interviewees the researcher was of the opinion that there would have to be at least four from each group in order to see possible correlations in responses from groups. It was also deemed prudent to include a fifth interviewee for each group in case during the process of arranging interviews any interviewees decided not to participate for any reason. With there being five groups this resulted in 25 interviews.

The interviewee groups are considered in greater detail below, with an account of a brief justification for the selection of each.

4.2.2.1.1 Judges

Even though the judicial system in Iran, like other developing countries in the Middle East, is still fairly weak in its management of commercial cases, it was felt that it was important to try and obtain some data from judges, as the judiciary is core component of the legal system. It was decided that judges would be interviewed and arrangements were made accordingly. Of the five that originally agreed, two judges did not end up taking part in the interviews. When seeking permission to interview the prospective five judges, these two judges were sceptical over the purpose of the project querying the rationale for why a researcher from the UK wished to know their opinions on directors' duties in Iran. These two judges requested all the questions in advance and after they were presented to them, they elected not to participate due to the questions being, in their view, too open ended. It is possible to conclude that the reason for two of the judges declining the interviews was due to the subject matter. Prior to requesting the questions both had in principle agreed to the interviews. As the researcher had foreseen this kind of situation occurring, she had identified several other candidates who would be suitable replacement interviewees. An extra scholar and an extra lawyer were included to the list of interviewees as it was not possible to find replacement judges.

4.2.2.1.2 Corporate Lawyers

The researcher considered corporate lawyers to be useful interviewees as they have daily interaction with shareholders, directors and judges in their professional capacity. Corporate lawyers understand the business effect of any legal decisions they make and also the legal effect of any business decisions their clients make. They ensure the legality of commercial transactions, they advise corporations on their legal rights and duties and they have a professional knowledge of company law. LAW1 and LAW2 work for large companies and they also work privately advising different firms. Their knowledge and understanding of directors and their duties for this reason could be expected to be more than adequate. The other three lawyers are general solicitors who practice all types of law.

4.2.2.1.3 Legal Scholars

The scholars interviewed are knowledgeable about business law and legislative and regulatory developments. They participate in drafting committees for law reforms and give suggestions to draft legislation and other legal documents. They provided analysis of current laws, and they suggest the direction that company law reform should take. Since they are working in academia, and they are therefore more independent, scholars may also be able to give fairer views on some of the issues being considered. All scholars interviewed work in academia at prestigious universities ranked within the top ten universities in Iran.

4.2.2.1.4 Company Directors

As the research topic is about directors' duties in Iran selecting directors in public, private and governmental companies was necessary. The selected directors include both executive and non-executive directors. Including the opinion of directors in this research is instrumental to understanding directors' duties and how they considered by directors themselves. DIR1 is a director in a national bank, DIR2 is a director in a state owned oil company, DIR3 is a director who runs a family Mining Company, DIR4 is a director in a private Inertial Design Company and finally DIR5 is a director of Money Exchange Company.

4.2.2.1.5 Shareholders

The researcher chose to select shareholder candidates from various types of companies. It was expected that interviewing shareholders would help identify the apparent weaknesses in Iran that exist from not having sufficient directors' duties. SHA1 is a shareholder in a government company that is the shareholder represents the government's interest. SHA2 is a public company shareholder and SHA3, SHA4 and SHA5 are private company shareholders (in family companies).

4.2.2.2 Selecting the Questions

Whilst it is common for practised interviewers to take a list of themes as opposed to a series of questions to the interviews, the nature of semi-structured interviews necessitated a prepared set of questions. This method increases the interviewer's ability to have a clear path to follow for the course of the interview with a logical progression in the questions that have been prepared in advance.[618]

Question construction for interviews can be geared to produce responses that are factual, descriptive, thoughtful or emotional. With the purpose of this study it was predominantly factual and thoughtful information that was preferred. The majority of questions for this reason were prepared with a view to extract responses that are factual and thoughtful. In the initial stages of the interview however the researcher adopted a softer approach that aimed to make the interviewees feel comfortable in the environment as opposed to immediately having to produce factual and thoughtful responses.

[618] J. Ritchie et al, *Qualitative Research Practice* (London: SAGE Publications Ltd, 2013), 77-79.

To assist the flow of the interview the interviewer had to be very familiar with the questions.[619]

The purpose of the questions was to secure data from the responses that built upon the theoretical and doctrinal research already carried out. From the doctrinal research, certain issues in directors' duties in Iran had already been identified and it was the researcher's aim to acquire new information on these issues from the interviewees. Having already carried out a great deal of the doctrinal research in Chapter 3 at this stage the researcher already was thoroughly versed in the subject field and was at a suitable stage to gather new empirical data. From the issues in directors' duties that had been highlighted, the researcher developed 21 questions that would potentially be able to extract useful responses that would develop these points.[620]

At the beginning of the interview the researcher posed several general questions that required short and factual responses that the interviewee was able to answer without too much thought or effort. These preliminary questions established the interviewees' names and their professional background within the field of law. These questions allowed the researcher to collect valuable background information about the interviewee whilst at the same time letting them begin by covering familiar territory.[621]

The more sensitive and testing questions were left for the latter stages of the interview. By the time the first question of significance arose the

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[619] J. Ritchie et al, *Qualitative Research Practice* (London: SAGE Publications Ltd, 2013), 77-79.
[620] Ibid.
[621] J. Smith et al, *Rethinking Methods in Psychology* (London: SAGE publication, 2005), 28-30.

interviewee felt settled and relaxed.[622] Without adequately warming up the interviewee prior to posing the significant questions, there would have been the possibility that they would not have opened up and spoken freely in their responses.

Detailed below is the list of questions that made up the semi-structured interview. Also alongside the questions was an explanation of their intended purpose.

Question 1: What is your post in your organisation in which you work? What are your general duties?

- The purpose of asking this question was to ascertain from which of the five groups the interviewee belonged and what the interviewee's job entailed. The nature of the interviewee's duties could have provoked additional questions.

Question 2: Do you regard the court as an efficient means of settling business disputes in terms of cost and time expenditure?

- The aim was to understand the efficiency and affordability of the courts. It was crucial to understand clearly if one of these factors is reducing the courts' popularity and use. Also, the answer to this question helped to discover the popularity of the courts as a means for settling disputes. Moreover, when hearing from directors it was likely that they would share their experience of directors' duties cases and provide their opinions on the speed and cost of the courts.

Question 3: Do you feel that in your current job you and your colleagues have a professional understanding of directors' duties?

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[622] M. Walsh & L. Wigens, *Introduction to Research* (Cheltenham: Nelson Thornes, 2003), 90-98.

- It was important to know what level of understanding interviewees had of directors' duties both to enable the researcher to explain questions and to gauge the general understanding of duties in Iran.

Question 4: Where would you go to find out about directors' duties?

- This was to asked to discover just how accessible information about directors' duties in company law is in Iran and whether people know how and where to access the information. There was the potential for varying answers between the different groups as well, which would have produced interesting results.

Question 5: Do you know what duties are imposed on directors?

- The aim of this question was to get a clear picture of which groups know what about directors' duties in Iran. The duties that get more focus than others by the different groups will suggest how duties are perceived from group to group.

Question 6: What do you think are the strengths and weaknesses of the law on directors' duties in Iran at this time?

- The aim of asking this question was to find out about how the present law on directors' duties in Iran is perceived. The interviewer thought that if multiple interviewees repeat the same weaknesses then it would highlight those weaknesses.

Question 7: In the cases where fiduciary duties are set out in the articles of association of a company, is it the directors' duty to always act in the company's best interests or is it the shareholders' duty to make sure the director is doing what they want?[623]

- This question relates to whether directors are viewed as opportunistic agents motivated by self-interest or whether they are viewed as loyal stewards. It was of interest to hear how the directors responded to this and compare it against the view of the judges and the lawyers.

Question 8: Occupying the post of director comes with a host of liabilities; do you think the insertion of directors' duties in the company's articles of association is a sufficient way to protect the company and the shareholders?

- The responsibility to include fiduciary duties in the articles of association is uncommon in most countries as it is usually included in legislation or case law. This question was posed to gain an understanding of how Iranians working in law view this. Perhaps they would be oblivious to the practices in other countries or perhaps they would see it as a flaw that there is no legal code to stipulate that directors owe fiduciary duties to a company.

Question 9: Do you think that it is better to insert directors' duties in legislation? If so, why? If not, why not?

- The aim of this question was to get each interviewee's opinion as to the advantages and disadvantages of introducing specific directors' duties in Iranian legislation.

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[623] For this question the researcher referred interviewees to the glossary at the end of the questions, where *fiduciary duties* is defined. It is defined as a legal obligation of one party to act in the best interest of another. The responsible party is typically a fiduciary, that is, someone entrusted with the care of money or property.

Question 10: Do you know of instances where directors have taken advantage of corporate opportunities? Do you consider the current law sufficient to manage instances of corporate opportunities?[624]

- This was to ascertain firstly their opinion on corporate opportunity and secondly to understand whether they consider the current law capable of tackling it? Iran is well known for its corruption and this is a subject where corruption could exist. If examples of corporate opportunities with outcomes were found, the information would have been useful for the research.

Question 11: Can directors be trusted to make decisions on behalf of shareholders in the shareholders' interest? What problems can arise from this relationship? How can this be dealt with?

- The aim of asking this question was to find out what each interviewee thinks about trusting directors, and the risks that are present in trusting directors.

Question 12: As directors are in positions of power they can find themselves in situations of conflict, that is, where their interests and the interests of the company/shareholders might be in conflict. What do you think should be done in such cases?

- The aim of asking this question was to understand how commercial law in Iran could control the conflict of interest when the directors get opportunities. Is there a sufficient deterrent in place to prevent directors from taking unfair advantage of commercial opportunities?

[624] The researcher referred interviewees to the glossary at the end of questions where *corporate opportunity* is defined. It is explained as when directors have the opportunity to benefit personally from a business opportunity that is presented to their company or comes to the directors in their role as directors of their company, and the directors take advantage of it at the expense of the company.

Question 13: From your own experience have you found that people who occupy the position of director in companies have been appointed through merit or family ties or social contacts?

- The aim of asking this question was ascertain whether the decision to appoint directors is typically based on the candidate's merit or rather through a social or family relationship. Also it was useful to hear the interviewee's thoughts about the benefits and disadvantages of both sides when it comes to appointments.

Question 14: Do you think that directors should be subject to a duty of care?[625]

- The aim of asking this question was to find out the views of the various interviewees about whether they believe there is a need for a duty of care in the law. As the duty is common place in most countries' legal codes, these perspectives provided an insight into potential issues that come up when the duty is not in place in a country.

Question 15: Directors are often trusted with making judgments that will contain an element of business risk, and it is often these judgments that will either propel the business forwards or cause it difficulties. If directors make a bad judgment should they be liable for it?

- This question has two parts to it. Directors' liability for making poor judgements in their role and also directors' freedom to take risk to attempt to progress a company forwards. It was key to find out how much freedom the directors feel they have when it comes to decision-

[625] The researcher referred interviewees to the glossary at the end of the questions where *duty of care* is defined. It was stated to be a legal obligation which is imposed on an individual requiring adherence to a standard of reasonable care while performing any acts that could foreseeably harm others. It is the first element that must be established to proceed with an action in negligence.

making or whether they feel that sometimes their concern over personal liability (losing job, etc.) outweighs the potential reward for the company.

Question 16: Do you think that Iran could benefit from adopting the Business Judgment Rule?[626]

- The Business Judgement Rule does not exist in Iran. The researcher wanted to see if anyone believed that Iran could benefit from its introduction and whether they think it could work within the parameters of the legal system in Iran.

Question 17: As the government owns controlling interests in many public companies, do you feel directors of these companies fear-taking risks believing that the law will not be on their side?

- This question was trying to uncover the opinion of the interviewees on the pressures on directors in companies controlled by the government. Do directors feel that, should the eventuality arise where a disagreement between shareholders and directors reaches court, the court would be on the state's side. And if they do feel this, does it influence their risk taking?

Question 18: Do you know how breaches of directors' duties are enforced?

- This question was trying to understand what can be done if there are breaches of duty and how effective the court is in enforcing breaches of directors' duties. It was also trying to gauge the level of

[626] The researcher referred interviewees to the glossary at the end of the questions where the Business Judgment Rule as envisaged in the US is defined (the one used was one of two definitions available the one used in Delaware). It is recorded as a presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company' and as a consequence if the directors so act they are not liable.

understanding from each of the five groups about the level of punishment involved with breaching directors’ duties and whether they believe punishment is balanced given the breach.

Question 19: Do regulators have sufficient power in Iran to enforce rulings? Do you understand Iran’s enforcement to be effective in the sense that there is belief that rulings will be upheld?

- The aim of asking this question was to find out whether enforcement is well managed and all rulings are upheld. The general view of enforcement was also important as if directors are aware of rulings for various breaches and are aware of strict enforcement it acts as a deterrent to breaches being committed.

Question 20: Do you think that breaches of duties should be subject to criminal prosecution in any case?

- The purpose of asking this question was to find out the opinions of the interviewees surrounding the severity for breaches of directors’ duties. It was possible that opinion in Iran might vary from other countries as it has very little in its legal code that addresses directors’ duties and perhaps it is regarded differently.

Question 21: What changes to the law governing directors’ duties would you make?

- This open-ended question was trying to understand from interviewees about any possible reforms relating to the directors’ duties in Iranian Company Law.

The questions were translated into Farsi so that the interviewees would be able to understand them.

4.2.2.3 Surveying the Location

When considering the most suitable city within Iran to carry out the interviews, the selection had to be a city where it would be possible to carry out 25 interviews within 30 days and where it would be possible to find the most suitable candidates to interview. The researcher decided to select Tehran, the nation's capital city. An ideal study area for the empirical research, Tehran whilst being the political and administrative capital of Iran, is also the central hub of commerce.[627] It makes up for more than 40 per cent of the nation's economic activities, 30 per cent of Iran's public-sector workforce is based there and 45 per cent of the principal industrial firms.[628] It is home to a significant proportion of central governmental agencies, legal service companies, universities and research institutes. Those who inhabit this young metropolis have come from around the country with different beliefs, cultures, languages and life styles and live in a national and international context together. With the location chosen, it was then necessary to select the interviewees and communicate with them about the project.

The environment can impact upon an interview and the objective is to identify a place where both the interviewer and the interviewee feel comfortable. The interview is primarily a conversation, which is recorded and the environment for that reason had to be somewhere quiet and private so

[627] A. Bryman & E. Bell, *Business Research Methods* (Oxford: Oxford University Press, 2011), 385-413.
[628] Tehran Municipality, *Industrial Firm* (2016). Available online: http://www.tehran.ir/ [Accessed 08/02/2016].

that the two people could hear each other and for the tape to record accurately.[629] While a neutral setting is perhaps preferable for meetings with business people or lawyers, judges and scholars, it is more common to visit them at their place of work in their offices. This is typically their preference as it is logistically the least demanding option for them and it is what occurred. Researchers find that interviewees are more likely to not accept an invitation if they realise they will have to go out of their way to take part.[630] The rooms of the interviews were always private and there were not any issues with the interviewees speaking freely. It can be possible that in certain environments at work interviewees may feel uneasy about saying negative things about their place of work, but the researcher did not encounter this.[631]

4.2.3 Organisation of Empirical Research

With the preparation concluded, it was next necessary to commence making the arrangements for the interviews to take place. Within this stage the researcher had to communicate with the chosen interviewees and request their agreement to take part in the interviews, complete the ethical review for the research and correspond with the interviewees to organise a date and time to visit them.

4.2.3.1 Communication between the Researcher and the Interviewees

Whilst the researcher had identified the types of professionals to interview, there was still the matter of identifying the exact people to interview and making sure they were both prepared to be interviewed and

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[629] R. Longhurst, *Interviews: In-Depth, Semi-Structured* (Oxford: Elsevier Ltd, 2009), 580–582.
[630] Ibid.
[631] R. Longhurst, *Interviews: In-Depth, Semi-Structured* (Oxford: Elsevier Ltd, 2009), 583.

available during the period of time the researcher planned to be in Iran. Family members assisted the researcher in sourcing suitable interviewees, some of whom were leaders in their field.

The first point of contact with the interviewees was an email from the researcher explaining who she was, the person who had referred them, what the research was about and a question asking whether it was something they would be willing to take part in. Following a succession of positive replies, the researcher sent off the participant consent form required by the rules on ethical research work at the University of Leeds. The vast majority agreed to participate and sign the forms, however there were some who responded with requests for clarification of various points. Once all the responses were received and queries satisfied the schedule was arranged starting on 25th November 2015 and running to 15th December 2016.

4.2.3.2 The Ethics Review

Before the empirical research was actually carried out, the researcher attended particular courses to educate themselves about the ethics of empirical research. At these courses they learned about the process of the ethics review and data protection issues along with how the university administers such ethical review applications. Subsequently, an application form for the ethical review was drafted in consultation with the researcher's leading supervisor and it was submitted to the University of Leeds' Ethics Committee for approval. Prior to commencing any research project that involves human participants it was necessary to first acquire ethics approval.

After the first submission of the ethics application from the researcher, the committee responded through email highlighting certain points that needed to be addressed for the researcher to receive approval. The researcher addressed these points and resubmitted the application to the committee. On 24th November 2015 the researcher received approval and was granted permission to proceed.

4.2.3.3 Organising the Timetable

After arriving in Tehran, the researcher used her time to coordinate with the interviewees to finalise the individual meetings. The schedule was prepared according to the availability of interviewees and their location within the city.

4.2.4 Execution of Empirical Research

With all of the interviews scheduled it was necessary to make sure that they all were carried out successfully and provided the researcher with the data required. In this section it is explained how the interviews were carried out, complications that arose from the interviews and what tools were used to extract further information from interviewees in particular situations.

All the interviews were carried out on a face-to-face basis and lasted between 60 to 90 minutes. The locations were the interviewees' offices, which were university buildings, court chambers and office blocks.

4.2.4.1 One-to-one Interviews

The most common form of semi-structured interviews is the one-to-one interview variety, which involves a meeting between one interviewer and one interviewee.[632] There are several positive aspects to one-to-one interviews, the first being that for the interviewer they are the simplest to

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[632] J. Mason, *Qualitative Researching* (London: SEGA Publications, 2002), 62-68.

arrange. The second advantage is that the opinions and views expressed during the interview stem from one source (the interviewee).[633] This makes it straightforward for the interviewer to converse about specific ideas with a particular interviewee. Also, one-to-one interviews help the interviewer create a relaxed, controlled environment in which the interviewee is more likely to feel comfortable in and respond best.[634] It is easier to create an open atmosphere in these kinds of interviews than in ones where there are a number of interviewees present.[635] In the case of this research the format allowed the researcher to question the interviewee directly on relevant questions about directors' duties in Iranian Company Law with no interruption or distraction from others present.[636] Also, another advantage is that the one-to-one interview was straightforward to transcribe and produce an audio record from.[637]

4.2.4.2 Recording

The recorder allowed the researcher a much fuller record than note taking during the interview. It also meant that the interviewer was freed up to focus on how the interview was proceeding and where to steer the dialogue. It relieved the researcher of much of the burden of note taking during the interview.[638] Moreover, note taking could have led the interviewer to lose the train of the conversation or eye contact with the interviewees. The researcher did not have to interrupt the flow of the interview to ask for clarification about

[633] J. Mason, *Qualitative Researching* (London: SEGA Publications, 2002), 83.
[634] J. Mason, *Qualitative Researching* (London: SEGA Publications, 2002), 65-67.
[635] N. Proctor & M. Butcher, *Human Resource Management - Standard Level* (Cambridge: Select Knowledge Limited, 2010),108.
[636] Ibid.
[637] M. Denscombe, *The Good Research Guide: For Small-Scale Social Research Projects* (Berkshire: Open University Press, 2014), 187.
[638] B. Christopher & B. Cason, *Overseas Research II: A Practical Guide* (Oxford: Routledge, 2010), 110-115.

a word or phrase, which could have seriously impeded the discussion and disrupted the interviewee's train of thought. By knowing that there would be an exact record of the interview that could be referred to at a later moment, the researcher was able to approach the interview with more freedom to focus on the dialogue and the extraction of valuable content.[639]

Prior to all interviews it was made clear that whilst the interviewer's preference was to record the interviews, it would not be a requirement of the interview. All interviews that were carried out were recorded with the consent of the interviewee and the only signs of concern over the recording came from the two judges who decided not to take part in the interviews. These two judges were concerned that there might be a recorded copy of their answers to the questions proposed. Even when informed that recording was not essential and that the information will be presented anonymously in the research, they remained sceptical.

4.2.4.3 The Transcription Process

Transcribing the Farsi audio recording was not a straightforward mechanical exercise in which the researcher simply wrote down the words that were spoken by interviewees. In practice, the task was made more difficult due to spoken language being different to written language. The cause of this was that the interviewees did not always speak in nice finite sentences.

During the process of transcribing the audio recordings it was necessary to verify some of the statements from the interviewees. The researcher had to corroborate some interviewee information to confirm that

[639]B. Christopher & B. Cason, *Overseas Research II: A Practical Guide* (Oxford: Routledge, 2010), 113.

the interviewees' statements were all accurate. Typically, the checking was carried out using electronic sources and also through comparing it against other interviewee's content for consistency.[640]

There were several examples where interviewee information did not prove to be accurate: In section 5.2.5 'The Role of Judges', JUD1 stated that minimum age requirement for becoming a judge was 24/25 but also that he was not certain of this fact. The researcher verified the information with the governmental website which clarified that the actual minimum age required is 22.[641]

JUD1 suggested that 30 years had passed since the general law including directors' duties was last updated in Iran. Through referring to the Iranian Parliament Research Centre website it was possible to confirm that this date was incorrect as law surrounding directors' duties had not been updated since the 1940s.[642] Apart from this, the researcher had to amend certain dates provided by the interviewees.

4.2.4.4 Using Probes in the Research Interview

Since the aim of the researcher's interview was to gain a profound understanding of the interviewees' experience and perspective in relation to directors' duties in Iran, probing the interviewee effectively was an important skill applied by the researcher in the interviews. By probing an interviewee's response, the researcher was able to add to the richness of the data, and

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[640] M. Denscombe, *The Good Research Guide: For Small-Scale Social Research Projects* (Berkshire: Open University Press, 2014), 173-189.
[641] Sharayete-Ghazio shodan, *Judges Requirement* (2016). Available online: www.mashreghnews.ir [Accessed 15/04/2016].
[642] The Iranian Parliament Research Center, *Company Law* (2016). Available online: http://rc.majlis.ir [Accessed 02/04/2016].

end up with a better understanding of the subject matter. Patton describes a probe as,

> 'An interview tool used to go deeper into the interview responses.'[643]

4.2.4.5 Conducting the Interview

It was important for the interviewer to keep the momentum going during the course of the interview and keep the dialogue on track. Whilst it was important for interviewer in general to try to limit any interruptions, there was little that could be done in particular circumstances.[644] Delays and temporary cancelations whilst being a normal issue of interview organisation, proved to be very problematic on occasions for the study. On one occasion JUD2 did not come on time. He had overlooked the appointment and eventually arrived one hour later. He only came once it was made clear that the researcher had travelled a long distance to carry out the interview and would soon be returning to the UK and would not be available again. LAW3 cancelled on two occasions, 30 minutes prior to the meeting. Eventually it was possible to carry out the interview. The interview with SCH1 lasted three hours due to the detail the scholar went into when answering the open-ended questions.

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[643] B. Thyer, *The Handbook of Social Work Research Methods* (London: SAGE, 2001), 314.
[644]J.A. Smith et al , *Rethinking Methods in Psychology* (London: SAGE Publication, 2005), 18-30.

4.2.4.6 Difficulties and problems

The main issue that arose, as was mentioned earlier, was that two of the requested interviewees decided not to take part. A further issue that occurred was that certain questions were too personally or politically sensitive to answer. It was clear in some of the responses that interviewees skirted around their genuine opinions to offer answers that were brief and failed to acknowledge the key points of the subject matter. This was demonstrated in question 17 and 19 where the subjects of governmental involvement in the economy and criminal persecution for breaches are discussed. To deal with this issue, the interviewer would moved on to the next question and return to the skipped question later on with a rephrased version of it. This approach proved to be successful as the interviewee felt relaxed when the conversation subject was diverted away from the issue in question. When later returning to the subject matter generally the interviewer rephrased the question and often it seemed that the interviewee had a fresh approach to answering the question, most probably due to the time afforded them to consider the point. Overall, the interviewer considered it a useful strategy to obtain answers on points that were poorly addressed the first time around.

Moreover, there were certain subject areas where many interviewees struggled to address the subject matter due to a limited understanding of the law. This made it difficult to extract useful answers, as the interviewee's knowledge was insufficient to produce a meaningful opinion. Examples of the topics that proved to be difficult were the Business Judgment Rule, fiduciary duties, duty of care and corporate opportunities. In these instances, answers would be general and superficial without suitably grasping the point of the question. The groups that struggled with the legal terminology were the directors and the shareholders, while the legal professionals were more comfortable with the terms used and the principles referred to.

4.2.5 Data Collection of Empirical Research

Following the completion of the interviews the researcher had acquired recordings from all 25 interviewees. At this juncture the researcher had to transcribe the recordings and produce digital files that could be uploaded to the University Postgraduate Development Record (PDR).

The duration of each recording was between 60 minutes and 90 minutes. The transcripts of the recordings were made in Farsi where the responses were numbered 1 to 21 and the interviewees were labelled appropriately. The digital files of the transcripts were accompanied by the time, date and location of the interview. This process left the interviewer with digital files of all the data stored on the university's PDR.

Having completed the transcripts, the interviewer began to code the data. All the names of the interviewees were replaced with appropriate labels. All judges were labelled JUD1 to JUD3, lawyers were labelled LAW1 to LAW6, scholars were labelled SCH1 to SCH6, directors were labelled DIR1 to DIR5 and shareholders were labelled SHA1 to SHA5. The order of whether an interviewee was JUD1 or JUD3 was based on the order in which the interviews were carried out.

The reason for the anonymity of the interviewees is to protect the interviewees from the data they provided for the interviews. Also the anonymity was also a requirement of the University's Ethics Committee who seek not to divulge the identity of participating individuals nor their company or organisation.

All quotations to be included in the research were translated into English and the Farsi transcripts were coded, labelled appropriately and saved. Each question was considered individually and the responses from all the interviewees were grouped together to allow the researcher to see how all the interviewees responded to the same questions.

The beginning of the coding process involved reading the entire transcript, analysing it and dissecting the key points that the interviewees highlighted as issues with respect to directors' duties. 15 points were identified as the main core issues uncovered in the interviews and these points were labelled 1 to 15, for example point 1 was fiduciary duties. The next step undertaken was revisiting each transcript and attaching to relevant material the appropriate number in accordance with the coding key. After this practice was carried out 25 times, the interviewer had coded the transcripts and was ready to start tackling each of the 15 points, drawing from the 25 opinions provided by their interviewees.

4.3 CONCLUSION

The inclusion of empirical findings within the thesis was to build upon the doctrinal research with the addition of new data that would be able to uncover what the present situation of directors' duties in Iran was like. Qualitative semi-structured interviews were selected as the form of data collection to be carried out. The selection was chosen as it was considered to be the most appropriate research means for encouraging targeted interviewees to share their understanding of complex and specific issues. Furthermore it was practical in that it allowed the flexibility needed to converse freely with the different interviewees to gain the most from the interviews.

The questions constructed for the interviews were carefully formulated around the issues that had emerged from the doctrinal research documented in Chapter 3. The phrasing of the questions was designed to best permit the interviewee to expand their answers on the various subjects. The interviewer arranged 25 interviews with lawyers, judges, scholars, shareholders and directors. The first form of contact was an email to each selected person.

Prior to visiting Tehran, the researcher carried out an ethical review application due to the research containing human participants. Following on from this the interviewer travelled to Tehran and contacted interviewees. The 25 interviews were held at various places in Tehran.

All the interviews were conducted on a one to one basis and they were recorded. The interviewer used probes to push the interviewees to extract more information. Transcripts were made in Farsi and quotations for the research were translated into English for the purpose of including the data in the thesis.

In order to code the transcripts, the interviewees were made anonymous and replaced by labels. There were certain difficulties that arose during the research such as only being able to interview three of the five judges, a reluctance from interviewees to engage on certain subject materials due to their sensitivity and also a lack of knowledge of certain subjects from some of the interviewees.

CHAPTER FIVE

AN EMPIRICAL STUDY INTO DIRECTORS' DUTIES IN IRAN

5.1 INTRODUCTION

The research in Chapter 3 demonstrated that Iranian Company Law has not developed and evolved to an adequate extent in order to satisfy the needs of commercial life and practice, and this is particularly so in relation to the law on directors' duties. This chapter aims to build upon this analysis developed in Chapter 3 by providing data from empirical research that addresses the issues highlighted by this thesis. The empirical research takes the form of the information collated from 25 interviews with high level scholars, judges, lawyers, directors and shareholders that were carried out in Tehran, the capital city of Iran. These interviews delved into specific topic areas that had the potential to unearth insights into the true nature of the current practice of law as it relates to directors and their duties. These insights can assist the research to provide a more thorough and accurate picture of the state of directors' duties today in Iran to provide a basis for reform proposals.

The transcripts of the interviews are the source of the data for this chapter. Within all the interviews there were 11 principal points of discussion on which data has been collected. While engaged in coding the interview transcripts these points clearly stood out as critical matters that needed to be examined and they will form the structure of this chapter. The 11 points range from specific subjects within directors' duties, such as fiduciary duties, the duty of care, the Business Judgment Rule to broader issues which greatly affect duties in Iran, such as courts and the role of judges.

Whilst there will be a degree of commentary and analysis concerning the data obtained, no attempt will be made in this chapter to pass judgment on the interviewees' responses or to engage in any systematic analysis and synthesis of the data. The aim is to display the findings and provide a context for them. Detailed analysis of the data obtained will be undertaken in Chapter 6 in the context of assessing the position overall in Iran and arriving at some recommendations for reform.

5.2 MAIN FINDINGS

From the 25 interviews carried out in Iran, both specific and broad issues are discussed. The findings have been coded and arranged to be able to address the principal points of discussion. Direct quotations are used to contextualise the material in instances where it is appropriate or necessary. Where interviewees provide examples of cases, more contextual information is provided in order to highlight the relevance of the information and to contextualise it.

5.2.1 Fiduciary duties in Iran

The first issue discussed with the interviewees was the presence of fiduciary duties in Iranian Company Law. Whilst previous research had suggested that Iranian Company Law does not address fiduciary duties it was important to hear the views of interviewees on the matter. The interviewees offered a diverse range of opinions on the inclusion of fiduciary duties in Iran and it could be stated that the lawyers, judges and scholars were the most informed on this issue. As one might expect, directors and shareholders had insufficient expertise to provide a meaningful perspective on laws that do not appear to exist in Iran. Both LAW1 and LAW2 highlighted the fact that in statutory law there is no mention of fiduciary duties. LAW6 corroborated this appraisal of fiduciary duties admitting to not being aware of there being any in Iranian Company Law. JUD1 stated,

> “Often cases arise which are related to fiduciary duties and you cannot refer to any code and article as there is none.”

JUD2 furthered the point by adding that he thought that in general directors’ duties are a particularly weak area of company law. He added that the company law on directors solely provides a general overview of how companies should be run and that there is no mention of directors’ duties. JUD3 dismissed fiduciary duties as not part of Iranian Company Law, stating that it is not possible to refer to a breach of fiduciary duties in court, as they are not mentioned in statutory law. Scholars also referred to the lack of fiduciary duties in the law with SCH1 stating that the statutory and civil law is silent on fiduciary duties. SCH2 mentioned that there is added responsibility carried by shareholders in monitoring directors due to the absence of fiduciary duties. SCH4 raised concerns for the shareholders, as they are not protected by fiduciary duties. Overall, the message is conclusive that authorities of law are acutely aware of the absence of fiduciary duties in statutory law in Iran.

When shareholders and directors were asked about fiduciary duties, they expressed both a lack of knowledge and in many cases they failed to see the importance of such duties. DIR2 mentioned that he did not believe any business shareholders read the statutory law in Iran. As both a shareholder and a director he was not aware what legal duties he had towards his company, only that he should try to make it always better and more profitable. In a similar way, DIR5 believed that as long as you do your job, you do not need to pay attention to these things. SHA3 was aware of fiduciary duties although he was of the belief that 80/90 per cent of directors do not know what duties directors have under statutory law and often under the articles of association as well.

A theme that emerged from speaking to the directors and the shareholders was that when there is a relationship built on trust between the shareholders and the directors there is not such a need for fiduciary duties. SHA2 was of the belief that directors should be trusted as most of the time they are appointed from within shareholders. SHA1 was a director of a company of which he was the largest shareholder. He believed that shareholders have a fundamental necessity to trust directors. He also struggled to see why a director would act in a way that was not in his own company's best interest. DIR1 was of the belief that because shareholders get to elect their directors they have the control to simply elect someone they are sure they can trust. He added that they do have options if the relationship does not work out as planned as they can always dismiss that person. He understood that as long as they always have that control, it is not necessary to have any laws in place.

Within family companies directors and shareholders seemed satisfied with the status quo in Iran. SHA1 felt a benefit to being the managing director and also the largest shareholder as he felt that other shareholders were not able to affect his decision-making. Directors who have this attitude can marginalise minority shareholders, as they will prioritise their own wishes before those of others. LAW3 was of the opinion that in family companies there was not the same belief that family members could not be trusted or would act outside the best interests of a family company.

As statutory law does not address directors' duties and fiduciary duties, in many cases fiduciary duties are added to the articles of association. DIR1 stressed the importance of the appointment of a suitably experienced lawyer to prepare the articles of association of a company. He argued that it is the responsibility of the lawyer to understand the business operations and adapt the articles of association to contain all the relevant directors' duties and of course include fiduciary duties. He added that in the eventuality that the articles were still lacking, it would always be possible to update them. DIR2 seconded this point stating that he believed that fiduciary duties belonged in the articles of association. In his company they updated the articles of association annually and did not follow any other company law. LAW1 was satisfied with fiduciary duties existing solely in the articles of association, however he added that there are many examples where the addition of fiduciary duties to companies' articles is overlooked. LAW4 believed that the situation was not bleak, as the articles of association would provide companies the opportunity to protect themselves with the inclusion of fiduciary duties. LAW4 stated,

> "All they need to do is call a meeting of the shareholders and agree upon amendments."

SCH2 placed the responsibility on shareholders to be aware of the absence of fiduciary duties in the law and he added that it was on their shoulders to make sure that duties were included in the articles of association, warning that failure to do so would expose them potentially to grave consequences. SCH3 also placed the responsibility with the shareholders, adding that he feared their inclusion was less common than one would imagine.

From the interviews it also became clear that whilst there was a need for the inclusion of fiduciary duties in the articles of association, one could not expect all companies to have them in place and even if they were to, they would not be sufficiently detailed to fulfil their purpose. Many companies were not appointing a lawyer to prepare their articles and it was in these circumstances that fiduciary duties were not included or were insufficient. If we refer back to DIR1 and DIR2 who spoke about updating articles of association, one has to agree that this would be good practice, however the requirement of updating every year would most likely arise due to problems arising that would demand the updating of the articles. The concern is that the remedial action would be after the breach of duty had occurred. Statutory law, in contrast, could cover most if not all eventualities. JUD1 made a strong argument that there were occasions when cases were covered by neither company law nor the articles of association of a company. JUD3 further this point by stating that he had never come across the inclusion of duties in the articles of association of any case he had encountered. SCH1 confirmed this when saying that,

> "It is rare to find fiduciary duties in the articles of association of companies."

As an alternative to including fiduciary duties in the articles, DIR4 who worked in a bank stated that their constitution included all the duties for the employees as well as the directors. As opposed to following any statutory law, they updated their constitution annually and it functioned to remind directors of their duties. He stated that it was unwise to rely on the company charter, as it would not be as extensive as statutory law could be. He added that fiduciary duties were not covered to a sufficient degree and that the bank could easily encounter issues with directors.

DIR5, who is a bank director, stated that he followed the obligatory law set by the bank regulations that were established by the Islamic Consultative Assembly. He stated that whilst the law remained as it is, the system would be lacking, as they did not cover any fiduciary duties.

In instances where fiduciary duties were not covered it was necessary to ask the judges what their experience had been. Where statutory law, articles of association, and Islamic sources were failing to cover fiduciary duties it was important to highlight which resources judges turned to in order to determine cases. JUD1 mentioned that for fiduciary duties it was often the case that typical legal sources would fail to assist, and they would have to refer to the *fiqhh*.[645] He referred to code number ten of the Iranian civil law[646] that stated that all company dealings were acceptable as long as the actions were in line with company law and did not contravene the teachings of Islam. LAW6 agreed that in examples where law failed to provide the answers they would need to refer to Islamic sources (the Fighh). He stated that, if there were nothing in the law that could solve a particular case, the default solution would be to refer to the Quran and the Fighh.

Having considered the existence of the current sources for fiduciary duties in Iran some interviewees were keen to see the status quo ameliorated. SHA3 accepted that it would be a step forwards to have fiduciary duties in statutory law, because in most articles of association they cannot be found. He also added that fiduciary duties would be useful in protecting shareholders, as there were a lot of uneducated people in senior positions who work as directors of companies. LAW1 supported this statement for the same reasons, adding that there should be statutory fiduciary duties because there were many examples where directors were making decisions for themselves instead of for their companies. LAW2 reiterated the point and said that having no fiduciary duties had resulted in many cases of corruption in Iran. SHA3, much like LAW1, believed that,

> "Directors occupy their positions for their own benefit as opposed to the company's benefit."

[645]The Fighh is the theory or philosophy of Islamic law based on the teachings of the Quran and the traditions of the Prophet.

[646] Iranian Civil Law 1922. Article 10 (Tehran: Didavar Book Publisher): Any private agreement that made by people is applicable until they are conflict with law.

He stated that their mentality was not one of having a duty towards the companies' interest but of having opportunity to advance their own interest. When directors were out to further their own ends then potentially it would be damaging for companies. SCH2 remarked that,

> "There is no substitute to statutory law, especially in the case of fiduciary duties. It is not sufficient to merely include duties in the articles as in many cases it will be overlooked and they will vary from company to company leading to great inconsistencies. For something so fundamental statutory law is the only solution."

SCH3 also confirmed the fear that exists with the danger of not including fiduciary duties in company law. He argued that without these duties directors would be able to stray on to an undesirable path. SCH4 highlighted the clear lack of fiduciary duties and expressed their importance in protecting the shareholders. Amongst the legal professionals there was a general consensus that the addition of fiduciary duties to company law was a fundamental and urgent requirement. But the view of some of the directors and shareholders was that the addition of fiduciary duties would not necessarily be beneficial. SHA2 believed that even if they had fiduciary duties in law, most directors would not be aware of them anyway as nobody reads the statutory law in Iran. SHA3 confirmed this point warning that if fiduciary duties were added to statutory law, directors and shareholders would still not be aware of them. He stated that in terms of just and consistent decisions in the courts the addition of fiduciary duties would fulfil its purpose. DIR5 showed a lack of respect for current company law and a disregard for the effectiveness of any proposed changes. The responses from SHA2 and DIR5 highlighted the issue that added changes to statutory law would not suddenly be common knowledge amongst business shareholders and directors so it was unlikely to change their understanding of their roles. LAW5 indicated that,

> "Code number 51 of the Iranian Civil Law Code states that directors are regarded as a trustee of the shareholders' assets."

LAW5 also said that directors were considered to be responsible for protecting the assets of the company as if they were their own. According to this way of thinking, the director would be accountable for fiduciary duties, as he would have the duty of protecting the asset. Clearly this would not be the same as providing for detailed fiduciary duties, but rather it would be an example of the concept of bestowing trusts in the director. It would however touch upon the essence of fiduciary duties, which in the reform of company law in Iran could be expanded upon.

Another interviewee brought up the subject of revisions to company law highlighting that some years ago changes to company law legislation were submitted for approval to the Islamic Consultative Assembly. LAW6 stated that,

> "Within the proposed changes to company law, there was no mention of the reform or addition of fiduciary duties, nor any part of directors' duties."

He was unaware why this was the case. He stated that the suggested improvements did not get passed anyway, as they were rejected when put forward to the Islamic Consultative Assembly. In Iran the purpose of this body is to make sure new legislation is in line with Islamic principles. As long as the Islamic Consultative Assembly is in place it will be difficult for fiduciary duties to become a part of statutory law.

Without fiduciary duties, certain issues continue to exist in company law. SHA1, a managing director and majority shareholder in a company, explained that his position allowed him ultimate control. When questioned about whether the minority shareholders in the company could trust him to look after their interests. He responded that,

> “if they do not like it they cannot do anything as they are the minority. If they do not like it they can sell their shares or just accept it.”

He stated that a director/shareholder in this position had nothing to gain by having duties in place. Other shareholders however were greatly exposed and potentially other directors who had less say than the managing director also would be exposed. If the managing director were to act without concern for the company and/or shareholder interests then the other directors could be liable for the actions of this director who would be accountable to no one. SCH4 reiterated this point adding that great power was afforded to the board of directors and minority shareholders were left in a vulnerable position. There are no fiduciary duties in place to protect shareholders and particularly minority shareholders. SHA3 raised the risk of unqualified and uneducated directors not being accountable for their actions under fiduciary duties as they are in theory free to make whatever actions and decisions they like without any fear of liability. LAW2 was of the opinion that having no fiduciary duties results in significant cases of corruption in Iran. He stated that,

> "Directors occupy their positions for their own benefit as opposed to the companies' benefit. Their mentality is not of having a duty towards the companies' interest but of having an opportunity to advance their own interest."

In conclusion, firstly, the lawyers, judges and scholars confirmed that fiduciary duties do not exist in any part of Iranian Company Law. As a result knowledge and understanding of fiduciary duties was low amongst shareholders and directors. They stated that without duties, appointments of directors were made on trust and were often family members. They added that companies were able to place duties in the articles however they acknowledged that many companies overlook carrying this out. Introducing fiduciary duties was a popular suggestion amongst many of the interviewees and without them they thought that issues between shareholders and directors would continue to exist and cause problems for businesses in Iran.

5.2.2 Duty of Care in Iran

The duty of care is one of the core principles of directors' duties in many nations around the world, and it was an essential point on which to gain the interviewees' perspective. It was interesting to find that many interviewees did not understand the general meaning of the term. LAW1 stated that in Iran there was not such an expression as 'duty of care' but that the concept of ‘trust’ between directors and the company did exist. LAW2 added that,

> “Directors’ duties are not a core part of company law in Iran and in my professional career I have never focused on this area, I do not have any idea about the duty of care.”

Other interviewees, whilst being aware of the concept of a duty of care also concurred in the argument that perhaps it was not required to the same degree in Iran as it was elsewhere. SCH1 mentioned that when companies were built up from family members and the controlling parties were principally family members then the issue of duty of care would be less important. SCH1 stated that,

> “The problem is less since the director is one of the shareholders and they all have the same goals. The director might have less knowledge if they got their position through the family or relation, but in regards to trust we can guarantee the duty of care as they are a family member.”

Also, he mentioned, that when directors are not family members then there is a greater need for the duty of care. Many of the lawyers believed that the duty of care should have a place in statutory law.

There was a consensus as far as JUD1, JUD2, DIR1, SHA2 and DIR2 were concerned that it was paramount that the director would be accountable for the duty of care and that it would be wrong for it to be overlooked in the Iranian Company Law. DIR1 went on to state that without the duty of care directors could be distracted from achieving company targets and safeguarding the company assets. He stated that this was a serious risk, as without the duty directors have no liability for the company’s welfare. DIR2 agreed with this point adding that it was fundamental that one has the duty of care and without it the company would be built on weak foundations, as shareholders need directors looking after the business as if it were their own. DIR3 believed that the duty of care was one of the main duties that the director should have and without it the company could become insolvent. There was a strong point raised by several of the interviewees that the duty of care can encourage slow and cautious practices from directors. JUD1 emphasised the importance of the duty of care, however added that this is fine up to the point where it starts having a detrimental impact on the speed of the director’s actions and a company’s functions. JUD1 said,

> “If the director always prioritises the duty of care then it will have a negative effect on the company’s interest. Directors need to work with speed to get deals done and the more barriers of care involved the slower they will be leading to wasted opportunities. Also if they are too careful in their decision making they will miss opportunities.”

DIR3 provided a case whereby the speed of the director was impeded by the duty of care to the point that it caused issues for the company. A Bank had strong procedures in place for carefully managing different aspects of the business. This was due to a duty of care being inserted into the company constitution. In order to take necessary care in controlling expenses, the main director in Tehran made all orders for equipment required for the business instead of allowing branch employees to make the orders. The result was that for minor things like stationery for the bank in another city, they had to wait a week to receive these items. In this situation speed was required for such purchases and the duty of care was a hindrance to efficient practices. Instead of the company receiving the stock requirements as and when needed, it had to go through a long process due to additional levels of care for company funds.

SCH1 furthered this point by stating that the duty of care was necessary but risk taking by the director was also crucially important. If the director can balance these two (having risk plus duty of care) then that is ideal. LAW1 went one step further by adding that whilst the duty of care was useful, it did not necessarily mean that it needed to be a statutory law. He argued that it is likely to have a negative effect on shareholders' interests, as the director might not take risks for the maximum interest of the company due to a fear of breach of duty of care. Whilst being of this belief, LAW1, when pressed further on the point, was unable to offer any alternative apart from stating that those who do believe it to be of importance are able to include it in the articles of association. LAW3 agreed on this point, stating that the most important duty of directors was to make profit for the company. Directors will potentially fail to pursue opportunities for the company and be able to excuse these failings by saying that they are exercising their duty of care. The duty of care therefore could be used as a shield to protect the directors rather than as a tool to protect shareholders.

As noted by LAW4, directors in Iran are not bound by a duty of care at the moment and there are many examples in Iran whereby directors' actions are not in accordance with a duty of care. Should the duty come into effect in Iran, directors' practices would have to change to meet the standards required of the duty. Also LAW4 stated,

> "In one case I recall, a company was registered as a finance company. This company appointed a director who was not an expert and was unskilled in that area. This director repeatedly exercised a lack of care, but there was no law in place to claim against the director. As far as I know this individual is still the director in that company."

Interviewees also commented that whilst there is not the duty of care in statutory law, there are laws that refer to care. LAW1 began by saying that in Iran, the law gives the court relevant authorities for applying the duty of care. SCH3 expanded on this point,

> "We have a general concept for this duty called *Ghebte* (Islamic term for 'caring for your work and not going over board with duties)[647] in our Islamic law*,* which is an Islamic source that is only used in extreme cases. It is not possible however to find this subject in any statutory law. For instance, in common law countries this duty is well known and documented. Frequently judges refer to this duty in relation to the actions of directors. Unfortunately we do not have any case law or statutory law on the subject."

SCH3 also stated that *Khianat-dar-Emanat* (Islamic term for the duty of care and morality) is part of *Ghebte* and is typically only used when cases are very serious and are not considered as minor breaches of the duty of

[647]Ebn-e-Manzour, The Fighh Library in Arabic, *Feghahat Madrese Publications* (2015). Available Online,
http://lib.eshia.ir/40707/7/358/الغين [Accessed 10/08/2015].

care. He clarified that it is rather for when directors have made dire decisions for a company and should have known better especially from a moral stance. LAW4 described the duty of care as a moral issue that every director should be accountable for. He went on to state that according to the Fighh the director is a trustee and is responsible for the welfare of the company and LAW4 said that,

> “The duty of care refers to a duty to look after a company, directors in Iran have this duty as they are placed as the guardian of the company under the Fighh.”

SCH6 lamented that the duty of care does not form part of Iranian statutory law, but said at least directors are accountable for their care of companies under the Islamic sources. The duty of care is one of the principal duties for every director and in the Fighh, directors are accountable for how they look after their companies.

In conclusion many of the interviewees did not have a strong knowledge of the duty and only knew of it in a basic form that exists in the Fighh. On the whole the interviewees thought that there was a strong consensus that the duty of care was important and deserved a place in statutory law in Iran. Several reasons were provided for why the duty should be included. Firstly it was suggested that it prevents directors from being influenced to act against the company’s interest, it prevents the company from being built on weak foundations and also it reduces pressure on directors which makes it less likely that a company would slide towards insolvency. The greatest concern highlighted about the duty was that it could discourage directors from taking risks.

5.2.3 The Business Judgment Rule

The interviewees were asked about whether the Business Judgement Rule had any place in Iranian Company Law. There was a general consensus that this type of law did not exist in Iran, as SCH3 explained that the concept of good faith is not clear and there is not any kind of Business Judgment Rule. SCH3 was correct in his assessment, however it was important to ascertain whether there were any laws that touch on the concept of good faith.

Several interviewees pointed out that Iran was not without any law on this subject and good faith was covered in certain areas of the law. DIR2 mentioned that there are two useful articles on this subject, articles 125 and 126 of the Iranian Constitution.[648] These state that if the directors take any action outside of their duties, they can be held responsible. DIR2 stated that,

> "We also, have a rule '*Ghaedeye Ehsan*' in the Fighh which is similar to the Business Judgment Rule in that if a director acts with good faith and for the interest of the company they should not be held responsible."

[648] Article 125 of Iranian Constitution [Treaties]: 'The President or his legal representative has the authority to sign treaties, protocols, contracts, and agreements concluded by the Iranian government with other governments, as well as agreements pertaining to international organisations, after obtaining the approval of the Islamic Consultative Assembly'. Article 126 of Iranian Constitution [Planning, Budget]: 'The President is responsible for national planning and budget and state employment affairs and may entrust the administration of these to others.'

SCH2 agreed with this comment, stating that the law covers a similar concept in Islamic sources, and he further added that there was also something similar in Iranian Civil Law.

JUD3 mentioned that according to article 171 of the Iranian Constitution[649] the rule '*Zarar-va-Zian be Taghsir*' sets out that if the director causes damages and harm through breaching their duties in the article of association then they should be responsible regardless of any good intentions or good faith. JUD1 was of the opinion that whilst directors may take actions in good faith, they are still responsible if these actions were carried out due to a lack of knowledge. JUD1 said,

> "We have a rule in Fighh, *'Al'Amalo-bel-Niat'*[650], which means 'the intention of the action is important'. The principle is the requirement of a presence of good faith and good intention. The director should prove to the judge that their actions were made in good faith and if they are not able to do this then the culpability falls on their shoulders."

JUD2 stated that the rules that come from the Fighh, whilst they might seem applicable on the surface should not really be used in commercial instances. He said,

[649] Article 171 of Iranian Constitution [Liability of Judges]: 'Whenever an individual suffers moral or material loss as the result of a default or error of the judge with respect to the subject matter of a case or the verdict delivered, or the application of a rule in a particular case, the defaulting judge must stand surety for the reparation of that loss in accordance with the Islamic criteria, if it be a case of default. Otherwise, losses will be compensated for by the State. In all such cases, the repute and good standing of the accused will be restored.'
[650] According to Hadith (sentence) from Mohammad, 630 CE (Common Era).

> “These rules *‘Al-Amalo-bel-Niat’* [651] are applicable for humans in normal life but not for companies and commercial cases.”

Outside of Islamic sources there is also a rule of good faith that exists in Maritime law. SCH2 who spent time working in merchant shipping in the Persian Gulf said,

> “There is a rule in the ‘ Iranian Maritime Convention Act’ that states that a ship’s captain is required to care for the ship and its cargo within his professional role on the ship. It is his duty to do his upmost to prevent any damage being caused to the vessel or cargo. As long as the captain in charge carries out their role with good faith using their ability and skill, then they should not be held accountable.”

The good faith element to this rule is similar to the one that is part of the Business Judgment Rule in that it exempts the captain from liability if they have acted in good faith. This law is unique to maritime law though and cannot be considered more than an example of a specific legal field in which the concept of good faith exists.

Many interviewees were not in favour of adopting the Business Judgment Rule. JUD1 argued that having the Business Judgment Rule would have the potential to harm companies, for a director whilst acting in good faith can do great damage to companies, if they are not experts and free from responsibility for their actions. SHA2 agreed with this point adding that the rule is not in companies’ interests, and without director

[651] According to Hadith (sentence) from Mohammad, 630 CE (Common Era).

accountability, a director can misuse his position in the company by taking risky decisions.

SHA4 stated that directors are in their position as they are meant to understand the decisions they take for the company. It is their job to predict occurrences in the industry and the circumstances in which decisions are made. They cannot be excused due to their good faith. SHA3 appreciated the merit in the rule, but struggled to believe it could be applicable in Iran. SHA3 said,

> “The role of the director is more transient here, they can be fired very easily. If shareholders believe a director is responsible for a poor decision, the Business Judgement Rule will not save them. There is insufficient control on directors as well so there is greater need for the law to hold them accountable for their actions.”

SHA4 made it clear that he believed that directors should have a degree of fear of accountability for any poor decisions they might make on the company’s behalf. The Business Judgment Rule makes the directors too carefree over potentially damaging decisions. The profit of the company is always the priority and the director should be accountable for anything that jeopardises it. SCH4 stated that in theory the rule has merit in that it protects the director if decisions are made in good faith for the company’s interest. In his experience however, there are situations where directors should have been liable. In one case he said that a judge ruled in the director’s favour, when they should not have. He explained,

> “There was a rice company whose director made a decision to export rice to Iraq. After some months the government of Iraq forbade Iraqi companies from having business with Iran suddenly. As the Iranian company had mass produced so much rice, they ended up selling most of it half price to get rid of the stock and they lost a considerable amount of money. It turned out that the director had been aware of the risk involved in the deal with the Iraqi company, however decided that it was worth the risk for the company’s interest. Surely he is liable if he was aware of the risk.”

Of course, in this situation it is questionable whether the director had been acting in good faith and would have been saved by a Business Judgment Rule.

SHA5 also provided an example that leads him to believe that the Business Judgment Rule could not be applicable in Iran. He stated,

> “I worked in a company that was building a general hospital in Tehran. After the project started it became apparent that they had spent less than expected on certain elements of the construction. The director had used cheaper materials to save the company money however the company eventually ended up losing the contract. The blame for losing the contract was placed on the director even though he claimed that his actions were made for the benefit of the company. The director was rightfully liable for that mistake.”

Many of the interviewees however were in favour of the Business Judgement Rule. DIR1 who worked in a family company did not believe the rule to be applicable in family companies as decision-making is more collaborative. He strongly believed however in public and state owned companies, the rule would be extremely important, as those directors are often fearful of taking risks. SCH6 seconded this point stating that it is especially important in government companies as directors are often not adequately qualified and will need protection of a Business Judgment Rule in case they make any mistakes. DIR2 agreed adding that business is about taking risks and that it is the director's job to take these decisions to progress the company. He added that some risks do not go as planned and the director should not be liable if it goes wrong.

DIR4 argued that the rule is only there to protect directors if they are unfairly being held accountable. Auditors[652] still exist to investigate directors in case any faults occur through negligence or conflicts of interest. DIR3 also mentioned this point stating that the director should not be responsible if they act in good faith. He stated,

> "Without this rule, directors feel wary about taking risks to achieve the company's target. If the director is innocent, it is not fair to make him responsible."

LAW2 added that no directors are perfect. Sometimes they can make a decision and not obtain the intended result for the company. There needs to be a margin for error, as directors will be weakened if they are punished for every mistake. And in the long term the company will suffer more for not having an empowered director.

SCH4 suggested that directors needed the support of the law and that it is right that they receive it. He explained in Iran it is possible for directors to

[652] 'Auditor' use for 'internal and external control over management'.

win cases through the principle of good faith and that certain judges do allow the principle in their courts. SCH4 said,

> “This rule is not in our company law, but some judges support this rule according to the directors’ good faith for companies.”

SCH 5 states that often directors’ mistakes can be classed as indirect. Issues occur in companies that are caused through the actions of employees, however due to the scale of the error the blame is attributed to the director. As directors are ultimately responsible for the company’s actions, they can be liable for anything that goes wrong in a company. In the interview with SCH1, he shared his experience of a case whereby the director could not prove that he did something for the company’s benefit with good faith. This director defended himself by stating that the company was under considerable pressure and no other director would have done a better job under the circumstances. In this case, the director was found to be liable for breach of duty of care in the articles of association. The Business Judgment Rule is needed in cases like this SCH1 argued.

In conclusion the interviewees clearly conveyed the view that in Iran there is no Business Judgment Rule. It is possible to say though that the subject of good faith does appear in different parts of Iranian statutory law and Islamic law and can save a director from liability. The interviewees were split on their opinion as to whether it could be beneficial or detrimental for Iran to have the Business Judgment Rule. The shareholders were concerned about directors’ having more freedom to take risks whereas directors were in favour of the added protection that the rule provides to allow them to take risks without fear of liability.

5.2.4 Lack of Commercial Court and Coping Mechanisms

In every jurisdiction there is the need for effective enforcement of breaches of duties, as without such systems in place the duties themselves have no power upon directors. The way the courts function is a core element of the enforcement system, as companies need to have faith in them to bring actions against directors. Having faith in the courts is only achieved by when the courts are reliable and efficient and consistent. It was important to learn how the interviewees understood the process and whether they believed that it was functioning to a satisfactory standard. The interviewees were first asked which courts were used for commercial cases in Iran. JUD1 described the judicial system as having many layers of courts. The constitution dictates that there must be civil courts, criminal courts and military courts. He went onto say that cases originate in lower courts and can be appealed to in higher courts. The highest court is the Supreme Court whose purpose is to review cases of capital offenses and rule on death sentences. JUD2 added that there are also the Revolutionary Courts and the Special Court. Both these courts are based on decrees made by Iran's supreme leader Khamenei. They have never been incorporated into the constitutional clauses defining the role and structure of the judiciary.

Many interviewees remarked about the non-existence of commercial courts. LAW1 stated,

> "In Iran there is no specific commercial court and instead general courts are used"

SCH1 agreed mentioning that in Iran there is not an expert court for commercial cases. Whilst in the past there was suggestion that it was required, in practice the implementation of commercial courts was never realised. SCH1 backed up the point that the courts were ineffective for commercial cases, stating,

> "They are not specific to commercial cases and they lack the expertise to rule on commercial cases."

SCH2 also agreed, stating that unfortunately the courts are not proficient in Iran as they fail to specialise in company law and often they fail to assign a sufficiently knowledgeable judge to preside over cases.

With the interviewees having established that there were no commercial courts, it was necessary at this juncture to uncover what coping mechanisms the system has developed to survive. The first coping mechanism was to develop the expertise of certain judges in the general courts for specific fields, such as company law.

SCH2 stated that in the last 15 years there had been an improvement of the knowledge of certain judges for specialist cases. For cases that pertain to a certain field of company law, there will be a referral to a specific judge if there is one with appropriate knowledge and experience. Whilst this is not uncommon, often even allocated judges will not be sufficiently knowledgeable about a subject matter.

The second coping mechanism that many interviewees remarked about was the courts using delays or adjournments to gain time to allow themselves to become more informed about a subject matter. SCH3 and SCH6 also stated that the courts do not have enough knowledge to solve complex commercial cases and their solution was to delay the cases until such time as they can make a decision. SCH4 stated,

> "The court for commercial cases always draws things out. When it is like this more frequently than not, the delay causes more problems than the reason you are in court."

LAW1 reiterated the same concern, stating that legal proceedings in Iran were long and expensive due to judges' lack of familiarity with commercial cases. LAW1 said,

> "Throughout my twenty years experience, it is very rare that commercial cases will be resolved successfully in court."

SCH3 was of the view that if the courts had more expertise they could deal with cases on time. SCH4 firmly agreed with this point stating that in European countries there are specific courts for commercial cases making proceedings more straightforward and quicker. LAW2, much like SCH3, made comparisons with Europe stating that Iran obtained its commercial code from France but not the framework of the courts. LAW2 believed that,

> "We do not have the court system in place to make decisions on our law. I had a case that was opened 18 years ago in the court and

> has not been resolved by now. In different courts, similar commercial cases are decided totally differently."

DIR1 spoke of the effects that delay has on companies, and stated that,

> "When the case in the court takes time, that delay damages the company and the problems become more complex to solve."

JUD3 explained that for company cases, it is natural that it takes a long time to get the result. He currently is the judge in a case that has been open for ten years. He said,

> "It is necessary to arrange for experts on different matters, which can take a long time. These experts have to first be selected, then they have to prepare their findings and a date has to be arranged to hear their findings. Always there are delays after delays."

The third coping mechanism is the increasing popularity of arbitration. SCH1 stated that since the introduction of the 1997 International Arbitration Law in Iran, arbitration has become a less expensive and quicker process. Many other interviewees supported the usefulness of arbitration. LAW3 stated that from a professional point of view, it is more practical using arbitration to solve disputes and circumventing the courts. SCH2 furthered this point by adding that now it has become standard practice for the joint stock companies to use arbitration as a means for resolving issues as opposed to the court. JUD2 added that in smaller cities, arbitration is a better solution for commercial cases. JUD2 stated that,

> “All the best courts are in Tehran, in smaller cities the courts available are of lower quality and you stand a better change with an arbitrator”

DIR3 was of the belief that in many cases arbitrators are more knowledgeable and experienced than the judges as they have often become specialists through experience in certain fields of disputes. Moreover, he added that they are less expensive and considerably quicker than the courts.

It is article 282 of Civil Procedure Law that sets out basic requirements for arbitrators in Iran. Arbitrators are selected from members of the general population who put themselves forward for the job. It is a general requirement that they possess a good understanding of law, as the basis of all their decision-making should be based on law. Often though, the typical applicant from the general public has a superficial understanding of company law. Articles 469 and 470 of Arbitration Law in Civil Procedure Law in Iran sets out that the person must be a minimum of 25 years old. In any case the arbitrator should disclose any connection they have with either party. If the arbitrator has any bias then they should abstain from the role and pass the case onto an alternative arbitrator. There is a requirement that arbitrators’ prior experience cannot include that of someone who has professionally practiced law. Judges and lawyers are not able to become arbitrators. If the two parties in the case cannot agree on one specific arbitrator then they should both select one. Once there are two arbitrators in place, those two can choose a third. Three arbitrators are classed as a board of arbitrators and are useful in instances of disagreement of arbitrator choice.

SCH3 mentioned that it has become commonplace to include in the articles of association that legal disputes will be settled through arbitration. SCH3 said,

> "Large professional companies have recently started to include the use of arbitration in their articles of association. Obtaining a resolution of a matter through the court can harm the company's interest due to delays. Arbitration is handled by experts, familiar with commercial cases, who can deal with issues quicker and better than the court."

The final coping mechanism is settling disputes internally without the assistance of the courts. In Iran the interviewees remarked that many cases do not go to court, as companies do not have any faith in the court being able to fulfil its function. DIR2 explained that often the most cost effective way of closing a dispute is to settle. Once it is clear that a case is going to take a long time to resolve, reasonable parties will choose to settle, especially if it is causing issues for the businesses' operations. An alternative as SCH6 pointed out, is that many company cases are solved through the traditional method of empowering either the eldest member of the company or an independent third party to make a decision on a dispute within a company.

DIR2 showed a degree of frustration in speaking about the courts. He stated that in his company they never take matters to the court, as it is not an intelligent way to resolve a matter. He said,

> “It is slow, expensive and you can not trust it to give you a just outcome. We do not use the court at the moment nor will we use it in the future.”

SHA4 concurred with DIR2, stating that his colleagues, who also direct companies, had advised him not to solve his issues through the courts. JUD1 advised that in Iran today the standard first step for resolving disputes is for the shareholders to attempt to agree on a resolution internally within the company. If this proves to be unsuccessful then the second step would be escalate the claim to an arbitrator. If arbitration were unsuccessful then the final option would be to refer to the court.

In conclusion, the interviewees confirmed that there are no commercial courts in Iran and that instead general courts are used. These courts are on the whole under-performing and are not effective. The absence of commercial courts contributes to having many judges who are not sufficiently experienced or knowledgeable for the cases and this results in many delays. Arbitration has become increasingly popular and many companies try to settle disputes outside the court. What this means for directors duties is that cases on the subject matter are often not being dealt with as they should be which can lead to the incorrect outcome, especially if matters are resolved internally within the company or they go to arbitration. Without all cases being properly managed by a commercial court, there is a danger that outcomes will be inconsistent.

5.2.5 The Role of Judges

A key instrument in the legal process is a competent judicial institution that the public can rely on to determine decisions in line with the law of the country. Judicial outcomes have a significant role in deciding breaches of directors' duties, as a thorough understanding from judges on the matter should produce the consistency that is required. It is important to firstly analyse whether the judges are carrying out their role effectively and the public are satisfied with them. Attention should also be focused on the path to becoming a judge and whether this process prepares judges suitably. The judgement making process will then be looked at to see how decisions are made and finally attention will be given to any issues that currently exist with the system.

The first point raised with the interviewees on the subject of judges is how competent judges are and whether they can be trusted in their position. Not one shareholder, director, lawyer or scholar responded in the affirmative. A key complaint of judges is that they are not sufficiently experienced and knowledgeable to make decisions in line with the law. SCH1 claimed that it is rare to come across a judge who is suitably educated and has the relevant expertise. In his opinion, Judges are appointed according to their political and religious connections. DIR4 attested that judges do not have an adequate grounding in company law. Also, he said,

> "For me, I should have some experience related to my job if I am to do some managing in a company, but the judges do not seem to have any experience."

DIR3 added that from his experience as a director and having a degree in law, he was yet to see a judge who was sufficiently knowledgeable and experienced to make fair decisions. LAW1 also agreed with this point, adding that if one wants to complain about any breaches, achieving a correct decision in line with the law was difficult, as the judge often did not have sufficient understanding of the law and business to be able to adequately understand the situation and make a correct decision. LAW2 backed up the point further by contesting that judges were not proficient enough to make logical, correct and fair decisions. He said,

> “Proving the breach of directors is difficult and also conflict of interest is difficult to prove and therefore judges struggle with these cases as they fail to adequately grasp the situations and apply law to reach decisions.”

The opinion of the scholars supported the criticisms made by the shareholders, directors and lawyers. SCH1 believed that judges’ unfamiliarity with the commercial context of cases and the understanding of which laws are the most appropriate for such cases was the reason that court proceedings were often long and expensive. SCH2 was of the opinion that judges were not very familiar with company law in comparison with other forms of law. SCH3 was of the same opinion that,

> “Company law is complex in Iran and in order to give good decisions the judges must be very experienced and knowledgeable in the field of company law. Unfortunately, our judges do not have

> sufficient opportunities and time to become experts in commercial law. If judges properly understood commercial law, it would solve half the flaws of the company law in Iran. The lack of understanding of law by judges is more serious than the lack of company law."

There was a clear consensus amongst the interviewees that practising judges were insufficiently knowledgeable and experienced.

The next point considered was whether there is suitable academic training in place to become a judge. JUD1 revealed that at the time when he became a judge the minimum age requirement was 22 years old and the only academic requirement was that one has completed a bachelors degree in law. In his case, following the completion of his degree in law at university, he became a judge at the age of 25. Of his entire undergraduate course there was only one module on company law and that was the extent of his company law experience. JUD1 said,

> "When I first started there were cases that arose where I felt out of my depth and sometimes even lost."

As SCH1 pointed out, the process these days to become a judge had changed. The main criteria is passing an examination which is only open to attendees of the judiciary course at the Judicial Sciences University in Tehran or those who have studied Islamic studies at university. SCH1 said,

> "Needless to say neither will adequately prepare a student to be a judge for commercial cases. An academic foundation

> in Islamic sources will assist students for family legal cases or criminal cases, but for company law it is less useful. For judges of cases involving company law, I expect it would be far more useful to study at the judicial school, but even still it is far from sufficient preparation to make company law judgements."

The third point the interviewees responded to was the decision making itself. SHA3 shared his first hand experience of a case where the judge made an incorrect decision due to a poor understanding of companies and shareholders' legal identities. He, as a shareholder, was forced to personally discharge his company's liability due to a judge's ruling. This error was due to a lack of knowledge of the law.

Another type of error that judges have been making is deciding judgements according to their own tastes as opposed to the law. DIR2 stated that despite all judges having to base their decision-making on company law, decisions lack consistency. He added that you see examples whereby in similar cases that deal with the same principles, judicial decisions were different. JUD1 confirmed this point, by stating that they were the people entrusted to make the right decisions when the law is not specific enough. Errors in judgments have also frequently come about due to the Islamic principle of siding with the weaker party. In cases where the law is on the side of the stronger party, the judge has ruled in favour of the weaker party. DIR1 who works in a bank went to the court to settle a matter that was causing the bank problems. He believed the reason the judge ruled against the bank was because he thought that the bank was wealthy enough to pay the amount claimed.

DIR1 explained that errors of judgement were made sometimes when there was an external factor influencing the decision of the judge. SHA2 stated that if you do not have enough money and good connections with someone in the courts, you would struggle to get a favourable decision or a decision at all. He went on to say that he knew of a case where someone successfully paid an amount of money to the judge in order for the judge to rule in his favour. In that example the person who brought the action continually had issues with the trial date being postponed. It was brought to light that the opposing party had been bribing the judge to force the court to continually delay the hearing. The official reason for the delay was that the judge was out of the country on annual leave, however it transpired that the opposing party had paid for the judge to take this leave of absence in order to keep delaying the case. SHA4 refrained from providing examples, however he was in agreement that judges were including irrelevant factors in their decision-making and producing incorrect and unfair judgments. He stated that it was not only bribery that encourages judges to be biased, it was also fear of higher authorities. DIR3 provided the example of the case of a well-known bank (the interviewee did name the bank) that was accused of permitting loans that failed to comply with standard protocols. He said that there was more than enough proof to demonstrate corruption however the judge ruled in favour of the bank due to its connections. LAW3 stated,

> “Sometimes I have had cases where it was very clear that the law was on my side however due to the opposition being a public company with state elected directors

> I lost the case as the judge chose to side with the company which was state owned."

LAW4 supported the claim that judges often favour particular companies. He stated that if the judge were to face a governmental company or even a private company with powerful connections, he definitely would demonstrate bias toward the powerful party. This has often proved to be the case when judges feel there is state involvement. LAW5 provided an example from his own experience,

> "A colleague had an agricultural project to make a man made 'green area'. He worked on it spending six billion Iranian Rials.[653] The company that hired him was a government company and it refused to pay the whole amount offering a payment of half of his claim. The colleague sued and the judge ruled in favour of the governmental company despite having contracts in place for the amount owed and the work to be done."

SCH1 provided an explanation for the instances where government backed companies receive support. SCH1 said,

> "Specific groups like the Army of the Guardians of the Islamic Revolution and Basij [654] are exempt from liabilities that normal directors face. The Army of the Guardians of the Islamic Revolution has powerful links in finance, government and the military. In companies run by these people, the judges have fear of repercussions if they provide a negative decision. As more than 60 per cent of the economy is run by these

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[653] 137107.40 pounds.

[654] Basij is 'a Paramilitary Volunteer Militia' established in 1979 by order of the Islamic Revolution's leader Khomeini.

> kinds of companies, such as all telecommunication companies, Petro-Pars company (PPL), lots of agricultural companies, etc."

Apart from these external factors influencing judges' decision making, one of the most debilitating aspects to the judiciary process is, as mentioned earlier, delays. SHA1 provided an example from her former role as an officer of the court, where it was her job to gather information about a case and provide her opinion as to how the case should be determined. In most of the cases she was involved in, the judge delayed cases due to the court's difficulty in making a decision with certainty. SCH1 and LAW1 further supported this statement by suggesting that the reason the court proceedings are often long and expensive is due to the judge's unfamiliarity with cases. SHA5 further added that delaying could be a tactic to make parties resolve cases outside the court. SCH1, SCH3 and LAW3 all agreed that judges do delay cases for this purpose.

In conclusion, all of the interviewees besides judges had damning points to raise about the quality of judges today in Iran, branding them insufficiently educated and experienced to be placed in the position of authority that they hold. Modern education procedures and training for judges were criticised and they were suggested of being susceptible to external pressures such as bribery and influence from higher authorities. Again the outcome is much the same in that cases of directors' duties are not being adequately managed. It is a fundamental requirement for consistent judgment making that judges in charge of cases of directors' duties are suitably experienced, educated and knowledgeable to handle the cases.

Without these criteria being met, they will not be able to make the correct decisions.

5.2.6 Inconsistent Judicial Interpretations

Having now considered the role of judges, the next step is to look at the orders made and what impact this has on directors' duties. The consistency of judicial decisions is a key ingredient to a successful legal system and through the doctrinal research it has been called into question whether judges are interpreting the law consistently. It was important to hear from the interviewees to see whether they believed this to be the case and if not, what was happening.

SCH1 believed that the law is not sufficiently precise and this results in the judges finding it hard to interpret the law. SCH1 said,

> "Many aspects of Iranian Company Law can be interpreted in different ways. In a lower court the judge might decide a case through his interpretation of the law, which then gets overruled in a higher court due to a more senior judge having a different interpretation. Overturned judgments are not uncommon."

SCH4 stated that many of the 600 articles in Iranian Company Law produced in May 1932 were too vague in their translations, allowing for subjective interpretations. Subjective interpretations produce inconsistent rulings by judges. The judges mainly agreed with this point, with JUD3 stating,

> “The result is that we, the judiciary, are widely considered to be one of the Islamic Republic’s most dysfunctional institutions.”

LAW2 offered a possible cause of the problem. He argued that the root of the problem is that judges have too many different sources of law to draw upon. LAW2 stated,

> “Our company law is originally imported from France and it is mixed now with Belgian and Islamic law. It is too muddled up as judges have options for which laws they want to use to base their decisions on.”

SHA1 in contrast suggested that the fault lies with the judges. He stated that if there was a higher standard of judges in Iran who were all well educated and experienced, there would not be the same variety of interpretations. He added that the established, experienced judges were making correct decisions however the younger ones were out of their depth, making incorrect judgments. LAW1 suggested that the simplest solution was that all law on duties should form part of the Iranian Company Law, as it would prevent judges interpreting the law in different ways.

In conclusion it is clear that the interviewees believed the judges are interpreting the law in an inconsistent way producing varying judgments for similar cases. One cause suggested by SHA4 was that the company law translated from the original French codes was translated in such a way as to produce vagueness. Another cause suggested was that there were too many sources of law which had led to confusion as to which were the most suitable sources for particular cases. The last suggestion was that the standard of expertise and experience of judges varied considerably from one to the next. The interviewees when asked about solutions suggested simplifying the law by having all company related law provided for in one document, namely in statutory law. Directors' duties naturally would be included in this document, which would greatly limit the inconsistency of judicial interpretations.

5.2.7 Weak Legislation

As has already been seen in Chapter 3, the legislation on directors' duties in Iran is weak. The interviewees were asked for their opinion on the current legislation to gage how functional the existing code is considered. It was hoped that their responses on the subject could offer a professional perspective as to the current state of it and whether it is able to fulfil its function.

The first clear message from the interviewees was that legislation for directors' duties is not sufficiently modernised to deal with the issues that present themselves in cases today. LAW3 stated that Iranian Company Law is very old and it fails to fulfil the function they require it to. SCH2 stated that there was no doubt that company law was in need of an update, as there were serious gaps in the legislation. SCH3 agreed, stating that over the passing of time it would be necessary to amend the law to ensure that it is in keeping with the changes in the country's economy and society. He added that in Iran's case there had not been any updates. SCH4 mentioned that Iran had many different articles in codes and it would take a lot of time to update, but it was overdue and necessary.

SCH1 stated that there were many weaknesses in company law and that it required amending and updating to make it more in line with business activity that operates today as opposed to when the law was written. SCH5 agreed with this point adding that Iran's Company Law was old and it was not in harmony with either the economy or with society. JUD1 added that it was 80 years since the law had changed. He attributed the reasons for this failure to be due to the fear of the new law not being successful and the lack of qualified experts to assist a successful reform of the law. SCH2 stated that the law was exceptionally out of date and also remarked that it had never been satisfactory. He added that not only is company law out of date but also it was translated poorly from the original French codes.

After this clear message that the law is out of date and there are no revisions in the pipeline, the natural question to ask the interviewees was whether there was anything that was preventing these updates. The interviewees made it clear that the lack of updates was not the fault of legislators but rather that proposed amendments were rarely getting passed. JUD1 stated that the committee that oversee updates to the law fears updating it since the time of the revolution. They fear that if they change the law it might make it worse.

SCH2 feared the influence of the Islamic Consultative Assembly,[655] the religious committee responsible for approving, tweaking or refusing any suggested law reforms. SCH2 said,

[655] The Guardian Council of the Constitution is an appointed and constitutionally mandated 12-member council that wields considerable power and influence in Iran; The Iranian constitution calls for the council to be composed of six Islamic *faqihs* (expert in Islamic Law), 'conscious of the present needs and the issues of the day' to be selected by Khamenei (Iranian Supreme leader), and six jurists, 'specialising in different areas of law', to be elected by the Iranian Parliament from among the Muslim jurists nominated by the Head of the Judicial Power 'Powers and Authority of The Islamic Consultative Assembly'.

> "One day if there is desire to change the law, there is great risk that amendments will not be what the country's economy needs. If any laws are put forward that are deemed not to be in keeping with Islam, they are rejected without providing reasoning for their decision. Typically the only laws that are passed are watered down and twisted to meet the criteria of the committee."

SCH3 echoed the same ideas, stating that they wanted to update and improve the law a while ago, however the Islamic Consultative Assembly did not accept it and failed to provide a reason.[656] It was suggested that if the Islamic Consultative Assembly had accepted this, there could have been great improvement of codes. SCH3 said,

> "I was invited to the committee of law makers to amend and change the law which I agreed to. The team working on the changes were all experts in their fields and we spent great amounts of time and money developing the proposed amendments. In the end the proposal was declined by the Guardian Council, and the laws put forward were not implemented. The reason for the failure was that the amendments were not in line with the Islamic principles of the regime and the Guardian Council."

SCH4 stated that the last update to company law was in 1969, not that long before the revolution. This update touched on some aspects of public and private joint stock companies. Since then the Islamic Consultative Assembly had not accepted any reforms. JUD2 made the point that whilst there was a desire to make reforms a few years ago, the addition of directors' duties was never included in the plans.

[656] See Chapter 3, section 3.3.3: Legislation Reform.

Without any updates and without directors' duties being included in the law, companies either operate in ignorance or try to find solutions in another way. The most common solution, as SCH5 stated, was including duties in the articles of association. Companies' articles have become the main source of law governing companies. He added that if there was statutory law it would be easier for people to follow and practices would be greatly ameliorated. Furthermore, it would protect those involved in companies who were not sufficiently knowledgeable to produce articles of association that are all encompassing. SCH5 said,

> "As for directors' duties, they belong in statutory law as they are one of the fundamental pillars of company law. As it stands today the law on them is weak and imprecise and the result is that no directors know about their real duties."

SCH5 argued that the system would function much better if everything were to be covered in the law. SCH4 stated that laws should be found within company law not just in articles of association. If all directors knew about their duties, company practises in Iran would be revolutionised.

Moreover, apart from the articles being the main source of law, with the law being so silent about the role of directors, there is little knowledge in Iran about many aspects of the position. JUD1 argued that there was not even a specific definition of directors and what their role consisted of. There was not a clear understanding as to what was the difference between executive and non-executive directors. There are different types of companies in Iran and it should be the case that the role of the director differs between these, however without clear duties directors are not able to know the parameters in which they can operate. Also, the lack of updates to the law has resulted in limitations to companies that should no longer exist. JUD1 further added that under Iranian Company Law, it was not possible to have single shareholder companies, and this was circumvented by the use of people acting as token shareholders to allow the companies, which were effectively one-shareholder companies, to operate. Recently in Iran, some labour law has been translated from Swiss law. The translation was not adapted to account for the Iranian economy and the law failed, and in the process many businesses became casualties of this failure.

There were further criticisms of the limitations that emerged as a result of the lack of updates. LAW1 stated that it was necessary to include the rights of shareholders in Iranian Company Law, as these were not adequately provided for in the law that exists today. Moreover, he added that, there was no mention of joint ventures, which has become a staple feature of all modern nations' company legal code. DIR1 stated that the Iranian code was silent on the issue of derivative actions. This makes the job of the lawyer considerably more difficult as it puts a lot of emphasis on the articles of association being watertight. In cases where the articles were not comprehensive, minority shareholders would not be well protected.

SCH4 stated that currently directors should be selected from one of the shareholders. He stated that this principle is archaic and should not exist in today's legal code as it would force shareholders to appoint someone who is often unqualified to be the director. SCH2 agreed with this point stating that the law is out of date since it was introduced in the civil code. He added that in France this was amended when a new law was introduced making allowances for single shareholder companies. In Iran, there was no such amendment and businesses still have to work within these confines, having at least two shareholders. In reality there are businesses in Iran that are family businesses where one person owns the company, however appoints other family members as token shareholders to bypass this law.

LAW3 stated that as it stands today directors are poorly controlled and might abuse the law in many ways but the law might be totally silent. There should be clear directors' duties in place to make them liable for their actions.

A further point added by LAW3 was that he believed there should be stronger legislation regarding who can set up companies. He stated that it should not be that easy to set up a company and that there should be requirements as to how little investment is needed to do so. Having clear law for this is necessary.

SCH2 stated that adapting the law to suit the economy and society is standard practice outside of Iran. SCH2 stated,

> "Our law in the beginning came from French code and was not adapted for Iran. It was copied and pasted and has proved in many circumstances to be unsuitable.
> Amendments that the French legal system has made over the years, the Iranian system has failed to make. The result is that Iranian civil code still resembles law from Napoleonic times when it was introduced."

SCH6 believed that the lack of legislation for company law was the principal reason companies did not trust the court. SCH6 said,

> "The lack of strong legislation behind judges prevents them from making decisions adequately and it results in companies' preference for arbitration or solving matters outside the court."

SHA2 agreed that it certainly would be an improvement to have all the main points accounted for in law, but warned that this would not solve the culture of corruption. He said,

> "Even if we have the law, it will not be for everybody. People in high positions can escape it with bribery or through their connections."

SCH6 concurred stating that companies do not follow the letter of the law, but rather they follow the board of directors. He suggested that when there is such poor knowledge of the law by shareholders and directors typically shareholders just trust the directors to use their judgement to keep the company on a good and legal path. DIR1 explained that there was a considerable amount that needed addressing and that in one interview it would not be possible to go through it all. He said that law on directors' duties is completely non-existent. He further added that he hoped that new law would protect shareholders and especially minority shareholders as many issues occur in this subject area regularly. DIR1 added that Iran was at a tricky juncture. Whilst it was clear that changes needed to be made it was important to select the most intelligent method and manner of making these changes. DIR1 said,

> "People are stuck between these four options,
> 1. Do not change law, bad experience of this in the past.
> 2. Total reform, delete what exists and replace it with new law.
> 3. Instead of changing it totally, get the experience of the past and modify it to fit, following the example of France, Egypt and Singapore.
> 4. Instead of changing all of it, just change it case by case."

Most interviewees agreed that the current issues could be addressed in legislative reforms. They further concurred that should these issues be changed and amended then there would be huge improvements in how the whole legal system operated for company law. With all these shortfalls in the legislation at this point it would be necessary to hear from companies about how they cope with such little legislation and also from judges about how they make decisions without the law on which to base decisions.

LAW3 stated that companies are required to have articles of association and the more '*savvy*' companies have extremely extensive articles to make up for the lack of legislation. JUD3 admitted that many more points should be addressed in law however there is a culture of companies managing to cope with the law as it is and he said,

> "The shareholders know best for themselves. They are able to put the points they need in the articles of association for the company."

SHA4 agreed with this point stating that she believed the law to be sufficient. She added that the articles of association contain all the needed points and any points that are lacking can be changed at the next meeting.

LAW2 suggested that it would be much better if the law were more coherent and accounted for everything as opposed to leaving the responsibility to shareholders and the articles of association. Normally clients would refer to the law if there were nothing in place in the articles of association. The law is seen as a secondary resource compared to the articles. The same interviewee stated that if the law were adequate, it would improve things greatly. Whilst the articles of association are a useful tool, they are typically created by the principal shareholders, who might structure the document to suit their interest. Updates to the law would solve many of these issues and could make the coverage of duties fair for all parties.

The judges too are limited by the lack of legislation. DIR2 mentioned that the duty of the judge in court is to produce a result based on law. If there is no point of reference in the law, then they have to use the Fighh. JUD2 also stated that the first resource for commercial matters judges use is the law and secondly they may refer to the Fighh or other Islamic sources. The Fighh is used as a core component of civil law for which there are many provisions on which the Islamic law is precise. JUD3 seconded this point stating that the Fighh is sufficient enough to answer most cases and he questioned whether there is the need for any more legislation. Nevertheless, according to DIR2 the role of the judge becomes significantly simpler if there is the law in place that can be referred to on a consistent basis for making determinations. Cases that are similar will always be resolved in the same way and it will be possible to have consistency.

In conclusion it is clear from the interviewees that company law in Iran is dated and has not been modernised with updates. Remarks are made that whilst the economy and society has changed over the years, the company law has failed to respond and move with the times. Reasons suggested for the lack of modifications is that there is fear that new legislation amendments will be successful and also that there are questions as to whether there is the professional expertise to put such changes into place. There have been efforts made to put forward improvements to the relevant authorities to make updates to the law however these have been unsuccessful. Should updates be put forward again there is need to completely update directors' duties and enforcement.

5.2.8 Family Companies

It is apparent from the existing research that family companies are exceptionally common in Iran and this was further confirmed by the interviewees. Family companies often are run differently from other companies, and it is the purpose of this section to understand what differences do exist and whether there are any issues that impact upon directors' duties.

5.2.8.1 Family Companies are Common

All the interviewees remarked that family companies are an incredibly prevalent feature of Iranian commerce and that most companies in Iran have been developed from family companies. DIR1 mentioned that from his 15 years experience more than 70 per cent of all companies he encountered were family companies. LAW3 said, and SCH1 agreed, family companies are most prevalent in cooperative and joint stock companies. JUD1 stated that more than 70 per cent of the private joint stock companies are family companies. SCH1 furthered this point by stating that he understood there to be about 700,000 private joint stock companies that are family companies. LAW4 and JUD2 explained that apart from large companies and governmental companies most companies are family companies. LAW5 stated that from his experience the majority of his clients are either family companies or involved in family companies. DIR3 said,

> "Our company is a family company, my friend runs his father's company at the moment as well. Also, another friend of mine works at a very well known car company, which is a family company too. It is common to meet people who are involved in family companies."

In contrast to the majority of interviewees who stated how prevalent family companies were in Iran, SCH3 stated that whilst there were many family companies in Iran, it seemed to be becoming less common.

5.2.8.2 Trust in Family members

It was important for the researcher to next ascertain why family companies are so common in Iran. DIR3 stated that installing family members in the main positions within a company is beneficial for the future of the business as it becomes easier to have trust. SHA1 agreed with this point stating,

> "We cannot trust in directors who are strangers. We just trust in those who have large shares in our company and our family members. We should be the ones running our company."

SHA4 remarked that for the security of the company and the company's best interest, it is better to have family or relatives as the members of the company. SHA4 stated,

> "It is easier to control the company, there should not be any conflict of interest as relatives should be trustworthy, and there should not be any need to go to the court to solve issues as it should be easier to communicate with relatives. When a company employs a stranger, after quitting the job they might do something in conflict with the company's interest through knowledge of the company secrets."

SHA5 stated that employing relatives is very popular among companies. Sometimes a person might not be able to afford to start a company on their own that is why they get some investments from relatives, as they can trust them for assistance in making the company profitable.

5.2.8.3 Connected or Qualified Directors in Family Companies?

The first questionable component of the practice of building family companies is that the reason for selecting certain people to occupy key positions is due to them being a member of the person's family. This reasoning has nothing to do with capability to carry out the role or experience of carrying out similar roles. SCH6 stated that the most important positions were occupied by individuals who had obtained them through their connections as opposed to skill and merit. SHA5 was also aware of the practice and stated that it was common that people use family connections to get important positions even if they lack the qualifications for the role and do not have the skill for that job. This opinion was supported by DIR4 and DIR5 who stated that the vast majority of people in key positions in Iran got there through their political or family connections. If you do not have any family connections you will never achieve any high position in a company. DIR3 offered the example of himself who is currently the manager of a bank. He explained that he obtained his first job in the bank because his father had been the manager for 30 years. DIR3 said,

> "That is why the same bank trusted me and gave me the job the first time. Most of the time for being the manager of big companies, you should have some connections and more importance is placed on these connections than your skill."

DIR1 explained that the standard procedure for recruiting new staff was to consider the manager's relatives and then the relatives of the current staff. This strategy is used instead of advertising the job.

JUD1 stated that it is common to see directors lose their jobs as the shareholders replace them for the purpose of installing a family member. JUD1 said,

> "In many cases, the majority shareholders decide to remove a director without any logical business reason. In one case I know of the shareholders removed a director because one shareholder wanted to replace him with his own son."

DIR3 who works in a state company admitted that they have used family connections for hiring people for sensitive and important positions. SCH3 furthered this point about state companies, adding that in almost all cases they select the close relatives or family member of the relevant Minister. So, the recruitment for senior positions depends on an individual's connection to the Minister rather than their capability. LAW6 who also had experience of government companies confirmed that people were using their political, family and friendship connections to get the role of director. DIR5, who is currently the director of a state company, said,

> "I can see this weakness and it is so common to select important staff according to the interest of the director rather than any other requirement. If you can employ a good friend to the company, you know they will support you and be loyal."

DIR2 lamented that unfortunately in Iran, they do not separate family and friendship from business. Until there is a redefinition of these boundaries, companies will always be limited by these practices.

LAW1 provided an example where a customer came to him to write up the articles of association of a new company. The director knew so little about the company that it was very difficult to understand exactly what was needed to be included because the director was uninformed. It was clear that he was a puppet of the main shareholder and had obtained the role through connections. JUD2 stated that unfortunately, many wealthy people who incorporate companies are not educated and they do not use educated people as a director. Also, many educated people are not wealthy as well and they cannot control a company or be appointed as a director of the company.

The next questionable component of family companies is token appointments. When setting up a business there are certain requirements in the Iranian Company Law that stipulate that there must be more than one shareholder, that there must be a company auditor and that every five years it is necessary to change the director. SCH2 stated that for registering the company, a person would typically appoint a family member as an auditor. This person might not even know about the company's name or existence. JUD2 stated that it is common that both directors and auditors are family members and do not have enough skill to run the company. SCH2 stated that most of the time companies have one person in control, the principal shareholder. If you look at all the other appointments like the auditor you find they are artificial. For instance, DIR5 stated that there is a well-known car company, which is a family company that installed the wife of the director as the company auditor. DIR1 stated that there are many companies in Iran in which the shareholders and directors are made up of the wife, the children and the relatives of the real company owner. SHA5 said,

> "I know a company where the wife has had periods when she has acted as the official director. This person has zero basic education and cannot even read and write. She knows how to do a signature, which is all her husband needs."

JUD3 stated that most family companies in reality have only one shareholder. According to Iranian Company Law, it is a requirement of all companies to have at least two shareholders.[657] That one shareholder

[657]Iranian Company Law 1968. Article 94 (Tehran: Didavar Book Publisher).

appoints a family member they can trust to be a nominal second shareholder to meet the legal requirement. In practice though the company is run by the one shareholder and the second person is just asked to sign the odd document every once in a while. LAW3 was familiar with this practice and stated that they needed to use family members as token shareholders otherwise they cannot run their businesses on their own. He said,

> "I had a case where the main shareholder had appointed his 12 year old child as the second shareholder. This is illegal, which the man learned, however it is an example that people are forced into these practices by the law which does not suit them."

In conclusion, the interviewees clarified that family companies form a large proportion of registered businesses in Iran. The issue with placing family members in positions of power is that more often than not they will not be qualified if they obtained the position based on their family connections. Many interviewees agreed that the default way to obtain a high position in Iran was to use your family, political and friendship connections. Standard recruitment procedures in many companies are to speak to relatives and friends as opposed to advertising a job in the traditional way. Having unqualified relatives appointed to positions they do not deserve, can result in dire consequences for companies. It is also commonplace for family members to be appointed in an artificial way, which allows one person to maintain complete control of a company as if it were a single shareholder company. The present company law rules force directors to become inventive with their company structure, which leads to token appointments of relatives who in fact are not involved in the day to day running of the company.

5.2.9 Unqualified directors in companies

Within the debate of the effectiveness of directors' duties in Iran it is also necessary to look at who becomes a director, their degree of expertise, how the appointments are made and what effect this is having on companies. From speaking to the interviewees there was an overall response that most appointed directors are unqualified for their positions. LAW2 stated that directors were unfamiliar with their duties and that they did not know what responsibilities they had in the company. DIR2 furthered the point by adding that the title of director does not necessarily indicate that a person is worthy of such a role. Often there is no test, no interview, no training and the selection process is non-existent. DIR2 said,

> "The director should have appropriate experience and knowledge. He or she should at least have the necessary training in running the finances of a company."

DIR5 stated that often it is the case that the directors do not have enough experience and this can lead to them harming the company and shareholders' interests. Several interviewees suggested situations in which the wrongful appointment of directors led to issues within companies. LAW1 mentioned that he was involved in a case where there were two people that had a company and one of them had the company money in his personal account and there was nothing in the law to control the situation. LAW1 argued that there should be safeguards in place against a director doing this, and also against someone becoming a director who is not aware that this not permitted.

LAW4 stated that it is common for companies to end their existence in a negative manner. There are many bankruptcies and many companies are dissolved. The majority of the time the cause of the issues is the action of an incapable director who has been appointed according to either family or political connections.

Apart from a consensus that directors are unqualified, the interviewees also agreed that the requirement of directors to be selected from the shareholders is having a detrimental impact on companies. DIR3 stated that the decision to limit the selection of directors to just shareholders was based on good intentions. The reality for companies though is that limiting the pool of candidates to select from has become a weakness for them. LAW2 agreed and said,

> "In Iranian Company Law, directors are appointed from the shareholders. This has a detrimental impact on the choice of director as it limits the candidate selection to a small group. Naturally the level of expertise of the director will not be to the required standard unless a shareholder happens to be sufficiently experienced to take on the role."

SCH1 made the point that there is no requirement in Iran that directors have a minimum standard of expertise. The only requirement that directors should possess is having shares in the company. SCH2 stated that it should be the other way around. Firstly directors should be appointed on merit and once they develop and succeed in a role, they should be able to become a shareholder. SCH2 said,

> "In other countries, first he or she becomes director and then that person might invest in the company and purchase shares. Being rich enough to be a shareholder does not qualify them to be a director."

DIR3 stated that the main issue that comes from having one of the shareholders as a director is that they will always put their own interest ahead of that of the company or the other shareholders. DIR3 said,

> "Majority shareholders will pick the individual that will pursue their interest most. That is how they understand the selection process."[658]

DIR5 reiterated this point stating that directors do not realise they are meant to be working for the best interests of the company, they see the company in more personal terms and consider themselves to be working for the majority shareholders.

DIR3 made the point that it is possible to select the non-executive directors from outside of the shareholders, which can help to create a board of directors with a balanced skillset. He furthered the point by stating that, certainly the practice of favouring family members and running the company for majority shareholders is not unique to Iran and it happens in small companies all across the world. If they are installed as directors though they will be liable for any breaches towards the company.

[658] Iranian Company Law 1968. Article 107 (Tehran: Didavar Book Publisher).

In state owned companies interviewees believed that there were many unqualified directors who had been appointed in their roles through their connections with those who were in political power. LAW1 stated that in governmental companies the selection of directors is made according to taste and there are extremely lax controls on their monitoring. LAW2 said that,

> "It is common for appointments of directors to be made according to politics. When you look at the experience of some directors you realise they are the son of someone important or a relative of someone in government. It is all fixed."

LAW6 argued that in business in Iran, it is all about politics. He explained that,

> "I was a lawyer who advised the government on navigation issues in the Persian Gulf during the years 1997 to 2005. In August 2005 there was a change of president in Iran[659] and in many sectors the advisors to the former regime became obsolete and new ones were appointed. I, like many others, was not invited to advise for the government again. Instead of selecting the most qualified people for jobs, the government makes appointments in line with their taste."

In conclusion, the interviewees revealed it to be commonplace to have vastly unqualified directors at the helm of companies. With there being no duties in place many directors have no reason to adhere to any duties. One

[659] Iran's 9th presidential election, Mohammad Khatami, the previous President of Iran, stepped down on 2 August 2005 and the election led to the success of Mahmoud Ahmadinejad.

of the reasons why directors are often unqualified is that directors can only be appointed if they are one of the shareholders. This limits the pool of candidates and reduces the opportunity to select a sufficiently qualified individual. Another element that produces unqualified directors is that in family companies relatives are often appointed. Having unqualified directors greatly increases the need for duties as those individuals are more likely to steer the company in to harms way through error.

5.2.10 Separation of powers

From research documented in Chapter 3 it has been established that Iran has a theocratic government that involves itself in business and law. Apart from the government there is another political institution that involves itself in business, which is the Army of the Guardians. This is a religious organisation controlled by the office of the Islamic supreme leader, Khamenei.[660] It was important when speaking to the interviewees to understand the extent to which these two bodies affect on cases of directors' duties.

It is clear from the interviewees that certain directors are not subject to the same rules as other directors. Due to the involvement of the government and the army of guardians in companies the directors who are appointed in these companies have political duties before company duties.

Directors are often installed in companies with some agenda from the government. Instead of working in the company's interest they are doing favourable deals for the government and thus abusing the company's investment. They are installed to promote government interests using the

[660]See Chapter 3, Section 3.2.4 State-owned Companies.

company they direct as their tool. When these actions are discovered, often the director is excused and in many cases relocated to a different company. It is not right that all directors are not subject to the same duties.

SCH5 suggested that in governmental companies, directors who are appointed through their political connections are more important to the government than the roles they occupy. If they abuse their position for self-interest or if they do something that is not in the company's interest, the government turns a blind eye. SCH5 stated,

> "If there is a tender process, the director will select the contact he prefers to win the bid as opposed to letting the market dictate the highest paying or most suitable candidate."

There is not a desire in these companies to hold directors accountable for duties like there would be in a normal private company.

Decisions on duties can be affected due to the courts' vulnerability to the pressures of both the government and the army of guardians. According to the interviewees, both institutions are able to exert political influence on the courts. LAW3 shared his experience of being involved in a case between a private company and a governmental company. The governmental company had clearly acted unlawfully and the law was on the side of the private company. The actions of the governmental company had been in line with the government's interest though. All the advisors in the case made arguments in favour of the governmental company and in the end, unsurprisingly, the judge ruled in favour of the governmental company. JUD2 stated that,

> "The court would always side with the government. If there is a case with the government or the Army of Guardians, the judge will not be able to rule against them."

DIR4 stated that judges are pressured to rule in the interest of the government. The directors in the governmental companies are often fearful that in the event that the company brings an action against them, the judge will be biased towards the company. DIR2 stated that the law is meant to favour the weaker party. In most cases this practice is carried out in judicial decision-making, however when governmental companies are involved, this rule is superseded by the court's loyalty to governmental companies. LAW3 stated that it is extremely common that the judge makes a decision in favour of the governmental company, even when the right is with the director.

SHA5 explained that in his opinion judges favour the benefit of the government even if the law does not. In the companies that are not governmental companies, they too can receive favourable treatment from judges if they have connections with the political personnel that can influence the judge. SHA5 said,

> "Our company intentionally avoids dealing with governmental company or companies that have governmental connections as we know that in the court we will lose the case."

SCH2 added that he thinks that the courts are on the side of the Army of Guardians and that they help it expand. SCH2 said,

> "It controls billions of dollars and they have grown to be so powerful. I know lots of

> judges in important cases change the decision for the political and religion reasons to appease the Army of Guardians."

LAW6 explained that the Army of the Guardians of Islamic Revolution direct many important projects and also they are exempt from the law. They have the support of the supreme leader and the army and they are both political and religious. The judges are fearful in making any decision against them in the court as they organisation has the power to impact upon their lives.

JUD1 argued that the directors of governmental companies are aware of the influence the government has with the courts. This makes them more cautious as they believe that should the company accuse them of anything then the court will not treat their case fairly; they will be found liable whatever case they might have. JUD1 said,

> "They might be afraid of taking risks as they can easily be punished for little errors and the judge will not support them.[661] X was a public figure frequently in the Iranian media. He used his platform to stress his opinion that directors should not be taking large risks with governmental companies, but rather their job is to manage them safely and protect them from harm. He was publicly in favour of controlling directors and reducing risk taking."

In conclusion the interviewees made clear arguments that both governmental companies and army of guardian companies often have directors that do not adhere to duties and have less regard for duties than

[661] From 1989 until 1998.

directors of private companies would. Also judicial decisions on duties of directors of private companies are often influenced when the government or army of guardians pressurises judges.

5.2.11 Inspectors and Auditors

The role of inspectors and auditors is paramount in the successful operation of companies as it allows shareholders to understand how their businesses are being run. Periodic reports from auditors should alert directors to any breaches from directors or any incidences of mismanagement of businesses. The interviews revealed that there was a strong understanding of the role of auditors from all the interviewee groups. It would appear that auditors have a broader role to play in Iran compared to auditors in western countries. SCH1 understood that auditors should provide some control to ensure that directors are doing their duties. DIR1 stated that the auditor should report all of directors' breaches in the general meeting. DIR3 added that the auditor is in place to expose the negligence of the directors only. LAW2 stated that the auditor is responsible for controlling the director,

> "The auditors are there to stop the director acting against the articles of association and Iranian Company Law".

JUD2 remarked that whilst auditors' purpose is to control directors, one must remember that auditors do not have anyone controlling them. The first point highlighted by the interviewees is that auditors are needed in Iran as many directors place their own interests before that of the companies.

DIR4 suggested this to be the case, saying that he knows many fellow directors who act predominantly in their own personal interests, or those of their family's as opposed to in the company's best interest. Whilst agreeing with this point, DIR2 added that without proper auditors, directors would abuse their position. He had experience of this as a shareholder of a company. Whilst in this role a co-shareholder in the company was occupying the position of director and his wife had been nominated to be the auditor. The director breached many of his duties, misusing the company's asset[662] and also dealing outside the company for his personal interest. Naturally with his wife as an internal controller, none of the breaches were reported to the other shareholders. Therefore, his wife had also breached her duties as she was the auditor and had not reported the director's breaches.

SCH3 stated that in Iran there is not any law to control the exploitation by directors of corporate opportunities. The concern is that auditors are selected from the majority shareholders, and in private joint stock companies the auditors are from a member of the controlling family. The closeness of these relationships can result in these auditors failing to adhere to their duties stringently. JUD1 added that there is serious control from auditors in some companies, but typically in family companies these positions are artificial.

The second point discussed by interviewees is that auditors can often be corrupt. LAW5 stated that of course it is the obligation of the auditor to be professional and exercise their expertise. The issue occurs however when

[662] Iranian Company Law 1968. Article 133 (Tehran: Didavar Book Publisher): The executive and non-executive directors cannot do any deal such as company deal that competing with the company. In other words, every director who breaches this law and his or her breach harm the company is responsible to all that breaches. Harm in this section means effecting in the companies' interest.

instead of acting in the best interest of the company, the majority of them act in the interest of the director due to their personal relationships. He went on to mention that most of the time the auditors do not report the conflict of interest of directors and this ends up resulting in many cases on this subject.

SCH3 stated that in Iran the auditors are corrupted as they get their salaries awarded by the directors. In other countries, such as the UK and France, the auditors are independent and this allows them freedom in their decision-making. Directors often have power over auditors in Iran and if the auditors are not on their side, the directors can force them out. SCH3 said,

> "In Iran, auditors are not selected according to their skill and abilities. Their selection is more based on connections and friendship, and it results in them controlling every part of the company by themselves."

DIR2 added that the principal issue is that the auditors are not independent as they receive payment from the company which is essentially the root of the corruption. He went on to state that there is one tool to catch the miscreant director and that is the auditor, who is vulnerable to being corrupted by the director. DIR5 stated that of the directors that he knows, most act for the interest of themselves, family and friends as opposed to the company.

SCH6 stated that in Iran, selecting the auditor is a ceremonial action because the role in most cases will not be performed as it should be to check on directors, but rather it will be carried out under the supervision of the director. SCH6 stated that if the auditors fail to correctly assess the company, the minority shareholders would not be able to challenge the actions of the director, as all the breaches would have been concealed. Auditors have the power to cover up all breaches of directors. Frequently when auditors are selected, the director chooses the person who can best assist them in keeping control and concealing their errors.

Unfortunately Iranian Company Law does not give clear duties and responsibilities for auditors. Often reports are first shown to the director before reaching the shareholders, permitting the director to influence them before they are made public.

In conclusion, from the interviewees' responses it has been possible to learn that there is concern over how auditors are carrying out their roles in Iran. There was a common opinion that directors often put their own interests before those of the company, which increases the need in Iran for the auditor to carry out their role with integrity and honesty. There also seems to be a common theme that auditors are frequently connected to directors or shareholders in a way that makes them biased and not sufficiently independent in judgement. In governmental companies, there is often a degree of corruption as directors with connections are often exempt from unfavourable audits due to their connections. Auditors in practice have no duties and responsibilities, and it is perhaps in this extent that their roles do not demand the performance that Iranian companies require of them. Breaches of directors' duties are considerably more likely to be reported if auditors are independent and perform their jobs correctly and it is for this reason that their role is so crucial in regards to duties.

5.3 CONCLUSION

The interviews highlighted a host of issues concerning directors' duties both directly and indirectly. Firstly, fiduciary duties do not exist in Iranian Company Law and can only be found when they are included in the articles of association. Cases of breaches of duties that get brought to court are determined with the Islamic sources such as the Quran and the Fighh. Due to these Islamic sources not providing a broad scope of duties, there are many examples of incidences that would be classed as breaches of duties in other jurisdictions that are not breaches of duties in Iran. For instance a duty to act in a company's best interest gets regularly breached in Iran as several interviewees reiterated that directors occupy their positions to further their own interests. Also shareholders are for the most part powerless to claim against breaches of the duty of care. This is demonstrated by LAW4's example of the company that could not claim against a director who repeatedly breached their duties. Many interviewees called for the introduction of some form of the Business Judgment Rule, as directors need more security in their risk taking due to them at present being liable for mistakes that are made with good intentions.

Commercial cases in Iran are dealt with in general courts and there are many issues with the process including delays and inconsistent judgments. With the courts not being popular, arbitration has emerged as a popular alternative for settling commercial cases. Judges are often insufficiently educated and experienced to occupy the positions they do and many adjust their judgments through bribery. Duties can only be effective if shareholders have the confidence to use the courts to settle cases.

Concerns over the quality of judges, delays in the courts and the fear of judges being susceptible to bribery are currently preventing cases from reaching courts.

Company law is in need of being updated. Many areas of directors' duties were listed as points that need updating and improving. The interviewees highlighted that the main obstacle impeding legislation reform is the reluctance of the authorities to allow any updates to be introduced. The Islamic Consultative Assembly has developed the reputation for wanting to keep the law as it is.

Family companies often have inexperienced directors and auditors who lack knowledge. This is due to family members being appointed on the basis of being relatives rather than their ability to do the job. The directors appointed often are unaware of directors' duties, which can lead to breaches of duties that are included in companies' articles.

One reason put forward as to why directors are often so inexperienced and unqualified is that that the pool of candidates available for the role is legally limited to the shareholders in the company.

Another reason for this occurrence is that there is a culture in Iranian commerce of appointing friends and relatives to vacant positions. As there is already a relationship of trust in place, it is convenient and safe to appoint someone who they know well and can rely on. The risk of these connected appointments is that in practice, these individuals will struggle with their roles and their decisions and actions can lead to cases of negligence through directors' lack of experience or knowledge.

Separation of powers has a detrimental impact on directors' duties in Iran. This is due firstly to directors of governmental or army of guardian companies having to take into consideration the interests of the institution as well the company. Also, the directors of governmental companies are often afforded considerable freedom, to the extent that the government turns a blind eye if they help their political connections gain contracts or pursue opportunities that further their own interests.

By not having any laws surrounding corporate opportunities, auditors are needed even more to monitor directors. Issues with auditors however are common due to auditors not being independent from the companies.

CHAPTER SIX

AN EVALUATION OF IRANIAN LAW AND PROPOSALS FOR REFORM

6.1 Introduction

Having completed the doctrinal and empirical studies, the research has arrived at the point of enabling there to be an overall assessment of the state of directors' duties in Iranian law. From the examinations of law and practice in Chapter 3 and Chapter 5 it was possible to see clear issues that are causing problems for Iran. Chapter 3 raised some apparent flaws in the Iranian law and the empirical study documented in Chapter 5, involving first hand testimony, affirmed these flaws and raised other issues. These data obtained from both the doctrinal and empirical studies will be used to provide an evaluation of the law and then it will be employed to enable the research to adopt a positive approach to ameliorating the current state of directors' duties in Iran.

In regards to directors' duties, there is a failure in Iranian law to define or even provide for the role of company directors, the liability of directors and the rights of shareholders. When considering practices in other countries it is possible to understand that there are examples of jurisdictions that over the years have made changes to their practices and their experience can hold many answers for Iran.

One of the aims of this chapter is to assess whether it is possible to draw solutions for the shortcomings in Iranian legislation from the practices of other jurisdictions that we considered in Chapter 2, either through adoption or adaption.

Each section will consider the current legislation in place, the issues that exist in Iran, possible solutions as how to improve the situation and finally the application of these potential solutions.

Initially the subject of legal transplantation will be considered in section 6.2, examining the effectiveness of the practice. The shortcomings of the practice will be examined along with the benefits, and there will be a consideration of examples of its success in different jurisdictions. The application of legal transplantation will be considered in relation to the Iranian situation and how effective it could be as a means to reform the law.

Section 6.3 will consider the general duties of directors and what the broad issues are in Iran in relation to these duties. Following this basic development of general duties, the chapter will focus on fiduciary duties in section 6.4. Next there will be an examination of the issues that are faced by directors in Iran as a result of the law not being thorough enough. Solutions will be put forward as to how the law could be improved. This will be followed by an overview of the application of these legislative reforms.

The duty of care will be dealt with in section 6.5. The problems that result from gaps in Iranian law will be mentioned and after this the chapter will provide an insight in to what solutions can be brought forward to improve the duty of care. Once recommendations have been made, the application of the duties will be considered. The Business Judgment Rule will be focussed on in section 6.6, where the issues of good faith in Iran will be assessed. Section 6.7 will consider enforcement in Iran with a consideration as to whether it can be improved, before moving on to company audits in section 6.8. Section 6.9 will consider the extent to which the courts and judges impact upon directors' duties. Next there will be an examination of legislative limitations in section 6.10. Finally conclusions will be drawn from the chapter, which will include suggestions on improving the state of directors' duties in Iran.

6.2 Transplanting Law

Transplanting law from one jurisdiction to another is a process that occurs today in many countries with emerging markets that seek to adopt tried and tested law from other jurisdictions. Legal transplanting dates back to ancient times, when Solon of Athens educated himself in the laws of other Greek states in order to carry out social reform.[663] Nowadays, it is jurisdictions such as France, Germany, the US and UK that are the most highly regarded as sources from which many countries have transplanted elements to form their own code of directors' duties.[664] From the jurisdictions considered in Chapter 2, we can see that over the years Hong Kong has transplanted duties and aspects of law that relate to duties from the UK and China has transplanted laws from various jurisdictions into its own code.[665]

Transplanting can be considered useful for countries in need of adding a particular legal concept into its legislation. When law is functional and successful in one country, it can potentially serve another country in the same way, or at least it can assist a country to develop its own code based

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[663] H. Cisse et al, *The World Bank Legal Review: Legal Innovation and Empowerment for Development* (World Bank Publications, 2012), 163.
[664] P. Mantysaari, *Comparative Corporate Governance: Shareholders as a Rule-maker* (Berlin: Springer Science & Business Media, 2006), 380-400.
[665] Chapter 2, section 2.4.2.

around the same concepts. It is not necessary to consider the source of the law in the foreign jurisdiction, as it is the concept and the functionality of the law that will determine its success or failure. Of course, there is no stipulation on transplanted law that requires a host country to adhere completely to the exact template set by the source country.[666]

Another reason that legal transplanting is popular in emerging economies is that there is desire to have legal systems in place that are in line with international conventions. This is a result of globalisation and the need for economic development to fall into line with standardised conventions of what legal systems should be like. This also exists in other fields such as environmental protection and human rights values.[667] The effect is that,

> "The economic development, democratisation, and globalisation have today so sharply increased the number of legal transplants that at least in developing countries, most major legislation now has a foreign component".[668]

6.2.1 Issues that exist with Transplanting

The principal issue with transplantation is that jurisdictions vary from one to another and it can be challenging to make the new laws fit into a system which was not the system for which the new laws were designed. Many sceptics of legal transplantations believe that the flaws extant in the practice make it likely that transplants will not function as intended and will

[666] H. Cisse et al, *The World Bank Legal Review: Legal Innovation and Empowerment for Development* (World Bank Publications, 2012), 116.
[667] H. Cisse et al, *The World Bank Legal Review: Legal Innovation and Empowerment for Development* (World Bank Publications, 2012), 165.
[668] Ibid.

fail to be as successful as they were in the originating country. Montesquieu noted,

> "the political and civil laws of each nation ought to be only the particular cases in which this human reason is applied. They should be adapted in such a manner to the people for whom they are framed that it should be a great chance if those of one nation suit another.[669]"

Kahn-Freund and Legrand agreed with this point adding that, the ingrained difference in the legal systems of countries means that it is not possible to simply transplant law. Simply moving a set of rules from one place to another does not work, and they will no longer be the same rules.

The established theory of path dependence puts forward the argument that when a country updates a law, the reform will reflect that country's own historical, social, cultural context.[670] This theory originated in the 1980s and is based around legislation updates being produced as a means to address specific issues that exist in that jurisdiction's code as time passes.[671] Each jurisdiction will follow its own path and the social, economic and political environment will dictate what code needs updating and how it should be reformed. This idea criticises the notion of transplanting legal code from one jurisdiction to another arguing that law only suits the country in which it evolved. Any other country that transplants it will lack the historical, social, economic and political path that led to its advent.

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[669] H. Cisse et al, *The World Bank Legal Review: Legal Innovation and Empowerment for Development* (World Bank Publications, 2012), 165.
[670] J. Stanley Gillespie, *Transplanting Commercial Law Reform: Developing a 'rule of Law' in Vietnam*, (Melbourne: Ashgate Publishing, Ltd., 2006), 23.
[671] M. Dietrich & J. Krafft, *Handbook on the Economics and Theory of the Firm* (Cheltenham: Edward Elgar Publishing, 2012), 263.

Path dependence theorists argue that the ‘one-size fits all’ approach will not work when emerging markets copy and paste the law from mature markets.[672]

> “Copying a code from one country to another without analysing the details of a corporate governance system or considering the applicability to a specific country’s judicial system or ensuring effective enforcement, will not bring the expected benefit and reform to the country.”

Transplantation usually occurs when countries with weak legal systems adopt a code or provisions of it that has proved to be effective in other jurisdictions. Despite the introduction of transplantations, path dependence theorists argue that differences between systems will continue to exist because pre-existing social and political forces are what shape the legal code. The result will be a host country with a new code that does not have the framework in place to apply it in the same way as in the originating jurisdiction.

When considering borrowing, applying or adapting the law from one jurisdiction to another it is necessary to consider that it will have to be applicable despite the different political system, markets, legal system, governmental institutions, history and company structures regarding shareholdings and directorships.

It is also argued that the structure of the law that pre-exists in a host country will often determine whether law can or cannot be transplanted.

[672] A. Keay & J. Zhao, ‘Ascertaining the Notion of Board Accountability in Chinese Listed Companies, Ascertaining the Notion of Board Accountability’, *Hong Kong Law Journal*, 45 n2 (2016) 29-32.

Bebchuk and Roe provide the example of a proposal to transplant a new code for ownership structure. Certainly, the initial ownership structure in a country will influence any proposed new law. Parties who benefit from the initial ownership structure will seek to impede any changes and if these people are in positions of influence, they will be able to affect the outcome.

6.2.2 Solutions to Transplanting in Iran

Path dependence is not a theory that is universally subscribed to and many countries have arguably carried out transplantations successfully. Most countries that wish to modernise their legal system and align their law with more advanced systems will consider the implementation of the law of other places.

China's legal system, as an example, has been through considerable transitions at different stages of its life and it began over 2000 years ago as an aboriginal legal system. At the beginning of the twentieth century it was replaced due to the need for a legal system that would allow the nation to take part in a globalising international economy. The new political wave in Chinese politics that ushered in the People's Republic of China led to the abolition of this new law and it was replaced with transplants from the legal code of the Soviet Union. Subsequently, when China distanced itself from the Soviet Union in the 1960s the legal code in place in China had to be changed again. Since this moment, China has not borrowed from one jurisdiction but rather it has borrowed from many and adopted a legal system that has tried to be open to international business.[673] This form of

[673] H. Cisse et al, *The World Bank Legal Review: Legal Innovation and Empowerment for Development* (World Bank Publications, 2012), 173.

transplanting that China subscribes to, is known as selective transplantation.[674]

Reforms to the law must adhere to conceptual values in order to be approved, and the Chinese approach led to the following criteria:

- Transplanted laws and mechanisms must be matched with Chinese culture, political ideology and government agenda.
- Transplanted laws must solve problems that are faced by Chinese society. A targeted approach that identifies issues faced and marries it with law that can be transplanted.
- Laws must be studied by China's legislative, administrative and judicial agencies in relation to the Chinese social environment and the requirements of a proposed legal update. Implemented laws must be installed in line with decrees of Chinese sovereignty.
- Transplanted laws must be compatible with other laws already within the legal framework. Potential transplants must be studied to make sure that they integrate well with the legal system.[675]

This approach of selective transplantation has allowed China to successfully integrate a significant amount of law from different sources and the foreign law has been tailored to fit into the Chinese legal framework.[676]

Iran would benefit from applying a similar approach to China when it comes to transplanting law. Much like China, Iran has considerable factors to consider when deciding how to integrate foreign legislation into its system.

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[674] H. Cisse et al, *The World Bank Legal Review: Legal Innovation and Empowerment for Development* (World Bank Publications, 2012), 173.
[675] R. Petrov & P. Elsuwege, *Legislative Approximation and Application of EU law in the Eastern Neighbourhood of the European Union: Towards a Common Regulatory Space?* (Oxford: Routledge, 2014), 244-245.
[676] H. Cisse et al, *The World Bank Legal Review: Legal Innovation and Empowerment for Development* (World Bank Publications, 2012), 175.

Incoming company legislation must fit alongside existing legislation without conflict. Moreover, it must take into account the types of companies operating in Iran and how new legislation will be used differently from the jurisdiction the law is transplanted from. A particular transplanted law might work well in one jurisdiction with an open economy but in Iran where the majority of companies are state owned enterprises it might have to be amended considerably.

6.2.3 Transplanting in Iran

When transplanting law to Iran, one particular condition that is important is that the transplanted laws and mechanisms must be matched with Iranian culture, political ideology and the government agenda.

At present there is already an authority that decides on potential legal updates. The Islamic Consultative Assembly has previously refused legislation updates that do not adhere to the Islamic principles of the regime. Whatever is proposed through this study of duties must conform to these principles or risk being ignored totally. Whilst this is certainly a limitation to what can be suggested, it is reality and that must be accepted.

A further condition that would prove useful would be to acknowledge that transplanted laws must be compatible with other laws already within the legal framework. That is, potential transplants must be studied to make sure that they integrate well with the legal system.

In terms of duties in Iran, much of the law is fragmented. Certain principles exist in the Islamic code, in companies' articles and some are in statutory law. Any law proposed needs to be simple, straightforward to implement and should supersede any half-measures that already exist.

6.3 General Directors' Duties

Both Chapter 3 and Chapter 5 highlighted the fact that the state of directors' duties in Iran is lacking in many areas and it fails to adequately cover many eventualities. There is no part of Iranian Company Law that addresses directors' duties and instead the coverage is reduced to a few clauses and articles, some found in Iranian Company Law and others in Islamic sources, and they only indirectly address duties. Iranian Company Law also has not been regularly updated, and little reform has occurred since 1968. Furthermore, enforcement is weak in Iran as the structures are not in place for shareholders to have the necessary easy access to bring an action against miscreant directors.

6.3.1 Issues that exist with duties in Iran

The first issue that requires discussion is that presently the only way for shareholders to make sure that directors are liable for duties is to include them in the articles of association. There is no other source of law in Iran that sets out a complete series of duties and ultimately the responsibility is left to the shareholders.

The result of this practice is that many companies fail to adequately include fiduciary duties and the duty of care.[677] The reasons for failing to include adequate duties or not including them at all is due to shareholders carrying out this job themselves without the necessary level of knowledge.[678] If the shareholders do not seek legal assistance in the drafting of the articles, it is quite possible that a suitable set of duties will not be included. Due to this, there is a lack of consistency in the country as to the extent to which

[677] See Chapter 5, Section 5.2.4: Lack of Commercial Court and Coping Mechanisms.
[678] Ibid.

duties are imposed on directors. Certain companies' articles of association might focus on particular duties rather than others and this will result in an imbalance of coverage of the various duties. Equally there is no guarantee that a solicitor who prepares the articles will provide an appropriate provision of duties that matches the needs of the company.

The second issue regarding duties that emerged from the empirical research was that many directors and shareholders interviewed were unaware of the nature of directors' duties, and what they were and what they purported to do. For instance, DIR3 admitted to not knowing what duties were, however he also admitted that he was unaware of most legal obligations he had towards his company.[679] SHA2, SHA3 and DIR5 all expressed the point that as long as you do your job, you do not need to pay attention to these things.[680] For the Iranian companies that do not have duties in the articles of association, it is arguable that understanding duties is irrelevant, as those directors are not bound by duties. In the cases where there are directors who are bound by duties but are unaware, these directors will conduct themselves without any realisation of the liability they carry for their actions. For these directors it is crucial that they have an awareness of their duties as their actions may differ if they have an understanding of what they legally should and should not do. For their own personal welfare it is important, as they could make decisions without understanding the legal consequences of their actions. For the business' welfare it is important as awareness of the duties might encourage them not to pursue a course of action that could cause damage to the business.

[679]See Chapter 5, Section 5.2.4: Lack of Commercial Court and Coping Mechanisms.
[680]Ibid.

6.3.2 Potential Solutions

Both issues highlighted in the last section can certainly be addressed to some degree by one solution. Iran could follow the example of many jurisdictions, including those jurisdictions considered in Chapter 2, and introduce duties into its statutory law.

The problem of company articles not including duties or the provisions contained being inadequate would be resolved, as all duties would be set out in sections of statutory law. This would result in all directors in every company having the same parameters of liability throughout the whole jurisdiction. This would also be a fairer state of affairs.

The inclusion of duties in statute will also lead to their acceptance as compulsory principles/rules of company law. It is likely that this advanced status will increase awareness amongst legal professionals and it is possible this awareness over time will reach directors and shareholders.

Realistically however, within the professional circles of directors and shareholders there is not considerable exposure to legislative reforms. DIR2 stated that,

> "I do not believe any business shareholders read the statutory law in Iran. As both a shareholder and a director, I was not aware what legal duties I have towards my company."[681]

Considering the practices of other countries, the Hong Kong example provides an insight into a jurisdiction that introduced duties into statutory

[681] See Chapter 5, Section 5.2.4: Lack of Commercial Court and Coping Mechanisms.

law.[682] Much like Iran prior to the introduction there had not been statutory duties (although there were in common law and in equity) and there was a considerable lack of awareness amongst shareholders and directors of what they were or why they might be important. The duties were adapted from the UK model (the Companies Act 2006 duties) as they are some of the most well regarded common law duties that exist.

Following their introduction in Hong Kong in a legislative reform, there was no significant change in the practices of company directors as there was no real chance for them to become aware of the new law.[683] Shareholders too had no knowledge of the update unless their lawyers had informed them. In Chapter 2 considering the practices in Hong Kong after the introduction of the statutory provisions, it was revealed,

> "Less than 40 per cent of directors in Hong Kong understand their fiduciary duties and legal responsibilities, and the remainder give them low priority."[684]

Solutions for improving awareness of duties can be to inform the public through national media coverage of high profile cases of breaches, or to set up educational courses to teach directors about the new legislation. In Hong Kong the latter was adopted and courses were introduced by the Institute of Directors.

It is even possible to suggest that there is greater potential for shareholders and directors to be more aware of duties with the present practice whereby the onus is on initial shareholders to include them in the

[682] See Chapter 5, Section 5.2.4: Lack of Commercial Court and Coping Mechanisms.
[683] Ibid.
[684] Ibid.

articles of association (in large companies this is not applicable). Certainly this active role in the creation of the articles would increase a shareholder's awareness of duties included. Should the shareholders include duties, it is likely that they will inform the directors of the duties as well as it is in their interest for their directors to be aware of them. With this being the case, it could be argued that it is not necessary to include them in statutory law as both directors and shareholders have greater accessibility to the fiduciary duties if they exist in the articles. The limitation to this is that it is only when the company is formed that the articles will be created and during the life of a company the shareholders and directors will often change. Apart from the initial shareholders and directors there will not be any increased awareness of the duties.

6.3.3 Application of these solutions

Directors' duties would have to be introduced into law as an amendment to Iranian Company Law 1968. Rules governing directors are currently in part one, section six (article 107 to article 143) and duties should be located within this section. This approach will create a universal standard of duties across Iran and it will lead to increased consistency in judgments in cases of duties. Judges will still be able to interpret the law when applying it to a case, however there will be a far greater chance for consistency if all directors are subject to the same duties.

In broad terms, there is no reason that the instalment of new duties in Iran would not gain approval from the Islamic Consultative Assembly as long as the suggested laws were in keeping with Islam. From the interviews there was consensus amongst judges that the introduction of duties in statutory law would greatly assist them and the government would certainly benefit from greater ability to control directors of state owned companies.

In terms of generating awareness for new imposed duties, Iran should use the tools it has at its disposal to get the message publicised. In Iran, due to the media being controlled by the state, it is within the powers of the government to broadcast footage of high profile cases of breaches of duties on television to educate the public about the liabilities of directors.

6.4 Fiduciary Duties in Iran

As it is possible to see from Chapter 3 and Chapter 5 there are some Fighh principles that provide for duties that are akin to fiduciary duties. Firstly within the Fighh there is a principle that relates to agents acting within the scope of their authority and in the best interests of his or her principal. This broadly covers the general fiduciary principle of the director acting within their powers.[685]

Moreover, within the Fighh there is a principle that relates to trust[686] which could be considered as a basis for a duty of loyalty. LAW5 mentioned that code number 51 of the Iranian civil law states that directors are regarded as a trustee of the shareholders' assets. Also, directors are considered to be responsible for protecting the assets of the company as their own property and acting loyally by the Fighh. In the Fighh there are principles that refer to trust and loyalty,

[685] See Chapter 3, Section 3.4.1 General Law on Directors and Section 3.4.2 Duties of Loyalty. N. Shirazi, *Descent of the Holy Quran* (Munich: Createspace Independent Publishing Platform, 2015), 2.188. 8.27, 2.283.

[686] N. Shirazi, *Descent of the Holy Quran* (Munich: Createspace Independent Publishing Platform, 2015), 15. 92: "God commands justice and good-doing…. And he forbids indecency, dishonesty and insolence"; Quran 22:38: "…God does not love anyone who betrays his trust and its bereft of gratitude…". N. Shirazi, *Descent of the Holy Quran* (Munich: Createspace Independent Publishing Platform, 2015), VIII, 180; 11:85.

> "…And if one of you deposits a thing on trust with another, let the trustee discharge his trust and let him fear God. Conceal not evidence: for whatever conceals it, his heart is tainted with sin and God knows all that you do.[687]"

> "-Give back the trusts to their legal owners, and when you judge between people, judge with justice.[688]"

> "Of those we created are people who guide by the truth, and by it act with justice.[689]"

> "…God does not love anyone who betrays his trust and it's bereft of gratitude…[690]"

The regulation of conflicts of interest is also included in article 133 of Iranian Company Law. Essentially this code dictates that directors should not have a personal interest in a company transaction and they should not be involved in a transaction that competes with a company transaction.[691] Equally, they should not issue personal loans from the company to themselves[692] and they should not enter into any business dealings with other directors in their personal capacity.[693]

Having considered what fiduciary duties Iran has in place, it is now necessary to see what problems exist in Iran as a result of the lack of provision of fiduciary duties. After each issue is examined, it will be

[687] N. Shirazi, *Descent of the Holy Quran* (Munich: Createspace Independent Publishing Platform, 2015), 2.283. For more cases refer to N. Shirazi, *Descent of the Holy Quran* (Munich: Createspace Independent Publishing Platform, 2015),9.4.
[688] N. Shirazi, *Descent of the Holy Quran* (Munich: Createspace Independent Publishing Platform, 2015), 4.28.
[689] N. Shirazi, *Descent of the Holy Quran* (Munich: Createspace Independent Publishing Platform, 2015), 8.180.
[690] N. Shirazi, *Descent of the Holy Quran* (Munich: Createspace Independent Publishing Platform, 2015), 22.38.
[691] Iranian Company Law 1968. Article 133 (Tehran: Didavar Book Publisher).
[692] Iranian Company Law 1968. Article 132 (Tehran: Didavar Book Publisher).
[693] Iranian Company Law 1968. Article 129 (Tehran: Didavar Book Publisher).

considered what legislative changes could be made to ameliorate the problem and how successfully the new legislation could be applied.

6.4.1 Fiduciary Issues that exist in Iran

The first issue to be considered is the existence of self-dealing and even corruption perpetrated by company directors. Corruption is an endemic characteristic of Iranian commerce. From both the doctrinal research in Chapter 3 and the interviews in Chapter 5 it is clear that cases of corruption are commonplace. It is possible to identify two types of corruption, the first being corruption of directors favouring their own interests ahead of the company's interests. The second is through company decision-making being based on political factors as opposed to business factors.

The first type of corruption was brought to light by SHA3, LAW1, LAW2 and LAW4,[694] who mentioned that directors, through not being bound by duties of loyalty in the articles, are free to direct the business they operate as they choose.[695] LAW2 was of the opinion that,

> "Directors occupy their positions for their own benefit as opposed to the companies' benefit. Their mentality is not of having a duty towards the company's interest but of having an opportunity to advance their own interest."

The interviewees highlighted several cases, which serve as useful examples of corruption where directors had acted inappropriately.

Firstly, DIR2 had an experience where he and a friend were co-shareholders of a company. They had agreed that the friend would be the

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694 See Chapter 5, Section 5.2.10: Separation of powers.
695 Ibid.

director of the company and they both nominated the friend's wife as the auditor. Within the role of the director, the friend misused the company's assets[696] and also executed deals in his role as director for his personal interest. As his wife was the internal controller, none of the breaches were reported to the other shareholders.

Secondly, DIR1 provided an example of corruption in his own family company. Many years ago his brother was the director of the company and during his directorship the company was not doing particularly well however it was clear that the brother personally was becoming richer through evident personal expenditures. It transpired that the brother had set up a personal consultancy firm where he would provide other companies information and guidance on how to do well in the same industry as the company. In reality, he was using his position as director of a well-known company to gain clients and then he would give out information about the company to, essentially, company competitors.

Both these examples are of directors subjugating the interests of the company to further their own interests. The first case is through the director using the company asset to gain a personal advantage and the second case is through using their position and company secrets to earn profit for themselves personally.

In terms of corruption of directors in state owned companies, LAW4 stated that the relationship of the state owned company director with the government provides them with advantages in the market that directors of

[696] Iranian Company Law 1968. Article 133 (Tehran: Didavar Book Publisher): the executive and non-executive directors cannot do any deal such as company deal that competing with the company. Every director who breaches this law and his or her breach harm the company is responsible to all that breaches. Harm in this section means effecting in the companies' interest.

private companies do not have. When large state contracts are available, directors of state owned companies are in a privileged position to acquire the contracts for their business before the opportunity reaches the market. This advantage in the market is a result of the willingness of the government to prioritise their relationships with the state owned companies.

Furthermore, DIR3 who works in a state company admitted that he only recruits new employees through his family connections. This policy is not appropriate in that his family will be benefitting from his position as director at the expense of the company having the most qualified employee. SCH3 furthered this point, stating that in almost all state companies they select the close relatives or family member of the relevant Minister. The recruitment for senior positions depends on an individual's connection to the Minister rather than their capability. DIR5, who is currently the director of a state company, said,

> "I can see this weakness and it is so common to select important staff according to the interest of the director rather than any other requirement. If you can employ a good friend to the company, you know they will support you and be loyal."

In Chapter 3 it was highlighted that since the revolution in Iran a lack of appropriate surveillance and monitoring systems allowed managers to abuse their power and steal from the businesses they ran.[697] Common offenses have been pocketing salaries from non-existent employees, setting

[697] N. Bozorgmehr, 'Iran's Revolutionary Guards Wary of Threat to Business Interests', *Financial Time*s (2015). Available online: https://www.ft.com/content/e88a1dae-2096-11e5-aa5a-398b2169cf79 [Accessed 20/09/2015].

up fraudulent sales contracts and transferring funds to favoured individuals.[698]

The interviewees also highlighted that it is common for directors of state owned companies to subjugate the companies' interests for political benefits. For instance, if there is a tender process, the director will select the contract he prefers to win the bid as opposed to letting the market dictate the highest paying or most suitable candidate. Sometimes, the director might personally benefit from the transaction through receiving a bribe or other times it might be done for political reasons.

In the event that the director of a state owned companies is suspected of wrongdoing, then often the state intervenes and re-positions the director in another company. Often the state protects those who are considered within the inner circle of the state. LAW1 stated,

> "When one of the directors of a state owned company is suspected of corruption they just switch his position from one company to another company instead of charging him."

In Iran, there is no particular company law legislation that deals with theft from companies by directors. Any cases in which a director steals from a company will be classed as a criminal offence and the law stipulates that guilty parties can be sentenced to between five to twenty years in prison and receive up to 74 lashes.[699] Certainly directors could be liable for criminal theft

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[698] K. Crane & R. Lal, 'Iran's Political, Demographic, and Economic Vulnerabilities', *Rand Corporation* (2008). Available online: https://www.rand.org/content/dam/rand/pubs/monographs/2008/RAND_MG693.pdf [Accessed 21/09/2015]

[699] Iranian Penal Law 2012. Article 498 (Tehran: Didavar Book Publisher).

under the general criminal law should serious cases of theft from the company become apparent.[700]

The second issue to be considered is how external forces are able to influence directors' judgments. The most common forms of this are in family companies and state owned companies. In Iranian family companies it is common that the director's judgment can be affected by their sense of duty to their relatives as well as to the company. When directors are making important decisions for the company, they may allow individual family members to contribute their opinions due to a sense of duty to the family members. This can often lead to the company suffering, as individual family members will make judgments based on their own interests as opposed to company interests.[701] This can be the case when there are dominant family members who try to manipulate the director to pursue a certain cause.

DIR2 for example who runs a Gilsonite[702] company had to recruit a new member of staff for an administrational role within his office. Whilst the role was not going to determine the success or failure of the business, it was an important role, which involved sending invoices out to customers and it required a degree of good organisational skills. The wife of DIR2 pleaded with him to employ her brother, an individual who had struggled to hold down jobs for longer than a few months. Reluctantly DIR2 employed the relative on the advice of his wife. The relative quickly started making and the other employees in the company suggested to DIR2 that this individual was unable

[700] Iranian Penal Law 2012. Article 498 (Tehran: Didavar Book Publisher).
[701] Ibid.
[702] Gilsonite, or Asphaltum is a natural, resinous hydrocarbon found in the Uintah Basin in northeastern Utah. This natural asphalt is similar to hard petroleum asphalt and is often called a natural asphalt, asphaltite, uintaite, or asphaltum.

to do the job. Several further chances were given to the brother in law, but each time a new problem occurred and eventually DIR2 had to dismiss him.

Accommodating the interests of family members can often take priority, even if those accommodations are not in the best interests of the company. Against the director’s better judgment they may permit members of the family to be paid salaries even if they contribute little or no work to the business. Some members can have the belief that they are entitled to salaries just through being a family member. If this is the custom in a family company, it may be difficult for a new director to end this custom.

In family companies, the directors are likely to be faced with an internal conflict. They are meant to be working for the prosperity of the company as any director should, however their judgment can be clouded by their sense of duty and loyalty to their family. Law is required to discourage directors from allowing the judgments of others to influence them in their decision-making.

In state owned companies, there is a common trait of directors having to balance the interests of the state alongside the interests of the company. The risk here is that state interests take priority over the interests of the company and the director permits the company’s interests to be disregarded.

DIR4 explained how he believed this to be the case, stating that directors are often installed in companies with some agenda from the government. Instead of working in the company’s interests they are doing favourable deals for the government and thus abusing the company’s investment. When these actions are discovered, more often than not the judge excuses them and rules in their favour due to pressure from the government.

This example demonstrates that in certain state owned companies, the role of the director is not to promote the success of the company, but rather to manipulate the position of the company to assist the government's agenda. This influence of the state on the director's role is significant and directors' judgment is considerably affected by the relationship.

6.4.2 Potential Solutions

When dealing with the endemic culture of corruption, for instance, the current law in Iran is insufficient and the only tool at the shareholder's disposal is to include duties of loyalty in the articles of association. The solution moving forwards is to have new duties of loyalty in statutory law that are comprehensive and cover all acts of self-dealing and corruption including bribery, misappropriating company funds and pursuing opportunities of personal gain at the expense of the company.

When considering law that could be transplanted, it is worth considering the UK duties of loyalty. Section 175 of the Companies Act (UK), 'duty to avoid conflicts of interest', section 176 'duty not to accept benefits from third parties' and section 177 'duty to declare an interest in proposed transactions or arrangements' are all geared towards preventing corruption and conflicts of interest. They are also geared towards working in the company's best interests as opposed to one's own as well.

When considering how directors can be subject to influence from third parties any new law introduced on the matter would be the first of its kind. Having law in place that states that it is the duty of the director to promote the success of the company and to exercise independent judgment would be a significant improvement in protecting the welfare of companies.

It is my suggestion that amendments are made to the Iranian Company Law 1968. As set out in Chapter 3, there is article 142, which articulates that duties should be included in the articles of association. Also, conflicts of interest are dealt with in articles 129, 130, 131, 132 and 133. Negligence and the duty of care are referred to in articles 141 and 114. These duties in place are far from adequate for their purpose and I suggest that they be removed and replaced by UK duties 172 and 173.[703]

By having the duty to exercise independent judgment directors will become liable for making damaging decisions based on wishes of third parties and not what is best for the company. Including a duty to promote the success of the company directors will mean that directors will be obliged not to allow external pressures to dictate any company decisions. When put into the context of state owned companies, the director would be liable if they were to allow state agenda to dictate any business strategy. Equally, in family companies, directors should not allow any family members to draw salaries if they do not contribute to the success of the company. In cases where the director is the majority shareholder or controller of the company this duty is unlikely to be able to impact on their decision making process unless the company was going into liquidation where there would be influence from third parties such as creditors.

The reality is that whilst these duties will help, it is likely that these practices of third parties interfering will continue to a degree. As family

[703] See Chapter 3, Section 3.4.3 Duty of Care.

companies and state owned companies are integral components of Iranian commerce, it is always likely to be the case that external pressures will continue to be placed on directors to influence their decision-making. It is crucial to withhold any ability for directors to avoid these proposed duties and for this reason it is necessary that the new fiduciary duties I have proposed be mandatory. With them existing as mandatory statutory code it will not be possible to override them by any means including in the company constitution.[704]

6.4.3 Application of these duties

As previously mentioned these new suggested fiduciary duties would have to come through into law as an amendment to Iranian Company Law 1968 in part one, section six.

With these duties in place, there would be statutory law to prevent conflicts and directors engaging in self-dealing. By having these precise duties in statutory law, it will be easier for judges to refer to them and make more consistent decisions in cases. This is a vast improvement on the current law of duties of loyalty that are scattered throughout Islamic law, the articles of association and statutory law.

The success of the duties would be based on the new fear that directors would have of an action being brought against them. This would be a sufficient deterrent in many cases to encourage a director to refrain from pursuing situations for their own self-interest. Whilst this deterrent will exist for all directors, it will not always be successful in deterring all directors from

[704] C. Bruner, 'Opting Out of Fiduciary Duties and Liabilities in U.S. and U.K. Business Entities', Research Handbook on Fiduciary Duties; A. Gold & G. Smith eds, *Research Handbook on Fiduciary Law*, (Cheltenham: Edward Elgar Publishing, 2017) 12.

pursuing conflicts of interest and the reality is that corruption will still continue. As SHA2 stated, despite having all the principal duties of loyalty accounted for in law being a significant improvement, it will not be possible to solve the culture of corruption by this alone.

SHA2 went on to say that even if the law were in place, it would not be for everybody. People in authoritative positions would still be able to escape it with bribery or through their connections. In state owned companies it is likely that corruption from directors would still continue in many forms in instances where individual directors are supported by the state.

As also already mentioned it is likely that influence on directors from third parties will also continue as state owned company directors are controlled by the state and are effectively answerable to the state. In family companies there will be cases where the duties will be overlooked in many instances as family interests may take precedence in the directors' mind.

The Islamic Consultative Assembly should approve these duties as they can be considered modern day functional versions of the former Islamic principles. It should be considered that whilst the Islamic principles have merit, they are not comprehensive enough for judges to use to make consistent judgments.

6.5 Duty of Care in Iran

From Chapter 3 and Chapter 5 it is accurate to say that there is some basic provision of the duty of care in Iran. The closest broad duty of care can be taken from the Fighh where principles are interpreted to mean that a director should act to the best of his or her ability in the best interests of the company and in a rational manner as a responsible director would act.

Within this appraisal of how a director should act, the phrase ‘in a rational manner as a responsible director would act’ suggests an objective standard of care is required of directors.

Also in the Fighh is the Khianat-dar-Emanate (Islamic term for ‘the duty of care and morality’) a rule that is part of Gheb*te*, which is typically only used when cases are very serious breaches of the duty of care. This rule is essentially for when directors have made decisions for the company and should have known better, often when the decision can be questioned from a moral stance.

Another element of the duty of care is mentioned in article 141 of Iranian Company Law where the subject of negligence is treated. When a threat to the value of the company’s share arises, it is the duty of the director to inform the shareholders of this risk to the company’s share value. If they fail to inform the shareholders, this is considered negligence.[705] Articles 58 and 59 also mention a similar point, that in instances where there is damage to the company’s assets or value that will reduce the value of shares, the director must organise an emergency meeting of the board to establish what the company’s intentions are.[706]

6.5.1 Duty of Care Issues that exist in Iran

The first issue is that at present there is no liability for negligence from directors for general damage to a company from reckless decision-making. Without any form of liability, directors can take whatever risks they like

[705] Iranian Company Law 1968. Article 141 (Tehran: Didavar Book Publisher).
[706] Iranian Company Law 1933. Article 59 (Tehran: Didavar Book Publisher).

without having to face any repercussions for their actions. Shareholders therefore are risking their investments on the judgment of directors.

LAW4 provided an example of a case he recalled whereby a company was unable to bring an action against a negligent director.

> "a company was registered as a finance company. This company appointed a director who was not an expert and was unskilled in that area. This director repeatedly exercised a lack of care, but there was no law in place to claim against the director. As far as I know this individual is still the director in that company."

It is not uncommon for non-expert directors to be appointed, however it is expected that in moments where they are lacking required knowledge in making a decision they must seek professional advice to help them make informed decisions.

When appointing the director the shareholders are making the decision and it is arguably their fault if they appoint someone who does not exercise an appropriate level of care for the company. Shareholders can make these mistakes of judgment and appoint someone who does not reach their reasonable expectations. If they appoint someone who is not adequately experienced and skilled, whilst they are not liable for the damage to the company, they are arguably culpable indirectly for the damage.

SHA3 provided the example of a company that ran a shop selling Jewellery. He was a shareholder in the company and he appointed a friend's son to be director and to run the shop. Every month the shareholders would receive a bank statement, which would be their way of supervising the director. One month the takings were considerably lower than the shareholders expected and they asked the director what had happened. The director explained that he had closed the shop for two weeks and gone on holiday, as it was Iranian New Year. When asked why he did not get an employee to work instead, he said he did not think they should have to work during the New Year either. The shareholders considered this as a uncultured act of negligence and decided to replace the director. SHA3 explained that if the director was not from a friend's family they might have tried to claim against him.

SHA1 mentioned an example where he had shares in a public company. The shares were very steady for several years and one day they dropped in value considerably. It transpired that the director had lost several large contracts to a rival company and the business was seriously affected as a result. The director had known about the possibility of losing these contracts for several months and failed to tell anybody. As a result of the bad effect on the company the director lost their job, there was no action brought against them.

Without safeguards in place to be able to bring actions against a director, the only tool at the shareholders' disposal is to dismiss the director, which is an incredibly common practice. One of the shareholders, SHA2 stated that the power to easily dismiss a director and maintain that control reduced the need to have any duty of care in place. Whilst shareholders have this power, it is not the same as having the ability to claim against a director for having breached a duty. Dismissing a director will not return any lost funds for company damage a director may have caused.

The second issue is that there is a culture of appointing family members or social or political connections as directors in Iran. Many interviewees agreed that the default practice in getting a high paid job in Iran is to use your family, political and friendship connections. Without using these connections, the empirical data indicated that it is not easy to rise to a good position. The issue with this practice is that family members who are gifted these positions will lack the necessary attributes to fulfil their role successfully and this can cause harm to a business. For this reason, this issue increases the need for a comprehensive duty of care.

The third issue is that directors should be liable for shirking their responsibilities. Harm can be caused to a company from directors failing to manage the business responsibly. Shirking responsibilities can come in the form of, for instance, not attending to the company's finances and failing to appropriately manage employees. In all cases the director is effectively deciding to deliberately not take actions that they know they are required to take. Equally directors may not carry out a responsibility due to lack of understanding of their responsibilities. This has the same effect and damage as shirking however the director's liability will be determined on the basis of whether they should have understood that they had that responsibility.

6.5.2 Potential Solutions

All three issues raised can be improved by holding directors liable if they breach a comprehensive duty of care that is included in statutory law. As a basis this would protect companies that fail to include a duty of care in the articles of association or include poorly drafted provisions dealing with care.

The first issue of holding directors liable for negligence will have a significant impact on the practices of directors. At present, without a proper duty of care in place, directors do not have any personal consequences for damaging decision-making. As soon as personal risk becomes a consideration they are likely to take more care in their actions. When referring back to the example of the Jewellery store director, the prospect of being liable for lost earnings for two weeks would certainly have forced this director to keep the shop open.

Negligence can only be combatted by forcing directors to adhere to an objective standard as well as a subjective standard of care. If only a subjective standard of care was applied to the duty, Iranian directors who are not qualified or experienced would be able to avoid liability due to them not being experienced or qualified.

In the UK and Australia directors have a duty to exercise reasonable care, skill and diligence, which is applied with a dual objective and subjective standard. This dual standard is key to imposing the liability, as directors are held accountable for what they should have done in the situation based on their own experience and ability and also what a reasonable person appointed to the position of director would have done in the situation. It is my suggestion that this dual standard based on the UK Duty of Care be included in part one, section six of Iranian Company Law 1968.

The second issue is that there are a high number of unqualified directors causing harm to companies. All directors that are appointed need a degree of motivation to refrain from taking certain risks that might damage the businesses they direct. Having duties attached to the role will in some cases make candidates for the role of director consider whether they are prepared to accept the liability that comes with the role.

The ideal solution would be for shareholders to only appoint qualified directors who would obtain their position based on merit. This is however unachievable and in reality appointing directors based on connections is a global phenomenon and it is not unique to Iran. In the UK there are plenty of family companies that become successful with their appointments of family members as directors. In Hong Kong, a jurisdiction with many family companies, if a family member does not fit the criteria then someone who does is appointed.[707] However, in the event that there is a family member who is a good match who possesses the required qualities then it is common for that person to be appointed. Even appointed family members who might lack certain attributes can be instilled with values, vision, passion for business and abilities to build loyalty with key owners, customers, suppliers and employees.[708] China is an example of a jurisdiction that, much like Iran, has a cultural trend of appointing unqualified directors based on connections.[709] The solution of installing a duty of care into statutory law in 2005 to make directors liable for damaging decision making has not had a significant impact on encouraging unqualified directors to not accept appointments that could burden them with liability.

Holding directors accountable for shirking their actions through a statutory duty of care has the potential to make a significant impact on improving management practices. If directors realise that they are liable for

[707] J.A. Davis, Managing the Family Business: Firing the CEO Article, *Harvard Business School* (2014). Accessed online: http://hbswk.hbs.edu/item/7394.html [Accessed 13/04/2015].
[708] Ibid.
[709] Ibid.

failing to properly manage the employees and address all their responsibilities then they will be more attentive to these responsibilities.

It is also critical to prevent directors having the ability to amend the articles and override the duty of care. In the UK Companies Act

> "any provision in a company's articles that purports to exempt a director of a company (to any extent) from any liability that would otherwise attach to him in connection with any negligence, default, breach of duty or breach of trust in relation to the company is void." [710]

A provision of such should be included in the proposed update to Iranian Company Law as it renders the duty of care mandatory as directors are prevented from bypassing it through an update to their company's constitution. Although it will be possible to authorise or ratify actions that amount to a breach of the duty of care, it will not be possible to alter the nature of the duties themselves by any means.[711]

6.5.3 Application of these duties

Overall when considering the issues that exist and weighing up the potential benefits against the queries over suitability it becomes clear to see that Iran would greatly benefit from incorporating the duty of care into statutory law. The most suitable model as already mentioned is the UK duty to exercise reasonable care, skill and diligence with a dual objective and subjective standard. This transplant has been adopted in several jurisdictions including Hong Kong and also recently in Kenya. The dual standard is

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[710] C. Bruner, 'Opting Out of Fiduciary Duties and Liabilities in U.S. and U.K. Business Entities', Research Handbook on Fiduciary Duties; A. Gold & G. Smith eds, *Research Handbook on Fiduciary Law*, (Cheltenham: Edward Elgar Publishing, 2017) 12.
[711] Ibid.

needed in Iran, as there are potentially many cases of unqualified directors breaching their duty of care that would pass the subjective assessment but fail the objective assessment.[712]

SCH4 provided the example of the rice company whose director decided to mass produce rice in order to export it to Iraq knowing that it was possible that trade with Iraq could be forbidden in the near future. When the trade restriction came into place the director decided to sell the stock half price to a different purchaser and the company ended up making a loss. The risk taken by the director was high as the consequence for the deal not going in their favour was a significant financial loss for the company. When the shareholders claimed for negligence, the director was excused because he passed the subjective standard. If there were a dual standard applied in this case, the director would not have passed the objective standard, as a reasonable person would not have taken such a considerable risk.

Whilst it has been raised that there are aspects to the duty of care that could be detrimental to Iranian company practices, these are not sufficient to merit not introducing the duty. There is the risk that due to a duty of care some directors may take fewer major risks through fear of liability. In reality though it is more likely that in such scenarios directors can obtain permission from shareholders to pursue such risks, which would absolve them from liability. In terms of shirking responsibilities, the duty of care can only assist in raising the standard of directors' conduct.

In China there is a lack of desire from shareholders to change their practices and bring duty of care cases forwards. It is possible that Iran could

[712] See Chapter 5, Section 5.2.2 Duty of Care in Iran.

pass down the same route after introducing the duty of care. For real change to occur the duty would have to be brought in along with strong enforcement that will demonstrate to businesses that the duties work and that they are there to help. As previously mentioned, the government has the power to get media coverage of these updates and news stories of cases of breaches are the most powerful way of getting the message of reform across.

6.6 The Business Judgment Rule

The Business Judgment Rule is not provided for in Iranian law and directors who are liable for the duty of care in company's articles need protection when they have acted in good faith. The concept of good faith does appear in different parts of Iranian law. At a basic level Article 125 and 126 of Iranian Constitution Law insist that directors must not act outside of their duties. Islamic sources have a closer rule '*Ghaedeye Ehsan*' as mentioned in Chapter 5 that exempts a director from responsibility if they have acted in good faith.[713] There are however two other Islamic rules, which are mentioned in 5.2.3 that contradict this rule. '*Zarar va Zian be Taghsir*'[714] is interpreted by judges as articulating the notion that if a duty in the articles is breached and harm is caused to the company then the director is liable regardless of good faith. Judges use this rule in Iran to hold directors accountable for their duties.

This text does not refer to a director or his breach however judges interpret the law in relation to directors' duties, as it is the closest Islamic source on the subject. Similarly to this rule there is also '*Al'Amalo bel Niat'*

[713]See Chapter 5, Section 5.2.3: The Business Judgment Rule.
[714] Ibid.

which states that the person must prove the good faith or he or she is subject to liability.[715] The contradiction is potentially a source of confusion for decision makers. Furthermore, JUD2 highlighted,

> “The Islamic rule *(Al’Amalo bel Niat)*[716] is applicable for humans in normal life but not for companies and commercial cases.”
>
> “God commands justice and good-doing…. And he forbids indecency, dishonesty and insolence.[717]”

In contrast to JUD2, it was stated by SCH4 that the concept of the Business Judgment Rule does have support from legal professionals in the context of Iranian Company Law,

> “The Business Judgment Rule is not in our company law, but some judges support this rule according to the directors’ good faith for companies.”

It was evident from the interviewees’ revelations that there are certain laws that touch on the subject of the Business Judgment Rule, however there was debate as to how relevant and applicable they can be in commercial cases.

6.6.1 Issues With Duty Of Good Faith

The law that currently exists in Iran is not sufficiently comprehensive and it fails to protect directors from unfair claims of breach of duty of care.

[715] See Chapter 5, Section 5.2.3: The Business Judgment Rule.
[716] According to Hadith (sentence) from Mohammad.
[717] N. Shirazi, *Descent of the Holy Quran* (Munich: Createspace Independent Publishing Platform, 2015), 15: 92.

Through not having adequate provision of law on good faith, certain issues have arisen in Iran.

Firstly, the interviewed judges found that the current Islamic principles that provide law on good faith are difficult to apply due to them not being clear and succinct. This lack of clarity leads to inconsistency in determining cases from one judge to another.

Secondly, the current law does not prevent against directors' decisions being challenged by the courts. Judgments based on hindsight question the decisions of directors as opposed to the decision making process. SCH1 provided an example where a director was found liable for a decision that damaged their company. The director argued that whilst he could see that he had made a wrong decision, in the moment he made it he had a limited amount of information and it seemed like the correct decision. Law on good faith is ineffective if it does not prevent the courts from second-guessing the decision making of directors.

Thirdly, good faith law should provide directors security to pursue risks for the benefit of their companies. From the interviews it became clear that many directors in state owned companies choose not to pursue risks in fear that the companies will hold them responsible should those risks fail to prove successful. Good faith law in Iran is lacking in that it does not provide directors the necessary security to allow them the freedom to pursue such opportunities.

Fourthly, when the proposed duty of care comes in to place that is based on a dual objective and subjective standard, directors will have increased accountability for their decision making process. This is of concern for those directors who are appointed based on family or social connections as opposed to merit. Unqualified directors who acquire their positions based on connections are more at risk of failing to meet the criteria of the objective standard of care in cases of negligence. The decision making process that they practice might be less thorough than that of a reasonable person in the same circumstance who has the knowledge and experience of someone who can be expected to occupy the position of director.[718] The existing law on good faith would not assist directors against a more robust duty of care. As defences of good faith are often unsuccessful in Iran[719], stronger law on good faith would be required if the proposed amendments to the duty of care are introduced.

6.6.2 Potential Solutions

There is a need in Iran to amend the law on good faith in order to alleviate the four issues that have been identified. The current good faith law based on several Islamic principles can be replaced by a more comprehensive and clear set of regulations in a business judgment rule that should be located within the statutory duty of care reform proposed in section 6.5. This code would be based on the Australian model of the business judgment rule. The Australian model dictates that a director who makes a business judgment in good faith fulfils their duty of care, skill and diligence if:(a) he or she does not have any interests in the subject of the business judgment; (b) he or she is well-informed about the company subject to the degree he or she rationally considers to be appropriate; (c) he or she

[718] *Hicks & Goo's Cases and Materials on Company Law* (Oxford: Oxford University Press, 2011), 385.
[719] H. Tehrani, 'Trade Law', *Dehkhoda Publication Press*, 2.1 (1997) 175-176.

reasonably believes that the judgment is in the company's best interest.[720] By including a business judgment rule based on the Australian model, the law on good faith would immediately be clear and straightforward for judges to apply.

The issue of second guessing directors' decisions would also be solved by the introduction of a business judgment rule. Essentially, the rule prevents directors' decisions being challenged unless it can be proven that making such a decision does not fit within the Business Judgment Rule.[721] Part of the rule is to assume that the director is more knowledgeable than the courts at making decisions for their business.[722] The business judgment rule is applicable as long as the officer took reasonable steps to become informed about the matter, had a rational basis for their decision and did not have a conflict of interest between their interests and those of the company.[723]

A business judgment rule would also provide a safeguard for directors against unfair persecution, which is an issue for many directors of state owned companies who currently fear taking risks. The majority of interviewees agreed that the rule would be beneficial in Iran, adding that they thought it would ease the fears of the director over their accountability and allow them to focus on doing their jobs as opposed to worrying about possible liability for mistakes. Directors are not to be regarded as insurers for

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[720] M. Legg, D. Jordan, 'The Australian Business Judgment Rule after ASIC v. Rich: Balancing Director Authority and Accountability', *Adelaide Law Review*, 34(2), 2013.

[721] J. Farrar, 'Corporate Governance, Business Judgment and the Professionalism of Directors', *Corporate and Business Law Journal*, 1(1), 1993, 18.

[722] J. Levin, M.Ginsburg & D. Rocap, *Structuring Venture Capital, Private Equity, and Entrepreneurial Transactions* (New York: Wolters Kluwer Law & Business, 2008), 413.

[723] R.,Miller., *Business Law Today, Comprehensive: Text and Cases: Diverse, Ethical, Online, and Global Environment,* (Stamford: Cengage Learning, 2014), 732.

businesses and they should be permitted to act without fear of liability affecting their judgment.[724]

Whilst the benefits to solving this issue are evident, certain interviewees had concerns that should directors be granted greater freedom, they would abuse it and risk the security of the businesses they direct. Whilst it is understood that business risk is a fundamental component of business growth, the shareholders interviewed felt that having fear of liability for selecting the wrong risks is equally crucial. In the current business context of Iran, shareholders do not have enough trust in their directors that they will consistently make the right decisions and protect the business.

The issue of protection for directors from any unreasonable liability when the proposed duty of care comes into place will be solved by the introduction of a business judgment rule within the duty of care legislation. The rule will provide a mechanism for directors to defend themselves against unfair challenges of their decision-making where they have acted in good faith in the best interests of the company. It's existence within the duty of care legislation will balance out the need for the director to be empowered to make decisions with the need of the business for the director to be always accountable.[725]

6.6.3 Application of Business Judgment Rule in Iran

The rule should be applied in the form of a subsection of the suggested duty of care. This status for the rule is suitable as it is essentially

[724] Craig W. Palm & Mark A. Kearney, A Primer on The Basis of Directors' Duties in Delaware: The Result of The Game (part 1), 40 Vill. L. Rev. 1297, 1302-03 (1995) (the rule was developed to give boards of directors significant protection and discretion in making business decision).)

[725]S. Bainbridge, 'The Business Judgment Rule as Abstention Doctrine', *Vanderbilt Law Review*, 57.1 (2004) 83-84.

a qualification to the duty of care in that it is a tool for directors to defend themselves when an action is brought against them for breach of the duty of care.

In Australian Company Law, the Business Judgment Rule is thoroughly established and has been in practice since 1999. Whilst it has its critics the rule is regarded as functional in that it serves the purpose of being a tool for defending directors. Australia's success in its application of the rule does not necessarily mean that Iran would enjoy the same success should it follow suit. Iran essentially would be superseding the Islamic principle of good faith that exists in '*Ghaedeye Ehsan*'.

6.7 Enforcement of Directors' Duties

In Iran, it was not until 1968 that derivative actions were first mentioned in company law, despite general company law first being introduced in 1924. The new law consisted of two articles. Firstly, Article 276 of the Iranian Company law 1968 set out that a shareholder who owns at least one fifth of a company's shares would be able to bring a claim on behalf of the company against the board of directors or the director if they fund the claim themselves. If the director were to lose the claim, the director would pay the cost of the claim to the company. Article 277 Iranian Company Law 1968 sets out that these provisions cannot be overruled by anything inserted into the articles of association of a company incorporated after the provision came into law.

6.7.1 Issues with enforcement of duties in Iran

Articles 276 and 277 make derivative actions possible in Iran, but despite the power to bring an action existing, it is still a difficult task for minority shareholders. This is firstly due to the court and lawyers' fees that minority shareholders have to personally finance. Secondly, any shareholder who has less than a 20 per cent share of the company is not entitled to bring an action. In 2011, an attempt was made to reform the law. Legislators put forward to the Islamic Consultative Assembly four articles that dealt with derivative actions. The principal point would permit the derivative action to be brought by any of the minority shareholders against the directors. Also it was suggested that the minority shareholder should be exempt from paying the court fee when they claim against the director or the board of directors.[726] These reforms were not embraced however and the law is still as it was in 1968 however as the updates were never accepted by the Islamic Consultative Assembly. Iran's enforcement is in desperate need of reform as without an effective method of bringing actions and claiming against directors, there is no way to hold directors accountable for their duties.

6.7.2 Potential Solutions

The UK example of private enforcement, which allows for derivative action and oppression (unfair prejudice) action, is the most logical model that Iran can follow. The derivative action in the UK differs from the Iranian one in that it is contained in the main statutory source of company law and all the code is set out in one part. There are also clear instructions concerning the

[726] Iranian Company Law 2011 (Amendment). Article 93 (Tehran: Didavar Book Publisher)

procedure for bringing an action and the stages involved to guide shareholders on the process.

Public enforcement is also considered as a possible solution to improve Iran's enforcement practices. This type of enforcement is where a public authority has the task of identifying instances of breaches of duties and bringing actions against directors. This method is arguably successful in some jurisdictions, the best example of which is Australia as documented in Chapter 2. The Australian Securities and Investments Commission is the body by which breaches of directors' duties are regulated. The role of the Commission is to educate the public and increase awareness about enforcement. They are also responsible for monitoring, enforcing and administering compliance under the range of corporate governance provisions included in the Corporations Act. When required they are also consulted on law reform in relation to corporate governance.[727] One study of the Australian Securities and Investments Commission reported by Michelle Welsh recommended that,

> "Enforcement action by the Australian Securities and Investments Commission was a significant component in encouraging companies to engage in complying with the law, and therefore discouraging misconduct.[728]

Australian Securities and Investments Commission as a public body is

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[727]M. Berkahn, *Regulatory and Enabling Approaches to Corporate Law Enforcement (*Deakin University, 2003), 134.

[728] M. Welsh, 'New Sanctions and Increased Enforcement Activity in Australian Corporate Law: Impact and Implications', *Common Law World Review*, 2.1 (2012) 134-136.

better placed than shareholders to bring actions against directors due to their experience, skill and resources. Having a public body carry out this role greatly increases awareness of enforcement, which deters directors from risking breaching their duties.[729]

When Public enforcement is practiced however, for its effective functionality, the authority that carries out this work must be independent of the state. In contrast to the Australian model of public enforcement, the Chinese model has been less successful due to the influence that the government wields over the public authority.[730] When considering public enforcement as a potential option for Iran to improve its current enforcement practices, the weaknesses of the Chinese model are relevant.

It can be regarded that there is a fundamental lack of independence between the listed companies and the state enforcement agencies.[731] The China Securities Regulatory Commission (the CSRC), the main enforcement agency is,

> “Susceptible to political influence, local protectionism and other forms of corruption”[732]

The Chinese Securities and Regulatory Commission (CSRC) can be influenced by the state in cases that involve SEOs or companies that have

[729] H. Jackson & M. Roe, ‘Public and Private Enforcement of Securities Laws: Resource-based Evidence’, *Journal of Financial Economics*, 93.1 (2009) 207-208.
[730] Ch. Ding, *Corporate Governance, Enforcement and Financial Development: The Chinese Experience* (Cheltenham: Edward Elgar Publishing, 2013), 77.
[731] Ch. Ding, *Corporate Governance, Enforcement and Financial Development: The Chinese Experience* (Cheltenham: Edward Elgar Publishing, 2013), 77.
[732] Ibid.

some governmental ownership. When the state has an interest in a company, they are likely to decide that an action against the director will have a negative effect on the image of the business. One commentator said that,

> "If the government were suddenly to expose all of the fraudulent and illegal behaviour in the listed companies, it could cause a stock market crash and a potential loss of a large amount of State assets.[733]"

As a result of this weak enforcement China struggles to deter company directors from breaching their duties, as there is not the concern from directors that there is an authority that will enforce the breaches.[734]

In Iran it would be likely that if public enforcement were introduced at the moment, a public authority would not be permitted sufficient independence to operate without allowing the government influence to affect their work.[735] In Iran if one takes the example of how the government impacts upon the various levels of the judiciary, then it would suggest a public authority would receive pressure from the government in much the same way.

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[733] Ch. Ding, *Corporate Governance, Enforcement and Financial Development: The Chinese Experience* (Cheltenham: Edward Elgar Publishing, 2013), 77.

[734] Q. Liu, 'Corporate Governance in China: Current practices, Economic Effects, and Institutional Determinants', *CESifo Economic Studies,* 52.2 (2006) 415-453.

[735] A. Keay, *Board Accountability in Corporate Governance* (Oxford: Routledge, 2015), 207. See also R. Jones & M. Welsh, 'Toward a public enforcement model for directors' duty of oversight, *Vanderbilt Journal of Trans,* 45 (2012) 343. See also A. Keay, 'The Public Enforcement of Directors' Duties: A Normative Inquiry', *Common Law World Review*, 43 (2014) *89*.

6.7.3 Application of Enforcement in Iran

Reform of enforcement is fundamental as directors' duties can only be applied if there are robust enforcement mechanisms there to allow shareholders to bring actions. Iran should continue on the route of private enforcement and it will need to reform article 276 and 277 of Iranian Company Law. The reform that was proposed in 2011 would be suitable in enhancing derivative actions to allow minority shareholders to bring actions without any barriers. The removal of the requirement of a 20 per cent shareholding to bring actions will make a considerable difference, as it will allow all shareholders to bring actions regardless of the amount of shares that are held. Minority shareholders are limited in the same way in China and the same issues occur there as a result. The removal of the fee that shareholders must pay to bring the actions has the potential of increasing the number of actions brought forwards as it is one less barrier that they will encounter.

The Islamic Consultative Assembly must have their response acknowledged however and the reform must be redrafted to render it more in keeping with the Islamic principles of the regime. This can be achieved through correspondence with the Islamic Consultative Assembly to establish the exact grounds of their disagreement with the proposed legislation update.

6.8 Auditing

In Iran the directors select auditors and they are employed by the company to perform their function of delivering an objective and unbiased view of specific elements of a company. Under article 54 of Iranian Company Law directors periodically have to send financial statements to the auditor after which the auditor will make an assessment of their findings for the board of directors .[736] Essentially the role of the auditor is to assess financial statements and make sure they are free of material misstatement, whether due to fraud or error. They are also meant to develop an understanding of the companies they audit and make sure no malpractice occurs.

Overall, the role of the auditor is important for keeping directors on track and accountable. For shareholders, the audit is a report that will be looked at annually that should flag up whether there have been any breaches of duties. There were several areas of potential reform that were mentioned in this section, all of which have merit. The example of China having implemented new legislation for auditors has also provided an example of reformed law on auditors that has not been successful and can be learned from.

6.8.1 Issues with Auditing

Issues with auditing occur when the practice of providing shareholders with accurate assessments of the accounts and corporate governance of their companies is replaced by inaccurate assessments. This can only occur when auditors are not sufficiently qualified, skilled and experienced or because they have a reason not to provide accurate assessments.

[736] Iranian Company Law 1933. Article 54 (Tehran: Didavar Book Publisher).

The first issue with auditors in Iran is that they lack sufficient independence to be able to successfully fulfil the role they are intended for. The director appoints the auditor and from this position they can select someone who they can influence. This relationship is open to corruption, as directors can appoint an auditor who will cover up their breaches. Frequently when auditors are selected, the director chooses the person who can best assist them in keeping control and concealing their errors.

Often in family companies there is a common tendency to appoint family members, a practice that produces a conflict of interest. In Iran it is exceptionally common and perfectly legal for a family member to occupy the role of auditor in a relative’s company. Allowing these appointments immediately negates the authority of any audit and it goes against the principles of effective internal control, independence and conflict of interest.

Also the dependence of the auditor to the director comes in the form of their financial dependence to them. Auditors receive their payment from the directors and they might fear that their fee will not be settled if they do not produce a report that the director approves of. Often reports are first shown to the director before reaching the desk of the shareholders, permitting the director to influence it before it is made public.

A legislative issue of the auditing in Iran is that there is no specification that auditors need to assess the corporate governance mechanisms of the company. At present whilst it is common to assess this, due to it not been required by law, many auditors do not make any assessment of corporate governance.

6.8.2 Potential solutions

The solution for having an effective auditing process is to have auditors that are independent who have no personal connection to directors and whose professional remuneration is not dependent on them.

When addressing who can and cannot be an auditor, the UK code stipulates that family members cannot be appointed to the role.[737] The new Chinese legislation prevents candidates with conflicts of interest from being appointed as auditors and stipulates that they must be independent.[738]

One solution offered by Hong Kong is to force the director to periodically send off a Corporate Governance Report when they deliver the accounts for audit.[739] Within this Corporate Governance Report directors must set out that they have taken measures to ensure internal control. The first step is to carry out relevant internal controls to safeguard shareholders' investments and the company's assets. The second is to annually scrutinise the effectiveness of the internal controls in place and file a report about the preparation of the corporate governance report. This report will include all elements of business practice from finances to operations.[740]

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[737] APB Ethical Standard 2 (Revised), 'Financial, Business, Employment and Personal Relationship', *Financial Reporting Council* (2010). Available Online:
https://www.frc.org.uk/Our-Work/Publications/APB/ES-2-(Revised)-Financial,-business,-employment-and.pdf [Accessed 22/05/2016].

[738] L. Hua et al , 'Main Principles and Practices of Auditing Independence in China: A Multifaceted Discussion', *Asian Social Science*, 6.7 (2010) 4-8.

[739] U.A, 'Internal Control – the UK Corporate Governance Code', *Outlaw.Com* (2010). Available Online:
http://www.out-law.com [Accessed 22/05/2016].

[740] UA, 'Internal Control Review on Corporate Governance', *Crowe Horwath (HK) CPA Limited* (2017). Available Online:
http://www.crowehorwath.net/hk [Accessed 22/05/2016].

6.8.3 Application of these solutions

To apply new legislation that requires auditors be independent from directors, a section would have to be added to Iranian Company Law. The Chinese stipulation that all auditors must not have any conflicts of interest should be adopted as it is comprehensive and it is better suited to Iran.

In the UK, Australia, Hong Kong and China the task of appointing auditors is assigned to the shareholders. The introduction of this rule in China is yet to be proved successful however as there are still many family members being appointed as auditors.[741] This is predominantly due to the number of instances where the shareholder is the director and can select an auditor who they can influence.

6.9 Courts and Judges

Through the doctrinal research and the interviews there was a clear message that the courts and Judges in Iran are performing below an acceptable standard in commercial cases. There are several issues that have been highlighted by the interviewees that have resulted in many businesses losing faith in the courts and choosing alternative methods for resolving disputes. Without companies using the courts to solve their disputes, the law in place will fail to serve its purpose. These issues will be addressed in order to find potential solutions so that the courts can address cases of directors' duties efficiently and effectively.

[741] K. Yong & J. Wiley & Sons, *Due Diligence in China: Beyond the Checklists* (Singapore: John Wiley & Sons Singapore Pte. Ltd, 2013), 6-10.

6.9.1 Issues with the Courts and Judges

A concern put forward by the interviewees is that commercial disputes are dealt with in general civil courts instead of being referred to designated commercial courts. Commercial cases can be exceedingly complex and the infrastructure around a case needs to be in place to allow for the appropriate processing of a case. Much of the Iranian Company Law was borrowed from French Civil Code, however the structures of processing cases were not borrowed. France has about 230 commercial courts.[742] It was argued by the interviewees that there is a contradiction of process between the law and the courts due to a failure to borrow the French court structure that accompanied the code.[743] The interviewees expressed great frustration at the lack of unity between the law and the courts. SCH3 and LAW2 both made this point with the latter stating,

> "We do not have the court system in place to make decisions on our company law. In different courts, similar commercial cases are decided totally differently."[744]

Besides not having commercial courts, companies that bring cases forwards are let down by the calibre of the appointed Judges. Judges have been deemed by the interviewees to be insufficiently equipped in terms of knowledge, experience and education to serve in the position of authority that they hold. Shareholders, Directors, Lawyers and Scholars from their professional experience all had damning points to raise about the quality of

[742] P. Herzog & M. Weser, *Civil Procedure in France* (Columbia: Columbia University, 2014), 144.
[743] Ibid.
[744] Ibid.

judges today in Iran, questioning whether they are capable of dealing with complex issues that form the subject matter of commercial cases. Without experienced and well-qualified judges in place, companies expose themselves to a considerable risk in taking cases to court, even if the law is on their side. Without having confidence in judges to consistently make decisions in line with the law, many companies that would ordinarily seek to take matters to the court might refrain through concern over the added risk of not being able to depend on judges to rule in line with the law.

Moreover, it is clear that Judges can have difficulties remaining impartial in instances where they are offered bribes. Several interviewees stated that they did not trust judges to provide fair judgments, as they believed many to be susceptible to corruption. The interviewees provided several examples of how through payments or favours to judges, people had won cases or had cases intentionally delayed.

One weakness of judges that can be exploited is that they only earn modest salaries when compared with other legal professionals. The possibility of bribery is certainly increased through Judges not being in such a financial position that bribery can appear so appealing.

Another instance where judges are susceptible to being influenced is when the state exerts pressure on them. Both the government and the army of guardians have a reputation for influencing judicial outcomes in their favour. Judges have fear that their careers might be jeopardised if they do not follow the instructions of these powerful factions. With such a high proportion of companies being run by the state and the army of guardians, there are regularly instances where cases are influenced.

Another issue that has emerged over time is that the courts are no longer the primary method of resolving commercial disputes. Interviewees voiced their frustrations over the length of time taken for cases to be resolved through the courts and their concern over the inconsistencies of court judgments. As a result of this unreliable service the popularity of the courts has reduced. Arbitration has increased in popularity at the same time and is viewed by many as a genuine alternative to using the courts. Interviewees listed the attributes of arbitration to be its efficiency and the competence of the arbitrators.

The rise in popularity of arbitration is also due to the legislature in 1997 passing the International Arbitration Law, which made the process of arbitration quicker and less expensive. This law being passed is most likely a consequence of the commercial court's struggle with its case volume. The result has been the relief of pressure on the courts as the responsibility of deciding cases has been shared with arbitrators.

6.9.2 Potential Solutions

Improving the processing of cases will be best achieved by introducing commercial courts. This change should result in an improved standard of dealing with commercial cases through greater efficiency in carrying out the administrative operations of receiving and processing claims. The expertise of judges working in commercial courts will improve at a greater rate than if judges continue to work at civil courts moving between commercial cases and other kinds of civil cases. Each court's reputation will also be a reflection of the public perception of the standard of judges working at that court, which will increase the court's requirement to appoint the best candidates as judges. It is also the case that the record keeping at the commercial courts would be improved, which would enable greater analysis of received cases, decisions and results. This is not to suggest that Iran should adopt case law like the common law countries, but only that keeping a record of what cases are received and the judge's ruling should allow the court to monitor the consistency of verdicts.

As one scholar (SCH2) mentioned, there is an attempt at present to allocate commercial cases to suitable judges who have experience in the specific field. Provided this allocation of Judge is correctly organised, there is no reason this practice is not a perfectly adequate solution to a lack of commercial courts. Many interviewees though, who have plenty of experience with these judges, are still left dissatisfied with the suitability of assigned judges. Commercial courts would be able to better allocate judges to cases, as the courts themselves will be in charge of the allocation. Having the assignment of these cases dealt with through one body will improve this aspect of the case processing chain.

In order for Iran to produce high calibre judges for the courts both the academic courses and the selection process needs to be addressed. Firstly, the academic requirement to become a judge is set at the achievement of a higher education qualification of at least a bachelor's degree either in Law, Islamic Law or Islamic Studies. Whilst Islamic law forms part of Iranian Law, entering the profession without any knowledge of statutory law will result in new judges being ill prepared. In comparison with France, which is also a civil law country, in order to meet the academic requirements, applicants must have a higher education qualification in Law, which is a Masters degree.

The principal reason why young judges in Iran are deemed to be ill prepared is due to the courses that they are being taught at university. They are principally being trained in sharia law and they are learning very little statutory law. One interviewee, JUD1, explained that during his studies he only took one module on company law. This interviewee was a company law judge who further admitted to feeling out of his depth when he first started mentioning that he often even felt lost in cases. This level of preparation is incomparable to that of a judge in other jurisdictions. In the UK an entry level judge would have had years of experience as a legal practitioner and training as a judge prior to practicing.

The selection process to become a judge can be reformed to make sure that only the most suitable candidates are selected to become judges. The first requirement is the age restriction that only permits those who have the appropriate qualification who are over the age of 22 to become judges. Secondly, applicants must fit the character profile set by the Council of Justice. Amongst the specification requirements, one must be a Shia Muslim, believe in sharia principles, be an Iranian citizen, complete military service, have soundness of mind and have completed Itjihad.

Many interviewees agreed with this point claiming that there is a bias towards appointing more religious candidates. One of the interviewees, SCH1, stated,

> “It is rare to come across a judge who is suitably educated and has the relevant

> expertise. In my opinion, Judges are appointed according to their political and religious connections."

All jurisdictions should have a thorough vetting process, however in Iran the focus of the vetting is to make sure that the future members of the judiciary believe in the Islamic principles of the government.

It is necessary to remove the incentive for judges to accept bribes. Whilst the natural solution is to pay judges sufficiently so that they have a comfortable enough lifestyle that they are not tempted by bribery, it is unlikely that the judiciary will follow this course as they are already financially constrained.[745]

In order to safeguard judges from the pressures to favour state owned companies or army of guardian companies there would have to be increased separation of powers. The pressure to make decisions in the state's interest would be reduced if these bodies did not have the power to affect the careers of the judges.

Moreover, restoring the courts as the principal means of resolving cases can be achieved by increasing the court's efficiency and reliability. The unacceptable level of delays to commercial cases will have to be addressed. Whilst often reasonably, judges in Iran might adjourn cases for time to allow expert witnesses to make statements, they also often delay cases to give themselves more time as they struggle to fully understand some cases. These delays are caused by lack of knowledge of commercial cases. The solution could come in the form of introducing commercial courts, as it would

[745] T. Beck et al, 'New Tool and New Test in Comparative Political Economy: The Database of Political Institutions', *The World Bank Policy Research Working Paper*, 15.1 (2000) 165-176.

be expected that the judges working in these courts would become experts on different forms of commercial cases.

6.9.3 Application of these Solutions

There should be new regional commercial courts introduced in Iran to solely address commercial disputes. All new commercial disputes will be referred to and processed by these courts. Judges that operate in these courts will solely treat commercial cases and new cases that arise will be assigned to the judge with the most experience in that field. This should result in judges becoming experts in their chosen area of commercial law. The example of China is useful when considering the implementation of commercial courts. It too had a similar situation in regards to a common trend of judges delaying cases and a lack of efficiency in processing cases. China has now had commercial courts in place many years[746], however it still suffers from a low rate of judicial efficiency especially in regards to the delivery of judgments.[747] In China the most common cause of reduced efficiency of the courts is judicial delay of cases. Often cases that continue for years without court decisions end up being resolved after companies have gone bankrupt or have illegally extracted all the valuable assets.[748] This example suggests that introducing commercial courts will not solve all Iran's problems although it certainly will improve the situation.

The selection criteria for judges should also be reformed in order to improve the standard of new judges. The first stage of the selection process

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[746] T. Beck et al, 'New Tool and New Test in Comparative Political Economy: The Database of Political Institutions', *The World Bank Policy Research Working Paper*, 15.1 (2000) 165-176.
[747] Ibid.
[748]J. Chen et al, *Implementation of Law in the People's Republic of China* (The Hague: Kluwer Law International, 2002), 62.

is having a suitable qualification. At present a suitable qualification can be either a degree in Islamic studies or in law. This restriction should be amended to allowing only those who have a degree a law. Removing the ability for students of Islamic studies to become judges would result in candidates with a greater knowledge of statutory and general law as well as Islamic law.

Once candidates have the academic requirement they must pass a competitive examination that is mainly based around sharia law. Again, it would be an improvement for this examination to be focused as well on statutory law to challenge a more broad understanding of the country's legal framework.

Passing this examination at present demonstrates that applicants are ready to become judges. In other jurisdictions however there is an additional step, where a successful examination allows applicants to enter an 'academic institution for the education of Judges.' In France for example successful candidates are admitted into the national college of the judiciary and are appointed as assistants to judges.[749] This extra level of training under the supervision of practising judges would help new candidates to develop the practical skills they will need to become competent judges. The researcher suggests that colleges of this nature are developed for the purpose of educating legal professionals. Apart from having practical courses for prospective judges, the colleges could also offer practical courses for other types of legal professionals.

[749] 'UA, 'Legal Professions, France', *European Justice Website* (2013). Available Online: https://e-justice.europa.eu/home.do?plang=en&action=home [Accessed 04/06/2016].

The French example is that of a civil law jurisdiction and it is worth considering the practices of common law countries as well as they differ significantly in their appointment of commercial judges. In the UK judicial posts require a relevant legal qualification[750] which to attain, one must complete a three-year degree and follow this up with a training contract or pupillage. At earliest, in order to satisfy these criteria, one must be usually be at least 23 years old. There is the additional requirement to have acquired either five or seven years experience in practice as well, which will take applicants to at least 28 years old. In practice lawyers do not become judges until they have much greater experience than the minimum required save in very exceptional cases. In order to be selected to become a judge, one must receive an invitation from the Judicial Appointments Commission, which puts forward candidates that in their opinion have the required attributes. This system dictates that only the most capable recognised legal professionals are selected.

The UK process in reduces the need to have strict official guidelines about who can become a judge. For this reason there is no upper or lower age limit apart from the statutory retirement age of 70 for all judges.[751] Applicants should be able to offer a 'reasonable length of service' – usually at least five years.[752] In reality though the Judicial Appointments Commission is unlikely to invite candidates under the age of 35 as there will be many other candidates who they can appoint that are in their 40^{s} and 50^{s} who will

[750] UA, 'Becoming a Judge', *Courts and Tribunals Judiciary* (2008). Available Online: www.judiciary.gov.uk [Accessed 23/04/2015].
[751] Ibid.
[752] Ibid.

be vastly more experienced.[753] Australia has adopted a similar system to the UK. Invitations to the bench are only offered to those who have reliable reputations as high performing barristers or, on occasions, solicitors. To accrue such a reputation usually takes professionals at least into their late 30s by which time they have amassed a great deal of experience in litigation and in the courtroom.[754] Iran can learn from practices in these common law countries as these examples of UK and Australia produce judges of a high calibre. The vocation of being a judge in common law countries is in most cases well paid and it is a position of great status. In Iran however this is not the case as the salaries of judges is typically inferior to those of lawyers and any status to the position is diluted by the public perception that the courts are dysfunctional. Lawyers of distinction would not be sufficiently incentivised to leave their roles to become judges in Iran.

Restoring the courts as the principal means for resolving commercial disputes would be achieved by improving the service and the faith businesses have in its ability to resolve cases. As has already been mentioned the introduction of commercial courts will assist in increasing efficiency. Improving the standard of judges will also be an integral component in restoring the courts as the principal means for resolving cases.

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[753] UA, 'Annual Report 2009/10, Independent Selection of a Modern Judiciary', *Judicial Appointment Commission (*2010). Available Online: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/248050/0219.pdf [Accessed 17/04/2016].

[754] UA, 'Ensuring a Strong, Independent and Diverse Judiciary through a Transparent Process', *Attorney General's Department (*2012). Available Online: https://www.ag.gov.au/LegalSystem/Courts/Documents/JudicialApptsEnsuringastrongandindependentjudiciarythroughatransparentprocess.pdf [Accessed 10/06/2016].

6.10 Legislative Limitations

There are certain legislative rules that are limiting Iranian companies from having company structures that suit their needs. Company law has not been updated regularly in Iran and companies have to adhere to the law that is in place, regardless of how out of date it may be. There are two examples of these legislative limitations that will be considered in this section. The first is the requirement that directors must also be shareholders and the second is that all limited companies must have a minimum of two shareholders.

6.10.1 Issues with legislation

In Iran there is a legal requirement according to article 72 of Iranian Company Law that any candidate who becomes a director must also be a shareholder of the company.[755] This requirement however is more of a limitation as shareholders are forced to select the director of a company from amongst themselves. The only other option is for companies that want to hire someone who is not a shareholder to allot them a share to bypass the qualification requirement. This is the case with all non-governmental companies. In companies where the government has a controlling share the director will be selected by an employee of the government to represent the government's share in the company.[756] Reforming this law would allow shareholders to recruit directors who have the best skillset and experience to run companies without having to allocate them shares.

[755] UA, 'Ensuring a Strong, Independent and Diverse Judiciary through a Transparent Process', *Attorney General's Department (*2012). Available Online: https://www.ag.gov.au/LegalSystem/Courts/Documents/JudicialApptsEnsuringastrongandindependentjudiciarythroughatransparentprocess.pdf [Accessed 10/06/2016].
[756] Iranian Company Law 1968. Article 110 (Tehran: Didavar Book Publisher).

Another limiting legal requirement in Iran is that all limited liability companies are required to have a minimum of two directors. As a result of this companies that would ordinarily have been single shareholder companies appoint token shareholders to meet the legal criteria. As SCH2 stated,

> "In practise there are businesses in Iran that are family companies where one person owns the company and appoints other family members as token shareholders to bypass this law."

The interviewees made it clear that there are many cases of this in Iran where there are individuals running companies on their own, who appoint token second shareholders to circumvent the law and allow themselves to keep running the company as they wish. As DIR1 added,

> "In Iran there are many companies where the wife and the children are selected as a shareholder and a director. These companies do not have real board meetings annually they simply get their wives and children to sign a document now and then when required."

6.10.2 Potential Solutions

Iran can learn many lessons from the case study countries that have all encountered this issue at some point. In the UK and Australia, there is no statutory requirement for directors to hold shares in the company.[757] In Australia it was required that directors have at least one share in a company

[757] A. Keay, *Board Accountability in Corporate Governance* (Oxford: Routledge, 2015), 134-136.

however the Company Law Review Act 1998[758] repealed the section on the grounds that it had no merit.[759] Also in the UK the law required that directors must own a share qualification in order to hold their position. `This law was however removed and it is now regarded as out dated and limiting.[760] Mayson, French & Ryan state that,

> "It was also common for a company's articles of association to require its directors each to hold a certain number of shares in the company. Share qualifications are now much less common and the model articles of association in SI 2008/3229 do not mention them.[761]"

China and Hong Kong also have no statutory requirement for directors to have shareholdings in the company.[762] In both jurisdictions however the law does not stop shareholders including such a requirement in their articles and it is not uncommon for companies to do so.[763]

In order to address the appointment of token shareholders the solution would be to allow single shareholder companies to exist. In western countries the policy of not allowing single shareholder companies was phased out during the nineteenth century, as companies were able to get around the rule by having token second shareholders with small stakes and no economic or voting interest in the companies. China provides a more

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758 Section 223(1) of the Company Law Review Act 1998 (Cth) required the director to obtain the share qualification in the company within two months from his or her appointment, or such shorter time as stated in the constitution.
759 J. Cassidy, *Concise Corporations Law* (Sydney: Federation Press, 2006), 192.
760 J. Cox, *Business Law* (Oxford University Press, 2015), 27.
761 D. French et al*, Mayson, French & Ryan on Company Law* (Oxford: Oxford University Press, 2016), 444.
762 G. Minkang, *Understanding Chinese Company Law* (Hong Kong University Press, 2010), 172.
763 Ibid.

recent example of a jurisdiction that has addressed this issue.[764] Before permitting single shareholder private companies, China permitted companies to exist that only had one shareholder as long as that shareholder was a state entity. As a result of their experience with single shareholder companies of this type, in 2005 single shareholder companies were introduced in an update to Chinese Company Law.

In Iran there are many companies that should be single shareholder companies that operate with token shareholders. The solution is to reduce the minimum number of shareholders to one.

6.10.3 Application of these Solutions

It is clear from all the example countries that there is a consensus that it is not practical for companies to have a requirement that directors must be shareholders as well. It is therefore necessary to remove article 72 from Iranian Company Law to prevent this restriction on companies from continuing.

Unlike the UK and Australia, Iran would not require any law that stipulates that Shareholders are not able to include in the articles of association a restriction that limits the choice of a director from being amongst the shareholders. For Iran, it is perhaps best to follow the approach of China and Hong where companies are allowed to include the requirement in their articles of association. This would allow the flexibility to include the rule in the articles for companies who want to keep the directors being selected from within the shareholders.[765]

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[764]B.L. Liebman & C.J. Milhaupt, *Regulating the Visible Hand?: The Institutional Implications of Chinese State Capitalism* (Oxford *University Press, 2015),* 46-47.
[765]Ibid.

Amending article 107, which specifies that the minimum number of directors a limited liability company can have is two, is the way to allow single shareholder companies to be permitted in Iran. It is necessary to reduce the minimum number of shareholders to one to allow companies to be formed by individuals who wish to operate companies on their own.

6.11 Conclusion

The chapter focused on issues that exist with the duties of directors, potential solutions that can address the issues and also the application of such solutions. The principal theme that arose when considering directors' duties in company law was that despite whatever legislation was in place, it was all out of date, insufficiently comprehensive, too divided between different sources and generally not fit for purpose.

Suggestions for possible reforms of the law and reforms of mechanisms in place have been offered as potential solutions. The suggested reforms are targeted at the weakest elements of the law on directors' duties and on enforcement and auditing. Having considered legal transplantation at the beginning of the chapter it has also been possible to actively consider the application of any legislation updates.

In terms of transplantation, it has been suggested that Iran should apply a series of conditions for transplanting modelled from the Chinese system. Of greatest importance would be the need to make sure that new legislation is in keeping with current legislation and that it can integrate successfully. Furthermore there is a need to make sure that new legislation is in line with the culture, politics and government agenda.

This research proposes a series of general duties that should be included in Iranian Company Law part one, section six between article 107 to 143. Within this series of duties, Iran should replace any current statutory law that relates to fiduciary duties with a transplant of five fiduciary duties from UK law: ‘duty to avoid conflicts of interest’, ‘duty not to accept benefits from third parties’, ‘duty to declare interest in proposed transactions or arrangements’, ‘duty to exercise independent judgment’ and the ‘duty to promote the success of the company.’ These duties will assist in providing comprehensive legislation that tackles corruption and influence from third parties. Also it is suggested that a dual standard duty of care, skill and diligence should be transplanted from UK law with the addition of the Australian Business Judgment Rule. The inclusion of the Business Judgment Rule in this duty of care would mean that there is adequate cover for both shareholders and directors should any action of breach of negligence be brought.

A reform of the enforcement mechanisms is also suggested in the form of amending two articles of Iranian Company Law to allow all shareholders greater ease in bringing actions against directors. Iran will need to update article 276 and article 277 to allow for any shareholder, regardless of the size of their share, to bring an action on behalf of the company at a cost to the company. In order to achieve improved supervision of directors there should also be a law that stipulates that auditors must be independent from directors and that they have no conflicts of interest. At present there are very few actions brought against directors from the shareholders. This is mainly because directors are not bound by many duties within the current law, but also it is because the mechanisms are not in place to bring actions against them. Once new legislation is in place for directors' duties, as has already been suggested, then shareholders will need to be able to use it and bring actions against directors when breaches are made. In the event that the board of directors does not bring the action, then derivative actions allow the shareholder and the minority shareholders to bring actions on its behalf. This will vastly improve the powers of minority shareholders who are currently greatly exposed. With the introduction of the duty of care in Iran, there would also be great benefit in including the Business Judgment Rule alongside it in the same code. Iran could greatly benefit from more protection for both shareholders and directors. Whilst the duty of care is principally to assist shareholders, the Business Judgment Rule will protect directors for unjust claims against them.

A reform of the infrastructure of the courts is also suggested. Regional Commercial courts should be introduced to deal with high numbers of commercial cases that are brought forwards in Iran. These courts will have assigned judges that solely deal with commercial cases and this focus should increase efficiency and reliability.

Two other legislative reforms that are suggested are the alteration of the minimum number of shareholders in a limited liability company from two to one and also the removal of article 72 that specifies that directors must also be shareholders in the company. These two amendments allow single shareholder companies to exist and will allow shareholders to select directors from a far wider pool of candidates.

The updates to the law will have to undergo assessment from the Islamic Consultative Assembly. The updates will have to be inline with the Islamic principles of the regime in order to achieve approval. Any legislation updates that fail to meet their requirements will fail to meet approval.

CHAPTER 7

CONCLUSION

This research has involved a detailed study of directors’ duties in Iran, something that has not been attempted previously. The thesis has progressed through the course of six chapters each consolidating an integral part of the study to be able to arrive at this point where overall conclusions may be drawn. These can be relatively brief given the points made in the previous chapter, which assessed the overall state of duties in Iran and proposed some areas for reform.

The introductory chapter identified the research question that formed the basis around which the study was structured. The question presented was, should directors’ duties in Iran be modified, and if so in what way? In order to answer this question the introduction also set out several aims to guide the study. The first aim was to identify and articulate the existing company law in Iran as it applies to directors’ duties. Once this could be established, the second aim was to identify any weaknesses and problems in the way in which directors’ duties function in Iran. With these issues identified, the final target was to suggest solutions and improvements that could be implemented and this would include consideration of the situations in other jurisdictions that might be said to have, in many ways, superior practices in place.

Chapter 2 examined the role and nature of directors’ duties in broad terms. It explained how there are various types of directors. It stated that the rationale for imposing duties upon a director is a means for ensuring the company's well being. It added that the duties are firstly a regulatory measure to deter directors from committing an act of wrongdoing. Secondly they are in place to ensure compensation from the director in the event of any wrongdoing. Thirdly it can be considered that duties are in place as a guide for directors to follow to assist them carry out their roles appropriately. Directors' duties cover duties of loyalty and duties of care. These duties are owed to the companies for whom the directors act. Whilst the duties are owed to the company as a whole, it is often held that this means the shareholders are included within this definition. Shareholders are able to claim against directors on behalf of companies and even minority shareholders are able to do this through derivative actions.

In Chapter 3 the thesis focused on Iran and explained that the legal code is principally adopted from French civil code and has been placed within a Shia Islamic framework. Statutory company law was first developed in the 1920s and has only received minor amendments up to the present day. The greatest impact on company law is the increased reliance on Islamic law since the 1979 revolution. Where the statutory law conflicts with the Quran or the Fighh it is routinely the Islamic ruling that prevails due to it being a source of higher authority. The 1932 Act of Iranian Company Law is the main source of statutory law for companies and between articles 107 to 143 there are rules relating to directors. In terms of duties of loyalty article 118 sets out that directors must act within their powers with the scope of that power being deferred to the articles. Articles 129 to 133 are dedicated to specific conflicts of interest however they are too specific to cover a broad range of conflicts.

Overall the articles in place in Iranian Company Law do not adequately provide for duties of loyalty. The duty of care is addressed in articles 141 and 114 where it is set out that companies can bring actions against negligent directors. The articles fail to set out any meaningful guidance for directors to follow. The principal article on duties within Iranian Company Law is article 142 that dictates that directors' duties will be contained in companies' articles of association.

The purpose of Chapter 4 was to set out the framework for the empirical research and consider the theory that underpins the use of semi-structured interviews. Semi-structured interviews were chosen as the means for data collection as they were considered the most effective method for extracting information on complex and specific subjects and for enabling the research question to be addressed. It was possible to identify suitable interviewees through the existing contacts the researcher had in place. Three Judges, six scholars, six lawyers, five shareholders and five directors agreed to the interviews, which the researcher considered to be a fair representative sample. 21 questions were crafted that would intentionally probe the subjects that were most likely to extract the core information about the state of directors duties in Iran. These answers would ultimately aid the researcher to address the research question of the thesis. The interviews were carried out during the month of December 2015 and they produced a significant amount of data that was very useful for the researcher.

Chapter 5 details the findings from the empirical research and presented each issue highlighted by the interviewees separately. The interviewees clarified that duties are not well understood in Iran and that there are rarely cases of breaches of duties that arise. In cases that are brought, the outcome is usually determined by Islamic sources unless provisions are made for duties in the company's articles. There was a strong consensus that duties are required in law and that the reliance on the articles was unsustainable. The Business Judgment Rule was considered necessary by many interviewees, as there was a strong agreement that directors are currently exposed to unfair treatment in cases where they are called up on a breach of the duty of care.

The judicial system was heavily criticised by the interviewees with suggestions that it is plagued by corruption, it routinely leads to lengthy delays and that the judges are inexperienced and unknowledgeable. The interviewees were also heavily critical of companies that appoint unqualified directors. The culture of appointing relatives or friends to the role of director is a common practice in Iran and it often means that companies have an insufficiently experienced or qualified director, as the appointments are not made on merit. This culture of appointing friends and relatives also spills over into other domains as auditors are often appointed in the same way. The interviewees highlighted the concern that the governing body that decides on legislative reforms is reluctant to allow any amendments to be approved. Legislation changes that have been submitted in recent years have not been approved.

Chapter 6 is where all the research is drawn together to present the findings of this work. In terms of the state of directors' duties in Iran today, it was concluded that they are out-dated, insufficiently broad, fragmented and unsuccessful in their purpose. Also it should be noted that the empirical research demonstrated a large degree of discontent from the interviewees around the present state of duties in Iran and a real desire for change in how duties could function.

Before setting out the potential reforms for Iran, there was a decision made that any form of transplantation would have to be applied in line with the culture, politics and government agenda of Iran. In order to do this there would have to be a series of conditions for transplanting that any new law would have to comply with.

The first reform suggested was the inclusion of a series of general duties into Iranian Company Law. These duties would be transplanted from the 2006 UK Companies Act, however attention would have to be paid to make sure they are in keeping with the Islamic principles of the country. The suggested duties are the ‘duty to avoid conflicts of interest’, ‘duty not to accept benefits from third parties’, ‘duty to declare interest in proposed transactions or arrangements’, ‘duty to exercise independent judgment’ and the ‘duty to promote the success of the company.’ Of these five duties there are certain ones that are more fundamental than others in protecting shareholders from miscreant directors. For instance, the duty to exercise independent judgment will help tackle directors who succumb to pressures exerted from external sources. Also, the duty to avoid conflicts of interest will be instrumental in instances where Iranian directors use their positions to gain opportunities for themselves personally. These fiduciary duties are needed to increase the loyalty of the director to the company. The chapter also proposed a dual standard duty of care, skill and diligence that was to be transplanted from UK law with the inclusion of the Australian Business

Judgment Rule. This would provide Iran with a much-needed subjective and objective approach for assessing breaches of the duty of care. This would help shareholders to protect their companies should a negligent director be installed. The addition of the Business Judgment Rule will be in place to protect directors and allow them the tools to defend themselves should they have caused damage to the company through a decision that was made with good intentions.

The second reform suggested is the amendment of two articles that are currently limiting the effectiveness of enforcement. Firstly, the requirement that shareholders must personally bear the cost of the legal fee to carry out a derivative action should be altered so that the company bears the cost. This is necessary because the personal financial cost is a barrier that prevents many actions being brought. Secondly, there is a need to amend the law that prevents shareholders with less than a 20 per cent shareholding a company from bringing an action against a director. Allowing all shareholders, regardless of their share, the ability to bring actions will vastly improve the power of minority shareholders who are currently greatly exposed. These reforms to enforcement are an integral feature to the objective of improving directors' duties and they are likely to empower the shareholders to bring actions against the directors.

The third reform suggested is to introduce new regional commercial courts. The purpose would be to improve the processing of commercial cases so that all disputes are handled in the same way and that the judges are experienced and specialists in commercial cases. There should be increased efficiency in the handling and coordination of the cases and the public faith in the courts should over time be restored.

The fourth reform consists of two legislative amendments that are associated with reform of directors' duties. The first is the amendment of the minimum number of shareholders in a company from two to one. This change will make it possible to register single shareholder companies in Iran. The introduction of single shareholder companies will reduce the culture of principal shareholders appointing relatives as token shareholders in order to fill the role of the extra-required shareholder. The second amendment is the removal of the article that stipulates that directors must also be shareholders in the companies they run. This amendment will allow shareholders to select directors from a far wider pool of candidates.

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