



# ICLG

The International Comparative Legal Guide to:

## Corporate Recovery and Insolvency 2012

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# Egypt



Dr. Ahmed El Borai



Dr. Ramy El Borai

## El-Borai & Partners

### 1 Issues Arising When a Company is in Financial Difficulties

#### 1.1 How does a creditor take security over assets in Egypt?

Under Egyptian law, the principal and most common securities are either taken on moveables or immoveables (real) property. There are four types of security: the real estate mortgage; the possessory pledge; the *fond de commerce* (business) mortgage; and the pledge of securities.

##### Real estate mortgage

Real estate mortgages remain the primary form of security that is customarily taken by lenders to secure a given debt. The process of registering a real estate mortgage involves the allocation of a certain property to a creditor by way of security for the repayment of debt. The real estate mortgage does not entail the delivery of possession; however, the secured creditor has the right to enforce the security even if the mortgaged asset is transferred by the mortgagor.

##### Possessory pledge

The asset at stake will remain in the actual possession of the creditor or pledgee until the loan is repaid and the latter will be allowed to dispose of such assets following an event of default from the borrower or pledgor. The pledgee has the right to sell the underlying assets (pledged) upon any default by the pledgor but subject to a special approval by the competent court. The possessory pledge, since it depends on “possession”, involves only assets that can be offered and sold in a public sale.

##### Fond de commerce mortgage

Classified as the most common commercial security in banking credit facilities, the borrower or pledgor may grant its creditor a pledge over its *fond de commerce* (business). Such type of security is regulated under Law No. 11 of 1940. The mortgagee here includes, among other business elements, the trade name, address, licences, approvals, equipment, the right to contact clientele, the right to lease the premises used, etc. Such type of security, however, does not entail any enforcement over the premises *per se*.

##### Pledge of securities

A pledge of securities is the right to retain the possession of shares and other types of securities by way of security until the repayment of a loan. A pledge of securities has a similar nature to a possessory pledge; however, the pledgee may, subject to an agreement with the pledgor, enforce such security upon a defaulted obligation without entailing any court ruling.

#### 1.2 In what circumstances might transactions entered into whilst the company is in financial difficulties be vulnerable to attack?

Under Law No. 17 of 1999, there are certain types of transactions made during the period commencing from the suspension of payment and the declaration of bankruptcy, which transactions may not be enforceable *vis-à-vis* creditors and could be challenged by a liquidator or administrator; namely, any payment by a financially distressed company that involves charity, endowment, early settlements of loans or creating or granting of any pledge or security over its assets, or any other transaction that involves a fraudulent act by the debtor and a third party.

A period of up to two years before the bankruptcy declaration date may be declared as a suspect period, during which creditors may claim the non-opposability of fraudulent transactions as well as prepayments made by the debtor during such period.

#### 1.3 What are the liabilities of directors (in particular civil, criminal or disqualification) for continuing to trade whilst a company is in financial difficulties in Egypt?

There is presently no specific legislative scheme regulating the liabilities of directors *vis-à-vis* the creditors in connection with financially distressed companies in Egypt. However, directors' liability is subject to the general provisions of bankruptcy proceedings regulated under Law No. 17 of 1999 and the Egyptian Criminal Code, which specify the criminal liability for the acts of directors committed on or before the declaration of bankruptcy upon the finding of certain elements such as bad faith or fraud (or both) – and allow for the filing of criminal charges against the bankrupt entity, its directors, managers with the potential penalty of imprisonment and/or a fine.

Article 704 of Law No. 17 of 1999 provides for the directors' personal liability to severally and jointly pay the company's debts, in the event the company's assets are not sufficient to pay more than 20% of its total liabilities upon declaring bankruptcy.

This provision establishes a rebuttable presumption of liability based on the assessment and valuation of the bankrupt's assets versus its ability to reimburse the debts at stake. The legislator inserted this provision into the law in order to assist creditors when they collect on their claims when it is otherwise difficult to prove or substantiate the negligent management of the bankrupt's directors or board members.

Also, as a part of personal liability, directors and managers may be disqualified by a court ruling for any fraud or gross negligence in connection with the company that may lead the company to a more

financially distressed situation and thus suspension of payment of its debts.

## 2 Formal Procedures

### 2.1 What are the main types of formal procedures available for companies in financial difficulties in Egypt?

When a company is in financial difficulties, there are several formal procedures which it may apply:

- Appointment of a receiver.
- Voluntary/involuntary reorganisation.
- Involuntary liquidation.
- Voluntary liquidation.

The appointment of a receiver or a liquidator is an indication that the company in place has no future and its shareholders are only targeting the maximum value for liquidation proceeds of its assets or business. Whenever it is decided by the court, subject to the approval of its creditors, a company may, instead of being placed in the liquidation process, apply a reorganisation plan for the purpose of rescuing such company, which is seen as viable for seeking such alternative.

The company may consensually opt for liquidation. In such case, the company in place must be solvent and accordingly it is a voluntary liquidation. On the other hand, if the company is financially distressed, the involuntary liquidation scheme will apply in such case.

Other procedures entail the issuance of a moratorium against all claims and a retroactive nullification of all acts or contracts (and their legal effects) the debtor may have entered into during the period starting from the debtor's inability to meet his financial obligations (cessation of payments) and ending when the debtor was judicially declared bankrupt (the 'suspect period').

### 2.2 What are the tests for insolvency in Egypt?

The Egyptian Trade Law does not refer to the test for insolvency *per se*, rather it refers to the suspension (cessation) of payments. Accordingly, under the Egyptian Trade Law, a company can be found insolvent if it is unable to meet its financial obligations.

### 2.3 On what grounds can the company be placed into each procedure?

#### Involuntary liquidation

There are three conditions for creditors to place a debtor into involuntary liquidation. First, the debtor must be a merchant, mandated to keep and maintain commercial books (trade registry). Second, the debtor must have ceased to meet its financial obligations to creditors and such a default stems from financial distress. Third, there must be a court judgment (from the economic court) declaring the insolvency of that merchant. Once all three conditions are fulfilled, creditors may place their debtor in involuntary liquidation.

#### Voluntary liquidation

Appointment of a liquidator may be done by the company in case of voluntary liquidation, in which case, the liquidator could be one of the shareholders. The company in voluntary liquidation must apply for liquidation according to a proper corporate action taken in this regard.

#### Appointment of a receiver

The court declaring the bankruptcy may appoint one or more receiver who shall satisfy certain conditions specified under the Trade Law in order to be eligible for acting as a manager of the company's assets and business, as well as an authorised representative for the company in bankruptcy.

#### Voluntary reorganisations

As far as out-of-court procedures are concerned, there are no laws or guidelines that dictate the process to follow or that detail the effects that will result from voluntary reorganisation. In contrast, in-court procedures for voluntary reorganisations under Egyptian law are subject to the approval of a court-sanctioned composition of creditors.

#### Involuntary reorganisations

While the effects of a reorganisation plan – whether voluntary or involuntary – would be similar, it is noteworthy to mention that under the Trade Law, the judge is endowed with the authority, even without being asked by the debtor, to postpone the declaration of the debtor's bankruptcy with the view that the debtor's financial condition might improve notably as a result of a reorganisation plan.

### 2.4 Please describe briefly how the company is placed into each procedure.

#### Involuntary liquidation

Subject to fulfilment of the conditions referred to above (in question 2.3), a financially distressed company may be placed in involuntary liquidation upon a court judgment (from the economic court) declaring the insolvency of the debtor and the appointment of a liquidator or receiver (as the case may be).

#### Voluntary liquidation

The company in voluntary liquidation must apply for liquidation following a proper corporate action taken by the company's shareholders in an extraordinary general meeting pursuant to the voluntary liquidation rules set out under the Companies Law No. 159 of 1981.

#### Voluntary reorganisation

As provided, there are no laws or guidelines that dictate the process to follow for placing a company into a voluntary reorganisation as they are out-of-court procedures.

#### Involuntary reorganisation

Involuntary reorganisations take place through the court-supervised and sanctioned process related to the composition of creditors. The involuntary reorganisation may be ordered by the court even without being asked by the company with the view that the company's financial condition might improve as a result of a reorganisation.

### 2.5 What notifications, meetings and publications are required after the company has been placed into each procedure?

Generally, there are a number of notices sent to creditors in the course of bankruptcy proceedings. Such notices include the general notice for creditors to present their claims, the notice to secured creditors allowing them to enforce their rights against the pledged assets of the debtor, the notice sent to creditors for the appointment of the insolvency trustee and controller, etc. Among the most significant notices is the general notice for creditors in relation to the lodging of their claims, based on which the composition of creditors may or may not be approved.

Creditors can assert a bankrupt estate's remedies and defences against third parties and are explicitly afforded a right to claim from and pursue any third party who is indebted to their debtor.

### 3 Creditors

#### 3.1 Are unsecured creditors free to enforce their rights in each procedure?

The initiation of insolvency proceedings precludes secured and unsecured creditors from pursuing their claims individually and entails a stay of proceedings in relation to any ongoing lawsuit initiated prior to the opening of insolvency proceedings against the debtor in question, and yet to be adjudicated as of the date of the declaration of insolvency.

#### 3.2 Can secured creditors enforce their security in each procedure?

Upon the initiation of insolvency proceedings, whether voluntary or involuntary, a general moratorium against all individual creditors' claims is issued, and creditors are prohibited from independently initiating any lawsuit to recover their claims from the debtor (whether secured or unsecured). However, by way of exception to this general prohibition, the legislator has endowed creditors, subject to obtaining an authorisation from the court, with the authority to undertake preservation measures to protect the assets of the debtor if the insolvency trustee fails to adequately fulfil his role.

#### 3.3 Can creditors set off sums owed by them to the company against amounts owed by the company to them in each procedure?

Creditors may, subject to one condition, exercise their netting or set-off right in each procedure unless for reorganisation. In this regard, article 591 of the Trade Law stipulates that creditors may exercise such a right, whether temporarily or permanently, for as long as there is a clear and unambiguous link, connectivity or causation between the obligations of the debtor and those of the 'exercising' creditor. By way of illustration, a set-off will be possible if and when the debt of both the creditor and debtor finds its source or emanates from the same dealing, contract or tort. Any right of set-off or netting in the course of insolvency proceedings must be subject to the prior approval of the insolvency judge and must not derogate to any privilege and/or priority ranking.

### 4 Continuing the Business

#### 4.1 Who controls the company in each procedure? In particular, please describe briefly the effect of the procedures on directors and shareholders.

##### Voluntary/involuntary reorganisations

In the course of a reorganisation, the debtor can carry on its business subject to the approval of the composition of creditors. There are no criteria imposed by the law other than the prior consent of the composition of creditors. If so allowed, the debtor would not, however, be allowed to charge its assets with any further encumbrances, unless so authorised by the court to do so. The court exercises its supervisory powers through the insolvency trustee and a controller specially appointed to that effect. In addition, and since the reorganisation possibility is a consensual rather than a legal

process, the composition of creditors would be required to sanction each and every act of the debtor that may produce a material adverse effect on creditors' rights.

##### Appointment of a receiver

The receiver is the manager of the company's assets and property whose duty is to seek repayment of the company's debts *vis-à-vis* its creditors and repayment of its debts. Accordingly, the appointment of a receiver will entail the suspension of the directors' powers and authority in connection with the management of the company's assets.

##### Liquidation

The liquidator has, under the Companies Law No. 159 of 1981, a wide range of powers and authority to manage the assets of the company placed in a voluntary or involuntary liquidation. Accordingly, the directors and board members will lose their powers and endowments to dispose of any corporate assets upon the appointment of the liquidation trustee. The trustee under voluntary liquidation exercises the same powers and prerogatives he has in the course of involuntary liquidation.

#### 4.2 How does the company finance these procedures?

A company in liquidation or reorganisation cannot obtain any credit facilities, whether secured or otherwise. That said, the composition of creditors may grant certain leeway to the debtor in the course of reorganisation subject to conditions determined on an *ad hoc* basis.

#### 4.3 What is the effect of each procedure on employees?

The effect of each procedure on the company's employees is not specifically regulated under the Egyptian bankruptcy regime. However, a company placed into any of the formal bankruptcy procedures is - by operation of law - obliged to satisfy creditors' priority rankings and privileges, which include, *inter alia*, the wages of employees and their various benefits (such as severance pay, pay *in lieu* of leave, etc.).

#### 4.4 What effect does the commencement of any procedure have on contracts with the company and can the company terminate contracts during each procedure?

Generally, the law prohibits the debtor from entering into any transaction with the intent to defraud creditors. Special emphasis and control, however, is exercised during the suspect period, which starts from the cessation of payments until the declaration of bankruptcy. On a more specific note, article 598 of the Trade Law prohibits certain types of agreements or acts of disposal such as charity, endowment, early settlements of loans or creating or granting of any pledge or security over its assets.

In the event that an act of disposition is made by the debtor with the intent to defraud creditors within the suspect period, such act will be annulled and shall produce no effect against the bankrupt's estate and will not be able to be used against the creditor.

There is a suspect period under Egyptian law and this period starts from the cessation of payments until the declaration of bankruptcy. Any transaction or act of disposal taking place during that period may be attacked and annulled as described above; however, the prerogative is reserved to the insolvency trustee. Differently said, creditors will only raise their concerns or share their knowledge regarding a specific act of disposal with the insolvency trustee, who shall take the necessary measures before the court to annul such acts.

The company undergoing reorganisation is not treated differently from any other company to a bidding agreement. Unless a given contract lacks one of the conditions necessary for its validity, a company - whether undergoing reorganisation or not - cannot disclaim or reject its obligations thereunder. Doing so, without being given the right to unilaterally terminate, would simply constitute breach of contract and possible damages could ensue.

## 5 Claims

### 5.1 Broadly, how do creditors claim amounts owed to them in each procedure?

In a typical insolvency case, liquidation takes place after the declaration of bankruptcy when any alternative reorganisation plans, whether in-court or out-of-court, have not been presented or failed. Pursuant to the priority of claims described below (in question 5.2), the liquidation trustee proceeds with the sale of the bankrupt's assets or business and distributes such proceeds accordingly. Though it is difficult to determine the time-span within which payment of claims takes place, liquidation cases in Egypt can take anywhere between one and three years. While the law prescribes a given time frame applicable to the filing of bankruptcy claims and the ensuing proceedings, judges are overworked, have too many cases and play too large of a role in connection with insolvency proceedings.

Creditors' claims are submitted before the docks of the economic court post a declaration of bankruptcy. The procedures followed are no different from any other lawsuit and creditors have 10 days to file their claim (creditors located overseas have 40 days). Claims would be disallowed if one of the conditions necessary for the declaration of bankruptcy is not satisfied. For instance, if the debt in question is not due (has not reached maturity), or if the debtor is still able to meet its financial obligations, or if the debtor is not required to keep and maintain commercial books (trade registry), then the claims would be disallowed. It is important to note that the legislation provides for no other test for insolvency, such as balance sheet insolvency.

### 5.2 What is the ranking of claims in each procedure? In particular, do any specific types of claim have preferential status?

Generally, major privileged and priority claims under Egyptian law rank as follows:

- (i) judicial expenses;
- (ii) public treasury claims;
- (iii) expenses related to the preservation and repairs of the bankrupt's assets;
- (iv) general privileges (which include wages of employees);
- (v) special privileges (for instance, debts related to agricultural expenses and tools, arrears owing to lessors or hotel owners, and payment due to sellers of movables); and
- (vi) special privileges over real estate (the priority of claim for a real estate seller ranks as of the date of registration and is followed by architects, subcontractors and co-real estate owners' claims).

It is noteworthy that creditors' priority rankings are mandatory provisions under the Trade Law and bear a public order character. Therefore, these priorities can neither be contractually amended among the parties to a contract nor changed by the decision of the court.

### 5.3 Are tax liabilities incurred during each procedure?

There are no tax implications specifically involved with each procedure. Tax treatment for a company declared bankrupt or placed under insolvency proceedings would be unaffected for prior tax liabilities, and for which a specific priority ranking (public treasury) is provided for under the law. In the course of liquidation, whether voluntary or compulsory, capital gain taxes will be applied on disposal of assets or on income earned during the sale of assets, which would have been a liability on the company had such a transfer been effected in the normal course of business.

## 6 Ending the Formal Procedure

### 6.1 Is there a process for "cramming down" creditors who do not approve proposals put forward in these procedures?

Upon the initiation of insolvency proceedings, whether voluntary or involuntary, a general moratorium against all individual creditors' claims is issued, and creditors are prohibited from independently initiating any lawsuit to recover their claims from the debtor.

Article 605 of the Trade Law clearly stipulates the aforementioned principle in addition to a general prohibition against any and all independent judicial proceedings to be taken against the debtor (such as preservation measures in the form of attachments, etc.).

This overriding principle applies to all creditors, whether secured, unsecured or generally privileged. While the law is silent as to whether "cramming down" dissenting creditors is a possibility, and as mentioned earlier, the entire reorganisation option is contractual rather than legal, the court has no power to impose any restructuring whatsoever upon dissenting creditors within a given composition.

### 6.2 What happens at the end of each procedure?

#### Liquidation

Liquidation procedures are concluded by either the full-repayment of creditors' entitlements or the insufficiency of liquidation proceeds deriving from the sale of company's assets to repay all creditors. In either event, the liquidation trustee must, within a month of the end of the distribution process, publicise the decision to close the liquidation process so that the liquidation becomes opposable to third parties. Furthermore, the liquidation trustee must ensure that the corporate debtor or insolvent at stake is duly stricken-off the companies' registrar.

#### Reorganisations

The Trade Law does not have specific or elaborate provisions to regulate reorganisation plans. The composition of creditors plays a vital role as to whether a plan, if and when prepared by the debtor, will be approved or rejected. Superseding the powers of the composition of creditors stands the economic court and a judge who, by virtue of article 643 of the aforementioned law, has discretion to allow the sale of the debtor's property during the period between the presentation of the petition and the issuance of the bankruptcy order, if doing so will realise a positive benefit to the creditors or the bankrupt. Therefore, there are no mandatory features of a reorganisation plan to be approved, and the composition of creditors, despite the process described above, may be impeded from implementing any given reorganisation plan if so instructed by the court.

However, a reorganisation plan is defeated if the composition of creditors or the insolvency court rejects it. The ensuing effect of its rejection or the failure of the company to abide by an agreed upon

reorganisation plan would be the liquidation of the company's assets or business and the distribution of the liquidation proceeds deriving therefrom to creditors according to their priority ranking.

## 7 Alternative Forms of Restructuring

### 7.1 Is it common to achieve a restructuring outside a formal procedure in Egypt? In what circumstances might this be possible?

There are no such proceedings under Egyptian law. Any restructuring must be properly sanctioned by a judicial process.

### 7.2 Is it possible to reorganise a debtor rather than realise its assets and business?

Despite the social and economic advantages that derive from the 'rescue' option known as restructuring or reorganisation (as opposed to liquidation), there is presently no restructuring law *per se* in Egypt. However, such an option remains a possibility before the courts if and when the court decides that restructuring has a greater value in supporting the debtor's financial conditions *vis-à-vis* creditors rather than liquidation realisation of assets.

### 7.3 Is it possible to achieve an expedited restructuring of the debtor by means of a pre-packaged sale? How is such a sale effected?

There are no procedures in Egypt in connection with expedited restructuring.

## 8 International

### 8.1 What would be the approach in Egypt to recognising a procedure started in another jurisdiction?

The recognition and enforcement of foreign insolvency procedures is subject to the same rules and conditions for the recognition and enforcement of a foreign judgment. In other words, there is no special regime that applies to insolvency cases when cross-border elements are involved. Foreign and domestic creditors are dealt with in the same manner, although foreign creditors do benefit from an extended time-frame in relation to certain aspects in order to respond and interact with the court and the different parties involved. Foreign insolvency judgments would be recognised in Egypt as long as such judgments do not contravene public order and policy. Although the concept of public policy is somewhat elusive and has never been defined, it is the role of the recognising court to assess whether a given foreign insolvency judgment constitutes a breach of this concept. Generally, violations of the principles or objectives pursued by the Egyptian legislator are often construed to be against public policy, and hence recognition will not be granted. As of this date, Egypt has not adopted the UNCITRAL Model Law on Cross-Border Insolvency.

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Dr. El Borai is currently a Law Professor and Head of the Social Legislation Department, Faculty of Law, University of Cairo and Advocate before the Egyptian Court of Cassation and the Conseil d'Etat (since 1983). From 1995, Dr. El Borai sits as member of the Committee of Legal Experts of the "Arab Labor Organization" (ALO), and, since 1999, as member of the Committee of Experts-Counselors of the International Labor Organization (ILO). Some of Dr. El Borai's publications include the following: "The International Legal Framework for Migrant Workers: the United Nations Convention on the Protection of Rights of all Migrant Workers and Members of their Families", July 2007; "The Regulation of Immigration of Labor between the Arab States according to International and Arab Labor Practices"; "Legal Framework for the Protection of Immigrant Labor in the Arab States", research (in English and Arabic) commissioned by the ILO for the First Conference on Immigration of Labor between Arab States.

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Former assistant lecturer at the University of London, Queen Mary and Westfield college, former assistant lecturer at Southern Methodist University, Dallas, Texas, lecturer for the ethics, conflict of interests and legal writing courses with the American Bar Association, Continued Legal Education Program (CLE), lecturer in Labor Law with the American University in Cairo - Management Centre, lecturer contract and commercial law in the MBA Program of Ecole Supérieure Libre des Sciences Commerciales Appliquées (ESLSCA). Dr. El Borai is a former legal consultant to the World Bank's financial sector in Washington D.C. He holds a PhD from the University of London in Cross-Border Corporate Insolvency, LLM from the University of Warwick (UK), LLM from Southern Methodist University (TX), LLB from Paris I Pantheon-Sorbonne and LLB from the University of Cairo.



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