LEGISLATION WATCH / EGYPT

Egypt's New Bankruptcy Law: A Step Forward in the Business Legislative Reform Process

By MOHAMED TAHA

In February 2018, Egypt issued the Restructuring, Preventive Composition and Bankruptcy Law No. 11 of 2018 (the "**Bankruptcy Law**"), which came into effect on March 19, 2018. The Bankruptcy Law replaced Chapter 5 of the Trade Law No. 17 of 1997, which governed the bankruptcy process in Egypt for almost 20 years.

The Bankruptcy Law is a significant step in the ongoing business-oriented legislative reform in Egypt, which resulted in the enactment of a new investment law in 2017, and in 2018, the most comprehensive amendments to the capital markets law to date.[1] The adoption of the Bankruptcy Law in Egypt also follows a series of business-oriented legislative reforms of the bankruptcy regimes in several Middle Eastern countries, such as the adoption of a new bankruptcy law in the United Arab Emirates in 2016[2] and a new bankruptcy law in the Kingdom of Saudi Arabia in 2018.

The Bankruptcy Law is not comprehensive in its reforms, however, as it applies to commercial companies and traders but does not apply to non-merchant individuals, who continue to be subject to the insolvency provisions under the Civil Code No. 131 of 1948. The Bankruptcy Law also does not apply to state-owned companies, which remain subject to the Public Companies Law No. 203 of 1991.

The Bankruptcy Law regulates three schemes that a debtor undergoing financial difficulties can resort to: restructuring, preventive composition and bankruptcy.

Restructuring

The Bankruptcy Law sets out a restructuring framework aimed at assisting a debtor facing financial difficulty to reorganize its financial position through, among other things, asset reevaluation, debt restructuring, capital increase, increasing cash inflows, minimizing cash outflows and managerial restructuring.

An application for restructuring can be made only by a debtor (or the successors of a deceased debtor) that has been carrying on a business continuously for two years and, in the case of corporate debtors, is not in liquidation. The restructuring application cannot be made by a bankrupt debtor or a debtor subject to ongoing preventive composition proceedings.

The application, which must include a proposed restructuring plan, will be considered by a court-constituted restructuring committee, which will prepare a report regarding the feasibility of the proposed restructuring plan. Once approved by the court, the plan becomes binding on the debtor and on the signing creditors. The Bankruptcy Law does not require the restructuring plan to be approved by a minimum threshold of the creditors, but it will only bind the creditors who approved it. The approval of the restructuring plan imposes a moratorium on all enforcement claims by the signing creditors against the debtor as well as any claims regarding the restructuring plan. This moratorium will be lifted once the restructuring plan is fully implemented or judicially terminated.

Preventive Composition

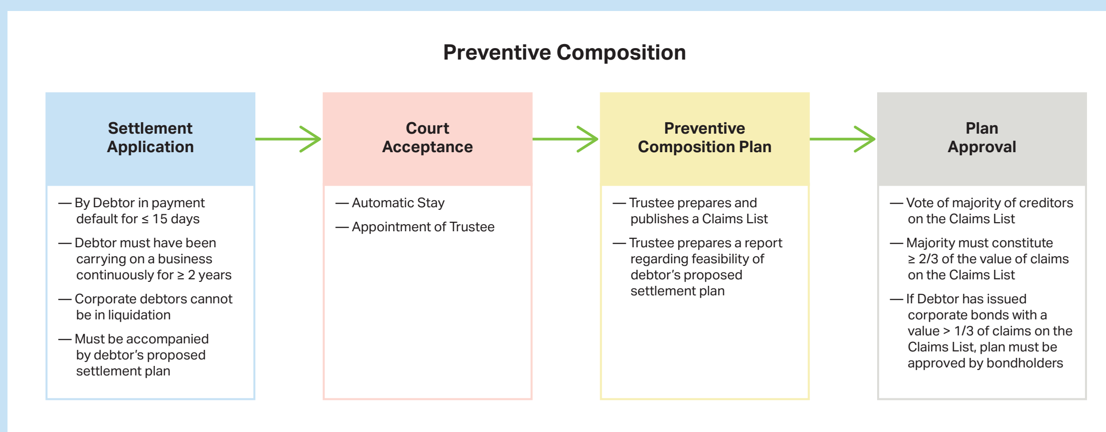
Preventive composition as applied in the Bankruptcy Law is similar to voluntary arrangement schemes under English law. The scheme under the Bankruptcy Law allows a solvent debtor to avoid a liquidation proceeding by agreeing with its creditors to a court-approved settlement plan pursuant to which it will repay all or part of its outstanding debts. The preventive composition application can be filed by any debtor undergoing financial difficulty, provided that such debtor did not commit fraud or gross misconduct. If the debtor has already stopped paying its debts, the preventive composition application must be made within 15 days of such last payment. As is the case for the application for restructuring, the applicant for preventive composition must have been carrying on a business continuously for at least two years and, in the case of corporate debtors, not be in liquidation. The application for preventive composition must be accompanied by the debtor's proposed settlement plan.

If the court accepts the debtor's application for preventive composition, it will appoint one or more trustees to supervise the settlement process. Following the court approval of the preventive composition application, the debtor can continue to manage its business under the supervision of the trustee, but any gratuitous transaction entered into by the debtor will not be enforceable against its creditors. The approval of the preventive composition application also imposes a moratorium on all claims and enforcement measures against the debtor, but claims and enforcement measures initiated by the debtor will continue with the trustee enjoined as a party thereto.

The Bankruptcy Law states that the approval of the preventive composition application shall not result in the acceleration of any of the debtor's loans. It is still unclear to what extent the parties would be able to contract out of this rule and adhere to the prevailing market practice, which generally considers a restructuring of the borrower's debts to be an event of default under financing agreements.[3]

The trustee is required to publish the decision approving the preventive composition application in a daily newspaper. All creditors, including secured creditors, must submit to the trustee original documents supporting their debts. The trustee must then prepare a list of claims against the debtor and publish it in a daily newspaper (the "**Claims List**"). The court will decide on any appeal by an interested party against the Claims List.

Following the determination of the Claims List, after considering any appeals, the court shall convene a meeting comprising the debtor and all the creditors whose claims have been included in the Claims List to review the settlement plan. The trustee shall then prepare a report comprising, among other things, his or her opinion regarding the feasibility of the settlement plan proposed by the debtor. While there is no quorom requirement,



the settlement plan can only be approved by creditors whose claims equal at least two-thirds of the value of claims included in the Claims List; provided that if the settlement plan is proposed by a company that has issued corporate bonds or sukuk with a value exceeding one-third of the claims included in the Claims List, the settlement plan must be approved by the relevant body representing the bondholders or the sukukholders. Secured creditors can only vote on the proposed settlement plan if they waive (and thus forfeit) their security, and such waiver will be conditional on the approval of the settlement plan. Following the approval of the settlement plan in the creditors' meeting, the court will consider the ratification of the plan after deciding on any objections made by the interested parties. Once ratified by the court, the settlement plan will become binding on all the debtor's creditors. The court can only ratify the settlement plan after it has been approved by the creditors' vote.

Bankruptcy

Similar to the previous bankruptcy regime, the Bankruptcy Law adopts a cash flow test to determine bankruptcy, whereby a debtor would be declared bankrupt if it fails to pay its commercial obligations when they fall due as a result of financial difficulties. An application for bankruptcy can be filed by any creditor, the public prosecution or the debtor itself. However, a fully secured creditor cannot file for a debtor's bankruptcy unless the value of its collateral is lower than the outstanding debt.

If the court declares the debtor bankrupt, it will determine the date from which the debtor stopped paying its debts (the "**Repayment Failure Date**") and appoint a trustee to manage the debtor's assets and financial affairs during the bankruptcy process. Between the Repayment Failure Date and date the debtor is declared bankrupt, no gifts, prepayments of debts, repayments on terms different from those in the debt agreement, or grants of security given by the debtor will be enforceable against the creditors.

Once declared bankrupt, the debtor loses capacity to manage its financial affairs or to dispose of any of its assets. However, a bankrupt debtor may, with approval of the court, start a new business using capital that is not subject to the bankruptcy proceedings, in which case any debts arising from the new business will have priority over other claims in relation to the assets of the new business.

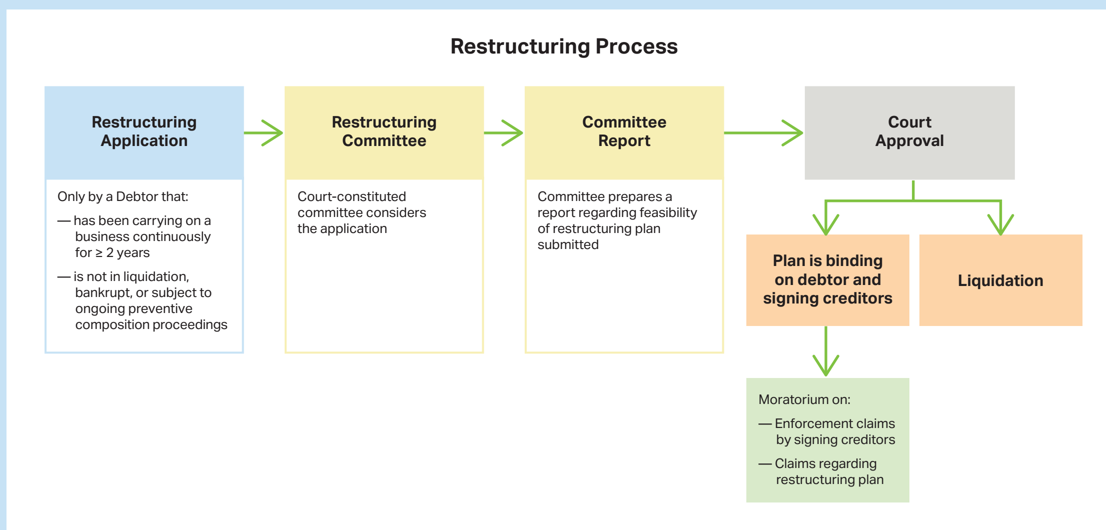
Following the bankruptcy decision, the unsecured creditors will not be able to initiate proceedings against the debtor, but the secured creditors can initiate or continue claims against the trustee. The bankruptcy decision will also accelerate all future financial obligations of the debtor, whether such obligations are secured or unsecured.

The court may, at its initiative or upon a request from any interested party, mediate between the debtor and the creditors to reach a settlement. The settlement will only be effective if approved by all creditors (excluding the secured creditors who have not waived their security).

A bankrupt debtor will be automatically discharged from bankruptcy three years after the date of the termination of the bankruptcy proceedings.

Directors' Liability

The Bankruptcy Law provides for civil and administrative liabilities for the directors of a bankrupt company in certain cases. If the directors are found to have acted with gross misconduct that resulted in the company's bankruptcy, such directors may be deprived of their political rights and be disqualified from assuming certain positions, such as companies' board membership. In addition, if the assets of the bankrupt company are insufficient to satisfy at least 20% of the company's debts, the court may oblige the directors personally to repay some or all of the company's debts unless the directors can establish that they exercised the care of a prudent person when running the company.



Outlook

While the new Bankruptcy Law has not yet been tested and the appetite for its novelty has yet to be assessed, it provides a much anticipated shift from the 20-year-old predecessor regime, which was in need of an update to reflect a changing market and a shift toward a more business-friendly approach. This new regime should also ease the process of restructuring for companies and creditors alike as it supports businesses that are not yet in bankruptcy but facing financial difficulties, and involves the court in the settlement process among a debtor and its creditors. As such, observers hope that the new Bankruptcy Law contributes to the ease and attractiveness of doing business in Egypt after several years of economic downturn.

The Bankruptcy Law still does not provide for cram down capabilities with respect to classes of creditors that constitute more than one third of the debts owed by the debtor company. Nonetheless, the series of business-oriented legislative reforms coming out of the country provides an enticing environment for companies looking for a friendly market within which to begin, and continue to do, business. ■

1. For more details on the amendments to the Egyptian capital markets law, please refer to Cleary Gottlieb's memorandum, *Egyptian Parliament Approves Amendments to Capital Markets Law, Opens the Door for Sukuk Issuance*, March 7, 2018, available at https://www.clearygottlieb.com/-/media/files/alert-memos-2018/egyptian-parliament-approves-amendments-to-capital-markets-law-opens-the-door-for-sukuk-issuance.pdf.
2. For more details on the new UAE bankruptcy law, please see Lawale Ladapo and Mohamed Taha, *The New Bankruptcy Law of the UAE: Towards A More Business-Oriented Bankruptcy Regime*, EMERGING MARKETS RESTRUCTURING JOURNAL, Issue No. 4 (Fall 2017), available at https://www.clearygottlieb.com/-/media/organize-archive/cgsh/files/2017/publications/emrj-summer-2017-issue-4/the-new-bankruptcy-law-of-the-uae--towards-a-more-businessoriented-bankruptcy-regime-updated-9-19-17.pdf.
3. For example, Clause 22.5(e) of the LMA Standard Form Single Currency Term Facility Agreement for Developing Market Jurisdictions states that the borrower will be deemed in default if any member of its group "by reason of actual or anticipated financial difficulties, commences negotiations with one or more of its creditors…with a view to rescheduling any of its indebtedness."

Mohamed Taha is an associate based in Cleary Gottlieb's London office. Mohamed's practice focuses on mergers and acquisitions, capital markets, and general corporate practice. Mohamed joined the firm in 2014.

Before joining Cleary Gottlieb, Mohamed worked with a leading Egyptian firm for two years, where he advised on various cross-border transactions. Mohamed has authored and published many papers in internationally recognized journals. Mohamed received his Master in Law degree from the Georgetown University Law Center and his diploma in law and bachelor's degree from the Cairo University, Faculty of Law.