Hawkamah/World Bank/
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Study on Insolvency Systems in the Middle East and North Africa

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Ministry of Finance, Jordan
Ministry of Finance, Qatar

Chapter 1

The MENA Region's First Regional Survey on Insolvency Systems

Mahesh Uttamchandani[1]

> *"Efficient, reliable and transparent creditor rights and insolvency systems are of key importance for the reallocation of productive resources in the corporate sector, for investor confidence and forward-looking corporate restructuring. These systems also play a pivotal role in times of crisis to enable a country and stakeholders to promptly respond to and resolve matters of corporate financial distress on systemic scales."*
>
> *World Bank Principles for Effective Insolvency and Creditor Rights Systems*[2]

We are pleased to present the enclosed Report which represents the culmination of over 18 months of research and analysis in the area of insolvency and creditor regimes in the MENA region. This survey represents the first-ever regional, comparative survey of insolvency systems in the MENA region. Such a survey is, by its nature, somewhat general but, from the outset of this work, this Report was always intended to be the 'first word' on insolvency in the region, rather than the 'last word.'

The time for turning our attention to insolvency regimes in the region has never been more urgent. The global economic downturn of 2008 and 2009, coupled with a steep decline in commodity prices and a global liquidity shortage has meant that an increasing number of businesses in the region find themselves in, or on the cusp of, financial ruin.

Effective debtor-creditor regimes form the backbone of sound credit markets and establish the rules by which market expectations and risks are set. Such regimes are important in today's global environment, with increased competition and heightened commercial risk, where investors are more keenly aware of the problems of recovery and have become more selective about where they invest or lend. While many factors drive investment choices, in volatile or tight credit markets, decisions often favor markets with less risk and more reliable structures to support recovery. Effective legal systems enhance credit access and protection, an ingredient of growth in all markets, and enable stakeholders to act swiftly to mitigate loss when a debtor defaults on

[1] Senior Counsel, Insolvency and Creditor Rights at the World Bank and Head of the World Bank's global Insolvency and Creditor Rights initiative. As at the date of this Report's publication, the World Bank's Insolvency and Creditor Rights initiative is being led by Dr. Riz Mokal, working with Dr. Jose Maria Garrido, both Senior Counsel in Insolvency and Creditor Rights at the World Bank. Riz Mokal and Jose M. Garrido have extensive academic and practitioner experience in insolvency matters and are internationally recognized experts in the field. Mahesh Uttamchandani has moved to assume a position as Head of the Insolvency Technical Assistance Program in the World Bank's Investment Climate Unit.

[2] The World Bank Principles for Effective Insolvency and Creditor Rights Systems were developed by the World Bank, working alongside its partners, to provide an internationally recognized benchmark for assessing insolvency and creditor rights systems. The Principles now serve as the basis for the World Bank's diagnostic work in this area. Please see the World Bank's dedicated site on insolvency law matters, the Global Insolvency Law Database, which provides a detailed background to the Principles as well as information on the World Bank's work in the area of Insolvency and Creditor Rights. The website may be reached using the following url: *www.worldbank.org/gild.*

its obligations. As such, they are pivotal to maintaining confidence in daily commercial transactions, and are vital to a prompt response strategy in the context of deepening insolvency, periods of economic decline or stagnation, or more systemic financial distress within a market.

As businesses become increasingly global in nature, investors, lenders and other stakeholders are seeking greater efficiency, predictability and transparency in commercial law systems in an effort to minimize or better manage performance risks. The existence of a more modern legal system can be a draw to investment, while its absence may lead to capital flight in times of recession or crisis. The notion of 'preparing for a rainy day' in order to stave off the domino effect of a financial crisis is equally important in emerging market countries. Of course, most investors do not plan on failure or crisis, which is perhaps why the repercussions of these events have a bigger impact on market confidence when they occur. Effective frameworks for insolvency and creditor right systems foster greater access to credit at more affordable prices; establish the legal framework within which corporate restructuring takes place; operate as a safety valve for corporate distress by enabling parties to salvage viable businesses or transfer assets efficiently to better uses; and serve to promote good corporate governance.

This survey aims to draw attention to, among other things, the absence of reforms of insolvency systems that have taken place in the region, seemingly because this topic has not been seen as important. Many of the surveyed countries would benefit from more in-depth diagnostic assistance, while others will want to proceed directly to tackling some of the challenging reforms that are clearly needed.

Overall, the survey revealed—as would perhaps be expected—a disproportionate emphasis in the region on issues relating to access to credit (credit information and creditor enforcement), although even on this topic the region does not perform particularly well, as opposed to business distress and, more specifically, business rescue. Indeed, the survey suggests that the region's laws are amongst the least developed in the world when it comes to reorganizing troubled companies.

Given the dearth of insolvency experience in some surveyed countries, the data-gathering process for this exercise was challenging. A comparative survey, based on the *World Bank Principles for Effective Insolvency and Creditor Rights Systems*, presented the most effective data-gathering tool. The survey was begun by identifying potential survey respondents in each country. These respondents were kind enough to devote significant hours to the completion of the survey and follow up inquiries and we are incredibly grateful to them for their efforts. From there, the survey responses were reviewed by our own expert working group (Dr. Nasser Saidi, Sumant Batra, Mahesh Uttamchandani, Elena Miteva and Neil Cooper) and draft country chapters were prepared. The country chapters were then submitted to the national regulators and central banks of participant countries for vetting. The country chapters in this volume represent the culmination of that process. We should emphasize that our role here has been that of facilitator; the aim of this study is to provide a platform for country contributors and regulatory authorities to begin a regional dialogue in this important area, one that we hope will result in meaningful legal reform where it is most needed and, in the years ahead, in a fully comprehensive and thoroughgoing study of insolvency systems in MENA.

In addition to the survey respondents, we are incredibly grateful to our institutional partners in this exercise who have continued to devote vast quantities of time and energy to this important project. We hope that those reading this Report will find that the results both illuminate and spark the next phases of an important conversation on this critical topic.*

* The findings, interpretations, and conclusions expressed in the Report represent independent contributions to this survey and do not reflect the views of the Executive Directors of the International Bank for Reconstruction and Development/The World Bank or the governments they represent.

The World Bank does not guarantee the accuracy of the data included in this work. It should also be noted that any boundaries, colours, denominations, and other information shown on any map in this work do not imply any judgement on the part of The World Bank concerning the legal status of any territory or the endorsement or acceptance of such boundaries.

Chapter 2

MENA Insolvency and Creditor Rights: A Call for Reform

Dr. Nasser Saidi[3]

Bankruptcy filings in developed countries, both business and personal, are rising at accelerating rates. The ongoing financial crisis poses major challenges to policy makers and regulators as they attempt to stabilize financial markets and prevent a further meltdown and the slide of the global economy from its deepest synchronized recession in 60 years into possible depression. However, the world has drawn lessons from the Great Depression: the monetary, financial and fiscal stimulus response has been unprecedented. Although we are not out of the tunnel yet, initial signs seem to show that the global response is working.

As we collectively assess the damage and take remedial actions, changing from a crisis mode to a prevention mode, our region has learned from this experience. Our region, particularly the Gulf, has not been as severely affected by toxic assets that started this financial turmoil, because of strong growth over 2002–2008 and profitable domestic markets; a negligible stock of domestic securitized/structured products; limited expertise in managing structured investment products; the regulatory prudential requirements which limited the region's exposure to sub-investment grade investments and instruments; growing importance of Shari'a compliance finance; the ample liquidity from net capital inflows and oil exports; fiscal discipline and the build-up of sizeable stock of foreign assets, providing us with a cushion against external shocks.

We were not immune to the crisis as the real economy felt the spillover of the credit crunch. Over the past few months, we saw marked declines in international trade, tourism, foreign direct investment, and remittances which affected labour exporting countries. However, the policy response of monetary easing, liquidity injections, a counter-cyclical policy response based on sustained infrastructure and investment spending have stabilised our economies and the credit and financial markets, setting the stage for resumed growth.

We are moving from crisis management and response to building institutions and strengthening economic policy making capacity. The MENA region countries are going through a process of adjustment to the financial contagion and real effects of the global crisis. However, we need to ensure a 'soft landing.' To achieve this, we will need to undertake structural reforms aiming amongst other things, at building local currency capital markets able to finance housing, infrastructure, long gestation investment projects and increased private sector participation for more diversified economies.

The countries of our region have been active and increasingly successful in reducing the costs of starting a business, addressing the bureaucratic and legal hurdles an entrepreneur must overcome to incorporate and register a new firm. However, we need to pay as much policy attention to the orderly exit of firms, through an efficient design of insolvency law and the related procedural and administrative steps involved in the insolvency process for businesses.

Insolvency and creditor rights are part of market infrastructure, and they are part of the core standards for sound financial systems. These international standards were developed to help

[3] Chief Economist, DIFC Authority and Director, Hawkamah Institute for Corporate Governance.

countries achieve transparency of economic risks, and a financial system governed and regulated in a safe and sound manner which serves the nation efficiently and sustains ongoing growth and economic development.

In our region, an appropriate insolvency regime also needs to strengthen the capacity of entrepreneurs and the private sector to be able to take risks, innovate, to reduce the stigma of bankruptcy and insolvency and to make it possible for debtors to restart businesses with a clean slate after a failure. The lesson from cross-country experience is that effective insolvency systems, based on well designed legal frameworks, relying on a sound judicial system, with competent and impartial judges and lawyers and accountants experienced in insolvency proceedings, play a critical role for the orderly exit of insolvent corporations and for the efficient reallocation of resources.

Insolvency in the MENA Region

The World Bank's Doing Business Report in 2009 has highlighted a very interesting set of benchmarks that show that the region must improve how it handles insolvency cases:

- For the MENA region it takes 3.5 years for a company to go through insolvency, double the OECD average of 1.7 years, while it takes 1.3 years for a company to go through insolvency proceedings in Tunisia. This is a marked contrast to Ireland, where it takes a little over 3 months to go through insolvency proceedings.
- You would expect about 14.1% of a company's value to melt away through insolvency proceedings in the MENA (OECD average of 8.4%)—compared to about 1% in Kuwait, similar to Singapore, Colombia and Norway. These four countries provide the lowest costs for going through the insolvency process globally.
- On average in the MENA region, you would expect to recover about 29.9 cents on the dollar (OECD about 68.6), while in Bahrain (the highest) you would expect to recover 63 cents on the dollar. These recovery rates can be benchmarked against Japan where businesses generally recover 92.5 cents on the dollar, the highest according to the 2009 Doing Business Report.

Regional Task Force on Insolvency and Creditor Rights

As a result of discussions at Hawkamah's first annual meeting, the Dubai Declaration of 2006 called for Hawkamah, World Bank, OECD, and INSOL International to focus on the building blocks of assessing insolvency and creditor rights in the region.

We had our first meeting in Cairo, Egypt, on 21 May 2007, hosted by the General Authority for Investment and Free Zones and the Egyptian Institute of Directors. This first meeting of the insolvency task force helped lay the groundwork for the year and a half of engaging governments and professionals in various countries on data collection.

With support from PwC and Korn Ferry, Hawkamah and the World Bank have been able to gather data on 11 jurisdictions in the MENA region, including the DIFC, Egypt, Jordan, Kuwait, Lebanon, Oman, Palestine, Qatar, Saudi Arabia, UAE, and Yemen. The survey questionnaire was based on the *World Bank's Principles for Effective Insolvency & Creditor Rights Systems* of 2005 as an indicator of international best practice.

The main results of our survey can be summarised in the following points:

- Insolvency systems in MENA are generally inconsistent with international best practice.
- The Gulf States have stronger insolvency laws, but need to improve creditor information systems and dealing with cross-border issues.
- Both Gulf and Non-Gulf States have room for improvement compared to international standards and practice, in particular in the area of reorganisation of companies.
- Based on Common Law and the advantage of "purpose-built," the DIFC insolvency framework is the most robust and highest rated in the region.
- Strengthening and modernising insolvency laws is crucial to mitigating the risks and effects of economic & financial crises on MENA countries.

Insolvency reforms will not move forward unless policy makers acknowledge the benefits of sound insolvency systems for the efficient allocation of resources. The development of effective

DOING BUSINESS 2009 World Bank-IFC report: Closing a Business

Region or Economy	Time (years)	Cost (% of estate)	Recovery rate (cents on the dollar)
Middle East & North Africa	3.5	14.1	29.9
OECD	1.7	8.4	68.6
Algeria	2.5	7	41.7
Bahrain	2.5	10	63.2
Egypt	4.2	22	16.8
Jordan	4.3	9	27.3
Kuwait	4.2	1	34.5
Lebanon	4	22	19
Morocco	1.8	18	35.1
Oman	4	4	35.1
Qatar	2.8	22	52.7
Saudi Arabia	1.5	22	37.5
Syria	4.1	9	29.5
Tunisia	1.3	7	52.3
United Arab Emirates	5.1	30	10.2
Yemen	3	8	28.6
Ireland*	0.4		
Singapore*		1	
Japan*			92.5

** Best in league*

insolvency regimes has to start from a review of laws, regulations and practices at a country level. Insolvency reform does not simply mean a modern law. It requires a holistic view of the insolvency regime, including its interaction with the corporate governance framework, with transparency and disclosure mechanisms based on international accounting and auditing standards. Reform will also require building the capacity of our judiciary in the area of insolvency and investing in the infrastructure of insolvency. We should also be flexible and develop guidelines for out of court settlement, based on tested principles such as those developed by INSOL.

Call to Action

As a region, we need to build institutions that would support the development of sound insolvency frameworks. These include institutions and systems that are part of the insolvency framework:

- Look at the Liquidation and Rescue process, assess the effectiveness of the process and provide clarity on the various stages of the process while ensuring that an appropriate support infrastructure is in place—be it formal or informal. Time and certainty are of the essence.
- Look at voting rights and requirements addressing the extent of creditor involvement in the process.
- Consider lowering financial reporting requirements, which affect the capacity of SMEs to access credit and to benefit from the insolvency process.

We also need to build financial information infrastructure institutions that will support modern insolvency regimes by:

- Developing Central Credit Reporting Organizations to provide information on bank and non-bank credit (including supplier credit). These CCROs can collect, organize and analyze valuable material information in an efficient manner;
- Promoting the establishment of "Companies House" in the countries of the region, allowing the electronic registration of companies and filing of documents and reports;
- Developing local Credit Rating Agencies, as they can provide a very valuable service to conduct risk assessments and credit ratings for companies and governments. This is also particularly important for capital market development as they provide credit benchmarks for local markets;
- Developing and modernize Registries of Security, for both immovable and moveable collateral;
- Developing Special Claim Financial Courts that would be able to facilitate adjudication of highly technical financial issues, particularly those related to insolvency law; and
- Establishing or providing sufficient resources for the administration of liquidation cases, and the development of trained and experienced private sector practitioners to take prominent roles in various aspects of reorganization of the affected businesses.

Market efficiency and integrity, corporate governance and insolvency frameworks and practices are organically linked. Evidence from both developed and emerging markets has shown that a sound insolvency framework and effective enforcement of creditor rights leads to improved access and greater breadth and depth of credit and financial markets. Sound and efficient insolvency frameworks will also assist our economies in the process of adjustment to external and domestic shocks. To date, we have been able to weather the current global economic and financial crisis. We need to strengthen our insolvency regimes and creditor rights to protect and to help immunize our countries against future contagion effects and crises.

Chapter 3

The Import of the Insolvency Professional

Sumant Batra and Robert O. Sanderson[4]

An efficient and effective insolvency system is an essential part of a nation's financial architecture. It is fundamental for economic growth, wealth creation and for encouraging both enterprise and investment. The insolvency system is vital to stability in commercial relationships and financial systems, to advance the important social objectives of maintaining public confidence in the corporate and financial sectors and investment, to enable market participants to more accurately price, manage and control default risks and corporate failure, and to encourage sound credit practice. An effective exit law promotes responsible corporate behaviour by setting higher standards of corporate governance, including financial discipline, with a view to avoiding the consequences of insolvency. Generally, a fundamental objective of an insolvency framework is to preserve employment through an effective system of rehabilitating otherwise sound but financially distressed enterprises, while assuring the maximization and a fair reallocation of the enterprise value to creditors and other stakeholders. It does not look to promote the continuation of enterprises that are not utilizing their resources in an efficient and meaningful way.

A key component of an effective and efficient insolvency system is the role undertaken by the insolvency representative or professional. A robust insolvency system seeks to achieve the appropriate balance between the debtor and its creditors, rehabilitation and liquidation, as amongst creditors, while preserving their negotiated rights and ensuring that preferential transactions are appropriately managed and misfeasance is effectively addressed. The insolvency professional plays an important role in getting this balance correct and in effecting the insolvency proceeding in a timely manner. If an enterprise has enough value and liquidity to meet all of its obligations, then a restructuring of the enterprise is implemented through a series of bilateral or multilateral legal agreements or in some cases by way of a scheme of arrangement pursuant to applicable local laws. In the case of an enterprise which has insufficient assets or liquidity, the process looks to arrive at a compromise collectively between the various legal entitlements of the stakeholders in such a manner as to preserve the integrity of the economic model and to ensure that misfeasance is redressed. The role, powers and nature of the insolvency practitioner must complement and facilitate this process; in fact this should arguably be a key driver of the process. Thus the insolvency system should provide a suitable framework for the work of the insolvency professional. Well-qualified and respected insolvency practitioners will command respect from and the attention of all of the enterprise's stakeholders. The benefit will be the achievement of a resolution that maximizes economic value in a manner that the participants trust and one that is least disruptive to the economy. It is important however, that the role of the insolvency professional fit with societal expectations.

To best ensure that a jurisdiction achieves the maximum benefit from the work of insolvency professionals, it is important to determine the model

[4] Sumant Batra is President of INSOL International and Managing Partner of Kesar Dass B & Associates, India. Robert O. Anderson is a former President of INSOL International.

that is most suitable for a particular jurisdiction. A fundamental choice needs to be made as to whether the insolvency practitioner will be a government official or from the private sector. If the choice is the private sector, the next question which must be decided is what approach, if any, to take to regulate the profession. We would respectfully suggest that private sector insolvency practitioners, properly regulated, represent the most appropriate way forward in this regard. Once this decision can be taken by country regulators, the qualities and attributes of the insolvency professional should dictate the effectiveness of their utilization.

Regulating the Insolvency Profession

The regulation of the insolvency professional can be achieved either through statutory professional bodies or by a specially mandated department of government. Regulatory oversight of the insolvency profession, by its very nature, restricts entry to those that possess the necessary qualifications and attributes. Stringent requirements, though somewhat restrictive, facilitate the appointment of highly qualified individuals and assure quality control with respect to the standard of service required. Stringent requirements can provide the greatest overall benefit even though they might result in higher fees charged than if there were open, unrestricted access. We believe that this is a small price to pay, as it is of paramount importance that the business and financial community, the employees of distressed enterprises and various government agencies all have confidence and trust in those charged with either the rehabilitation or liquidation process, and assist in providing an efficient resolution. They are agents of all of those who collectively have to accept an outcome different from that for which they bargained. Legislation which provides a mechanism to permit access to the courts by stakeholders seeking a review of the conduct or costs of the insolvency professional help in ensuring that there is the proper scrutiny of this process.

Qualifications and Qualities

The qualifications of the insolvency professional must be consistent with and complementary to the legislative framework. The complexity of the majority of insolvency and restructuring assignments demand that those involved are appropriately qualified. These qualifications should include a good knowledge of the law (not only insolvency law, but also relevant commercial, financial, labour and business law) as well as adequate experience in commercial and financial matters, including, to some degree, accounting. An individual should possess good interpersonal skills, an ability to communicate clearly and to reconcile the different positions of stakeholders. They need good management skills. They will be required to balance commercial reality with legal requirements in order to preserve the entitlements of stakeholders, such as creditors, as well as to recognize issues relating to the public interest, where appropriate. Whether or not the individual should possess specialized expertise in the distressed enterprise's particular business should be balanced against the ability to retain experts.

Equally important to the knowledge and experience requirement are the personal qualities of those who seek to be insolvency practitioners. These include qualities such as integrity, impartiality, and independence. Integrity should require that the individual have a sound reputation and no criminal record or record of financial wrongdoing. They should be financially secure; able to finance their overhead and other operational costs. While their fees are usually paid promptly, there can be periods where they must finance their mandate and should therefore not be in a position of having their liquidity requirements dictate in any manner the course of action adopted. Also, in liquidations, they will have substantial trust funds and ensure that these are adequately protected is vital to maintaining confidence in the insolvency system.

It is also critical that the insolvency practitioner be and be able to demonstrate that she is independent from vested interests, whether of an economic, familial or other nature. Insolvency law should include both principled guidance on conflicts of interest together with the positive obligation to make meaningful disclosure of potential and existing conflicts of interest. The disclosure process should not result in having to disclose what are likely trivial matters, but those which an informed person would find troublesome and result in a loss of trust and confidence in the insolvency system.

The standard of care to be employed by the insolvency administrator and her personal legal liability are important in the conduct of insolvency

proceedings. The establishment of a measure for the care, diligence and skill with which the insolvency professional carries out her duties and functions, usually in difficult circumstances, is vital. It requires balance; a standard that ensures competence but one that is not so stringent as to inordinately increase the costs of administration and to invite unnecessary litigation against insolvency practitioners. Liability for damages arising from misfeasance or malfeasance should be a civil matter. Where the insolvency administrator is required to incur liability, such as may arise from continuing the business in the ordinary course of affairs, the law must balance payment certainty with adequate protection for the insolvency professional from excessive legal risk. One solution is to limit liability to the value of the assets in the estate.

Remuneration

One of the thorniest issues is that of the insolvency practitioner's remuneration. The remuneration should be commensurate with the qualifications required and the tasks to be performed and should achieve a balance between risk and reward in order to attract appropriately qualified professionals. It should encourage that an appropriate level of care, diligence, skill and creativity be exercised. While there are different methods of fixing remuneration, including time based systems or commission or percentage based systems or some combination of both, there should be provision in the law for an independent review, including a judicial review, to be carried out where a stakeholder has concerns regarding this process. This safeguard coupled with disclosure to creditors and other stakeholders, as well as the pressures of a competitive market, all help to ensure that value is delivered. Any remuneration system should recognize that there are certain tasks or investigations that will be mandatory and provision for their costs should be part of whatever approach is adopted.

Where a jurisdiction has a well-developed cadre of insolvency professionals, who ascribe to the highest standards of conduct, together with the appropriate oversight, the insolvency system should function effectively and efficiently. A competent and recognized insolvency profession can overcome gaps in the legislative framework and make the system work for the benefit of all. The stature of insolvency professionals, their trust and skill enable them to bridge the differences between various stakeholders and to help ensure that business assets are deployed to maximize value.

Chapter 4

The OECD's Work on Insolvency in the MENA Region and Beyond

Alissa Koldertsova[5]

An efficient and effective insolvency system is a critical component of every well-functioning modern market economy. Strong insolvency systems contribute to the efficient use of resources, underpin investor confidence and improve financial stability and predictability. Recognising the importance of well-functioning insolvency systems, the Organisation for Economic Co-operation and Development (OECD) has worked to support regional efforts to address deficiencies in insolvency frameworks first in Asia and more recently in the Middle East and North Africa (MENA) regions. The OECD first became involved in supporting reforms of insolvency frameworks in the wake of the Asian financial crisis, establishing the Forum on Asian Insolvency Reform (FAIR) in 2001 in partnership with the Asia-Pacific Economic Co-operation (APEC) and other actors.

This Forum, a first of its kind, was aimed at addressing shortcomings in the insolvency frameworks of Asian countries which were revealed in the aftermath of the 1997–98 Asian financial crisis. Such shortcomings resulted in a situation where on the one hand, creditors avoided countries which did not afford them adequate protection, and where on the other hand, in the absence of clear rules promoting financial discipline, debtors could not be compelled to restructure debts. Designing both formal and informal insolvency mechanisms and building institutions capable of implementing them became a high priority for the countries affected by the crisis. Indeed, a number of governments in East Asia have undertaken profound changes to strengthen their legal and institutional frameworks of insolvency since the establishment of the regional dialogue facilitated by FAIR.

Though significant progress has been made as a result of OECD's engagement with Asian countries, the Organisation's work on improving frameworks for insolvency has not lost its relevance. In fact, the cooperation with Asian countries has deepened over the years and bankruptcy-related work undertaken by the OECD has expanded to other regions, including to the Middle East and North Africa (MENA) in the context of the work of the MENA-OECD Regional Working Group on Improving Corporate Governance. This work emanates from the continued demand of policy makers in these regions for OECD's expertise in navigating the complex set of issues posed by bankruptcy reform. In the context of the MENA region, the issue gained prominence already in 2006 when the participating business leaders and policymakers had highlighted the importance of this issue in the Dubai Declaration, which calls on MENA countries to establish effective insolvency systems and provide a framework for efficient allocation of capital. Since then, several countries (e.g. Egypt and Jordan) have taken positive steps to improve their insolvency regimes either through enacting specific insolvency legislation/regulation or by amending the provisions of the general companies legislation/regulation.

Noting the interest of MENA policymakers in reforming their insolvency frameworks, the OECD, in cooperation with the Hawkamah Institute for Corporate Governance, INSOL International and the World Bank, organised a regional meeting on

[5] Policy Analyst, Corporate Affairs Division Organisation for Economic Co-operation and Development

Building Sound Insolvency Systems in the MENA region in May 2007. The purpose of this meeting, which brought together approximately 80 officials from across the region, was to gather information about the legal and institutional frameworks of MENA insolvency systems, to present international guidance, highlight emerging insolvency issues, and identify areas of interest for a regional dialogue on insolvency. A number of important meeting conclusions are worth highlighting. First, a consensus among meeting participants emerged regarding further efforts to build more sophisticated insolvency laws in the region and the institutional capacity required for their implementation. Second, participants agreed that the absence of a well-functioning insolvency regime may precipitate capital flight, destroy value in the corporate sector, frustrate creditors and discourage domestic and international investors.

Third, the importance of country-specific solutions which embody different policy choices on risk allocation, taking into account the strengths and limitations of the institutional infrastructure, the level of economic development and the existing social traditions, was emphasised. Despite the importance of country-specific approaches to insolvency reform, given the overall balance between debtor and creditor rights in the MENA region, it appears that there is an argument to be made for empowering creditors. It was also highlighted that comprehensive insolvency reforms in the region should encompass rescue and restructuring proceedings, which are largely lacking in MENA countries' current frameworks. Furthermore, formal and informal (out of court) mechanisms should complement each other. Another issue highlighted by the discussions was the independence and expertise of judges, but also, the availability of qualified insolvency professionals. Participants saw an ongoing regional dialogue on this issue as a valuable process which could provide mutual learning opportunities for countries from across the region.

The interest of policymakers from the MENA region in insolvency reform has only been further supported by recent global macro-economic developments. The current financial crisis has put under the spotlight insolvency regimes all over the world, and as a result, policymakers in both emerging economies and OECD member countries have once again legitimate reasons to examine the suitability of their existing insolvency systems to the needs of stakeholders and to the overall objective of economic efficiency. Certainly, the MENA region does not seem to present an exception to this trend. Although the region has been relatively insulated from the effects of the current financial crisis, the liquidity has diminished significantly in recent months, and a number of large infrastructure projects have been delayed due to financing difficulties, particularly in the Gulf Cooperation Council countries. Some recent analysis emanating from the region suggests that in the real estate sector, some companies may be operating while technically being insolvent, adopting a wait-and-see approach in the expectation that they can eventually avoid bankruptcy. Certain observers in the region anticipate that the number of businesses filing for bankruptcy in the most affected sectors of GCC economies might increase, which might put under pressure the relatively untested insolvency systems in some countries. Only last year, Standard & Poors has issued a report suggesting that the outcome of the application of insolvency framework in one GCC country in the event of rising default levels remains unpredictable.

Though the impact of the global financial crisis on the MENA region has not been as dramatic as on other regions—with growth for this year estimated by the IMF at 3.3%, a decline from 5.5% in 2008—it has not been entirely insulated from the impact of the global recession either. While the financial sectors of MENA countries have been generally less affected, the impact on MENA economies from the slowdown in global demand is considered to be significant. From the point of view of oil producing countries in the region, the declining growth outlook has been exacerbated by the deteriorating price of oil experienced since mid-2008. In addition, the increased integration of regional economies makes countries more vulnerable to financial contagion risks. These developments further elevate the prominence of insolvency reform and fiscal stimulus measures on the policymakers' agenda. Indeed, a review of the bankruptcy frameworks in MENA countries might be considered appropriate, even taking into account the significant fiscal stimulus packages and measures to support the banking sectors some MENA countries have introduced in recent months.

Given its work with Asian countries in the wake of the financial crisis, the OECD has accumulated significant experience to offer to policymakers in

MENA countries on insolvency reform, especially in times of adversity. While governments in the region can be advised against a hasty reform of their insolvency frameworks to address the present economic conjecture, continued attention to insolvency regimes in the region is clearly warranted. The OECD, together with its partners, including Hawkamah Institute for Corporate Governance, the World Bank and INSOL International, stands ready to accompany MENA countries in their search for efficient and effective, country-specific insolvency regimes consistent with their overall corporate governance frameworks. This can be advanced by extending the regional dialogue on insolvency initiated in 2007, within the context of the overall work of the MENA-OECD Regional Working Group on Improving Corporate Governance supported by the Hawkamah Institute for Corporate Governance.

Chapter 5

The Need for Insolvency Systems Reform in the MENA Region

Omneia Helmy

Overview

The current global financial crisis is confronting the Middle East and North Africa (MENA) countries with a dramatic decline in capital inflows and a collapse in export demand.[6] The financial and external demand shocks are straining the MENA corporate sector and heightening the possibility of a significant increase in the number of corporate insolvencies.

An expected spike in corporate insolvencies raises concerns about the inability of costly, time-consuming and inefficient insolvency systems in MENA countries to resolve corporate financial distress by reorganizing viable firms and closing down unviable ones.

A brief overview of the benefits of well-functioning insolvency systems for efficiently reallocating resources, promoting investment and credit flows and protecting the rights of various stakeholders would encourage policymakers, legislators and regulators to work towards developing the legal, regulatory and institutional frameworks necessary for sound insolvency systems in the MENA region.

An efficient insolvency system offers several advantages. The first advantage is maximizing the total value of proceeds available to be divided between the debtor, creditors, shareholders, employees and other stakeholders. A firm should be reorganized, sold for cash as a going concern, or closed down and liquidated piece-meal, depending on which option will generate the greatest total value.

The second is keeping the absolute priority of claims. If the debtor opts for liquidation, or if he is unable to prepare reorganization plan that is acceptable to creditors and the court, his assets must be sold and the proceeds distributed among creditors in an order of priority that is established by law. Adhering to the absolute priority of claims ensures that secured creditors are paid first, followed by general creditors, and then shareholders if any residuals remain. It helps to ensure that creditors receive a reasonable return from bankruptcy estates, which encourages them to lend, improving access to credit (Gine and Love 2009)[7]. Reducing investors' risk is particularly important for MENA countries where there is an increasing pressure for rapid job creation and productivity growth, requiring an expansion of private investment.

The third is reducing transaction costs. The efficiency of an insolvency system is primarily measured by its ability to reduce the costs of insolvency procedures. Two types of costs are associated with insolvency: costs directly related to the insolvency procedure such as payment for the trustee, and opportunity costs resulting from the time needed to finish the insolvency process. In practice, prolonging insolvency proceedings can harm both debtors and creditors and clog the court system. The interests of various stakeholders can only be assured if insolvency proceedings take place in a timely fashion in order

[6] Net private capital flows to both emerging markets and developing countries are projected to decline from an inflow of $600 billion in 2007 to an outflow of $180 billion in 2009 (Ghosh et.al. 2009; Tuck 2009; World Bank 2009a).

[7] It may be important to give a "super secured" position to creditors that lend money to distressed companies, allowing them priority over previous secured creditors. That makes it easier for such companies to obtain new loans and continue operating.

to preserve the value of the debtor's assets. Therefore, an efficient insolvency system should prevent premature liquidation, and speed up the reorganization of potentially viable firms as well as the closure of those that are not.

In sum, the ability to exit the market in an orderly manner assures potential investors and creditors that they can reallocate their resources, whenever needed, thus rendering the national economy more attractive to investment and credit. It could also help protect the rights of various stakeholders, particularly workers and minority shareholders. An efficient market exit process could therefore help accelerate the rate of economic growth, create more job opportunities, and achieve social equality (Helmy, 2005).

In view of the above benefits, an assessment of the existing insolvency systems in MENA countries reveals that the insolvency process is far less advantageous in these countries than the average experience of the 27 high-income member states of the Organization for Economic Cooperation and Development (OECD) chosen as international best practices benchmarks. Efforts to improve the investment climate in MENA countries have usually focused on obstacles to starting and operating firms, while market exit—a fundamental feature of a well functioning market economy—has not been adequately addressed.

In MENA it takes an average of 3.5 years to complete an insolvency proceeding, whereas the time required in OECD states averages 1.7 years.[8] It costs an average of 14.1 percent of the estate in MENA, compared to an OECD average of 8.4 percent. The average recovery rate, which calculates how many cents on the dollar claimants (creditors, tax authorities and employees) recover from an insolvent firm is 29.9 cents on the dollar in MENA, compared to an average of 68.6 cents on the dollar in the OECD countries (World Bank 2009b and Financial Standards Foundation 2009).[9]

After expensive, drawn-out and inefficient insolvency procedures, only a small sum is usually left over for distribution among creditors, who receive far less than even partial satisfaction of their claims. Creditors fear that their claims will likely be trapped in the insolvency process indefinitely and will not be resolved in a timely or satisfactory way. Therefore, they tend to opt for informal workouts or out-of-court settlements as a way to get something in the short-run rather than receive less or nothing at all after the administration process has consumed nearly all of the estate.

Barriers to market exit such as excessive cost and bureaucracy have adverse repercussions on resource allocation, efficiency, and stability as well as on equality and fairness. Such barriers delay the necessary restructuring of potentially viable firms or the liquidation of those that are non-viable, and hinder the reallocation of assets and human capital. Exit restrictions can lead to increased disputes among various stakeholders, which in turn result in higher transaction costs and a loss of rights, ultimately undermining the investment climate.

Two main deficiencies could explain the inefficiency of MENA insolvency systems. First, the systems do not provide appropriate incentives for debtors, creditors, and trustees to enter the insolvency process, conduct it in a cost-effective way, or to reorganize potentially viable firms and avoid their premature liquidation. Second, the insolvency systems are not effectively enforced (Helmy, 2005).

As for the first deficiency, MENA insolvency systems do not motivate honest debtors who have failed due to no fault of their own, to make a fresh start or to prepare a sensible reorganization plan. The systems decrease creditors' confidence in secured lending, undermine their rights and increase the opportunity cost of their claims. The trustees are subject to various motives that lead to lengthy bankruptcy procedures.

Concerning debtors, the systems impose severe legal sanctions (e.g., depriving debtors of their civil and political rights) that harm the image of honest entrepreneurs who failed due to, for example, an economic crisis, and deter them from making a fresh start.[10] Honest bankrupts are stigmatized and have an incentive to delay a bankruptcy filing, all the while falling further into distress. Debtors are not discharged from their debts, restricting their ability to make a fresh start. The absence of a stay

[8] The longer a business is in distress, the more likely it is that valuable human capital will flee, the greater the damage to brand and the harder it is to negotiate with suppliers.

[9] The low rates of debt recovery in MENA countries often lead to antagonism between creditors and debtors. Access to credit shrinks and non-performing loans and financial risk grow because creditors cannot recover overdue loans.

[10] Reforms to encourage a fresh start raise rates of new business creation by 8–9 percent, on average (John and Cumming 2006).

on creditors' claims often positions creditors against each other in a race to seize assets, thus increasing the possibility of further financial distress and liquidation, and reducing debtors' chances to prepare a sensible reorganization plan.

Regarding creditors, the absolute priority for creditors' claims is not fully observed. In many MENA insolvency systems, payments to workers and government taxes have top priority and must be paid before the secured creditors are compensated. This undermines the investment climate by decreasing lenders' confidence in secured lending, increases the risk and cost of capital, and reduces the total amount of credit. Unfair transfers made before payment cessation cannot be recovered for the benefit of the estate, undermining creditors' rights. No time limit is set for finalizing insolvency procedures, increasing the opportunity cost of creditors' claims, as a result of freezing their resources.

With respect to trustees, three main incentives can lead them to prolong the procedure: their vast range of responsibilities, their legal liability for any unintended or intended negligence, and their ability to charge more fees by prolonging the insolvency proceedings.

As for the second deficiency, weak enforcement of MENA insolvency systems may help explain why debtors and creditors are reluctant to push for a formal bankruptcy resolution, preferring to resolve the situation through private negotiations.

The ineffective enforcement of insolvency systems in MENA could be mainly attributed to the high level of court involvement,[11] the multiplicity of appeals in both the adjudication and administration phases of insolvency, and the lack of penalties on debtors for failing to file for bankruptcy, thus prolonging their activities at the growing risk of creditors.[12]

Reform of insolvency systems in MENA countries requires providing the appropriate incentives necessary to allow debtors, creditors, and insolvency trustees to reorganize potentially viable firms and to enforce the systems effectively.[13] A shift towards a "rescue culture" is needed as reorganization is often preferable to liquidation and if successful, will likely produce better results, preserve job opportunities, achieve social equality, and help stimulate economic growth. Frameworks designed to deal with corporate rescue attempt to address concerns of equity, effectiveness and speed, enabling greater numbers of companies to survive when they get into financial difficulties (USAID, 2008; Helmy, 2005).[14]

Concerning the debtors, severe legal sanctions that are imposed on honest debtors should be removed allowing them a fresh start and giving them a chance to prepare sensible reorganization plans. Upon the filing of a voluntary petition for bankruptcy, the debtor should automatically keep possession and control of his assets while undergoing reorganization (i.e., assume the identity of a "debtor-in possession"). If a debtor knows that he will remain in charge of the firm, he will be more likely to file for bankruptcy early, as soon as the need becomes apparent. Filing early would allow him time to prepare a reorganization plan before financial distress becomes unmanageable. Discharging remaining debts, upon the confirmation of a reorganization plan is one of the conditions necessary to give honest debtors a fresh start. When discharge is readily available to the debtor, he has little reason to fear the legal consequences of a bankruptcy. Accordingly, he will not be motivated to delay his adjudication or prolong the administration of his bankruptcy estate. Upon filing for reorganization, no creditor should be allowed to seize or sell any of the firm's assets during the process for at least some initial period. An automatic stay on creditors' claims will increase the debtors' chance to prepare a sensible reorganization plan.

Regarding creditors, it is important that insolvency systems in MENA incorporate and enforce strict time limits on drafting, voting, and confirming reorganization plans. Time-limited reorganization period provides an incentive for the debtor to file a

[11] Some MENA countries have made it easier to process insolvency cases by creating specialized commercial courts or even bankruptcy courts. Judges can gain expertise in bankruptcy and be better equipped to deal with issues of insolvent businesses.

[12] France introduced an "early-warning" mechanism designed to notify the courts and business support associations that a business is facing financial difficulties and is at risk for insolvency, in an attempt to prevent bankruptcy altogether through negotiation and /or mediation (by a court-appointed mediator) between the debtor business and creditors.

[13] Although the concept of reorganization exists under the current legislation in some MENA countries, it is reportedly applied in only 1–2 per cent of the cases, thus preventing viable enterprises from the possibility to survive in situations of distress.

[14] Providing a simplified reorganization procedure for businesses with fewer than 50 employees and annual revenues below a specified total might be useful in MENA countries, particularly for smaller, family owned businesses.

plan within the exclusive period and also helps avoid excessive delay in the case.

The systems should also prevent a dissenting minority of creditors from delaying sensible reorganization plans, and allow the annulment of unfair transfers made prior to the debtors' payment cessation, thereby enabling the debtor to negotiate a reasonable arrangement.

With respect to trustees, they should be competent, impartial, and insured or bonded against loss due to fraud or other malpractice. Appropriate rewards and penalties should be established and enforced in order to ensure the integrity of the trustees. Their remuneration is crucial to creating the appropriate incentives to motivate them to maximize the value of recovered assets and satisfy creditors' claims. Trustees must be held accountable for their actions and be subject to maintaining professional standards of quality, by officially registering them with a professional organization.

Effective enforcement of insolvency systems in MENA countries requires getting the debtor and his creditors more involved in the reorganization process through direct negotiations between them,[15] keeping the level of involvement by courts and trustees at a minimum, and providing incentives (e.g., less penalties, easier settlement) for debtors who are aware that they can no longer pay their debts as a way of encouraging early action.

To conclude, MENA countries need a clear and predictable market exit policy in order to improve productivity; promote investment and credit flows; and protect the rights of various stakeholders, particularly workers and minority shareholders. Sound and efficient insolvency frameworks will assist MENA countries in the process of adjusting to external and domestic shocks.

More efficient insolvency systems that are effectively enforced should provide appropriate incentives for debtors, creditors and insolvency trustees to reorganize potentially viable firms, thereby preventing their premature liquidation.

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[15] Some MENA countries (e.g., Egypt and Morocco) are currently developing a mediation procedure to bring creditors and debtors together for reconciliation.

Chapter 6

Dubai International Financial Centre (DIFC)

Legal Framework for Creditor Rights

The Dubai International Financial Centre (the DIFC) is a financial free zone in the UAE and is one of the only free zones in the UAE to date that has the power to create its own legal and regulatory framework for all civil and commercial matters. Accordingly, the DIFC has its own set of laws governing insolvency. In addition, the DIFC has established its own court system. The DIFC legal regime does not extend to outside the DIFC free zone area.

As with many other countries in the region, the availability of credit is closely connected to the security available. Significantly, security can be taken to secure future obligations and there are no restrictions on foreign owned entities as grantors or beneficiaries of security interests. Although there are effective and transparent methods of collecting debts, these are not regarded as particularly cost efficient.

It is possible to grant security over a wide range of movable and immovable assets although the Law of Security appears to exclude intellectual property for collateral purposes. Although retention of title is available, it is not widely used in Dubai.

Security interests over movables are registered with the Registrar of Securities at the Office of the DIFC under the provisions of the Law of Securities. Registration is regarded as quick and simple but expensive. Searching the register is also regarded as reliable but expensive.

It is possible to own and freely transfer ownership interests in land and land use rights[16]. Real property is registered at the DIFC Real Property Registry at the Office of the DIFC.

Enforcement of security rights over both movables and immovable is only by judicial means. Enforcement can take up to one year and is regarded as a cost-effective process. While in theory a debtor could obstruct enforcement processes, this does not tend to be the case in practice.

Risk Management and Corporate Workouts

The economic environment encourages consensual arrangements to resolve liquidity problems. Debt-for-equity swaps are not excluded by DIFC Law but are subject to DFSA oversight. Debt trading is relatively commonplace and there are no adverse tax consequences to debt forgiveness.

Rules of arbitration that are based on the LICA model are in the process of enactment and where informal procedures fail, it is relatively simple to convert to a formal insolvency process.

The Companies Law provides for the personal liability of directors for continuing to trade whilst insolvent but in practice directors rely on insurance cover for such matters. The insolvency law referred to below introduced the concept of wrongful trading whereby a director who knew or ought to have known that there was no reasonable prospect of the company avoiding going into insolvent liquidation may be ordered by the court to compensate the creditors[17].

There are no reliable credit information systems available to the business community in Dubai.

[16] Real Property Law DIFC No 4 of 2007
[17] Article 79

Legal Framework for Insolvency

Insolvency law objectives are straightforward and generally in accordance with leading international practice. Indeed, Dubai has one of the most developed insolvency laws in the region[18]. The insolvency system is regarded as cost-effective, efficient and timely and balances the interests of the debtor and creditors.

The law applies to all companies and limited liability partnerships in the jurisdiction of the Dubai International Financial Centre. There are specific provisions[19]which make the application of the insolvency law subject to other laws, rules and regulations which provide for the orderly winding up of companies that are licensed as authorised firms or as authorised market institutions.

Under the law, interested parties receive appropriate notice and while the system offers liquidation and reorganisation procedures, reorganisation is not widely used, as referred to further below.

The company is deemed to be unable to pay its debts if a written demand from a creditor exceeding $2000 has remained unpaid for three weeks; if an execution or other process is returned unsatisfied or it is proved to the court that the company is unable to pay its debts as they fall due. Alternatively, a debtor company is also deemed to be insolvent if the court finds that the value of the company's current assets is less than the amount of its current liabilities taking into account contingent and prospective liabilities. In practice, it is not easy for a recalcitrant debtor to obstruct the commencement of insolvency proceedings. The court may also grant provisional relief to protect the estate.

It is equally straightforward for the directors of an insolvent company to commence winding up by an application to the court. Whether it is a creditor or the directors of the debtor who makes the application, the commencement of proceedings immediately prohibits any unauthorised subsequent disposition of the debtor's estate. The estate does not, for these purposes, however, extend to secured creditors whose rights are unfettered by the commencement of winding up.

On the commencement of insolvency proceedings a court-appointed administrator assumes full responsibility for the debtor's estate.

There are specific provisions requiring the liquidator to convene meetings of creditors; to hold annual creditors meetings and to furnish creditors with such information as they reasonably request. The creditors' assembly has the power to resolve to change the liquidator.

There are adequate provisions for the collection and protection of the debtor's assets and the law does not restrict the manner in which these may be sold for the benefit of the creditors. There are extensive provisions that apply in all insolvency processes obliging a wide range of parties to co-operate with the office holder in getting in the company's assets[20].

There are no provisions for encumbered assets to be sold free of security interests without the consent of the secured creditors in liquidation proceedings.

If it is considered to be in the creditors' interest, the liquidator may operate the debtors business; the liquidator may terminate onerous contracts and choose which uncompleted contractual obligations shall be completed.

Under Part 5 of the law, the court has the power to set aside certain transactions that are contrary to the creditors' interests and in this connection, it provides for lesser criteria where the other party is connected to the debtor.

Dubai insolvency law also includes provisions for receivers and administrative receivers[21]. The powers of the receiver are determined by the instrument under which he is appointed and, in addition, the law gives receivers the ability to apply to court for directions in connection with any matter.

Where a receiver is appointed over all or substantially all of the undertaking of a company, that receiver is an administrative receiver: an administrative receiver has additional powers set out in the law[22]. A person dealing with an administrative receiver in good faith and for value need not enquire whether the administrative receiver is acting within his powers[23]. Unlike a liquidator, an administrative receiver can sell charged assets free of any security interest with the permission of the court.

An administrative receiver is obliged to report to all creditors within three months of his appointment on the background to the appointment, the disposal

[18] Insolvency Law DIFC Law no. 7 of 2004
[19] Article 101
[20] Article 95
[21] Part three of the Insolvency Law
[22] Schedule 2
[23] Article 17

of the assets and the amount likely to be available for payment to creditors.

Cross-Border Recognition and Insolvency

Where a foreign company is subject to insolvency proceedings in its jurisdiction of incorporation, the Dubai court shall assist the foreign court in gathering and remitting any assets maintained within the DIFC upon receipt of a formal request from a court of the foreign jurisdiction[24].

It is also possible for a foreign company that is registered as a Recognized Company to be wound up under the insolvency law of Dubai by the court as though it were a Dubai company even where that company is the subject of insolvency proceedings in its home jurisdiction.

Reorganisation Proceedings

The law provides for such proceedings but they are not widely used in practice. A critical limitation on the usefulness of the procedure is that the creditors cannot bind the preferential or secured creditors to any reduction in their rights. Furthermore, the law does not require that a decision regarding a proposed reorganisation is reached within any specific time; it does not provide for any independent analysis of the proposed plan and it does not require that the anticipated return to creditors will be equal to that that they would obtain in liquidation.

The procedure is the company voluntary arrangement, under which the directors appoint a nominee who must be a registered insolvency practitioner. The nominee summons meetings of the shareholders and creditors to consider any proposal and those meetings decide whether to approve the proposed voluntary arrangement with or without any modification. The provisions for creditor voting are rather vague. Nevertheless a dissenting creditor has the right to appeal against a reorganisation plan and the court must approve any amendments to the plan.

After the approval of the voluntary arrangement, the nominee is known as the supervisor who, in addition to the powers given to him under the voluntary arrangement, may apply to the court for directions or for the winding up of the company or for a receivership order.

Implementation of the Insolvency System

According to shareholders, the courts of Dubai are independent and free of political and cultural interference. All insolvency matters are assigned to a judge with specialised insolvency knowledge and in practice, the courts are freely accessible by all parties without undue delay or bureaucracy.

In addition, shareholders consider that court decisions freely reported and written judgments are generally provided in disputed cases.

Insolvency practitioners are required to be qualified and licensed and are regulated by the state[25]. Registration of an insolvency practitioner as an official liquidator obliges that insolvency practitioner to accept any appointment made by the Dubai court. It is intended that the authorities will provide effective technical standards and ethical guidance. The Board of Directors of the DIFCA makes the Regulations,[26] including the requirements which need to be met before an application for registration as an official liquidator can be granted by the Registrar. The Registrar has absolute discretion in the granting of registration. The Registrar who is charged with supervision of insolvency practitioners has authority to make a wide range of supervisory orders: the Registrar also publishes a register of those insolvency practitioners who are registered as official liquidators.

Applicable Legislation

DIFC Companies Law No 3 of 2006
Insolvency Law No 7 of 2004
Real Property Law DIFC No 4 of 2007
The Law of Security, DIFC law No 8 of 2005

[24] Article 82
[25] Insolvency Law Part 9
[26] Article 89

Chapter 7

Egypt

Legal Framework for Creditor Rights

Credit is available in Egypt although there is a high dependency on the security that is available from borrowers. Both possessory and non-possessory security rights can be taken over movable and immovable assets, providing the borrower has ownership of the underlying assets.

Security over inventory and investments are the common forms of security over movables and asset-based lending including factoring and invoice discounting is widely used by lenders. Both retention of title and transfer of title are used to protect suppliers and lenders and caution must be exercised as regards the effective registration of such of such security interests. The correct location of registration of security interests is determined by the geographical location of the assets within Egypt.It is regarded as being relatively quick and simple to register security interests over movables. However, it is costly. It is relatively easy to search such registrations although there are reservations as to whether the registries are likely to be up to date.

As regards real estate, it is possible to own and freely transfer ownership interests in land and land use rights and to grant security interests over such assets. There are clearly defined rules for taking and registering such security interests. The process for registering such security requires the details to be registered at a public notary.

Registration of security interests in real estate is regarded as being expensive although relatively quick and simple and capable of being searched effectively.

There are relatively efficient and reliable judicial and non-judicial methods of enforcing security interests over both movable and immovable assets although in practice, problems are encountered with some of the provisions imposed by the Central Bank of Egypt on the enforcement of security. It is commonplace for the debtor to seek to obstruct enforcement processes.

Risk Management and Corporate Workouts

There are workable credit information systems covering the Egyptian business community. These include safeguards to ensure the accuracy of the data provided including the ability of subjects of information to obtain access to information held about them by the security bureaus.

All business enterprises are required to file regular audited financial statements. There are circumstances under which a director or manager may be liable for the debts of limited liability company although it is unlikely that this liability can be extended to include third parties.

The economic and business environment encourages consensual arrangements to resolve liquidity problems although there is no particular cultural issue that influences such arrangements. Most informal or out-of-court restructuring takes the form of simple debt rescheduling or a straightforward debt settlement with the client. It is possible to convert an informal procedure into a formal insolvency process quickly and simply although, as stated below, the formal insolvency processes in Egypt are limited.

Debt-for-equity swaps are permitted by law and are commonplace. Debt trading is permitted but not commonplace. There are significant tax consequences for debt forgiveness in Egypt, which should be borne in mind by both parties.

The Legal Framework for Insolvency

Both debtors and creditors regularly use the formal insolvency system but the general view is that the insolvency system does not work in a cost effective, efficient or timely manner.

While the insolvency system prevents individual creditors from gaining an unfair advantage, the system may not always work as well as it should.

The insolvency law applies to all corporate entities but not to state owned entities, which are the subject of special legislative provisions. All insolvency matters are dealt with by the Economic courts, which have developed some experience of handling insolvency matters. However, insolvency is not adequately defined in the law and recalcitrant debtors can easily disrupt proceedings by disputing the need for insolvency proceedings. The court is able to grant provisional relief to protect the estate.

On the other hand, a debtor can commence either insolvency or reorganisation proceedings simply and without delay.

On the commencement of insolvency proceedings, an insolvency practitioner is appointed with full management authority. However, it would appear that no insolvency administrator is appointed in the case of reorganisation proceedings.

There are specific provisions relating to the obligations of directors and third parties to deliver up assets and to generally co-operate with the liquidator but these are regarded as deficient.

The commencement of insolvency proceedings prohibits the unauthorised disposition of any assets in the debtors estate including restricting the rights of secured creditors to dispose of assets that are the subject of security interests in order to permit the liquidator to attempt to sell the entire business as a going concern. A secured creditor can appeal against this delay in the event that the secured creditor's position does not appear to be adequately protected against loss.

The law does provide for the timely and proper notice to interested parties of matters that concern that their rights. The powers of the general creditors' assembly are clearly defined and a creditors' committee is appointed in many cases. The creditors' committee has defined powers, membership and voting rights and these powers include the ability to change and appoint a liquidator. The law treats foreign and domestic creditors equally.

Cross-Border Recognition and Insolvency

There is no specific legislation that would assist a foreign administrator to gain access to or recognition by an Egyptian court. Nevertheless, in practice, a foreign administrator would be permitted to participate in local proceedings providing he can satisfy the Egyptian court as to his appointment. This would involve having details of his appointment from the appointing court notarised and translated into Arabic.

Reorganisation Proceedings

The debtor's business can continue to operate under the Courts control following the commencement of reorganisation proceedings. As stated above, there is no provision for the appointment of an insolvency practitioner in reorganisation proceedings. In practice, it is possible for finance to be raised to support the ongoing needs of a business attempting a reorganisation.

While at the law appears to require that a decision regarding the proposed reorganisation be reached within a specified time, that time limit is unclear. It is similarly unclear who is responsible for the preparation of a proposed plan of reorganisation; what percentage of creditors is required to approve a plan or the role of the court in the final approval of a plan.

Implementation of the Insolvency System

The constitutional system guarantees the independence of the judiciary. The courts are freely accessible by all parties without undue delay or bureaucracy.

Recently, judges have been receiving appropriate training and guidance on insolvency matters.

According to users, judges are able to give fully reasoned written judgments on disputed cases

without any overt interference. However the court process is not regarded as prompt or timely and court decisions are not predictable.

There are minimal provisions for the supervision and regulation of insolvency practitioners and they are not regarded as effective. There are no examinations for the role of insolvency practitioners but they are required to be registered at court.

Applicable Legislation

Mortgage Finance Law No1 of 2001 – as amended
Regulation of Guarantee and Subsidy of Real Estate Fund Activities, Presidential Decree No. 4 of 2003
Executive Statutes of Real Estate Finance Law, Law 148 of 2001
Commercial Law No. 17/1999
Civil Law No. 13/1968
Company Law No. 159/1981

Chapter 8

Jordan

Legal Framework for Creditor Rights

The Jordanian system offers broad access to credit at affordable rates. Collateral is expected in most loans and indeed it is unusual to have lending that is not collateralized. In practice, even personal loans tend to be secured by real estate or charges over the borrower's monthly salary.

There are no restrictions on foreigners as guarantors or beneficiaries of security interests.

There are a number of means by which creditors can enforce their rights against debtors including direct recourse to the enforcement authority; to the court to obtain judgment and enforcement; to the competent authority[27]; in the case of a trust mortgage; by recourse to mediation[28]; or the arbitration law[29].

The most common form of security over movable assets is in respect of motor vehicles. Such securities are required to be registered at the relevant competent authority[30], which, in the case of a motor vehicle, is the Lien Registry at the Traffic Department.

There are no centralized registration offices for moveable assets serving the whole of the country. However, in practice, it is quick and inexpensive to register security interests over such assets in Jordan.

All liens on all real estate are registered at the Real Estate Registration Department. The registration process relating to real estate is more costly and time-consuming than that relating to movable assets but searching is simple and inexpensive via a centralized computer registration at the central department responsible for registering charges over real estate. It is essential to note that the effect of non-registration of a registerable interest would have the effect of registering the lien null and void.

Enforcement of an authenticated trust mortgage takes place with the assistance of the Jordanian Department for Land and Survey which issues the final notice to the debtor and subsequently proceeds to realize the asset.

Court enforcement of security interests can be lengthy and costly and it is very common for the debtor to engage in delaying practices and to file spurious objections to court enforcement proceedings in the hope of enforcing a beneficial settlement with creditors. As a result, out of court security enforcement is generally preferred. Again, it should be noted that the law[31] provides that the effect of non-registration of security in respect of real estate, provides that any enforcement action taken shall be null and void.

There is limited provision in the company's law imposing liability on a director or manager of a company once the company's losses exceed 50% of the capital and in the event that the company is eventually wound up. In such cases, the director or manager shall call the General Assembly of the company for an extraordinary meeting. The circumstances in which a director may be liable appear to be limited and there are proposals to enhance the law in this regard.

[27] Law Number 46/1953
[28] Mediation Law Number 12/2006
[29] Arbitration Law Number 31/2001
[30] Jordanian Civil Law Number 43/1976
[31] Law Number 46/1953

Out-of-court restructuring does not appear to be widely used for companies in financial distress although there is specific provision in the Insurance Law[32] aimed at fostering the restructuring of insurance companies. The directors of the Jordanian Insurance Authority, on the recommendation of its Director General, may discharge any insurance company's board of directors in certain circumstances in order to take steps to avoid the liquidation of an insurance company.

Legal Framework for Insolvency

There is no Jordanian bankruptcy law although limited provisions for the liquidation of companies may be found in the Jordanian companies' legislation.[33] However, specific provisions in certain legislation deal with bankruptcy, for example, the Insurance Regulatory Act and the Jordan Deposit Insurance Corporation Act.

A company may be wound up either voluntarily by a decision of an extraordinary general meeting of its members or compulsorily by virtue of a court decision on the petition of a creditor or the debtor.

In the case of compulsory liquidation, the liquidation is deemed to have commenced at the date of submitting the pleadings thereof. Incomplete attachments of assets are unenforceable from the commencement of liquidation proceedings as are executions where the proceeds have not been passed to the execution creditor.

Transactions subsequent to the making of the winding up order and transactions to charge or transfer away assets or to prefer creditors during the three months prior to the making of the liquidation decision are deemed null and void unless it can be proved that the company is capable of settling all its debts after finalizing the liquidation, that is, that the company is not insolvent at the time of or as a result of the transaction.

The court may appoint a liquidator prior to issuing the liquidation decision. The liquidator may be obliged to submit a guarantee to the court appointing him. Once appointed, the liquidator has all the powers of management, the ability to collect its assets, employ lawyers and commence legal proceedings on behalf of the company. The law provides specifically that the liquidator may sell the assets of a public shareholding company that is being wound up if the court is satisfied that the sale is in the company's interests, although there is no guidance as to how this is to be determined.

Guarantee contracts are not avoided to the extent to which new money is paid to the company.

Within 30 days of issuing the liquidation decision, creditors must be given notice of the need to submit their claims to the company whether or not the claims are due for payment at that stage. The claim must be filed within two months if they are residents of Jordan or three months if they reside abroad. The liquidator or court may extend this period for a maximum of a further three months in appropriate circumstances.

The order of payment of creditors is as follows:

1. Liquidator's expenses including the liquidator's remuneration;
2. Amounts due to company employees;
3. Amounts due to the public treasury and municipalities;
4. Rents due to owners of real estate;
5. Other debts.

The Liquidator is obliged to report to the Controller of Companies in the event that the liquidation procedure lasts more than one year. Under no circumstances may liquidation proceedings exceed three years except with the permission of the Controller in a voluntary liquidation or by the Court in a compulsory liquidation procedure.

Reorganization Proceedings

Creditors with claims amounting to 75% of the debts due by the company excluding secured indebtedness may bind the creditors to a plan, although the law does not indicate any essential characteristics that such a plan is required to have or any safeguards for creditors.

With this exception, there do not appear to be any specific provisions in the companies' legislation for the reorganization of companies in Jordan. There is provision in the law relating to insurance companies[34], for the restructuring of insurance companies. Such a restructuring requires the approval

[32] Insurance Regulatory Act, Number 33/1999
[33] Company's Law Number 22/1997
[34] Insurance Regulatory Act, Number 33/1999

of creditors representing 75% of the non-secured and non-preferential creditors and the restructuring must take place within a maximum of one year.

Cross-Border Recognition and Insolvency

There do not appear to be any provisions in Jordanian law for the recognition of insolvency proceedings commenced in another jurisdiction.

Implementation of the Insolvency System

Judges are guaranteed independence by the constitution[35]. There is no specialist bankruptcy court—the regular civil court hears insolvency matters[36].

In practice, according to users, the courts tend to be free of influence. Courts are regarded as accessible and transparent with court decisions being freely reported and written judgments being provided in accordance with the law[37].

Alternative dispute resolution between parties is encouraged by Mediation Law number 12/2006 and Arbitration Law number 31/2001. The Amman Court currently has both mediation and arbitration circuits.

On the issue of a final uncontested judgment, the creditor can seek the assistance of the enforcement department affiliated to the court to enforce the judgment under the Enforcement Law.

Insolvency practitioners are not required to be qualified or licensed and are not the subject of any regulatory or supervisory control except that of the judge handling the case.

Applicable Legislation

Arbitration Law Number 31/2001
Commerce Law Number 12/1966
Companies Law Number 22/1997
Enforcement Law Number 25/2007
Higher Court Of Justice and Law Number 12/1992
Insurance Regulatory Act Number 33/1999
Jordanian Civil Law Number 43/1976
Judicial Independence Law Number 15/2001
Law Number 46/1953
Law Number 46/1953 and the Use of Immovable Property as the Loan Collateral
Mediation Law Number 12/2006 on the Settlement of Civil Disputes
Regular (Civil) Court Regulation and Law Number 17/2001
The Constitution of Jordan 1952

[35] Constitution of Jordan 1952 and the Judicial Independence Law number 15/2001
[36] Under Regulation Law number 17/2001
[37] Civil Court Law number 24/1988

Chapter 9

Kuwait

Legal Framework for Creditor Rights

The system provides broad access to credit at affordable rates. The most common security interest under Kuwaiti Law is the mortgage. These tend to be in the nature of either a possessory mortgage or a mortgage of business premises[38].

Except in limited circumstances, only Kuwaiti individuals or entities may own land in Kuwait. Foreign entities may act as a grantor or beneficiaries of security interests over shares. Except in limited circumstances, foreign owned entities may not own in excess of 49% of a Kuwaiti company.

The only types of mortgage over movable assets in Kuwait are the possessory mortgage or lien and the "premises mortgage"[39]. In addition to tangible assets, a possessory lien may be over intangible assets such as contract rights, receivables, equities and other financial instruments. There are specific requirements relating to the mortgages of rights that are established in documents to be used as security. A possessory mortgage does not need to be registered but the mortgagee must take possession of the movables or documentary evidence. Asset-based lending and retention of title is not widely used in Kuwait.

A 'premises mortgage' is in the nature of a floating charge made by way of mortgage deed between the creditor and the debtor and registered in the Commercial Register of the Ministry of Commerce and Industry (MOCI). The mortgage deed must include a detailed description of the property covered by the premises mortgage, failing which the mortgage will only cover the trade name, the right to the lease and the goodwill of the debtor. A registration of a premises mortgage is valid for five years and may be renewed. The premises mortgage is registered at the Commercial Register of the MOCI but there is no central computerised registry capable of being searched.

There are transparent and reliable means of satisfying creditors' rights by way of judicial process as determined by the Civil Code and the Procedure Law[40]. Any agreement between the parties to a mortgage that invests the beneficiary with the right to acquire or sell the mortgaged article without going through the required enforcement procedure through the court is null and void. After maturity of the debt, the parties can agree that the creditor can take the mortgaged article in satisfaction of the debt with the permission of the judge.

Mortgages over real estate are common in Kuwait and governed by the Law of Real Estate Registration[41]. There are clearly defined rules for the granting of such security and its registration. The registration of a mortgage over real estate requires the parties to appear before a notary public employed by the Authentication Department of the Court. The notarization requires the notary public to satisfy himself regarding the agreement in all its aspects. The original deed of title must be produced as part of the process and the mortgage entered in

[38] Kuwait Civil Code, Article 1027–1060; The Commercial Law Articles 40 & 224; Law Number 5/1959 On Real Estate Registration

[39] Defined By The Commercial Law Articles 40–46

[40] Procedure Law Number 38/1980

[41] Law Number 55 of 1959 on Real Estate Registration and Civil Code Articles 97–83

the public records in the Land Registry. This process is intended to expedite any eventual enforcement of relevant rights.

Mortgages and other security interests in land are recorded in accordance with their ranking. Registration is prompt and at a nominal cost. Any searches can be relied on as being up to date.

In the case of a notarized mortgage, the Notary Public may stamp the document in question as "self executing" if the parties so agree. This requires the borrower to commence action against the mortgagee to prevent the mortgagee from enforcing the security, failing which the lender has a right to execute the mortgage.

Enforcement may only be effected by judicial means. Enforcement of the security interest in land by a foreign beneficiary would be facilitated through the auction of the land.

There is a clear process by which the secured party proves to the court the non-payment of the obligation and there is a short timescale for compliance. While Kuwaiti law provides for an expedited process for enforcement proceedings, obtaining enforcement procedures are typically subject to delays by the debtor challenging the court process and the auction considerations.

If uncontested, the enforcement process can take approximately one year and if contested, up to four years. It should be noted that private dwelling houses of Kuwaiti debtors and their families may not be the subject of attachment providing that the residence was occupied prior to the debt arising[42].

Risk Management and Corporate Workouts

There is a reliable credit information system, CINET Network, which is used by lenders and banks to share information although this bureau is restricted to network subscribers.

Although there is no specific law relating to the data protection, there are penalties under the Civil Code for wrongdoing that causes harm to another person.

There are limited provisions in the Companies Act relating to the liability of directors or managers but these are restricted to fraud and mismanagement.

The business environment encourages consensual arrangements to resolve liquidity problems, typically through negotiation between the parties.

The Legal Framework for Insolvency

The insolvency law applies to all entities apart from state-owned entities. The insolvency system related to legal entities is set out in the commercial law[43]. In practice, insolvency proceedings are generally protracted, of a litigious nature and may take some while to finalise where proceedings are contested.

Bankruptcy proceedings may be commenced on the petition of the debtor, a creditor or the Public Prosecutor. The test of insolvency is unclear. A debtor whose business has been disrupted or who suspends payment of commercial debts may be made bankrupt but the debtor is entitled to dispute the finding of an insolvent status. On the other hand, it is relatively simple for the debtor to commence proceedings[44].

All insolvency proceedings are initiated in the Al Kulliyah court in Kuwait. On opening the proceedings, the court will fix a provisional date on which the suspension of payment of debts has been presumed to have occurred. In the absence of evidence to the contrary, this will be the date of adjudication of bankruptcy but it may be backdated by the court for up to two years before the date of adjudication of insolvency. The period of suspension of payments determines the period during which transactions may be avoided by the court on the basis that they were contrary to the interests of creditors.

An adjudication of bankruptcy or suspension of payments is advertised in the Commercial Registration of the company. The appointed bankruptcy manager advertises the proceedings and communicates with creditors. The list of creditors' claims must be filed with the court within 60 days of the adjudication of bankruptcy.

After the commencement of proceedings, creditors are precluded from taking individual action against the debtor's assets but secured creditors and creditors holding specific priority rights may initiate or proceed with actions against the property securing their rights[45].

The creditors have considerable rights in Kuwaiti insolvencies. Creditors' committees are

[42] The Procedures Law
[43] Commercial Law Number 68/1980
[44] Commercial Law Article 560
[45] Commercial Law Article 597

appointed in all cases and the creditors may appoint a Controller to oversee the activities of the bankruptcy manager and the administration of the bankrupt estate. The creditors' committee may request information from the bankruptcy manager and the creditors may resolve to change the bankruptcy manager in limited circumstances such as the failure of a composition proposal. In such circumstances, a majority of 75% of the creditors with the approval of the judge may appoint a "Union Manager" to replace the bankruptcy manager with power to continue the debtor's business trading[46].

The business of the debtor may be continued under the Court's control where it is deemed to be in the interest of the debtors, creditors or the public. Before making such an order, the judge will consult the bankruptcy manager or the bankrupt and seek the opinion of the Controller.

In the event that the debtor's assets are to be sold, secured movable assets are sold by auction; real estate is sold in accordance with the Procedures Law and other assets are sold as determined by the judge.

There are provisions in the law that permit the office holder to terminate onerous contracts with the permission of the judge and to terminate lease agreements within 60 days from the adjudication.

Priority status is accorded to the cost of legal proceedings incurred in the sale of collateral, amounts due to the State Treasury and debts due to employees for wages and salaries due within the six months prior to insolvency[47]. The owner of real estate leased to a bankrupt also has a priority right in respect of the rents due in the two years that preceded the adjudication and the current year.

The process for unsecured creditors to lodge their claims is regarded as straightforward but it does require the creditors to communicate the claims to the bankruptcy manager promptly.

Kuwait has adopted measures for managing the insolvency of financial institutions in exceptional economic circumstances and situations of financial distress. First, Law No. 41 of 1993 was passed in the aftermath of the first Gulf War to provide an exception to the general insolvency regime, enabling the banking and financial sector to operate in special economic conditions. Secondly, in a recent development, Kuwait has responded to the financial crisis by passing Law No. 2 of 2009 on financial stability. The law allows a banking institution to request the Central Bank of Kuwait to take rapid measures to manage its insolvency or re-organization in circumstances of high financial distress.

Cross-Border Recognition and Insolvency

The law does not specifically provide any mechanism to the recognition of foreign insolvency proceedings but the Courts of Kuwait will recognize and enforce a final judgement issued by a court that offers reciprocal treatment to judgments issued by the Courts of Kuwait.

Reorganisation Proceedings

Reorganisation proceedings are not common in Kuwait. Nevertheless there is provision in the Commercial Law for the company to continue to manage its assets under the supervision of a court-appointed supervisor with the objective of a negotiated scheme of arrangement with creditors. The supervisor of the scheme is responsible for the preparation of the plan of reorganisation and there are requirements for specific information to be disclosed to creditors.

The approval of the scheme requires a majority of the creditors present or represented at the relevant meeting holding two thirds of the value of the debts after excluding the debts of the creditors who did not vote. Secured creditors may not vote except to the extent that part of their claim is unsecured. Following the voting, the court will approve or reject the scheme and such judgments are not subject to appeal[48].

Where the court approves the scheme, it will appoint one or more supervisors from the body of creditors to supervise the enforcement of the scheme and report on any violations. The creditors may approve amendments to the schemewith the approval of the court. On the failure of a scheme, liquidation is not automatic but will require an application by a creditor.

Implementation of the Insolvency System

According to users, the independence of the Kuwait judiciary is guaranteed by the Kuwaiti constitution

[46] Commercial Law Articles 716–720
[47] Civil Code
[48] Commercial Law Article 776–781

and the courts in Kuwait are regarded as freely accessible and free from influence. In practice, litigation proceedings in Kuwait are protracted: on an appeal, all proceedings start anew and the merits of the case are considered in full as if the case was being heard for the first time. The bankruptcy circuit of the Kuwaiti court deals with all insolvency matters.

While the judges give written judgments for disputed cases, only some court decisions of the Cassation Court, the highest court in Kuwait, and the Constitutional Court, are reported. While courts are not bound, precedents are usually followed.

Although there is reference to the profession of bankruptcy managers in the law, in practice there is no formal body that regulates or supervises insolvency practitioners in Kuwait. No formal qualification is necessary although in practice, most insolvency administrators are lawyers or accountants.

Applicable Legislation

Kuwait Civil Code of 1980
Kuwait Constitution
Law Number 5/1959 on Real Estate Registration
The Civil and Commercial Procedure Law Number 38 of 1980
The Commercial Law, Decree of Law No. 68 of 1980
The Companies Law Number 15 of 1960

Chapter 10

Lebanon

Legal Framework for Creditor Rights

According to users, credit constraints in Lebanon are moderate although banks expect collateral. There are no restrictions over the types of assets that can be pledged as security although asset based lending, transfer of title and retention of title are very seldom used in Lebanon.

There are restrictions on ownership of real estate by foreigners[49]. Real estate secured for the benefit of a foreigner has to be sold for the benefit of that person by public auction. If a foreign creditor claims ownership of real estate, it must be sold within two years.

Some security interests require to be registered although there is no central computerised registration of security interests over movable property with the exception of motor vehicles.

Security over real estate must be registered with the Real Estate Registration Secretary. Registration is free of charge and simple to effect. In practice, the search process is regarded as reliable.

Enforcement of security is by judicial process[50]. However, the court procedures are poor and the enforcement of security over movables and immovable is time-consuming and lengthy. It will normally take more than one year to enforce security and recalcitrant debtors can aggravate this.

It should be noted that, according to Lebanese laws, "civil" debtors (i.e. non-traders) cannot be made subject to insolvency proceedings. Such procedures are applicable only to traders, whether individuals or legal entities.

Risk Management and Corporate Workouts

There are private companies operating credit information bureaus some of which will guarantee the accuracy of the information that they are providing. There are no special legal provisions relating to these bureaus.

There does not appear to be a strong regime governing director liability for mismanagement.

There is no regime that encourages informal workout procedures although there is no tax disincentive for debt forgiveness.

Legal Framework for Insolvency

The Trade Law (Article 489 et seq) makes provision for creditors to pursue their claims through the courts although the law is clearly aimed more at unincorporated debtors than legal entities. In the text of the law, it is explained that the term "insolvency" equates to the French term "*faillite*" whereas bankruptcy connotes the French term "*banqueroute*". There is an obligation on the debtor to commence insolvency proceedings within 20 days of his suspending payments, failing which a bankruptcy offence will be committed.

If, in the course of civil commercial or penal proceedings, judges accidentally discover that a trader is in a state of insolvency, they may initiate insolvency proceedings as laid down in the trade law[51].

[49] Foreign Ownership Law
[50] Civil Trials Law Article 828
[51] Article 498

There are detailed rules relating to the bankruptcy of commercial companies and private companies with shares, which permit a creditor to file a bankruptcy application in the court. There would not appear to be any particular formality attached to such an application or any formal tests of insolvency: all material decisions are left to the discretion of the court.

On the making of the order commencing proceedings, the court will fix the date in which payments have been suspended. The effect of the date of suspension of payments is to determine the period during which transactions are "suspect". This date may be a maximum of 18 months prior to the order commencing proceedings.

On the making of a bankruptcy order, a bankruptcy receiver will be appointed by the court to take control over the assets under the supervision of a judge. Thereafter the management have no authority to deal in the company's assets. The commencement of insolvency proceedings has numerous social consequences for an individual debtor.

The supervising judge and the bankruptcy receiver may convene creditors' assemblies but there is no provision as to the appointment of creditors' committees.

There are detailed provisions for the avoidance of transactions contrary to the interests of creditors from the period of suspension of payments[52].

The court may appoint up to three receivers to manage the debtor's estate. In addition, the judge may appoint one or two Supervisors from amongst the creditors. It is the responsibility of the judge to work with the receivers to accelerate the management of the insolvency process and there are detailed provisions in the law to protect the debtor's assets, to provide for their sale and to manage the relationship with the insolvent debtor. This includes making an allowance to the debtor and his family out of the assets.

The law makes provision for a scheme of arrangement to be proposed in bankruptcy or, where this is not possible, for the replacement of receivers with others to represent the creditors "in the union". The legal provisions for this are extremely detailed but these receivers may continue the debtor's business or may sell the assets under the supervision of the court.

The court may close the insolvency proceedings if it appears that there are insufficient assets to cover the costs thereof. In addition, there are provisions for a summary procedure to be applied in cases with minimal liabilities or the prospect of a dividend of less than 10%.

Cases of simple bankruptcy shall be tried by the Courts of Misdemeanour Police and are punishable by imprisonment from one month to one year.

It should be noted that Lebanese law makes special provision for bank insolvencies under Law n°2/67 dated 9/11/1966 and Law n°110 dated 7/11/1991. These specialist provisions and procedures constitute a significant exception to general bankruptcy rules.

Cross-Border Recognition and Insolvency

According to Lebanese laws, the legal principle of "Procedure of Exequatur" has granted final foreign court decisions enforceability in Lebanon, so that Lebanese laws encourage cooperation with other jurisdictions' courts by giving enforceability to cross-border insolvency rulings.

Reorganisation Proceedings

The Trade Law[53] provides for a simple process of conciliation between the debtor and the creditors as a result of which a debtor may enter into "a scheme of arrangement in avoidance of bankruptcy". The debtor's books of account and details of the proposed plan must accompany an application.

On acceptance of the application, the court appoints a trustee to supervise the management, audit the liabilities of the company and report to the creditors at a meeting convened by the court a maximum of 30 days after the order initiating the proceedings.

It is required that the debtor shall offer at least 50% to unsecured creditors if payment is going to be within a year, 75% if maturity is within 18 months and 100% if payment is 3 years away. Although such credit provides an invaluable breathing space to a financially troubled debtor, these dividends are hard for most debtors to achieve.

The court communicates by registered letter or cable with each creditor and provides details of the

[52] Articles 507–511
[53] Book 5 Article 557 et seq

creditors' meeting and a summary of the debtor's proposals. During this time, creditors are precluded from enforcing their security or pursuing the debtor.

At least three days before the creditors' meeting, the trustee shall deposit a detailed report on the debtor's financial position. There is a requirement that the scheme be approved by all of the creditors voting who shall represent over two thirds of the total unsecured non-preferential liabilities of the debtor. Voting excludes preferential and secured creditors and any parties connected to the debtor. Authentication of the agreement by the Court renders it effective and binding on all creditors including those outside Lebanon. There are rights of appeal to the Court by any affected party and the court can overturn the conciliation agreement.

There are no provisions for the amendment of the conciliation agreement unless the debtor becomes solvent before the end of the duration of the plan, in which case all debts are payable.

On the failure of the scheme, the court will make a bankruptcy order against the debtor.

Implementation of the Insolvency System

The independence of judges is secured by the constitution. The Penalty Law provides penalties for interference with or bribery of judges.

There is a division of the court specialised in bankruptcy law and judges from this court supervise all bankruptcy proceeding. The law requires judges to justify their decisions although it is unclear whether judgments handed down are subsequently published.

Insolvency practitioners are not the subject of any regulation or supervision. Such supervision, as there is, is left to the judge in charge on each case and, although there are exceptions, most bankruptcy trustees are selected from among lawyers in the bankruptcy trustee role held by the Supreme Judicial Council. Most insolvency practitioners act with integrity and independence.

Lebanese law states that judgments rendered by Lebanese courts, with the exception of decisions relating to criminal proceedings, are of a public nature and must be promptly published. This is particularly true for bankruptcy rulings.

Applicable Legislation

Civil Trials Law legislative decree number 90 on 16-9-1983
Lebanon Constitution
Penalty Law 302 of 1994
Trade Law – Book 5
Code of Obligations and Contracts

Chapter 11

Oman

Legal Framework for Creditor Rights

The granting of credit in Oman depends largely on the ability to furnish adequate security. Possessory security is possible only over movable assets and non-possessory security is possible in respect of both movable and immovable assets.

The ability to take a security interest over a changing pool of assets such as a fluctuating bank account has not been tested by the courts of Oman although under the Oman Commercial Code, intellectual property including patents, trademarks and trade descriptions may be included in a commercial mortgage. Asset-based lending including factoring and invoice doubt discounting is widely used, as is retention of title.

It is possible to register a charge over the contents of a bank account held in Oman by registration of a commercial mortgage at the Ministry of Commerce and Industry (MOCI). If the deposit is a fixed term (non-fluctuating) deposit, the charge is effective by specific identification of the bank account in the commercial mortgage. It is also possible to take a security interest over Omani bank accounts by way of an assignment but such a charge would still need to be registered as a commercial mortgage. In addition, a pledge could be created over an account by means of an Instrument of pledge and physical delivery of the passbook.

There are different registries of the MOCI serving different regions and different security interests. Security interests are cheap and simple to register and the consequence of non-registration is that security is not enforceable.

Only Omani nationals and nationals of the Gulf Co-operation Council States are permitted to owned freehold land in Oman. Foreigners may not own land except in areas designated as "integrated tourism complexes". There are no restrictions on foreign owned entities as grantors or beneficiaries of security interests.

All interests in land are required to be registered on the Land Registry at the Ministry of Housing (MOH): the title deed issued by the Land Registry constitutes evidence of ownership and security interests may be granted over such property by a legal mortgage in Arabic or bilingual form. The execution and registration of the legal mortgage must be effected at the Land Registry office at the MOH in Muscat or the relevant branch of the MOH in the locality where the property is situated.

All enforcement of security interests may only be through judicial process. This will involve delays of between six and 18 months and the procedures are not regarded as cost-effective.

Risk Management and Corporate Workouts

There are no reliable credit information systems available in Oman.

The insolvency laws of Oman provide for directors and managers to be liable for continuing to trade after the company is insolvent. In limited circumstances, this liability can extend to third parties.

The business and economic environment encourages consensual resolution of liquidity problems and these are not regarded as being affected by Shari'ah or other cultural considerations.

Legal Framework for Insolvency

The Commercial Code contains rules and procedures governing the insolvency of merchants[54]. This includes all persons, corporate entities and branches of foreign companies engaged in commercial activity but, by implication, not non-traders or consumer debtors. Shari'ah law applies only in the absence of specific legislative provision[55].

There have been few bankruptcy orders as the courts have not been inclined towards making such orders unless all other avenues had been pursued and exhausted. In practice, bankruptcy proceedings frequently follow attempts at solvent winding up.

Bankruptcy proceedings may be commenced on the failure of a debtor to pay a debt of Omani Rials 10,000 or more on the petition of a creditor or the directors with the consent of the a general meeting of shareholders. A creditor's petition for a debtor to be declared bankrupt must be made to the court "by using the normal way". The application must be in the form of a report to the Secretariat of the court, including details of the debtor's assets and movables including their values and the names, domiciles and amounts of indebtedness of all of the debtors and creditors of the debtor's estate[56].

An application to commence insolvency proceedings by the debtor also requires extensive documentary submission to the court.

On the making of a bankruptcy order, the bankruptcy judge, also referred to as the Adjudicator, and a trustee are appointed to assume the management of the assets. Despite the commencement of insolvency proceedings, secured creditors are generally free to continue the separate enforcement of their security interests.

On the adjudication of bankruptcy, a group of creditors is established as a committee[57]. This group enjoys legal personality and is represented by the receiver. The Adjudicator judge shall appoint one or more Supervisors from this group to inspect the work and reports submitted by the trustee and to assist the Adjudicator in supervising the work of the bankruptcy trustee[58].

The assets are disposed of in a manner determined by the Adjudicator[59] and it is possible for the debtor's business to be continued under the Court's control.

The insolvency law makes provision for an insolvency proceeding to be concluded by a composition or scheme of arrangement with creditors where it is deemed by the court to be in the public interest or the interest of the debtor or the creditors[60].

Cross-Border Recognition and Insolvency

There is no provision in the insolvency law of Oman for the recognition of foreign insolvency proceedings or for co-operation with the courts of other jurisdictions.

Reorganisation Proceedings

Reorganisation proceedings are not widely used in Oman although as stated above, there are provisions for compositions or schemes of arrangement in the Commercial Code. The legislative provisions relating to the form of such a scheme are not detailed but there is a requirement for the plan to be prepared and proposed by the trustee in bankruptcy and for a full disclosure of the proposed plan to be made to the creditors.

Approval of a composition requires the consent of a majority of the creditors whose debts have been admitted for not less than two thirds of the total admitted debts (excluding secured claims)[61].

There is also provision for the court to ratify the creditors' approval and the court may, when doing this, appoint one or more supervisors to monitor the implementation of the composition or scheme of arrangement[62].

Implementation of the Insolvency System

The system guarantees the independence of the judiciary, which is regarded as being free from any external interference and influence.

All insolvency matters are overseen by an independent court and assigned to a judge with adequate

[54] Articles 18–19
[55] Article 5
[56] Article 583/4
[57] Article 615
[58] Article 651
[59] Article 662
[60] Article 661
[61] Articles 703 and 706
[62] Article 711

insolvency knowledge. The courts are governed by the Omani Civil and Commercial Procedure Code.

There is no requirement for judges to provide written judgments for disputed cases and court decisions are not regarded as predictable. The courts are required to consider public policy matters in addition to the law.

Insolvency practitioners are not subject to any supervision or regulation nor are there any requirements for them to be qualified.

Applicable Legislation

Civil and Commercial Procedure Code 29/2002
Commercial Code Royal Decree No.55 of 1990
The Commercial Companies Law No.4 of 1974, Amended

Chapter 12

Palestine

Legal framework for Creditor Rights

The system installed by the Palestinian Monetary Authority ensures access to credit at affordable rates[63].

There is a wide range of security possible over movable assets in Palestine. Jordanian Commercial law[64]is applied in Palestine to govern such matters. Both asset-based lending and retention of title are used in Palestine.

As regards security interests over moveable assets, only security relating to motor vehicles requires registration—this is at the Traffic Department. There is a registration office in every district and all offices are linked to one database. However, it is not easily searchable.

The Law of Security over Immovable Assets[65] governs security interests in real estate. Registration at the Land Registration Department is a relatively quick and simple. However, the Registry is not computerised and generally not up-to-date.

There are legal provisions for debt collection but in practice there are no specific courts to consider summary proceedings or competent commercial circuits in the Palestinian courts. There are few judges and court staff. Abuse of process and use of delaying tactics is widespread. Although the Law of Security over Movable Assets is regarded as providing relief for enforcement over moveable assets without the need to involve the court.

The enforcement of secured rights over real estate can be problematic and is commonplace for the debtor to seek to delay enforcement.

Risk Management and Corporate Workouts

There is no efficient credit information bureau in Palestine.

The Companies Law Number 12/1964 imposes an obligation on directors regarding mismanagement although this is generally not regarded as being of sufficient robustness to encourage good corporate governance.

While there is no specific encouragement for the use of out-of-court restructuring procedures, a variety of cultural and Shari'ah influences encourage parties to reach out-of-court settlements in a manner that balances the rights of the parties.

Legal Framework for Insolvency

The Commerce Law Number 12/1966 governs the insolvency system but it is not often used. The Court Judgment Journal governs debt related matters and attachment proceedings according to "Hanafi Fekh", a school of Islamic jurisprudence, as being the basis for the rules which constitute the civil law in Palestine. Such judgments are regarded as logical, streamlined and easy to enforce. As a result, the number of bankruptcy proceedings and claims in the regular courts are extremely limited, although those that do take place are generally regarded as being fair and unbiased.

[63] Law Number 2/1997
[64] Law Number 12/1966
[65] Law Number 46/1953

There are no formal tests of insolvency. On the commencement of bankruptcy proceedings, the Court designates the bankruptcy administrator. The commencement of proceedings acts to restrict creditors from further pursuit of the debtor's assets but it is unclear as to whether this extends to restrict the ability of a secured creditor to realise its collateral.

Once proceedings are commenced, there are provisions for creditors to meet and for the appointment of a creditors' committee. Among the duties of the creditors' committee is agreement of the claims against the debtor.

The delegated judge controls the sale of debtor's assets and determines whether such sale would be by amicable methods or by public auction by the government department undertaking such procedures. If the creditors so decide, the judge may permit the sale of any real estate that exists.

Cross-Border Recognition and Insolvency

There are no provisions in Palestinian law for the recognition of foreign insolvency proceedings or for co-operation with the courts of other jurisdictions.

Reorganisation Proceedings

There are no provisions in Palestinian law for the reorganisation of financially troubled debtors.

Applicable Legislation

Enforcement Law Number 23/2005
Monetary Authority Law Number 2/1997
The Arbitration Law Number 3/2000
The Code of Civil and Commercial Procedure Number 2/2001
The Code of Civil and Commercial Procedure Number 2/2001
The Commerce Law Number 1219/66
The Enforcement Law Number 23/2005
The Law of Evidence in Civil and Commercial Articles Number 4/2001
The Law of Security over Movable Assets Number 46/1953

Chapter 13

Qatar

Legal Framework for Creditor Rights

Qatar has relaxed rules on the amount of credit that can be assumed without security, providing repayments do not exceed 50% of gross income. Personal loans are normally secured by way of a guaranteed cheque signed by the borrower because the dishonouring of a cheque constitutes a criminal offence. For financial institutions supervised by the Qatar Central Bank, the loan-to-value ratio is used for determining upper limits on loans to individuals and entities as well as for real estate financing.

Asset base lending has not yet taken hold in Qatar. Retention of title is widely used but no registration is required or possible. As a result, the most common forms of security over assets other than real estate are assignments and negative pledges. In practice, it is difficult to borrow money on the security of any movable or immoveable assets other than real estate because the lien process by which other security is taken requires physical possession of the security. The exception is in respect of motor vehicles where a charge may be noted on the registration of the vehicle.

In practice, there are no public registers available for the registration of security interests over movable assets except for motor vehicles, which are registered at the Directorate of Public Security, Traffic Department, Minister of the Interior. There are no central registries of security interests with the exception of motor vehicles and ships[66].

Security interests over real estate are considerably easier to register. All mortgages must be in Arabic and the mortgage must be registered[67]. The priority of mortgages is determined by the date of registration at The Land Registration Department. With respect to residential mortgages, banks granting mortgages benefit from complete protection of their security under Qatar law. There are strictly enforced restrictions on the abilities of foreigners to own real estate.

Secured interests are enforced by judicial process: once judgment is obtained it is executed through the Execution Court of The Civil Courts of Qatar. This typically takes between three and 12 months in the case of charges over movables and three to six months for the enforcement of security over immovable assets. In Qatar, there has been little in the way of enforcement of securities in recent years. There is potentially an issue in relation to the enforcement of claims, which include interest although in practice, claims for interest are generally accepted in commercial transactions.

Risk Management and Corporate Workouts

The Qatar Central Bank has taken steps to strengthen the framework for corporate governance in the financial sector with a view to making its implementation more robust and effective.

While there is no reliable credit information available to the public in Qatar, banks subject to regulation by Qatar Central Bank have access to a blacklist of customers maintained by the Central Bank.

[66] The Maritime Law Number 50
[67] The Real Estate Registration Law 1964

Directors are jointly liable for fraud, misuse of power or breaching the provisions of the Commercial Companies Law. If the losses at the company reach 50% of the capital, the directors have an obligation to convene a shareholders' meeting to restore the capital of the company or to dissolve the company. This action must be taken within 30 days failing which the directors are jointly liable for the company's obligations resulting from their failure[68]. While corporate governance is improving in Qatar, the laws are not regarded as particularly strong in this regard.

There are no restrictions on debt trading, debt-to-equity conversions or out of court consensual arrangements although these are not commonplace. There are no tax impediments to debt forgiveness

There are restrictions on foreign ownership requiring 51% Qatari ownership of limited liability companies. Because the majority of companies are family businesses or sole trader establishments, there has been very little M&A activity. Financial institutions are generally prohibited from owning real estate although there is an exemption allowing banks to hold property for a limited period on enforcement of security.

QCB Law 33 of 2006 provides a legal framework for the protection of depositors, investors and creditors when actions by a financial institution are deemed to threaten their rights. The Qatar Central Bank is empowered to take appropriate measures to correct the behaviour and operation of the financial institution involved.

Similarly, under Chapter 13 of Law 33 of 2006, the Qatar Central Bank can place any financial institution under temporary management if there is a risk that it may go into insolvency, as defined by Article 88 of Law 33. However, temporary management is for a fixed period only, and its duration may be amended by the Qatar Banking Committee (established under Article 60 of Law 33 of 2006). Where the Qatar Central Bank places a financial institution in temporary management, the Central Bank may rank the priority of claims as well as take action with respect to replacing the board of the institution under temporary management.

The Legal Framework for Insolvency

There have been very few insolvency proceedings in Qatar—the general insolvency provisions were only promulgated in 2006 and there has been no judicial consideration of them so far.

The law provides for timely and proper notice to be given to creditors. The relevant court is the civil court of first instance and insolvency proceedings are filed in the civil court[69]. However, there are no procedures permitting creditors to commence insolvency proceedings. It is expected that the debtor will apply to court for the commencement of proceedings. On the commencement of proceedings, all enforcement actions against the debtor are stayed although the stay as it affects secured creditors is subject to the court's approval.

On the commencement of insolvency proceedings, the court will appoint an insolvency practitioner with full powers of management. There is also provision for the appointment of an interim administrator to protect the assets.

The law is quite non-specific in many regards and leaves matters such as the rules relating to the convening of meetings of shareholders and/or creditors to the company's articles of association. There is no provision for the appointment of creditors' committee.

There appears to be considerable flexibility in the means of disposal of the debtor's assets and encumbered assets are able to be sold free of security interests with the secured creditor's interest passing to the proceeds of sale. The commencement of proceedings does not act to terminate contracts automatically—the administrator has the right to determine which contracts shall be completed and to terminate onerous contracts.

There are provisions for the avoidance of preferences and transactions at an undervalue—the court may backdate the commencement of bankruptcy for up to two years. There are no special rules relating to transactions with connected parties.

The order of payment of creditors is as follows:

1. Employee benefits
2. Amounts due to the state of Qatar
3. Rent of real estate
4. Other amounts due

[68] Commercial Companies Law Number 5 of 2002
[69] Commercial Law 27/2006 Article 615

Cross-Border Recognition and Insolvency

There is no provision in the law for the clear and speedy recognition of foreign insolvency proceedings or for the cooperation with foreign courts although the courts of Qatar would be able to accept evidence of foreign proceedings in any proceedings brought before them. A foreign representative would need to make application to the court for the commencement of fresh proceedings.

Reorganisation Proceedings

Reorganisation proceedings are not often used in Qatar. It is probable that the court would treat any such proceedings in the same manner as an insolvency proceeding. There are no provisions enabling the majority of creditors to bind a dissenting minority although the court does have considerable power to approve a reorganisation plan that would have the effect of binding all creditors.

Implementation of the Insolvency System

According to users, the judiciary of Qatar is guaranteed independence by the first constitution passed in 2005 and judges are generally free from interference and influence. All proceedings must be in Arabic and all documents submitted before the court must be translated into Arabic.

There is no general reporting or publication of judicial decisions in Qatar and no reliance on precedent. However it is normal for written reasons for judicial decisions to be delivered to the parties within 14 days of the decision.

Court proceedings are generally uncontrolled with parties able to tender fresh arguments or evidence at any stage prior to the closing of the proceedings. It should be noted that in Qatar there is no concept of "without prejudice" correspondence and offers to settle on a "without prejudice basis" are often tendered to the court as admissions of liability.

The judges do not receive any training in insolvency matters and insolvency practitioners are not subject to any regulation or supervision.

Applicable Legislation

Civil and Commercial Procedure Code, Law No. 13 of 1990
Civil Code Law No. 16 of 1971
Commercial Companies Law No. 5 of 2002
Commercial Law 27 of 2006
Law 10 of 2003
Qatar Central Bank, Law Number 33 of 2006
Real Estate Registration Law 14 of 1964

Chapter 14

Saudi Arabia

Legal Framework for Creditor Rights

The system allows broad access to credit at affordable rates within the regulatory limits set by Saudi Arabian Monetary Authority (SAMA)[70]. While security is an important factor, a sound financial standing is more important.

It is possible to take security over movable assets in the forms of inventory, tangible movable assets and accounts receivable although security interests over inventory can only be granted to banks[71]. There is no provision for security to be taken over intangible assets such as intellectual property rights. Suppliers use retention of title and while it is a security interest it is not registerable. The market for asset-base lending is developing and title registration is a preferred form of security.

There are no restrictions on foreign entities as grantors or beneficiaries of security interests, but beneficiaries must appoint local security agents. A foreigner must be a resident in Saudi Arabia to be a guarantor or beneficiary of a security interest[72]. The grantor of collateral shall be the original owner of such collateral or the security shall be considered null and void[73].

There is no process for the registration of a security interest in movable property other than ships and aircraft.

Acquiring ownership of and transferring interests in real estate and land use rights are hampered by the nonexistence of a clear mortgage law. Security interests in nominal stocks and bearer stocks are evidenced by written documents confirming the details of the pledge registered in the records of the issuer of the stock and by physical possession of the stock respectively.

All security interests are registered with a notary public and with the government authorities. Authentication of the registration of a security interest takes place by virtue of a document number and date and searching is possible only within the registration district. In practice, the parties concerned cannot easily search for security interests and such security searches are not easy or necessarily reliable.

The enforcement of security interests in immovable property requires the secured creditor to apply to Diwan Al Mazalan (Board of Grievances) for an order for the sale of the secured asset. A selling order issued by the grievances department shall be effective after five days from the date of service.

The enforcement of secured rights over real estate involves the governmental authorities and the courts. Obtaining a court decision and achieving an effective sale tends to be a lengthy and costly process, possibly lasting several years. Furthermore one cannot evict a family residing in mortgaged house. It is commonplace for the debtor to endeavour to obstruct any enforcement process.

Risk Management and Corporate Workouts

A credit bureau exists in the shape of SIMAH. The work of this agency is the subject of legal controls

[70] The Bank Control System Article 6
[71] The Commercial Charge System Articles 8–9
[72] The Bank Control System Executive Regulations Article 2
[73] Commercial Charge System Article 4

although subjects of information cannot obtain access to information held about them.

The legal system imposing liabilities on directors and managers of companies that continue to trade while insolvent is still not yet developed. It is only in respect of publicly listed companies that corporate behaviour is improving[74].

There are legal provisions to encourage consensual arrangements to resolve liquidity problems but this law is not yet in use[75]. The principal method of informal or out-of-court restructuring relies on arbitration at the Chamber of Commerce. The only cultural consideration affecting the willingness of parties to reach an out-of-court settlement tends to be the interest element of liabilities. Debt for equity swaps and debt trading are developing.

In practice, most out-of-court restructuring takes the form of debt rescheduling on a bilateral basis. SAMA encourages debt rescheduling for companies with repayment credibility.

The system allows the *Zakat* payer to deduct bad debts resulting from selling previously licensed goods or services and uncollectible debts for tax purposes.[76]

Legal Framework for Insolvency

Neither debtors nor creditors use the formal insolvency system to resolve the problems of insolvent companies. The process is regarded as inefficient with investigation procedures differing from one district to another. There is a perception that there are significant loopholes in the procedures. While the insolvency system, as enforced by the court, is regarded as fair and unbiased in practice there is no accurate organised standardised mechanism to establish the assets of the debtor. The process is influenced by Shari'ah but mainly in connection with claims for interest and consequential loss claims for breach of contract. The local commercial practices tend to assist the debtor take advantage of the insolvency process and to prolong the duration of disputes.

If no property is found to enforce the security interest against a convicted party the party shall be referred to the court which will consider bankruptcy adjudication[77].

Insolvency processes apply to all business entities except for State Owned Enterprises[78]. It does not apply to non-traders including consumer debtors. To initiate insolvency proceedings, a creditor must apply to the Ministry of Commerce or the Diwan Al Mazalan Board of Grievances[79]. A debtor's application can only proceed with the consent of shareholders who must apply to the court[80].

There is no formal test of insolvency determined by the law: competent administrative bodies are required to investigate the estate of the debtor before considering a bankruptcy case[81]

The law requires the debtor to provide its financial records to the council with an account including details of all its assets and liabilities. On the commencement of liquidation proceedings, the court appoints an insolvency practitioner as trustee to take possession of the debtor's estate. The court may retain other experts such as valuers at the same time[82]. The insolvency practitioner can decide which contracts to complete and many assign contracts to third parties and terminate an onerous contracts.

The commencement of proceedings prohibits the unauthorised disposition of the debtor's estate-[83]and this precludes secured creditors from enforcing their security. However, the administrator may sell the secured asset and account to the secured creditor from the proceeds. In the case of loss of value of the security secured creditor can rank for dividend with the other unsecured creditors[84].

The estate comprises all of the debtor's assets and requires the directors and third parties to deliver up any assets but there are no effective sanctions against those who refuse to co-operate. The debtor's business may be continued under the control of the court. There are no provisions for funding to be obtained and in practice, this is dealt with by the shareholders advancing further funds against additional security.

The law provides for arrangements for settlement procedures in the interests of both the

[74] Corporate Governance Regulations issued by the Capital Market Authority Board
[75] Corporate System Article 168
[76] Zakat and Income System Article 14
[77] High Decree Number 4/B/14590
[78] Commercial Court System Article 1
[79] Commercial Court Law Article 108
[80] Commercial Court System Article 10 And 109
[81] Executive Regulations Of Shari'ah Pleading System Article 231
[82] Shari'ah Pleadings System Article 124
[83] Commercial Court System Article 109
[84] Commercial Court System Article 121

creditors and the debtor[85]. In such a case the trustee provides a detailed report of the arrangements to the court and is responsible for the execution of the deed of arrangement, which gives effect to the reorganisation[86].

The creditors elect two from themselves or their agents as the "creditors agents". The commercial court system clearly defines the authorities of the council trustee and the creditors agents in verifying the bankrupt liabilities, seeking repayment of debts and balances due to the estate, maintenance of records and obtaining information from the debtor[87]. Debtors who fail to co-operate maybe made the subject of court trial, arrest by the Trade Council or put under police surveillance.

There are no adequate provisions in the law or for the avoidance of transactions that are contrary to the interests of creditors although fraudulent transactions can be set aside.

All creditors are treated equally. The order of payment of claims is as follows:

1. Costs and expenses arising out of the liquidation
2. One month's wages to employees, housing and business rentals, servants and clerk's wages and wife's dowry
3. Other creditors

This payment does not include distribution of property belonging to third parties and held in trust or payment of secured creditors from the proceeds of sale of the secured assets.

Creditors are obliged to register their claims within 10 days from the bankruptcy adjudication date.

Cross-Border Recognition and Insolvency

There are no formal provisions for the recognition of foreign insolvency proceedings or for the co-operation with courts of other jurisdictions. However, foreign representatives have access to the Saudi courts and the recognition of foreign proceedings may be facilitated. In such a case, a court judgement is required to enforce a foreign judgment. The Grievances Department attends to such matters[88].

Saudi courts have jurisdiction over lawsuits filed against Saudi nationals and will consider proceedings against non-Saudi citizens[89].

Reorganisation Proceedings

There are no effective reorganisation proceedings available to debtors in Saudi Arabia. There is a little-used procedure for an arrangement in the avoidance of bankruptcy under which the Grievances Department appoints one of its members to oversee a settlement procedure and a Controller to handle related procedures[90].

Under such a procedure a committee of three members negotiate a settlement with the debtor. The regulations require that the head of the committee is aware of the Shari'ah code of law and that the settlement procedure shall be in line with the Shari'ah code.

Such an arrangement is to be approved by a majority of creditors representing two thirds of any liabilities of the debtor and in addition make provision for the payment of preferential creditors, maintenance orders and liabilities arising after the commencement of the proceedings. The new approval process is overseen by the court and requires no further court order. A judge oversees implementation of the plan and, if the debtor fails to keep to the plan, creditors can apply to the Grievances Department for the termination of the arrangements

Implementation of the Insolvency System

The Grievances Board deals with all insolvency matters: this is a court without specific specialist chambers or members. As a result, the judges do not have specialist insolvency training. In addition, the Shari'ah court acts as a general court.

Although the judges give reasoned written judgments in disputed cases, these are not reported but are restricted to the parties involved.

According to users, in practice the judges are reliably objective and impartial but they do not have security of tenure and there is an absence of clear rules that would prevent any suggestion of corruption or undue influence. It is accepted that there is a

[85] Arrangements In The Avoidance of Bankruptcy Articles 1–22
[86] Commercial Court System Article 125
[87] Commercial Court System Article 113
[88] Grievances System Department Articles 8 And 13
[89] Executive Regulations of the Shari'ah Pleading System
[90] Arrangements in Avoidance of Bankruptcy Articles 1–12

need for improvement in some of the court processes and a number of recent reforms have been effected.

There are no provisions for the qualification, regulation or supervision of insolvency practitioners.

Applicable Legislation

Corporate Governance Regulations Issued By The Capital Market Authority Board
Corporate System
The Bank Control System
The Bank Control System Executive Regulations
The Commercial Charge System
The Law of Procedure before the Shari'ah Courts Royal Decree No. 21 of 2000
The Law of the Judiciary Royal Decree No. M/64 of 1975

Chapter 15

United Arab Emirates

Legal Framework for Creditor Rights

The UAE is a federal state that is governed by federal laws. The insolvency regime in the UAE, including that of the Emirate of Dubai, is primarily governed by a distinct chapter on insolvency comprising 255 provisions under the UAE Commercial Transactions Law No.18 of 1993. It should be noted that there are number of free zones within the UAE to which the UAE Federal laws would apply to the extent they are not exempted (See earlier section on DIFC, a designated financial free zone).

The UAE legal system provides broad access to credit at affordable rates. Credit may be obtained on the security of both moveable and immovable assets but while security is important, the creditworthiness of the borrower and the commercial risks determine the availability of credit.

The UAE is familiar with a wide range of forms of security including charges, liens, blank transfers, pledges, assignments and commercial mortgages. Movables security needs to be either in the form of a commercial mortgage or a possessory lien. It is only possible to grant security interests over intangible movable assets, accounts receivable and intellectual property by means of a commercial mortgage of a business. Asset-based lending is fairly widely used, as is transfer of title and retention of title. Of these, only commercial mortgages are registerable. Commercial mortgages must be registered with the Local Economic Department. Automobile loans must be registered with the Police and the Vehicle Registry. There is a national central registry system but this is not searchable.

For most of the country, only UAE and Gulf nationals may own the land and grant security interests. In addition, there are some restrictions on the ability of foreign-owned entities to borrow and grant security—a securities loan taken by a non-UAE national may not be guaranteed by another non-UAE national. Certain security interests may only be created in favour of banks licensed to operate in the UAE.

Mortgages over land must be registered with the Lands Department, a public registry. Registration is fairly straightforward in theory, but in practice there tend to bureaucratic impediments to effective searching the Land Registry.

Enforcement of security is by judicial means—there are no non-judicial means available. Enforcement can be time-consuming, costly and unpredictable. The process is fairly efficient but still vulnerable to any ambiguity in the security documentation. In practice, for cultural reasons it is not possible to enforce security over the debtor's home and it is commonplace for debtors to obfuscate and obstruct enforcement processes.

Risk Management and Corporate Workouts

In practice, there are no reliable credit information systems covering the UAE business community.

Directors or managers of companies that fail may be held liable but only where there are fraudulent transactions or the concealment of assets.

There is some encouragement for the use of consensual arrangements to resolve liquidity problems and in some areas there are cultural or Shari'ah

issues which may influence the ability to reach an out-of-court settlement. Debt for equity swaps are not commonplace and there is no debt trading. As a result, there is very little out-of-court restructuring.

The Legal Framework for Insolvency

Debtors and creditors very rarely use the insolvency provisions of the law although to the extent that it is used, it is regarded as fairly efficient.

Companies Law No. 8 applies to all corporate entities apart from state owned entities. An application for a bankruptcy declaration is made on the basis that the debtor has failed to pay debts due to its financial status being upset. The debtor may also apply for the commencement of insolvency proceedings[91].

From the commencement of the proceedings and the making of the bankruptcy order, un-authorised transfers of the debtor's property are prohibited but this does not extend to secured creditors who are permitted to continue to enforce their security.

On the making of a bankruptcy declaration a bankruptcy judge, an inspector and a trustee in bankruptcy are all appointed. The bankruptcy trustee is able to continue to operate the debtor's business after the declaration of bankruptcy although the law makes no provision for the funding of any ongoing business. The trustee has the option to complete any uncompleted contractual obligations of the debtor or to terminate onerous contracts. The law sets out the bases of transactions capable of being avoided or set aside as preferences.

In all cases, a creditors' committee will be appointed. The committee has established powers and rights to require relevant information and will consult with the bankruptcy trustee on most issues.

The law makes provision for all affected parties to be notified of the making of a bankruptcy order—creditors must lodge claims within 10 days of the commencement of the proceedings or 30 days in the case of foreign creditors. In all other regards, foreign and local creditors are treated equally.

Cross-Border Recognition and Insolvency

There are no provisions in the insolvency law for the recognition of insolvency proceedings commenced in other jurisdictions or for co-operation with the courts of other jurisdictions.

Reorganisation Proceedings

The concept of business reorganisation is not known in the UAE. The law makes provision for a deed of arrangement between a bankrupt and its creditors. There is little statutory provision for the requirements of any such plan but approval by a two-thirds majority of the creditors is required to agree a deed of arrangement. There is no provision for appeal by dissenting creditors but there are restrictions on voting by connected creditors.

Implementation of the Insolvency System

The extent to which the court system facilitates insolvency law and practice is capable of improvement—there are no specialist courts or courts that necessarily have any bankruptcy experience. Judges are moved around the courts and this precludes the development of experience or expertise. In practice, any legal provisions are enforced first, supplemented by Shari'ah law if required.

The courts are governed by the Civil Procedure Code and the Evidence Law and are largely free and accessible by all parties. While judges give fully reasoned written judgments, court decisions do not tend to be reported. The result is that court decisions are not predictable and it is necessary to the parties to bear in mind Shari'ah Principles as well as statute law. In practice, most judges are free from influence and the courts tend to be sensitive about delays and abuse of process.

There are no provisions for the regulation and supervision of insolvency practitioners and criteria regards their qualification. They tend not to be held in high regard in all quarters.

Applicable Legislation

Civil Procedure Code Federal Law No. 11 of 1992
Commercial Companies Law, Federal Law No. 8 of 1984
The Evidence Law, Federal Law No 10 of 1992

[91] Company Law Number 8 Chapter 9

Chapter 16

Yemen

Legal Framework for Creditor Rights

There is scope for extending access to credit at affordable rates both with and without security in Yemen.

However, it is considered that there are efficient and reliable methods of satisfying the rights of creditors[92].

It is not possible to grant security interests over non-movable assets such as accounts receivable or intangible assets such as investments and intellectual property. Asset-based lending has not developed and retention of title is not used. Any security over a movable property must be registered with the Notarization Authority or the Commercial Court. There is no central registry capable of being searched and the consequence of non-registration is the inability to enforce any such security.

In practice, most security interests involve real estate. This security is also registered with the Notarization Authority and it is possible to conduct searches, which are reasonably reliable. Enforcement procedures may be protracted.

Risk Management and Corporate Workouts

There are no reliable credit information systems available in the Yemen.

There is some legal provision for directors or managers to be liable for the debts of a limited liability company if they have continued to trade whist insolvent but this liability does not extend to third parties and the laws do not tend to promote responsible corporate behaviour.

The economic and business environment does not encourage consensual arrangements and there are cultural and Shari'ah issues that influence the willingness of parties to reach a settlement. In practice, informal work-out procedures are seldom used.

Legal Framework for Insolvency

There is no formal insolvency system for use by debtors and creditors. The Commercial Companies Law makes limited provision for the winding up of companies including state-owned enterprises.

Proceedings are commenced by an application to a court with jurisdiction to enforce bankruptcy law or by obtaining an order of the Attorney General. It is possible for the debtor as well as creditors to commence proceedings.

On liquidation proceedings being commenced, the court appoints an insolvency practitioner[93] who takes over control of all of the estate immediately on appointment. There is also provision for the retention of professional experts to assist the court but no evidence as to whether this happens in practice.

Once proceedings have been commenced there is a complete stay on attachments and disposals of the debtor's property, including a stay on the rights of secured creditors to enforce the security. When it is used, this law is regarded as capable of providing proper notice to interested parties.

There is no provision for a general creditors' meeting or the appointment of creditors' committee.

[92] Commercial Companies Law Articles 32–33
[93] The Commercial Companies Law Article 218

In practice, virtually all proceedings are controlled by court orders including the disposal of the debtor's assets, the continuation of the debtor's business and any funding required for ongoing trading. The court may make orders to set aside transactions that are considered to be other than in the ordinary course of business but there is no provision in the law for the avoidance of particular transactions or preferences.

Cross-Border Recognition and Insolvency

There are no provisions for the recognition of foreign insolvency proceedings or for cooperation with the courts of other jurisdictions.

Reorganisation Proceedings

There are no legislative provisions for the reorganisation of financially troubled debtors.

Implementation of the Insolvency System

The judges are regarded as being mostly free from political and cultural interference. The courts are controlled by the Civil Procedure Code and by Shari'ah law.

In Yemen, insolvency practitioners are not subject to supervision or regulation.

Applicable Legislation

Civil Procedure Code
Commercial Companies Law