EGYPTIAN BANKRUPTCY
REFORM ASSESSMENT AND RECOMMENDATIONS

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EGYPTIAN BANKRUPTCY
REFORM ASSESSMENT
AND
RECOMMENDATIONS

This paper has been prepared in support of the ongoing effort to revise and modernize Egypt’s bankruptcy provisions, which are Articles 550 to 772 in Law No. 17/1999, the Trade Law. The assessment is based on previous work on bankruptcy and commercial law in Egypt, assistance from consultants and a U.S. bankruptcy judge, on international standards, and the work of the Subcommittees appointed by the National Law Commission to study bankruptcy in Egypt and in other countries and to provide recommendations for revision. The recommendations of prior reports are incorporated by attachment as appendices to this paper. The paper highlights the main priorities based on the current stage of reform. As drafting proceeds, other issues may arise, which will be addressed separately, or through an update to this paper.
EXECUTIVE SUMMARY

This assessment and set of recommendations is provided to support the current initiative within the Egyptian government to modernize Egypt’s bankruptcy system. In order to avoid duplication of effort, the work of previous assessors is referenced, and their recommendations are also adopted through attaching their reports, rather than restating them all. The paper may be updated as the reform process continues, to address further issues.

The first section provides an overview of the current state of the Egyptian bankruptcy system, and the main differences between the Egyptian system and modern standards. One of the biggest criticisms of Egypt’s bankruptcy law is that a bankruptcy declaration is a declaration of “death” for the company. Reorganizations do not occur in Egypt. In contrast to modern bankruptcy regimes, the focus is on punishing the debtor rather than rehabilitating him. Procedural problems and institutional shortcomings prevent the liquidation procedure from providing a safe exit from the market. In Egypt, bankruptcy is a collection tool, filed by individual creditors, rather than a forum for rehabilitation of the debtor through collectively restructuring debts. Restriction of civil rights of the debtor conflicts with modern standards.

International standards are summarized briefly in order to provide guidance on the structure and purpose of a modern bankruptcy law. A modern law should be available to most debtors providing for transparent, efficient, and fair liquidation. The goal of the modern bankruptcy law is to rehabilitate a debtor where possible, but provide from an orderly exit from the market where it is not. Within the procedure itself, claims processes should be fair, efficient and timely. Reorganization procedures should be flexible, should involve creditor participation and approval of a plan, and should be binding with respect to forgiveness, cancellation or alteration of debts. Roles of courts, judges, and other professionals, particularly trustees, should be well-defined. Insolvency professionals (trustees) should be supervised and held accountable for performing competently and with integrity.

Recommendations for change:

- Reorganize legal provisions, with chapters holding related provisions, chapter headings, a logical sequence to the chapters, and cross-references to related provisions.
- Clearly identify debtors who may file a bankruptcy case, eliminating minimum capital requirements, and separating corporate identity from managers and owners of the business.
- Improve liquidation through increased accountability, and simplified, more flexible procedures for identifying and handling assets and claims.
- Develop a claims procedure that addresses creditor claims simultaneously, and produces a final list of claim amounts and priority to allow efficient distribution.
- Institute a pre-bankruptcy workout procedure that focuses on mediating creditor-debtor disputes.
• Allow a case to open and begin, and attempt to reorganize prior to a bankruptcy declaration, which should be re-characterized as a declaration of liquidation, rather than the beginning of the case.
• Extend the moratorium on creditor action to: 1) begin as soon as a case is filed, and 2) apply to secured creditors holding collateral.
• Reform the trustee institution.
• Institute a detailed, formal reorganization procedure to allow debtors to be rehabilitated under court supervision, with certain legal protections.
• Eliminate loss of civil rights for honest debtors.
• Allow debts to be discharged/cancelled after a debtor successfully completes either reorganization or liquidation.
• Carry out parallel institutional changes such as improved enforcement of rulings, training of judges, capacity development for trustees, case management improvement, and access to information systems.
• Institute legal changes outside the bankruptcy provisions, such as improved enforcement of judgments/debts, development of information sources such as a credit bureau, and other debtor information sources such as judgment registries, collateral registries, and accurate property registries, and improved corporate governance.
CURRENT STATE OF EGYPTIAN BANKRUPTCY SYSTEM

The Egyptian bankruptcy provisions require significant update. A visiting expert has noted that the law looks comparable to the 1967 French bankruptcy provisions. The current system is in need of update and modernization. The most often noted problems in bankruptcy practice in Egypt are noted below.

NLC INITIATIVE TO REFORM THE EGYPTIAN BANKRUPTCY PROVISIONS

In April 2006, the Government of Egypt launched the National Law Commission (the NLC), which is tasked with modernizing Egypt’s commercial laws. In February 2007, the NLC launched the reform of the bankruptcy provisions. Four Subcommittees were created to research and make recommendations for reform of various aspects of the law. The process has been participative, and has drawn extensively on expertise on bankruptcy in Egypt, as well as on international standards for bankruptcy. The results to date of this process are referenced and have been incorporated into this assessment.

LIQUIDATION ONLY, NO REORGANIZATION

a. Bankruptcy Declaration, Declaration of “Death”

Modern bankruptcy international best practice demands that both rehabilitation and liquidation be available for debtors. Bankruptcy is a liquidation tool in Egypt. There is no practice of reorganization or rescuing debtors. Moreover, the declaration of bankruptcy in Egypt has been likened to “death” for a company by many commentators. The company is closed, the trader is forbidden from conducting his trade, and the economy does not benefit, instead, it loses productive assets and traders.

b. Reorganization

There are provisions in the law for conciliation, but at the moment, there are not adequate legal tools, nor adequately trained professionals or institutions with sufficient capacity to allow effective rehabilitation/reorganization.

INEFFICIENT PROCEDURES AND ENFORCEMENT

Creditors rarely, if ever, recover money from a bankruptcy case. The system is not currently effective for liquidation or creditor recovery. The current system in Egypt does not allow for any of the steps of liquidation to be completed easily, if at all. The time in between steps involved in asset identification, seizure, sale, resolution of disputes, and distribution of proceeds is long, and assets diminish in value. Though the steps in a liquidation are straightforward, each step in the procedure is subject to

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1 Judge Samuel Bufford, a U.S. Bankruptcy Judge and scholar of bankruptcy law, reviewed the law and made the comparison during a workshop with bankruptcy reformers. He noted that France had revised the law again in 1985 and 2005 but that Egypt’s law did not appear to be similarly updated.
objection from parties. Judges are empowered to continue an execution on assets pending objection, but in practice, the objections delay the procedures. While the law allows for movable property to be sold in a method approved by the bankruptcy judge, generally it is still subject to auction, and procedures which delay seizure and auction/sale. Once assets are sold, resolving claims on the proceeds further delays distribution. Judges and lawyers report that even after the work of liquidating assets is done, a new claim may arise, and even at such a late stage in the case, severely delay resolution and distribution of funds.

The actual disposition of assets is further fraught with procedural and logistical problems. The procedures for auction are cumbersome, and difficult. Moreover, parties report that the rulings of the bankruptcy court often remain unenforced, rendering the proceedings meaningless. A further problem is that it has been reported that trustees sometimes retain the money obtained from assets rather than distributing them to creditors, without the type of supervision that may hold them accountable.

The value of assets can deteriorate due to the delay inherent in the procedures. Cases can take many years, due to difficulties with information, proving debts, or claims, difficulties selling assets, with creditors interrupting throughout the procedure. Lack of transparency in financial transactions slows it down, procedures are cumbersome, delays are endemic, and instead of safe exit from the market, debtors and their assets become unproductive, while creditors receive little payout.

Accountability is also lacking in the system. Tracking the proceeds from assets is also problematic. In some cases (by some reports, in many cases), trustees simply keep the proceeds and fail to distribute them to creditors.

IDENTITY OF DEBTOR/WHO CAN FILE

a. Qualifications to File

The question of who can file was discussed extensively in the Pre-Bankruptcy Subcommittee. Currently, bankruptcy is limited to traders who are registered in the Commercial Registry, and who have a registered capital of at least 20,000 LE, regardless of the amount of current capital. A Court of Cassation ruling may have challenged that.

b. Corporate Identity and Individuals Owning or Managing the Business

Corporations’ legal identity, and that of the owners or the officers of the company, often merge in a bankruptcy in Egypt. This leads to confusion regarding liability and financial consequences to individuals. In a modern system, the corporate entity isolates individual owners and stakeholders from unlimited liability for their business actions. In Egypt, the individual perceived to own or control the company, is held liable. The purpose of the corporate entity, to promote business activity by defining and limiting liability of individuals, and access to their personal assets, is defeated. People must risk their assets in total in order to start a business, which inhibits economic initiative.

BANKRUPTCY USED AS A COLLECTION TOOL.

Modern bankruptcy standards have emerged that define bankruptcy as a rehabilitative tool, as a system for assessing the claims of creditors together, and paying them collectively to ensure fairness
among them. However, in Egypt, in practice, bankruptcy is a collection mechanism for individual creditors, rather than a collective resolution of debt among creditors.

a. Creditors file a bankruptcy against a debtor in order to pressure him to pay their debt.

The process can be initiated by just one creditor, and the debtor can be punished with this declaration unless he pays the amount owed to the creditor to have the case dismissed. This is most often used to pressure the debtor to pay, rather than from a motive of liquidating the debtor to redistribute his assets, and distribute the proceeds fairly to creditors.

b. Highlights the lack of an effective system for enforcing judgments and debts

Creditors should be able to enforce their debts more reliably through the collection system, not have to resort to threatening bankruptcy. A modern bankruptcy system should be dedicated to resolving “bigger picture” issues such as rehabilitating a debtor, providing a collective forum to promote fair treatment among creditors, and promoting a safe, fair and effective exit from the market through liquidation/sale when a company is no longer viable. Individual collection action by creditors distorts modern bankruptcy’s purpose, and lead to companies entering the bankruptcy system, that do not belong there. If the bankruptcy system is to be structured to promote rehabilitation, bankruptcy will become an inefficient use of system resources for single-debt collection. The enforcement system for debts should be built up at the same time a broader mission and function for the bankruptcy system is administered, so that creditors do not lose one tool for debt enforcement without replacing it with another, more effective tool.

RESTRICTIONS ON CIVIL RIGHTS OF DEBTOR

Bankrupt debtors face restrictions on personal freedom of movement in order to prevent his leaving the country with the assets. They also face loss of other civil rights such as holding public office, and restrictions on running a business or practicing a trade.

a. Demonstrates that debtors are viewed as having failed morally, rather than economically.

As in many countries, in Egypt, the bankruptcy law, as well as society and legal institutions, have traditionally viewed bankruptcy as a moral failing of the individual involved. Thus, debtors are individually punished, sometimes with criminal sanctions, for financial distress. The stigma prevents debtors from seeking out the bankruptcy system’s help to recover from their debts, and also prevents the system from offering help, instead focusing on punishment, or simple tactics to force debt payment, that do not enhance a debtor’s chances of emerging from financial distress.

b. Highlights the lack of other adequate enforcement measures.

The connection between the inefficient civil debt enforcement system and the difficulty in modernizing bankruptcy is discussed above. Since there are few methods of forcing a debtor to pay through legal seizure and liquidation of assets, the law contains personal consequences in order to motivate a debtor to pay. However, such remedies are limited in their effect, and do not contribute to the modernization of the financial system. Moreover, they perpetuate the stigma of bankruptcy, which must be lifted in order to promote rehabilitation for debtors, and allow economic productivity even after failure of a business endeavor.
It is preferable to have better systems for financial enforcement, and enforcement both outside of and within bankruptcy, rather than having to restrict the debtor’s civil liberties.
INTERNATIONAL AND COMPARATIVE STANDARDS FOR BANKRUPTCY LAW

Since the goal is to modernize Egypt’s law, it is helpful to look at the international standards that have been developed by various international organizations using the experience of various countries as a basis. In reviewing the standards and comparing them to the Egyptian law and system, reformers can develop the Egyptian law but benefit from the experience and mistakes and successes of other systems. A broad overview of international standards is presented. Further details are available in the Principles for Effective Insolvency and Creditor Rights Systems, from the World Bank, 2005, and the UNCITRAL Legislative Guide on Insolvency Law.

INFORMAL, OUT-OF-COURT WORKOUT PROCESSES

International standards recommend some sort of informal workout procedure. The World Bank Principles and Guidelines for Creditors Rights and Insolvency Systems (The World Bank Principles) recommend an informal workout procedure to enable creditors and debtors to utilize techniques such as voluntary negotiation or mediation or informal dispute resolution. The UNCITRAL standards provide more detail and examples of informal, out-of-court workout processes, but focuses on larger, multi-creditor cases with significant assets involved. The main differences between types of informal workout processes is the level of legal assistance, and legal protection provided to debtors during the process, in order to promote reconciliation with creditors. One of the main legal questions is whether or not the moratorium on creditor action applies. In the most informal of processes, it does not. In some processes, it is enacted before actual court filing, but after the most informal of mediation has been tried. In cases with multi-bank creditors, utilizing the London Approach (discussed below), it is implemented by the consent of the creditors, and supports a voluntary workout of debt that benefits all creditors and debtors.

BROADEST POSSIBLE ACCESS

The World Bank Principles recommend allowing the broadest possible access to the bankruptcy system for companies. Economies are synergistic, and companies’ fortunes can affect one another. Allowing bankruptcy protection to extend to all or most companies also increases predictability in the market.

LIQUIDATION AND REORGANIZATION

Effective liquidation is addressed in both the UNCITRAL Guidelines and the World Bank Guidelines. Effective liquidation system starts with effectively being able to identify assets of the bankrupt’s estate, and being able to collect them and prevent their transfer by the debtor against the interests of other creditors. Once the assets are identified, and under the control of the bankruptcy court, effective liquidation requires a speedy disposal/sale of the assets. After sale, proceeds must be distributed to creditors, without undue delay. Preferably, the law describes the priority among different types of creditors so that the final distribution is easily determined, and objections that lead to delay are minimized and in most cases, eliminated.
For viable businesses, a reorganization procedure should be available under the law, in order to give debtors in financial distress some legal protections that allow them to restructure, emerge from the financial distress, and continue to operate. A modern insolvency regime focuses on reorganization whenever it is possible. When it is not, or it has been tried and failed, the liquidation procedure should be available for an orderly, fair, and quick redistribution of assets into the economy.

TRANSPARENCY AND CLARITY

The procedures should be transparent, and predictable. The rules should allow investors and businessmen to assess their risk in a bankruptcy, and understand their position should a bankruptcy affect their investment or business. Provisions should be readily available, and easy to read and understand. Procedures should promote transparency. There should be incentives for, and institutions that support, gathering and dispensing appropriate financial information.

DEFINING CREDITORS’ RIGHTS, TREATMENT OF STAKEHOLDER RIGHTS, PRIORITIES AND CLAIMS FILING AND RESOLUTION

Existing creditor rights should be recognized and rights and priority of claims prior to bankruptcy under other commercial laws should be upheld to the greatest extent possible in a bankruptcy proceeding. Predictability within bankruptcy should be promoted by clearly setting forth priority of claims in bankruptcy, and respecting the priority in payment. Secured creditors’ rights in their collateral should be preserved, and their priority in their collateral should not be subverted without their consent. Procedures for notifying creditors and permitting them to file claims should be cost effective, efficient and timely. There must be a system in place for resolving claims disputes. However, claims disputes should not be permitted to cause untoward delay in bankruptcy proceedings, as delay reduces the value of assets, and ultimately, the recovery for all creditors.

Trustees are an essential part of the bankruptcy system. Having a system for ensuring that they are competent, with the requisite skills in asset and financial management, among others, and that they act with integrity, is crucial to the operation of any bankruptcy regime. Trustee qualification criteria should be objective, clearly established and publicly available. They must act with integrity, impartiality, and independence, and must be accountable if they do not. They should be removed if found incompetent or negligent, and certainly for fraud or other wrongful conduct.2

INSTITUTIONAL CONSIDERATIONS: ROLE OF COURT AND TRUSTEES

Specialized judges, or specially-trained judges should oversee bankruptcy cases. The courts should be independent, impartial and effective. The courts’ role should be to monitor the progress of bankruptcy cases, and ensure compliance with legal standards without assuming a governance or business administration role for the debtor. There should also be an effective system for enforcement of debts of both secured and unsecured debts outside of bankruptcy.

RECOMMENDED CHANGES TO LAW

The current law will be substantially amended in the upcoming revisions. All aspects of the law should be reviewed, including the liquidation procedure, the rights of all parties, and the roles of all participants in the bankruptcy process. The change that is likely to be the most significant is the creation of a formal reorganization procedure, with mechanisms that allow it to be conducted effectively, that grant debtors protection sufficient to allow them to reorganize, and that protect creditors’ rights. A timely visit from a U.S. Bankruptcy Court Judge, Judge Samuel Bufford from the Central District of California, resulted in recommendations for change to allow reorganization that are insightful and practical for Egypt. His recommendations are largely reproduced in the recommendations related to reorganization, with enhancement based on previous work, in-country discussions among the National Law Commissions’ Bankruptcy Subcommittees, and among officials and consultants at TAPR II.

ORGANIZATION OF LEGAL PROVISIONS

One observation that has been made by previous assessors of the bankruptcy law is that it is poorly organized, and would be easier for businessmen to locate if it were in a separate law. Chaptering, with appropriate headings, would also make the law easier to read, and to understand. When a provision is related to another provision in the law, there should be a cross-reference within each provision, so that the reader can immediately turn to the related provision. Creating a separate bankruptcy law is worth consideration, though it is not necessary, as many countries place their bankruptcy provisions within their commercial codes.

As for organization, the provisions are not in an order that logically follows the progress of a case. Moreover, there are provisions that have conflicting effects, or that affect each other, that are not in the same section, and that do not cross-reference each other. For example, Article 606 states that “The ruling declaring bankruptcy shall cancel all the bankrupt’s outstanding cash debts. . . .”, which may lead the reader to conclude that the bankruptcy discharges the debtor’s debts. However, in practice, the provisions that are applied are Articles 712 and 713, which allows the debtor’s rights to be restored three years after the bankruptcy declaration (Article 712), and before that three year period, relief from the effects of bankruptcy is only granted if the debtor has repaid all debts, which counteracts any notion of discharge.

While reordering the law may create some confusion in the beginning, for those familiar with the current law, it will be worthwhile in the long-term. Moreover, as a significant number of new provisions will be added to the law in order to allow rehabilitation of the debtor, this amendment may be an opportunity to make the law well-ordered, with helpful section headings, which is easy to index and follow.

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3 Honorable Samuel Bufford, Revising Egypt’s Bankruptcy Law, May 2007. See Appendix I
When the drafters are incorporating suggestions into sections, they should consider reordering provisions, and renumbering them either within the Commercial Law (Trade Law), or in a separate law.

The DAI Report, attached as Annex X (bankruptcy portion translated into Arabic), provides a suggested order. These recommendations leave the determination to the drafters. For the purposes of making recommendations, in a clear and understandable manner, in this paper, the current section numbers of the bankruptcy provisions within the Commercial Law are used.

**DEBTORS: WHO CAN FILE**

a. Maximum Access Preferred

As previously noted, bankruptcy filing has been restricted to registered debtors with capital exceeding 20,000 LE. There has been discussion among reformers of increasing the minimum capital required to make companies eligible for bankruptcy, and discussion of reevaluating the measure of a company’s capital, as the registration amount is generally outdated, and the amount has usually increased substantially by the time of a bankruptcy filing.

For a bankruptcy system to work well, it should be applicable to most, if not all enterprises and corporate entities. In Egypt, as far as possible, restrictions on who can file should be removed. The consequences can be differentiated for individuals and corporations. If liability for corporate actors is limited and defined, it may encourage businessmen to register.

If it is not possible to allow all businesses to access the bankruptcy system, reformers may retain the requirement that companies filing bankruptcy be registered, but the minimum capital requirement should be eliminated. If a company is too small to make the expense of a bankruptcy case worthwhile, either it will not file, or the judge can dismiss it due to insufficient funds. Also, if the company was registered with low capital, the true amount would have to be determined if there were a minimum requirement. Determining the true amount of capital of a company, to qualify it for bankruptcy, requires time, and resources, and is unnecessary as it does not confer a systemic benefit.

b. Identity of Corporation vs. Owner/Officer/Manager/Individual

The other issue is that the identity of the debtor’s managers and the company itself become merged, particularly with the imposition of civil rights restrictions on the “bankrupt” pursuant to Articles 586-596. These restrictions by nature apply to an individual, though only registered companies may file bankruptcy. Who should be the “bankrupt” individual subject to these restrictions, and continuing liability for debts after the company is deregistered, is not defined in the bankruptcy provisions. In practice, the owner or the head of the company is the one that is treated as the “bankrupt” for purposes of personal consequences.

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5 *Id.* at p. 12.
Merging individual identity and corporate identity in the bankruptcy diminishes the benefit of doing business as a corporate entity. However removing individual liability, without a concurrent development of accountability for directors and officers of a corporation, could further diminish accountability in a system where accountability for bad acts in the business world is already lacking.

In order to create a modern system, corporate entities’ identities and the identities of the individuals that run them, particularly in the case of larger firms, must be definable. Individuals should have predictable limits on their liabilities, in order to encourage the entrepreneurial initiative necessary for a dynamic market economy. Protection for business decisions, as well as appropriate liability for bad acts, should be incorporated into the system, rather than automatic recourse to leaders of firms for all of a firms’ liabilities.

Carefully defining corporate entities and their liabilities, and creating accountability for business managers is the subject for another law or laws. Within the bankruptcy provisions, the identity of the “bankrupt”, and the intended subject of each provision (a manager or the company itself?) should be clarified throughout.

LIQUIDATION: INCREASE ACCOUNTABILITY AND SIMPLIFY PROCEDURES

Though the focus of the current revision of the bankruptcy provisions is to promote reorganization, liquidation procedures that allow an effective, fair exit from the market are important for any modern bankruptcy law.

a. Trustee reform is vital to improving the liquidation procedure

The most significant area in need of reform to improve liquidation is the institution of the trustee. While there is judicial supervision, as in many countries, Egypt’s bankruptcy law tasks the trustee with conducting the asset and financial analysis, management and liquidation and distribution, and the myriad of tasks involved, fall to the trustee. Currently, there is no system for ensuring the qualifications of trustees, nor a system for supervising their work. The possibilities for improving the trustee system are discussed in greater specificity below. As the professionals and institutions that participate in liquidations are developed, they will be able to implement effective procedures. Containing the details of procedures in regulations, rather than within the law, will allow amendment of procedures as practice reflects a need. Some specific aspects of the liquidation procedure are addressed below.

b. Procedure Simplification

In addition to the institutional issue of trustee qualification and performance, the current procedures in Egypt are long, cumbersome, and subject to constant objection and delay. From the standpoint of revision to the law, simplified procedures, allowing for greater freedom to arrange private sale, and speedier, more effective public auctions, would be an improvement.

In order to increase the efficiency of the process, the procedures for sale should be simplified. Claims should be resolved before the sale of the asset, as described below, and the proceeds should be
distributed immediately. In the 2005 revision of the French bankruptcy provisions, a simplified liquidation procedure was added, which would be valuable for Egypt, if combined with reform of the institution of the trustee. The relevant French provisions are Article 644-1 to 644-5. Some particular suggestions for improved procedures are described below.

Private sale of assets is more efficient. One of the features of the simplified French procedure that is recommended is that after the property is inventoried, the court decides, in an order, which property may be sold by private sale. Judges should also be encouraged to allow private sales when possible, particularly for personal/movable property, rather than insisting on public auctions. The final sale price could be approved by the bankruptcy judge to prevent asset stripping. Particularly with movables, and intangibles such as receivables and securities, it is not necessary to engage in a full public auction to obtain a fair price—if the price received is fair, the public auction confers no additional benefit. If a private sale cannot be arranged, an auction should be conducted, but with simplified procedures, and quickly in order to prevent the devaluation of assets.

Develop simplified foreclosure procedures for seizure and sale of real estate in bankruptcy. Sale of real estate is more complicated. While substantial overhaul of current procedures is needed, it appears that the main problem is the lack of effective registration of property. Addressing that problem directly is beyond the scope of this paper.

In order to mitigate the effect on the economy of unregistered property, one judge has recommended that the declaration of bankruptcy should allow real estate that is owned by the debtor but not registered\(^6\), to be sold by the court free of all encumbrances, and then be registered. Such an approach has the advantage of preventing a debtor from avoiding liquidation of a valuable asset through lack of registration. It also provides an opportunity to bring property into the formal (registered) sector, a benefit to the economy, and to the legal system. Bankruptcy provisions are a suitable area within the law to allow such clearing of encumbrances, and to give the property a “fresh start” as far as title. The idea merits consideration.

As far as procedure, currently, seizures/auctions/sales of real estate are subject to the Civil Procedure Code provisions. It would be preferable if simplified procedures, geared toward efficient seizure and sale of real estate assets in bankruptcy cases, were developed. Such procedures will be of limited effect until registration is improved. However, developing them in the current revision of the bankruptcy law would allow the procedure to be used and to develop as the institutional infrastructure required matures. Recently in Egypt, procedures for certain types of real estate procedures were improved through the Real Estate Finance Law. As of yet, the procedures have not been tested. It appears that these procedures are not applicable in a bankruptcy case, though their applicability has been extended to loans secured by real estate. They can be used as a model, though the preference would be that they be simplified even further for bankruptcy cases.

Resolving all objections at once. One of the complaints of bankruptcy practitioners in Egypt is that even at the end stages of liquidation, new claims and objections delay the distribution of proceeds, sometimes requiring their reallocation. Finality of claims amounts, and distribution plan, is important to insure an efficient, effective bankruptcy liquidation system. In the simplified French liquidation procedure, once the plan for liquidation is published, there is a limited time for objections by interested

\(^6\) Currently, imputed ownership of unregistered property is decided by courts through reviewing a combination of evidence such as police reports, tax records, contracts on the property, and other evidence that serves in practice to establish ownership of unrecorded property.
parties. Such resolution of creditor disputes at the same time, in the same forum, and finality of resolution, is vital to ensure fairness among creditors.

CLAIMS

An effective claims process is crucial to a successful bankruptcy system. One of the main goals of a bankruptcy system is to treat all creditors at the same time, so that the proceeds from a case can be apportioned fairly, according to the priority established by law. Therefore, claims must be collected within a short-time frame, disputes resolved, and a list of creditors with their claim amounts developed, to allow proper administration of a bankruptcy case.

The claims process in Egypt is problematic according to practitioners. Two main problems arise. First, many claims are simply difficult to establish. Creditors languish, as they are unable to prove their debts within a bankruptcy case, if they have not previously established them. Prior cases for determination of the amount of the debt are stayed, and the bankruptcy judges do not feel empowered to decide the cases. Without a court certification of the amount of the debt, many bankruptcy judges deny it. Another problem with establishing claims is that the documentation is often insufficient.

Claims determination. For the first concern, bankruptcy judges should be empowered to decide the amounts of claims based on evidence provided by both debtor and creditor. Where documentation is insufficient, debtors and creditors should be encouraged to come to an agreement. Where they cannot agree, the judge should decide based on the evidence. If cases regarding claims are pending in other courts, once a bankruptcy case is commenced, those cases that deal with claims and the debtor’s assets should be brought to the bankruptcy court, to be decided by the bankruptcy judge. If experts are needed to interpret documents, the bankruptcy judge should be empowered to hire experts, or consult a qualified trustee, to help them decide.7 Any legal barriers to bankruptcy judges resolving the debts should be removed, and judges should be encouraged to accept the power to resolve such disputes.

Addressing all claims at the same time. Another significant problem is that claims sometimes are filed at the end stages of liquidation, disrupting the distribution plan and delaying payment further. It is crucial that the participants in a bankruptcy case know the liabilities of the debtor at the outset of the case, in order to properly administer proceeds. In the U.S., when a debtor files a case, he lists all of his creditors. The discharge to be awarded at the end of the case is an incentive for him to list all of his creditors, as any that are not listed, will not be discharged, and can come after him even after the bankruptcy case is completed. Creditors are then notified and claims are verified.

In Egypt, there is a fear among practitioners that debtors will not list all of their creditors, or that failing to allow a creditor to intervene at a later date robs the creditor of his rights. Enacting a discharge, as described below, will motivate a debtor to reveal all of his debts. In regard to creditor’s rights, a creditor who is actively pursuing the debtor, will become informed of the bankruptcy through its publication, so there is little danger of an active, responsible creditor being unaware of the bankruptcy proceeding. Active creditors will generally assert their rights in a bankruptcy proceeding.

7 Commercial paper
After claims’ disputes are resolved and the plan of distribution is determined, further interference by “late-filing” creditors should not be allowed. The disruption of the proceeding is harmful to the process overall. If a creditor has not been diligent, “waking up” late in the case should not be rewarded. If the creditor is the genuine victim of fraud, special provisions can address his situation. However, this should be the exceptional case, not the norm.

Articles 622-24 to 622-27 and Articles 622-30 to 622-31 of the French Commercial Code set forth the claims verification procedure within liquidations, and may prove helpful as examples for Egyptian legal drafters. In addition, Articles 624-1 to 624-18 of the same Code describe the process for verification of claims in the reorganization procedure.

PRE-BANKRUPTCY INFORMAL WORKOUT SYSTEM

Based on international standards, Judge Bufford recommended establishing an informal workout system that operates outside the bankruptcy law. The different models for informal workout systems are described above.

a. French Model: Mediation Applied in a Flexible Procedure to Promote Pre-Bankruptcy Workouts

The French model provides the most relevant comparison for Egypt. In France, if the debtor has not ceased payments, and he so requests, the commercial court president may appoint a mediator to resolve specific issues with creditors. This procedure is referred to in French as mandataire ad hoc, or ad hoc mediation. The procedure is informal and flexible. In practice, due to the drastic consequences of more formal bankruptcy procedures, it has been a tool to prepare for a voluntary conciliation with creditors, and to prevent bankruptcy. Often, the debtor recommends to the court a professional who is familiar with the debtor’s situation, though the court retains the right to appoint the mediator.

If the debtor has ceased payments, he may use the slightly more complex conciliation procedure, a voluntary conciliation procedure between the debtor and creditors. It is a four-month process, supervised by the commercial court. There are more legal consequences than in ad hoc mediation, including the need for court approval, the binding nature of the conciliation agreement, and the potential for publication of the conciliation agreement, as well as for post-conciliation priority financing. The commercial court-appointed mediator has more power to negotiate agreements with creditors than the ad hoc mediator, including the authority to propose restructuring plans, and to preserve employees’ jobs. The agreement between the debtor and creditor must be approved by the court. After approval, the agreement is binding on all parties to the agreement. The ratification of the agreement in the voluntary conciliation procedure is not necessarily made public, though it may be in certain cases. In order to motivate the debtor to make the ratification public, the French law allows for financing obtained after ratification of the agreement to be paid on a priority basis.

The French model, particularly the simpler mandataire ad hoc, or ad hoc mediation, is most applicable for the needs of bankrupt debtors in Egypt. The availability of mediators trained in inter-creditor workouts would be a significant improvement over the current system. Since most cases are filed by a creditor trying to collect a single debt, resolution of the debt by mediation would help to provide an alternative to bankruptcy filing by the creditor. In more complex cases, trained mediators can work
between creditors and debtor, and among creditors, may help to create the culture of reorganization, and workout of debts, that Egypt is seeking to create. A court may be approached to ratify the agreement and give it the status of an enforceable contract. Even if the mediation is not successful in a full resolution of debts, the work done to address disputes may contribute to the success of a reorganization proceeding under court supervision, if such a case follows the attempt at mediation. The relevant provisions of the French law describing such a system are Articles 611-3, 611-4, 611-5, 611-7, and 611-8.

b. London Approach: Large, Complex, Multi-Creditor Workouts

The London Approach, described in greater detail in the UNCITRAL guide\(^8\), addresses larger cases, with multiple creditors, and assumes that the creditors are large financial institutions. In the London Approach, banks in a country form an agreement amongst themselves to provide temporary support operations to a company in financial distress, to promote restructuring. This approach is currently being used in the UK, and in India. It works when the company in distress is large, and has many bank creditors, with significant debt. In both the UK and in India, the banks agree to a standstill on collection efforts for their debts, and facilitate interim financing to keep the company operating through its period of crisis.

The London Approach has been implemented in several countries to address large, multi-creditor workouts, and is focused on bank cooperation. While such an approach may be helpful to Egypt for its largest cases, it is a complex system to implement. Currently, a placeholder in the law, an Article authorizing the Central Bank and banks to develop such a plan, to be implemented by decree, would be wise. The details of multi-bank restructuring should be left to a later date, when the bankruptcy/restructuring system has matured in practice.

c. Voluntary, Flexible Procedure Preferred

In order to be truly promote rehabilitation of the debtor, the informal workout system in Egypt should remain voluntary, and as flexible as possible. Imposing onerous requirements, either through government intervention, mandatory requirements, or additional bureaucracy will stifle the system and render it ineffective. The goal should be to assist debtor and creditor negotiations, not monitor or control either party. The majority of the work for an informal workout should be left to the parties to the case, the debtor and creditor.

DECLARATION OF BANKRUPTCY VS. OPENING A REORGANIZATION CASE: DEFINING THE CASE

a. Separate the opening order and the declaration of bankruptcy

In Egypt, a case is not open until a declaration of a bankruptcy. Until now, a declaration of bankruptcy in Egypt takes several weeks or even months, and is always followed by liquidation.

As the goal of the new law is to facilitate an attempt at reorganization, the law should be amended so that the declaration of bankruptcy is equivalent to a declaration of liquidation. The case should be opened with an “opening order”, that does not declare the debtor bankrupt, but allows for a period during which reorganization may be tried.

If it is clear from the outset that no reorganization is possible, or if the debtor does not request any type of conciliation or reorganization, the declaration of bankruptcy should follow immediately, to begin the liquidation. If a reorganization is tried, but then fails, a declaration of bankruptcy should follow quickly thereafter, in order to conduct a speedy liquidation.

Another reason that a case should be opened, and have consequences before the declaration of bankruptcy, is that in order for a reorganization to be successful, the debtor will need certain legal protections such as a moratorium on creditor action (to allow claims to be resolved together and ensure fairness among creditors), and provisions that govern the formation of creditors’ committees, the development of a reorganization plan, and confirmation/approval of the plan. These steps must happen without the declaration of bankruptcy, yet they will need to be part of a legal procedure, therefore, there must be an active case that is open, and within which parties can take action, for a significant period of time before a bankruptcy declaration is appropriate.

Section I of the bankruptcy provisions, beginning with Article 550 should be amended to reflect the new understanding of the opening of the case, and the bankruptcy declaration.

An example of how Article 550 may be rewritten:

1 – Any trader shall be entitled to request a conciliation or reorganization, as appropriate, when he requests so from the court, or when a creditor has filed a bankruptcy case against him, and the court shall open a case under this section upon such request.

2 – If a reorganization is not requested by the debtor, then he may be declared bankrupt if he is unable to pay his commercial debts as a result of financial instability.

3 – If a reorganization procedure is commenced under these Articles 550 to 772, but a plan is not successfully confirmed, then when it is determined that no plan will be confirmed, the debtor may be declared bankrupt.

Corresponding articles in Section I (Articles 550-570) should be amended to be consistent with the new scheme for opening a case based on the filing of either debtor or creditor, and issuing an “opening order” at the outset of the case. Where “bankruptcy declaration ruling” appears in the text in these articles, in most cases it can be replaced by “ruling opening the case” or an equivalent phrase. A bankruptcy should be declared only after a reorganization has been tried and failed, or when it is clearly impossible, or is not requested. French bankruptcy provisions’ Articles 641-1, 641-3, 641-5, and 641-9, are examples of how the liquidation order and the order that commences reorganization can be differentiated. These provisions also address the effect of a liquidation order, when there has previously been a reorganization attempt.
b. Eliminate the requirement to determine cessation of payments

The Egyptian bankruptcy provisions would be simplified, and more consistent with the modern approach of rehabilitating debtors, if the requirement to determine insolvency, cessation of payments, and the date of cessation of payments, is removed. How to determine the date of, or even existence of, cessation of payments, is a common topic of discussion among reformers. It is currently important in the Egyptian system because it is a requirement for a bankruptcy declaration, and since the date of such cessation is the time from which the court marks the suspicious period.

Based on international experience, it is preferable that the law not require a proof of insolvency. Significant resources are required to analyze whether insolvency exists, and there are few benefits to such a determination. If a reorganization is available to be tried, and fails, or if a creditor shows that it will not succeed, then it is not necessary to determine whether or not the debtor is insolvent. The debtor will either pay his debts, or allow liquidation, if a reorganization attempt is unsuccessful. The time and resources involved are better dedicated to reorganization efforts, than determination of insolvency/cessation of payments. The date for the suspicious period is more easily established by making it the date of the filing of the case, and there are few benefits to engaging in the determination of a cessation payments for the purposes of fixing a more “accurate” date. Legal consequences that are applied based on the date the case begins, should begin or be timed from the filing of the case.

**MORATORIUM ON CREDITOR ACTION**

The main articles (Articles of what? French Law, Egypt’s Law? – shouldn’t Egypt’s Law be included in the appendix as well?) governing a bankruptcy case’s effects on creditors are Articles 605-612. Currently, after the bankruptcy ruling, creditors may not take action against the debtor, unless they are secured creditors, in which case their rights they may pursue the debtor and execute on their collateral.

As previously stated, a case should commence with an opening order upon filing, rather than a bankruptcy declaration. The moratorium should be extended so that it applies when the case is filed and a case is opened. Delaying the onset of the moratorium until determination of insolvency, or other criteria, allows time for the depletion of debtor’s assets, and may make rehabilitation or reorganization very difficult.

Moreover, if reorganization is to be pursued, it is preferable that secured creditors, those with collateral, are also subject to the moratorium. If they are not, it is possible that the most valuable property in the debtor’s possession will be seized, instead of being available for the restructuring. In order to protect the rights of secured creditors, a procedure allowing a creditor to petition the court for relief from the moratorium, based on irreparable harm to the creditor if he is forced to wait to execute on his collateral, will need to be instituted.

In the United States, requests for relief from the moratorium9, by secured creditors, is one of the most frequent types of motions made in bankruptcy cases. The judge accepts the petition from the creditor, and determines whether or not the creditor’s interests can be protected without execution on the

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9 This motion is called a “relief from stay” in the U.S. Bankruptcy Law, the moratorium itself is called the “automatic stay”. See Appendix IV.
asset. If the creditor's rights can be protected by additional payments (adequate protection) during reorganization, or his interests will not be significantly damaged by leaving the moratorium in place, the motion is denied. If the creditor's rights will be irreparably diminished by the moratorium, the judge will lift the moratorium for that creditor, and allow him to pursue his civil remedies against his collateral.

The American bankruptcy law Sections 361 through 362, attached to Annex IV (with a brief explanation of the procedure), provide helpful models for extending the moratorium to all assets in reorganization. Sections 361 and 362(d) provide model language for adequately protecting the creditor, and for allowing a relief from the moratorium, respectively.

**IMPROVING TRUSTEES**

As many of Egypt's bankruptcy reformers have commented, the trustee institution needs significant reform. Observers cite numerous problems. The job of a trustee requires specific skills in identifying, analyzing, evaluating, and selling assets, as well as in accounting and financial management. Though there is a committee with judges that evaluates applications from trustee candidates, in practice, some trustees are not considered reliable. There is not a standard system for reliably tracking assets in bankruptcy cases and the proceeds from their liquidation. Trustees collect more fees by spending more time on a case, so that they do not have an incentive to finalize cases quickly. Professional fees can drain the money in a case so that there is no recovery for creditors. In some cases, money from sales of bankruptcy assets are not distributed to creditors.

At a minimum, according to the international standards, there should be clearly established and publicly available standards for trustee qualification, and appropriate supervisory bodies. Training and continuing education may also be required to ensure the necessary skills. Appropriate supervisory bodies are independent from the individual representatives, set the standards for the profession, and have appropriate powers and resources to oversee the trustees.

In order to reform the trustee profession in Egypt, the current qualification requirements and supervisory system will have to be reviewed and improved. A system for maintaining the credibility and integrity of trustees, so that the courts, the litigants, and the public can invest confidence in trustees, is also necessary.

In his recommendations for reform of the Egyptian bankruptcy law 10, Judge Bufford recommended that trustees continue to be appointed from the private sector. In his experience, government-employed trustees have been ineffective in every country where they have been used. His specific recommendations further include:

- Professional association: A professional association can establish professional standards and rules of ethics, and can discipline trustees who do not fulfill such standards. Professional associations have a successful history of disciplining professions in many developed countries.
- Insurance for malfeasance: Trustees should be required to obtain and maintain insurance, or bonds, against their bad acts. In many developed countries, professional associations create group insurance, and charge their members premiums to cover it.

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Such an arrangement has the advantage of inciting members to monitor each other, as their insurance costs will rise every time one member commits acts in bad faith that require a payout.

Judge Bufford also provided an example of a successful trustee reform effort during his bankruptcy workshops, conducted in May 2007. In Romania, a communist-era law (1985) assigned the function of trustee to judges. Judges did not function well in such a role, and wished to be relieved of those duties. Based on the UK model of using companies as trustees, large international accounting firms that were doing business in Romania expressed an interest in performing the trustee function. The Romanian Parliament changed the law, and assigned the duties to professional trustees. A professional association was created, and the government licensed each member individually after they passed an exam. Continuing education and ethics standards were established, and insurance was purchased on a group basis. The international accounting firms were the employers of the individual trustees. The accounting firms had international reputations to maintain, and thus had an incentive to enforce honest behavior. In practice, the system worked well. There were still some complaints, some based on incompetence, and a few on corruption, but overall the reform was considered worthwhile.11

There are advantages of such an approach in Egypt. The self-monitoring aspects, based on the international reputation of the firms, as described by Judge Bufford, could greatly improve accountability of trustees. Moreover, the accountants involved are trained to be fiduciaries at their accounting firms. Licensing by the Egyptian government would allow oversight.

The experience of reform in other countries can be studied to generate ideas to design a reform of trustee system that is appropriate for Egypt, and meets international standards. In amending the law, it may be preferable to make a reference to the appointment of trustees according to an implementing regulation and then develop the system through decree. Flexibility will be required to change the system based on practice and experience, as it develops. A decree or regulation allows greater flexibility for change than explicit provisions included in the law.

REORGANIZATION PROCEDURES (PROCEDURES, PLAN FORMATION AND CONTENT, VOTING, ADMINISTERING THE PLAN)

One of the main purposes of the current bankruptcy reform is to allow debtor rehabilitation, rather than “death”, the current effect of a bankruptcy declaration. The intent is to include a reorganization procedure in the law. Articles 662 to 683, and 702 of the Egyptian bankruptcy provisions address the possibility of conciliation. However, reorganizations are not occurring in Egypt. The provisions will need to be enhanced substantially, and many new provisions will be needed, in order for debtors to be effectively rehabilitated.

Chapter 11 of the American bankruptcy law is a well-known example of detailed reorganization procedures. The recent amendment of the French law was modeled after the system established by Chapter 11 reorganization.12 Egyptian bankruptcy law was originally based on the French model.

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11 The description of Romanian reform in this paper is derived from a discussion at a meeting held at the National Law Commission, with the Bankruptcy Management Subcommittee, on May 7, 2007.
12 Unlike the U.S. law, which has one set of provisions governing reorganization of businesses (with some exceptions or special provisions for certain situations), the French Law provides for two rehabilitation procedures after a case is filed: the safeguard procedure, prior to debtors having entered cessation of payments, and the reorganization procedure, after the cessation of...
Therefore, the French law provides a helpful model for Egyptian drafters in developing legal language for reorganization provisions to be added to the Egyptian bankruptcy law.

Judge Bufford provided a valuable summary of the elements that will be necessary to allow effective reorganizations in Egypt. Each of those elements is described below, briefly. For further information, Judge Bufford’s paper is attached as Appendix I. As guidance on drafting provisions to achieve the goals set forth, appropriate provisions of the French and American law are referenced as examples.

- Urgency of Action in a Reorganization

Many issues that financially distressed companies face are urgent, and must be addressed within days of initiating a case. The debtor files the case in order to seek the protection of the bankruptcy court, but in doing so, is restricted from certain actions that may be necessary to run the business, which may require a court order after bankruptcy. Examples include:

- Post-bankruptcy filing financing with priority status to allow the company to continue to run
- Permission to use the company’s cash to pay certain debts, or to pay employees
- Sale of certain assets whose value may be diminished by delay

Implementing this suggestion requires an institutional change, rather than a legal change. In order for rehabilitation of distressed companies to be effective, the courts must have the facility to respond to urgent requests throughout the case. Cases must be opened and begin upon filing. There should be provisions allowing for hearings with shortened notice. Judges and courts need to be available, and judges and the other professionals involved must understand the reorganization process well enough to recognize the urgency of certain debtor requests, and decide and issue orders quickly. As devices to allow reorganization are added to the law, the debtor must have the ability to use them quickly, shortly after filing the case.

- Financing of a Reorganization

Companies generally need credit/financing to survive a period of financial distress, and emerge from it. Both the U.S. and French law provide that the court may allow a company to borrow money after it begins its case, and that the new money may be repaid on a priority basis, before the older debts in the case. Without priority repayment status, banks and other lenders will be reluctant to lend to a financially distressed debtor, and especially to a debtor who has already filed bankruptcy. The ability to attract lenders after filing is one of the main tools the U.S. bankruptcy law confers on debtors who file for reorganization. The experience in the U.S. has also shown that lenders are very willing to provide such first-priority, post-filing loans, as over the years, it has been profitable for them.

The French law allows such priority for “new money” in Article 611-11. Article 611-11 is particularly instructive because it covers lenders who supplied new money provided in the informal workout stage, before filing a case with the court. This encourages lenders to participate in the informal workout, the
pre-case mediation, because if the case then proceeds to being filed in the court, their interests remain protected. The U.S. provision governing priority financing after filing, often called “Debtor in Possession” (DIP) financing, is in Section 364 of the U.S. Bankruptcy Law.

a. Debtor in Possession: Debtor Management Continues During Reorganization

While Article 645 of the Egyptian Commercial Law allows the bankrupt debtor to continue to run the business with court approval, it is still done under the supervision of the trustee. However, for effective reorganization, a debtor should be allowed to run the business, with permission from the court for actions that affect creditors (use of large cash amounts, selling assets, incurring further debt, etc.).

International experience has shown that appointing a trustee to run a company when a bankruptcy case is filed guarantees that the reorganization attempt will fail. A new manager does not understand the business, and does not have relationships with customers and employees. In the U.S., and under the recently amended French law, the pre-bankruptcy management continues to operate the business through the reorganization procedure. It may seem counterintuitive in a system where the debtor and its management are viewed as flawed, or even as criminals. Allowing the debtor to remain in control requires the assumption that most debtors are filing in good faith, from economic distress, and not with bad intentions. If rehabilitation of the debtor is the goal, the debtor should be allowed to continue in management during the reorganization process. The requirement of court approval for important actions, when implemented effectively, protects creditors’ rights during restructuring.

Article 622-1 of the French law reads “The management of the business shall be carried out by its manager.” Further language in that provision allows for the appointment of an administrator to work with the debtor’s management, if necessary.

b. Committee of Creditors

Articles 684 to 696 of the Egyptian law provide for a union of creditors to participate in a liquidation. In a reorganization, a committee of creditors is even more crucial. Creditor participation is the central element in an effective restructuring of debtor’s debt, central to debtor’s rehabilitation. In the U.S., a creditors’ committee is composed of the largest unsecured creditors of the debtor, with secured creditors sending individual representation in order to participate in the restructuring. In France, two creditors’ committees are created, one for banks/credit institutions, and the other for trade creditors (suppliers). Articles 626-29 to 626-35 of the French law set forth the guidelines for the designation and operation of creditors’ committees.

c. Reorganization Plans

The plan in reorganization is the result of negotiations among the debtor and creditors. It is the document that sets forth the parameters of recovery from financial distress. Provisions governing the reorganization plan will need to be added to the law. French law, Chapter VI: The safeguard plan, Articles 626-1 to 626-28, is an example of provisions governing the reorganization plan.
Contents. The plan will set forth the plans for the business. It provides the creditors and the judge with the information necessary for them to vote on the plan, and in the case of the judge, to approve it. The plan informs each creditor how his claim will be treated. The plan and related documents should also contain information on the debtor's financial difficulties, how it will emerge from those difficulties, and how it will prevent them in the future. The exact structure of the plan depends on the size and nature of the debtor's business, and can remain flexible, so long as it contains sufficient information to allow creditors to decide whether or not to accept it.

Proposal of Plan. Plans are usually proposed within a few months of the opening of the case. Many countries allow a debtor an “exclusive period”, during which only the debtor may propose a plan. After this period, creditors may also propose plans. The debtor should be given latitude to control the plan process in the initial period, in order to encourage creditors to participate in the necessary negotiations. However, allowing creditors to propose plans after such an initial period will help to protect creditors’ rights and also motivates the debtor to complete a plan within the initial time period.

Approval of Plan. Generally, creditors will vote on a plan. In the U.S., creditors are separated into classes, and confirmation requires the assent of creditors within each class that amount to a majority in number, and two-thirds of the debt. There are also provisions within the U.S. law to bind even creditors who do not approve the plan (called the “cramdown”), if the judge finds that the plan otherwise complies with all of the legal requirements for a reorganization plan. In France, the assent of the creditors’ committees is needed for approval of the plan. In both systems, as in most legal systems, the judge must approve the plan, based on its satisfaction of legal requirements.

Failed Plans. If the plan fails after implementation is attempted, the case will almost always result in a liquidation of the business. The effects of the plan in modifying creditors’ rights are invalidated, and creditors should be restored to their original position, except for any further recovery they may have made during the implementation of the plan.

DECRIMINALIZATION OF BANKRUPTCY: LOSS OF CIVIL RIGHTS

Egyptian bankruptcy law reflects the traditional belief that debtors are deserving of punishment. In order to develop a modern bankruptcy practice, there must be a shift in the legal culture toward viewing bankruptcy as an economic problem, rather than a moral and criminal one.

While criminal punishment is appropriate for those who are abusing the system to avoid debts, or those who engaged in egregiously bad behavior in running the business, most debtors do not fall into this category. Most businessmen operate their businesses in good faith, in Egypt and elsewhere. Even if they make improper decisions, very few are acting out of the bad faith, the bad intent that is normally required to establish criminal activity. Businessmen must have the freedom to make mistakes. Criminal sanctions for bad business decisions or even just bad luck or circumstances outside the businesses’ control (weather, earthquakes, acts of terrorism, etc) will prevent businessmen from taking risks that are necessary in a dynamic modern economy.

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13 In the U.S., a second reorganization may be attempted, but experience shows that these are exceptional cases.
Moreover, relying on criminal sanctions to incite certain behaviors prevents the development of more effective economic incentives within the financial and economic system. It would be better for the economy in the long term if more effective methods for enforcing economic consequences develop. Such mechanisms include effective collection, enforcement of judgments and court rulings, and effective financial systems that collect information (such as a credit bureau) to allow businessmen to determine their risk at the outset of a transaction and provide an incentive to maintain a good reputation.

Currently, restrictions on debtor’s personal freedom are used as an incentive for a debtor to avoid bankruptcy. Creditors file, so that the debtor’s freedom is threatened, in order to incite payment by debtor. However, if the bankruptcy system is to be converted to a rehabilitative one this approach is inappropriate. The possibility of recovery from his financial distress is the incentive to develop in the law, to encourage debtor to cooperate with creditors. The restrictions on debtors’ individual rights should be removed from the law, unless the debtor has been determined to have acted in bad faith. Mechanisms to prevent his transfer of his assets, such as financial controls which allow the court to freeze assets and prevent their transfer, should be employed more effectively. Criminal prosecution should be limited to cases where the debtor has engaged in fraud.

**DISCHARGE OF DEBTS**

A central concept of the U.S. system is that when debtors become burdened with debt that they cannot pay completely, they should have a mechanism to emerge from it, and be able to start anew, to receive a “fresh start”. The purpose of the bankruptcy case is to be sure that the debtor either: 1) recovers, continuing to operate as a business, or 2) through liquidation, the debtor has paid as much as is possible, and has distributed it fairly among creditors. After fulfilling these requirements, the debtor is relieved of the remaining debt, having done the best he can through the bankruptcy process.

Bad economic results are unavoidable in a market economy. All dynamic economies involve risk. Risk will lead to failure in some cases. Failure should be allowed, and those who have failed, should be allowed to recover, and become economically productive actors again. Currently, there is no clear discharge of debt in the Egyptian bankruptcy system. Some bankruptcy professionals consider the lifting of personal restrictions (imposed by a bankruptcy declaration) on practicing a trade after three years, to be an effective discharge. However, three years is a long time to render an individual economically inactive.

In order to motivate debtors to seek the bankruptcy system for rehabilitation, or even for a fair, orderly liquidation, debts that have not and will not be paid should be cancelled after the bankruptcy case is finished. In the case of reorganization, the process to confirm the plan will protect creditors by allowing them to participate in its development and confirmation. In the case of liquidation, if the company and its assets have been liquidated, and the proceeds distributed in the most efficient manner, then the recovery has been maximized, and there will be no more funds for payment. Remaining unpaid debts should be laid to rest.

\[14\] Article 712 of the Egyptian Commercial Law states “But for bad faith cases of bankruptcy, all rights lost by the bankrupt shall be legally restored. . . after three years from finishing the bankruptcy”. This provision is somewhat undercut by Article 713, which though unclear, seems to require repayment of debts in order to obtain a discharge. In practice, according to professionals interviewed, a bankrupt debtor may resume operation of a business after three years. Bankers suggest that this has motivated debtors to file bankruptcy cases, even though most cases, according to judges interviewed, are filed by creditors.
In a dynamic economy, debtors must be able to recover from burdensome debt. After they have followed a procedure that allows maximum payment to creditors, they should be allowed a fresh start, discharged from the former debt.
RECOMMENDED INSTITUTIONAL CHANGES TO SUPPORT REFORM

It has become clear, through experience in Egypt and internationally, that changes to laws in themselves do not create change. Institutions must learn to apply the law, and often must be reformed in order to be capable of implementation of new concepts.

IMPROVEMENT OF CIVIL ENFORCEMENT OF RULINGS AND JUDGMENTS AND DEBTS

The importance of an effective civil judgment enforcement system has been noted at the beginning of the paper. Without it, bankruptcy will remain a tool for collection rather than rehabilitation, a tool to pressure payment in the absence of another effective mechanism. A debtor will have a greater incentive to complete a bankruptcy reorganization successfully, if there is a credible threat of collection by the creditor outside the bankruptcy.

TRAINING OF JUDGES

The changes being proposed are not only legal changes, but cultural changes in the approach to businesses and their unpaid debts. Significant education will be required if the practice is to shift to support debtor rehabilitation rather than punishment. In addition, rehabilitation of debtors requires the development of a “rescue culture”, which requires knowledge of financial analysis and other aspects of debt and company restructuring. Reform will need to include substantial work with judges in understanding and implementing the new system.

TRUSTEES’ CAPACITY DEVELOPMENT

As stated above, the profession of the trustee will require redesigning. In addition to transparent and clear legal rules regarding selection, appointment, and performance standards, skills will have to be developed. A training plan for trustees should be developed as an integral part of any reform. Trustees will need to develop skills in evaluation, accounting, sales and marketing. In addition to technical training, trustees will need guidance on case management, and coordination with court case management systems for bankruptcy cases. This capacity development is essential to implement changes in the law successfully.

CASE MANAGEMENT IN COURTS

There are initiatives underway in Egypt to improve case management in courts. The AQJS II project, funded by USAID and implemented by AmidEast, is working with two pilot courts, in Alexandria and Monsoura, to implement a court management/reeengineering project. Information systems are being developed to track cases, and help to manage case information more smoothly. Baseline studies have been done, so that statistics can be gathered to determine needs for changes in process.
Bankruptcy cases have unique aspects, such as multiple litigants, intensive financial management and record-keeping, and their motion-intensive nature. As the bankruptcy system develops, the systems being developed should be utilized to gather information on case size and nature to help inform further changes. Creating a specialized system for bankruptcy cases should also be considered.

ACCESS TO INFORMATION SYSTEMS

There has been significant discussion within the NLC Subcommittees for a greater need for information and transparency in the financial system. Information at the outset of the creditor-debtor relationship, when the loan is being given, or the credit being extended, allows the lender/creditor to assess their risk and make better decisions on who may be creditworthy. Once a bankruptcy begins, and assets are being distributed, information on liens, or security interests, or judgments, allows assessment of other creditors’ claims on property of the debtor, to ensure a fair distribution, and protection of various creditors’ rights.

Currently, the Egypt Financial Services’ project, funded by USAID and implemented by Chemonics, is developing a credit bureau and a movable collateral registry. The credit bureau will hold information on borrowers, their payment histories, and their creditworthiness. The movable collateral registry will hold information on the security interests granted by borrowers on their movable collateral.

Courts and trustees should have access to these and other information systems that develop, and the real estate registry, in order to assist them in financial analysis and management of debtor’s liabilities and assets.
RECOMMENDED NON-BANKRUPTCY CHANGES

Many other areas of the law affect bankruptcy. In order to create an effective system, parallel, supporting changes will be needed.

ENFORCEMENT OF JUDGMENTS/DEBTS

As stated previously, effective enforcement of civil judgments is key element of a well-functioning system to address debt. It is also necessary to support effective bankruptcy procedures. Currently in Egypt there have been efforts directed at reforming the execution on civil judgments, including passage of laws related to real estate finance, and amendments to the civil procedure code. The impetus toward change should be continued, and an overhaul and major reform of the laws and institutions involved in enforcement of civil judgments should be seriously considered. In most countries undertaking such reform, the legal changes have included moving toward private enforcement officers modeled on the system of *huissiers*, the French independent enforcement agents that enforce judgments and debt collection in many European countries.

INFORMATION BANK/CREDIT BUREAU/INFORMATION ON DEBTORS

Creditors benefit from having information on debtors at the time they issue their credits. When they are deciding whether to lend money, it helps if they have information on the reliability of the debtor, and where appropriate, certain financial information on the debtor. As the goal of a transparent, effective bankruptcy system is to allow risk assessment, systems that allow risk assessment prior to bankruptcy, when creditors issue credit, make loans, supports the overall system. Currently, a credit bureau, that records borrowers' payment histories and histories of default, is being developed in Egypt. The information is expected to help lenders to issue their loans more prudently, and prevent some defaults. Since their histories will now be available to future lenders, it is also expected to provide incentive to debtors to pay in order to maintain their reputations. Further registries, such as registries of unpaid judgments, or other records that help creditors determine a borrower's creditworthiness, should be encouraged.

Information on debtors’ assets also helps the bankruptcy system to operate more effectively. Accurate property registries, registries for interests in collateral, and for other property help a lender assess risk at the outset, but also help in the execution stage of determining priority of interests in potential collateral. Currently in Egypt, such systems are underdeveloped. However, efforts are underway to improve the real property registry, and to develop a movable collateral registry. Both initiatives will enhance creditors’ rights, and creditor-debtor relationships in Egypt.

CORPORATE GOVERNANCE

a. Transparency

Transparency in corporate governance is essential to promote credibility and trust among businesses interacting in the market. Accounting standards that can be uniformly applied and relied upon, proper corporate governance practices, and accountability for company assets and for the performance of
officers and directors of a company, are essential. Without these in place, bankruptcy practitioners find it difficult to assume the good faith of debtors, which undermines the rehabilitative potential of the bankruptcy law.

b. Business Judgment Rule for Management Misconduct

Discussions among Egyptian reformers often turn to preventing, or punishing, the misconduct of businessmen when their businesses fail and there are negative financial consequences. In order to support the risk-taking that is necessary for a dynamic economy, a distinction must be drawn between misconduct by businessmen, and mistakes in business judgment. Often a business decision is only revealed to be a mistake in hindsight. In fact, the financial distress may have resulted from an event that is unpredictable, so that the businessman’s decision cannot even be called a mistake, but merely, a misstep of the sort that is inevitable in the world of business, where all events cannot be controlled. Businessmen must be free to make reasonable decisions in the context of operating their businesses, without fear of legal consequences if they are wrong. Such a fear can stifle initiative, which can lead to stagnation in the economy.

In the U.S., the Business Judgment Rule protects board members of a company from liability for financial losses caused by errors in judgment so long as they did not breach their fiduciary duties of loyalty and care. The definition of such a breach has been developed through substantial case law. In essence, the Business Judgment Rule means that in determining liability, it is presumed that the board member acted in good faith, even if the result was financial losses. In order to impose liability, they would have to have engaged in actions that indicated bad faith, bad intentions, an abandonment of their duties, not simply a mistake in judgment.

A policy such as the U.S. Business Judgment Rule, applied to businessmen in Egypt, would be helpful to address the desire to hold businessmen accountable. It would allow them to make reasonable decisions, involving punishment only when their acts are egregious.

OTHER AREAS

As the financial system in Egypt develops, more and more areas will intersect with bankruptcy. In a dynamic system, the reform of laws is ongoing, in response to economic realities. Bankruptcy’s effectiveness will need to be monitored as the practice develops, and the law will need to be changed based on practical realities. Changes in other aspects of the financial system, and the related laws, will also be revealed as modernization progresses.
APPENDIX I: REVISING EGYPT'S BANKRUPTCY LAW BY JUDGE SAMUEL BUFFORD
APPENDIX II: BANKRUPTCY REFORM ASSESSMENT BY KAREN RUSSELL
APPENDIX III: COMMERCIAL LAW DIAGNOSTIC DAI
APPENDIX IV: RELIEF FROM STAY IN U.S. BANKRUPTCY BY ANGANA R. SHAH
APPENDIX V: FRENCH LAW