



Inspection in the Commercial Companies of England, Iran and France

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Abstract

Nowadays, commercial companies are considered as the major players in the commercial arena and particularly in the arena of international trade. These companies are the owners of the prestigious commercial brands who having enormous capital and through a regulated administration over their affairs, have succeeded in gaining their customers' confidence. Basically, this confidence arises from the necessity of the existence of inspection principle in this legal person. There are different procedures under which the inspection is conducted in companies. One of the inspection institutions which plays an important role in gaining the public confidence is the external inspection institution. This external inspection which is performed independently of any intervention by the co-partners is treated differently in the legal systems of England, Iran and France. In England it is the commerce minister who recognizing the legal authorities implements this inspection; in Iran, court, companies registration department and securities exchange set about this subject; and in France, this will be performed by creating a high council of inspection by the ministry of justice. In this article, we will study the cases of external inspection in three legal systems mentioned above.

Keywords: External inspection, Legal system of Iran, Legal system of England, Legal system of France, Commercial companies.

Introduction

Forbidding a specific behavior in a section of a company by any system and generally controlling a company requires an effective and regular mechanism. The limitations imposed on specific behaviors and determining sanctions for the breach of these limitations aim to conduct this kind of behaviors. Obviously, inspection plays an important role in arranging the affairs and activities of the commercial companies. The legislative has attempted to impose regulations concerning the external inspection of the companies by creating some restrictions on the activities of the companies and also on the individuals who ought to perform these activities. For example, the external inspector is required to present a report based on the annual accounts. This is to some extent similar to the mechanism of the internal inspector.

The legal system of England

The nature of the inspection: Firstly, external inspection is a mechanism in which the co-partners have no intervention in electing, appointing or dismissing the inspectors (unlike the internal inspectors who are elected through a general meeting); secondly it is not considered as one the basic principles of the company (unlike the inspection in the legal system of Iran which is considered as a fundamental principle of a joint-stock company); thirdly, this kind of specific inspection of

commercial companies has been formulated and therefore some general inspections performed by government and state organizations are not liable to this concept¹.

Part XIV of the *Companies Act 1985* entitled "Investigating Companies and Their Affairs: Requisition of Documents" has been assigned to the external inspection of the companies. This part which includes sections 431-453 controls the appointment of inspectors and their duties, the powers of the minister of trade and industry in investigating the position of the company and requisition and recording its documents.

The mechanism of external inspection has been transferred to Department of Trade and Industry (DTI) by United Kingdom Companies Law (1985). Company investigations regime which is conducted by DTI plays therefore an essential role in policing the activities of companies and those individuals who run companies. On the one hand, it primarily concerns the interaction of companies, directors and shareholders and on the other hand it sets about the State as the Secretary of State for Trade and Industry, inspectors appointed by him and the Financial Services Authority¹.

According to the general rule, the external inspection will be performed with the aim of protecting the public, third parties and minor stock holders' rights. From the middle 18 century, the inspection systems were subjected to legislation. *Joint-stock*

Companies Act 1856 stipulated that the Department of Trade and Industry would have the authority to nominate inspectors to supervise the affairs of the company and these inspectors must draw up a report based on the distribution of stock among the stock holders and they could appoint staffs and representatives to present documents and verify their authenticity. Thus, during the recent 150 years, inspection has constituted a part of the companies law. However, the powers of inspectors have been modified in the acts concerning the companies. For example, the *Companies Act 1947* has entitled the Department of Trade and Industry to appoint inspectors and this power will be restricted only if the majority of the stock holders is agreed to this restriction.

In addition, the Department of Trade and Industry was charged also some more authorities by the Parliament among which the most important ones are introduced in the Act 1967 and the noteworthy one to be mentioned here is the power of requisition and specification of documents which was granted to the minister of economy.

Investigation Powers of External Institution (DTI): Under the *Companies Act 1985*, the minister of trade and industry undertakes two duties concerning the commercial companies. The mentioned office holder attends this performance through the relative ministry which is under his control.

The powers of this office have been introduced in sections 432 and 447 of the mentioned act.

Article 432 controls the power of the minister of trade and industry in appointing inspector in charge of administering the affairs of the company. This section provided that “The Secretary of State shall appoint one or more competent inspectors to investigate the affairs of a company and report the result of their investigations to him], if the court by order declares that its affairs out to be so investigated”. This power will be exercised where there is a strong public benefit in appointing the inspector to be in charge of administering the affairs of the company and the report is presented by the minister himself.

Article 447 treats of the limited authorities of the minister of trade and industry regarding the requirement of documents and their explanation (this is almost similar to the powers of internal inspector in the legal system of Iran which is introduced in section 149 of the Reform Bill). The power of investigating the documents of the company is absolutely devolved to the experts of the ministry of trade and industry which will be wielded following the action is brought.

The procedure of appointing the inspector or inspectors by the minister of trade and industry: The inspector will be appointed by request of different persons or it will be done had some conditions existed:

Application of Members: Article 431(2) (A) provided that “in

the case of a company having a share capital, on the application either of not less than 200 members or of members holding not less than one-tenth of the shares issued, (excluding any shares held as treasury shares)”.

Also, Article 431(2)(B) provided that “in the case of a company not having a share capital, on the application of not less than one-fifth in number of the persons on the company’s register of members”.

The application should be supported by some evidences because in order to show that the applicant or applicants have good reason for requiring the investigation the Secretary of State can require such evidences (Article 431(3)).

Before nominating inspectors, the Secretary of State may, require the applicant or applicants to give security, to an amount not greater than £5,000, or such other sum as he may by order determine, for payment of the costs of the investigation (Article 431(4)).

Application of Company: According to article 431(2) (c). If the company requests it, the minister may appoint inspectors to check affairs.

Court’s order: One or more competent inspectors could be nominated by the Secretary of State to investigate the affairs of a company; they should report the result of their investigations to him, if the court by order declares that its affairs out to be so investigated (Article 432(1)).

Intention of Defrauding Its creditors Or Fraudulent Or Unlawful Purpose: that the company’s affairs are being or have been conducted having the intention of defrauding its creditors or the creditors of any other person, or in other respects for a fraudulent or unlawful purpose, or in a manner which is unfairly detrimental to some part of its members (Article 432(2) (A)).

Omission of The Company: The omission of the company or any actual or proposed act (including an act or omission on its behalf) is or would be so prejudicial, or that the company was formed for any fraudulent or unlawful purpose (Article 432(2) (B)).

That individuals who are concerned with the company’s establishment or the management of its affairs have in connection therewith been guilty of fraud, misfeasance or other misconduct towards it or towards its members (Article 432(2) (C)).

That the company’s members have not been provided by sufficient information about the company’s affairs which they might reasonably expect (Article 432(2) (D)).

Since the exercise of these authorities and the entrance of external inspector to the company will expose the commercial goodwill of the company to a crisis and especially this process

will include unpleasant effects on companies adopted in stock market, the related ministry has been assigned under the Companies Act 1967 to gather the necessary information and do the investigation in an informal manner and on the quiet³.

Inspectors' power in conducting the mission: Once the inspectors are appointed, all the representatives and individuals in authority of the company which is under the inspection of related companies are obligated to present the documents of the company or companies which are under their control.

Where the inspectors hold that the individuals in authority and the mentioned managers are bound to attend in order to present them the documents of company position and concerning explanation, they ought not to fail in any collaboration regarding the investigation (section 434).

Where the appointed inspectors, in order to optimal performance of their mission, consider it necessary to investigate the circumstances of the other companies which are the subsidiary or parent company of the company under inspection or the parent company of one of the subsidiaries of the company under inspection, they have the legal authority to conduct such a process and they must present their report regarding the conducted investigation of the mentioned companies and the procedure which they have followed.

The inspectors' powers have been guaranteed through an imposition of sanctions and where the individuals fail in their duties provided in prementioned legislations or refuse to answer their questions, the inspectors can report them to the court (section 436(1)). After investigating the report and considering the evidences against the alleged trespasser and after hearing the evidences of the defendant, the court will hold him liable for overturning the legal proceeding of the court.

The latest evolution of the external inspection institution: During the last 150 years, the system of the inspections has been gradually reformed. The last major consideration of the regime took place in 1990 when the Trade and Industry Committee produced a report⁶ to which the Government issued a White paper in response⁴. "Business activity is becoming increasingly complex and the scope for fraudulent conduct in relation to shareholders and the public is increasing. The policing mechanism of the investigations regime has to be effective to detect and deter wrongdoing but, at the same time, the cost to the business community and the public purse should not be disproportionate. Also, the regime must operate in a way that does not unduly infringe the civil liberties of those involved with companies³. The essay concentrates on the power to appoint inspectors under s 432 of the Companies Act, since that is the power invoked in the most high-profile major investigations, and the more limited document-based investigation under s 447, because that is the most widely used power. In each of the years from 1996-97 to 1999-2000 the number of investigations completed under s 447 ranged from

167 to 218 whilst in the whole of the period only two investigations were completed under s 432. The DTI does, however, have other rarely used powers⁹ and the Financial Services Authority also has wide investigatory powers whilst other regulatory authorities have powers to investigate particular aspects of a company's affairs, for example, the Inland Revenue, Customs and Excise, Competition Commission, etc.

The next part of this essay, part 2, considers whether the statutory powers are appropriate to achieve their objective of identifying any illegitimate activity on the part of companies and those individuals who run companies. In particular, it focuses on whether the investigators have sufficient statutory powers to initiate investigations and then whether, once an investigation has been initiated, the investigators have adequate statutory powers to require the production of documents and answers to questions. It is only by the investigators having adequate powers that there can be any degree of confidence that they will be able to identify any wrongdoing. Part 3 briefly considers the interplay between the need for adequate powers on the one hand and the public law constraints on their exercise. Investigations must be carried out with due regard for procedural fairness and investigators must also bear in mind the impact of the Human Rights Act 1998 particularly in relation to search powers. There is inevitably a tension between exercising powers in a rigorous and thorough manner and the individual rights of those who are subject to the investigation and it will be argued that the current balance is about right.

Parts 4 and 5 of the essay consider the action that can be taken in the light of investigators' findings. The policing mechanism can only be effective if it is backed up by adequate criminal, civil or regulatory sanctions. Part 4 looks at the existing range of follow-up actions and, in particular, identifies the possible need for a new power to apply for injunctive relief to restrain particular types of conduct on the part of a company – a remedy which could be used more sensitively than existing sanctions such as winding-up proceedings. Part 5 concentrates on the use of evidence obtained by investigators in follow-up action. The need for an in-depth analysis of this topic springs from the European Court of Human Rights' judgment in *Saunders v United Kingdom* and then the subsequent introduction of the Human Rights Act effectively placing restrictions on the use of evidence in criminal trials. The case law in the area is not straightforward, but it will be argued that the balance between effective follow-up action and the procedural rights of individuals has not been upset.

The final discussion in part 6 considers the present law and practice concerning the publication of reports and, in particular, revisits the approaches advocated in 1990 by the House of Commons Trade and Industry Committee and the then Government. The importance of this debate is obvious: reports are paid for from the public purse and their publication can teach valuable lessons but the value of publication cannot override the need to ensure that, in particular, defendants in

criminal cases receive a fair trial.

The legal system of Iran

Companies registration department: This department will exercise a kind of external control over the affairs of the company based on the causes below: In order that the offices of traders such as their commercial companies be established on a legal framework and the trader himself who is the owner of the office be able of taking advantage of its documentation, after ensuring of some specific conditions, their documentation should be signed by the representative of the registration department⁶. In this way, the offices which should be used by companies will be therefore under the control of registration department.

Subscription in joint-stock companies requires the license of the registration department⁷. The establishment of companies will also be authenticated following their records in registration department and if the official fails in this duty, the public joint-stock company will be faced with dissolution.

In some cases, the registration department will directly intervene to solve some problems. For example, under the section 136 of Reform Bill, if the authorities responsible of calling the general meeting fail in their duty, all the parties in interest would be allowed to ask the companies registration department for the call of ordinary general meeting in order to elect the managers.

Securities Exchange Organization: Stock exchange is one the important market in which the accepted public joint-stock companies provide their financial resources through a capital market. This is an organization which enables the investors to sell and buy bonds or shares of the companies. Securities exchange as one of the inspector institution controls the stock exchange companies. One of the advantages of the securities exchange is its information transferring system and the transparency in the accepted companies' information. Stock exchanges are bound to provide the interested people with information about the statistics on trading of securities, prices problems and the daily turnover and publish the list of accepted papers by the close transaction institutions. Similarly, financial intermediaries are bound to provide institutions such as Association (Kanoon) and stock exchanges with information about the customers' accounts, capital adequacy and their periodic turnover. The securities issuers are obligated to publish their turnover information periodically in accordance with legislations of related stock exchanges and take measures regarding the necessity of immediate disclosure of important information.

This organization will control the exchange public joint stock companies so that under the sections 20-26 of Securities Market Act 2004, any public joint stock company which is under establishment or any public joint stock company which has already been established and intends to raise its capital, in order

to take out subscription which is a kind of public issuing of securities, should record those papers at the organization, receive the confirmation of subscription, provide the public supply during a fixed period of time and report the result to the organization.

Party in interest's inspection through court: Usually, the party in interest asks the court to function as a substitute for general meeting, board of directors or inspectors in order to remove the obstacle created in the trend of company's activities. This is apparently the party in interest's inspection which takes place through judicial authority of the court. Where the party in interest is a third party, creditor or one of the employees of the company, the party in interest's inspection can be considered as an external inspection of the company.

Examples of the court's intervention (inspection): Section 5 of the Reform Bill: If the total capital of the joint stock companies declines to a lower amount provided in the law and the company does not offset this decline during the following year, any party in interest is authorized to seek the dissolution of the company.

Section 111 of the Reform Bill: Any party in interest can seek the dismissal of a director who does not satisfy the qualifications required in section aforesaid. Sections 127 and 205 have imposed this injunction respectively to the chief executive officer and administrator.

Section 141 of the Reform Bill: If following the damages which have caused the loss of at least half of the company's capital, either the board of directors does not call the general meeting or the meeting subsequently called fail in being set up legally in accordance with the legislations, any party in interest will be entitled to ask the competent tribunal to dissolve the company.

Section 153 of the Bill: Where the general meeting has not appointed an inspector or where based on any reason one or some of the inspectors cannot report or refuse to report, the chief justice of the local tribunal following the request of any party in interest, will appoint one or more inspectors according to the number of inspectors provided in the articles of incorporation.

In the legal system of Iran, the above mentioned inspection authorities control the commercial companies. In this system, there are also authorities which control the public and state companies which are as follows:

Iran Bureau of Inspection (Principle 174 of Constitution): Section 2 of the Establishment of Inspection Bureau Act: Regular inspection of ministries, offices, military and police forces, state institutions and organizations, municipality and the bodies related to them, notary public offices, public institution, revolutionary bodies, organizations whose names or part of their capital or shares belong to the State or government controls them by applying one of the available procedures in this field

and all the organizations which to be involved in this law, the mentioning of their names based on a regular schedule is necessary.

General Accounting Office (Principle 55 of Constitution): Section 1 of the General State Accounting Act: According to the principles provided in the constitution of the Islamic Republic of Iran, the aim of the General Accounting Office is to exercise constant financial control and inspection in order to watch over the public revenues and this aim will be pursued through exercising control over the financial operations and activities of all the ministries, institutions, state companies and other systems which take advantage of the total budget of the State.

Administrative Tribunal of Justice (Principle 173 of Constitution): Section 1 of the Administrative Tribunal of Justice Act: This authority has been established in order to hear the complaints and injustices and take measures regarding the people's protests against the agents, offices and the state statutes which are illegal, illegitimate or out of the authority scope of the official who has approved it.

The Legal System of France

Unlike what have said the experts of trade law, the external inspection exists in this legal system. Regarding the inspector, section 266 of the Act 1966 provided that: Shareholder or shareholders possessing one tenth of the capital are allowed to ask the court to appoint expert in order to report in specific case or cases about the directors' administrative policy in running the company and place it at the applicants' disposal⁵.

In addition to *monetary and financial markets code*⁶, the rules concerning the inspection authorities in French stock exchange are found also in French *Commercial Law*⁷ (second title of the forth book).

It is also noteworthy to refer to the Commercial Law of France regarding the establishment of supreme council of inspection by ministry of justice which is comprised of members who are chosen without the intervention of co-partners⁸.

The structure of supreme council of inspection is described in sections 821-3 of Commercial Law of France.

This has been provided for protection of the individual rights of shareholders where the inspector fails in performing his duties completely and in a proper manner. According to some experts the article 153 of the Bill 1968 (in Iranian Law) is a restricted adoption of this solution because under the mentioned article, turning to expert out of the company is applicable when the company has not an inspector or based on any reason the inspector cannot or refuses to report; however in French Law, the appointment of expert is on parallel with performing the inspector's duty in company and it does not depend on his presence.

Conclusion

Inspection institution is one the important mainstays of the commercial companies whose main duty is verifying the financial statements of the company. This institution has been provided for preventing the misuse and ungovernability of the commercial companies and protecting the co-partners and individuals who deal with the company from suffering loss and damages. Inspection could be carried out by institutions or individuals whose appointments are made without the intervention of co-partners; such an inspection is known as external inspection. Since the co-partners make no intervention in appointing the members of this inspection system, it seems that their independence is less threatened and therefore their statements are reliable. This inspection system has been regulated in England by the *Companies Law*. Although this system has not been regulated independently in the legal system of Iran, but some forms of external inspection can be seen widely in many laws of this legal system. Since a specific law in this field will have positive and constructive effects, it requires that such a law be provided for in our legal system.

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