

Global Restructuring & Insolvency Guide

Egypt

Overview and Introduction

As in other jurisdictions, the primary objective of the Egyptian insolvency and bankruptcy regulation (collectively, the “**Insolvency and Bankruptcy Regulation**”) is to protect and maximise the value of the bankrupt company for the benefit of all the creditors. The bankruptcy regulation was substantially overhauled and culminated in what was perceived to be a “more modern bankruptcy regime”, which came into operation on 1 October 1999. However, the Egyptian Insolvency and Bankruptcy Regulation remains lacking and requires an in-depth review. Indeed, various parts of the legislation need to be updated, and the relevant legislation requires further consolidation for easier understanding and application.

Applicable Legislation

The Insolvency and Bankruptcy Regulation in Egypt is scattered among the Civil Code of 1948, Companies Law No. 159 of 1981, and the bankruptcy rules under Trade Law No. 17 of 1999 (“**Trade Law**”). It is worth noting that Egyptian law differentiates between insolvency, which is regulated under the Civil Law, and bankruptcy, which is regulated under the Trade Law.

In this respect, the Civil Law provides that a debtor may be declared insolvent if his assets are insufficient to pay his due debts. The insolvency rules, as regulated by the Civil Law, apply to non-traders with regards to non-commercial debts.

Meanwhile, bankruptcy rules, as regulated by the Trade Law, apply to traders who, according to said law, are bound to hold commercial registers. According to the Trade Law, a trader shall be considered in the state of bankruptcy in the event he stops paying his commercial debts following disturbance of his financial business. It should also be noted that, in order to apply the provisions of bankruptcy, the competent court in Egypt should issue a judgment declaring the bankruptcy of the trader.

Bankruptcy

Jurisdiction of the Bankruptcy Court

According to the Bankruptcy Regulation, the Economic Court, pursuant to Law No. 120 of 2008, assumes jurisdiction over a bankruptcy petition/dispute if:

- The debtor is domiciled and trading in Egypt;
- The debtor is a branch or an agency of a foreign entity, even if not declared bankrupt in the country of original nationality (without prejudice to any international treaty to which Egypt is a party); or
- The debtor has been ordinarily resident (or has had a place of residence) in Egypt, or has carried out business in Egypt and is dead or has ceased trading, provided that the petition is filed at any time within the period of one year ending on the day the petition is presented.

Bankruptcy Petition

According to the relevant Bankruptcy Regulation, the bankruptcy petition may be filed by any of the creditors holding commercial debt, by the debtor, by the Public Prosecutor or by the court. It is worth noting that a company’s legal representative may not request that its bankruptcy be declared except after obtaining permission for such request from the majority of the partners or the General Assembly, as the case may be.

In order for the petition to be accepted, there must be evidence that:

- The debtor is a commercial entity;
- The debt is a commercial debt which is due and undisputable, or a civil debt provided that the debtor has not settled his due commercial debts in addition to his civil debts;
- The debtor was not able to pay its debts; and
- The non-payment is a result of financial distress.

Notwithstanding the foregoing, a debtor is legally required to present a petition for a bankruptcy order against itself within 15 days from the date of stopping payment of its commercial debt. The advantages that a debtor may enjoy by presenting a bankruptcy petition include the following:

- If a bankruptcy order is made, the debtor relinquishes virtually all its property in return for being freed from the accumulated burdens of its debts and for being given a chance, in due course, to make a fresh start;
- The debtor avoids the inconvenience and dissipation of resources caused by multiple executions and other forms of enforcement processes;
- All ordinary creditors are dealt with in the most equitable way possible through a collective process, whereby the debtor's assets will be rateably shared by the creditors in proportion to the debts that were owed; and
- During the bankruptcy proceedings, the bankrupt (i.e. the debtor) may start new trading activities with fresh assets. In turn, the creditors arising from the new trading activities enjoy priority over the pre-bankruptcy creditors.

Despite the advantages, the court has a wide discretion to dismiss the bankruptcy petition and will do so if it is of the view that the petition is an abuse of the process.

Commencement of Bankruptcy

Bankruptcy of an entity against whom a bankruptcy order is being made commences the day the order is issued.

Upon issuing the bankruptcy order, the official receiver acts as the trustee of the bankrupt and must take all steps necessary to protect the bankrupt's estate.

In addition, upon the appointment of the official receiver (who also acts as a trustee), all property belonging to or vested in the bankrupt at the commencement of the bankruptcy shall vest in the official receiver. Accordingly, the bankrupt is under a duty to deliver up any part of its estate that is in its possession or under its control to the official receiver. In addition, any person, including bankers, lawyers, employees, partners and employers of a bankrupt, who possesses property of the bankrupt must pay for or deliver to the official receiver all the debtor's property that they are not entitled to retain.

Upon issuance of the bankruptcy judgment, all creditors, whether ordinary creditors or privileged creditors, are prohibited from independently initiating any lawsuit or undertaking any judicial proceedings in this regard. Also, the issuance of a bankruptcy judgment entails a stay of proceedings in relation to any ongoing lawsuit initiated prior to the opening of bankruptcy proceedings against the debtor in question and yet to be adjudicated as of the date of the declaration of bankruptcy.

The state of moratorium is not applicable to creditors with special privileges.

Bankruptcy Process

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 bankruptcy 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 an estate's remedies and defences against third parties and are explicitly afforded a right to pursue any third party who is indebted to their debtor.

Creditors' meetings can be organised by the largest creditors, inviting other creditors of the bankrupt entity to meet. Alternatively, the secretary of the bankruptcy court can assist calling in for such meetings inasmuch as the information relating to the various creditors would be readily available before the court. The composition of creditors, if any, would possess all the updated information regarding their debtor, including outstanding debts, maturity dates, and ongoing litigations, out of court settlements or reschedulings. The administrator's obligation is to assist all creditors in gathering such information and to cooperate with the latter so that no unfair advantage is extended to any particular creditor.

Voluntary Arrangement and Interim Order

This incentive was introduced with the objective of providing a "breathing space" or a moratorium for the debtor to reorganise its financial affairs and propose an arrangement that is acceptable to its creditors, should the court find that the financial position of the company is capable of being enhanced in the interest of the national economy. During this breathing space, which is limited to three months, no bankruptcy, enforcement or other proceedings can be brought or continued against the debtor without the leave of the court. Also, the court may order any measures it deems fit to protect the assets of the debtor during this three-month period.

Corporate Restructuring

Reorganisations, Restructurings and Workouts

There is no Chapter 11 or voluntary administration procedure in Egypt, so workouts are essentially contractual arrangements that are mutually agreed between the debtor company and its financial creditors without any need to involve the court. The aim is to achieve the continuation of the company's business without the need to commence winding-up proceedings. However, the bankrupt debtor may request a reconciliation to avoid bankruptcy provided that the debtor did not commit fraud or an error that does not emanate from an ordinary trader, and that his financial situation was disordered in a manner leading to his bankruptcy.

Also, it should be noted that Article 702 of the Trade Law authorizes the court on its own, or upon the request of a debtor which is an entity, to postpone considering the bankruptcy request for a period not exceeding three months if the financial situation of the entity may be restored or if a postponement is required to preserve the national economy.

Terms of the Restructuring or Workout

The terms of the restructuring or workout arrangement are set by the parties involved through commercial negotiation and often involve reorganisation of the company's business.

Reaching a restructuring arrangement requires all creditors to agree on suitable terms to prevent any dissenting creditor from commencing winding-up proceedings or seeking to enforce any judgments already obtained.

Debt Rescheduling

Restructuring or workouts often involve rescheduling the debt, whether matured or otherwise, of the company facing financial difficulties. The company will often seek to convince creditors not to demand or insist on full payment of debts.

Besides deferring payment, parties can agree to reduce, cancel or waive part of the principal amount of indebtedness and/or part or all of the accumulated interest.

Multiple Bank Restructurings

The restructuring of large corporations frequently involves multiple bank entities that often constitute the major creditors. Generally, banks will be prepared to embark on a restructuring only if the prospect of eventual recovery is greater than it would be if the company was put into liquidation. Cooperation and recognition of shared interests is integral to a successful restructuring or workout process.

Successful 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 Trade Law, has discretion to allow the sale of the debtor's property during the period between presentation of the petition and issuance of the bankruptcy order, if doing so will realise positive benefits for 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.

Corporate Bankruptcy/Liquidation

Types of Liquidation

Egyptian law recognises two types of liquidation: shareholders' voluntary liquidation; and compulsory liquidation.

In general terms, solvency is assessed on a cash flow basis for going concerns, which is the ability of a business entity to pay its creditors. However, after the bankruptcy process is underway, solvency is assessed when the entity can no longer meet its debt obligations as they become due. The financial consequences largely depend on the outcome of the foregoing assets/liabilities equation, as follows:

- The result is positive: the liquidation will be solvent, the creditors will receive complete recovery and there could be a return to shareholders;
- The result is negative: the liquidation is insolvent and there will be a shortfall of assets, which will result in a shortfall to creditors without any residuals remaining to the shareholders.

The outcome of the assets/liabilities equation controls the liquidation method that the company is capable of pursuing. The available methods are discussed below.

Shareholders' Voluntary Liquidation

This is only available where the company is bankrupt. According to the Egyptian Companies Law, if the company's losses exceed 50% of its paid-in capital, then it issues an extraordinary general assembly resolution to either liquidate the company or continue trading. If the decision is to liquidate the company, then the shareholders must appoint a liquidator who will work under the supervision of the general assembly.

In broad terms, the extraordinary general assembly's resolution to put the company into liquidation is usually passed on the basis that the company cannot continue its business due to its liabilities. As the company is insolvent, the company has to appoint a liquidator. Once the liquidator is appointed, he must serve a meeting notice on the company's creditors. The liquidator must then try to reach an agreement with the creditors. If an agreement is not reached, then the liquidator may be required to request permission to file for bankruptcy from the company's general assembly or ask the shareholders to inject money to cover any outstanding debts.

The Court's Role in a Voluntary Liquidation

Shareholders' voluntary liquidation is subject to the court's supervision. This means that stakeholders (e.g. the liquidator, creditors, shareholders, etc.) may apply for the court's directions as to how to conduct aspects of the liquidation. These liquidations can proceed with little or no guidance from the

court. Voluntary liquidations can therefore provide an opportunity for a more managed liquidation process.

Compulsory Liquidation

A company may be wound up by the court on a number of grounds, most often in an insolvency situation due to the debtor's inability to pay its creditors. There is also a broad discretionary power under which the court can order a company to be wound up where it is just and equitable to do so.

Application to Court

The application to the court to wind up a company may be made by a creditor, a shareholder or the company itself by virtue of a winding-up petition. Once the petition is issued, the winding-up of the company is deemed to have commenced.

Uncontested Cases

In a typical uncontested case, the process should run swiftly and conclude with a winding-up order being issued against the company.

The Court's Supervisory Role

The court maintains a supervisory role throughout the administration of the compulsory winding-up of a company. The court's approval is also required for certain matters, including the appointment of provisional liquidators and liquidators who act as officers of the court in managing the company during the compulsory liquidation or restructuring process.

Powers of a Provisional Liquidator

When a winding-up petition has been presented to the court, the court may order the appointment of one or more provisional liquidators (either the official receiver or a private insolvency practitioner). Appointment of a provisional liquidator typically takes place in cases where the company's assets are in danger or there has been an allegation that the management of the company has misappropriated the company's assets.

The purpose of appointing a provisional liquidator is to maintain the status quo of the company along with its assets and records. The order of the court appointing the provisional liquidator will specify the functions to be carried out in conjunction with the powers conferred upon him.

Powers of the Directors Cease

The company's management ceases to act as the authorised agents of the company upon the appointment of a provisional liquidator (or a court-appointed liquidator-trustee). This simply means that, upon the appointment of the provisional liquidator, the managerial and operational powers of the directors in the company are vested in the provisional liquidator. The company's managers/directors retain a limited non-managerial residual power. Decisions regarding the operation of the company are vested in the provisional liquidator from the time of his appointment and the directors' powers are suspended at that time.

Priority of Claims

In bankruptcy proceedings, the assets available to the company are usually insufficient to satisfy all of the creditors' claims in a manner preventing the disturbance of the business. As a result, the priority or order of ranking of different claims is of utmost importance. In general, claims are ranked in the following order:

- Costs and expenses properly incurred in preserving, realising or bringing in the assets of the company, including the liquidator's remuneration and disbursements;
- Preferential creditors (e.g. certain debts due to employees or the government);
- Secured creditors;

- Ordinary unsecured creditors (including any shortfall arising from secured creditors after realisation of their security); and
- Shareholders.

***Pari Passu* Principle of Distribution**

A general principle of *pari passu* distribution is applied, which means that ordinary creditors should rank equally amongst themselves.

Set-Off and Netting

Pursuant to the Insolvency and Bankruptcy Regulation, set-offs apply where there have been mutual credits, mutual debts or other mutual dealings prior to the company going into liquidation. Although mutual dealings need not be in relation to the same transaction, they must be between the same parties. In addition, mutual dealings are not restricted to debts incurred under contracts. In such circumstances, an account is taken of what is due from each party to the other in respect of the mutual dealings with the sums due from one party being set off (settled) against the sums due from the other. A set-off in a liquidation will result in only one sum owing with the net balance being paid to (or due from) the liquidator. To the extent that a set-off is available, the creditor receives 100% of the relevant amount and is in a better position than unsecured creditors who are relying on a *pari passu* distribution.

A set-off will be possible if and when the debt of both the creditor and debtor find their source or emanate from the same dealing, contract or tort. Any right of set-off or netting in the course of bankruptcy proceedings is subject to the prior approval of the bankruptcy judge.

Clawback and Recovery Mechanisms

In all forms of liquidation, liquidators are empowered to investigate the affairs of a company and seek redress from the court where it considers that assets belonging to the company have been dissipated. If an order is made by the court, the relevant directors, company officers or creditors may be required to repay or restore the property to the company, or contribute to the assets of the company as the court considers appropriate. Below are some examples of possible offences that liquidators may investigate.

- Unfair preference: the liquidator may challenge creditors who have received payments from the company and may have received preference over other creditors;
- Disposition of property with intent to defraud creditors: transactions of this nature are voidable at the instance of the person prejudiced by the disposition, except where such disposition is for valuable consideration and in good faith to any person not having, at the time of the disposition, notice of the intent to defraud creditors;
- Disposition after commencement of compulsory liquidation: these dispositions or payments are void against the liquidator and the recipients of these funds or assets must return the funds or assets to the liquidator;
- Fraudulent trading: where the business is carried out with intention to defraud creditors or for any other fraudulent purpose; and
- Misfeasance: where directors have breached their fiduciary duties to the company or have misapplied or retained company property for their personal benefit.

Disclaimer of Onerous Contracts

Where a company has entered into unprofitable contracts or its assets include land burdened with an onerous covenant, shares or stock in companies, or unsalable property, the liquidator may, with leave of the court, surrender or disclaim that contract or property or request that the court keep the contract in effect. The disclaimer is binding on the rights and interests of the company and will release the company and the property of the company from liability as far as necessary.

Court-Approved Arrangements and Reconstructions

The court also has jurisdiction to sanction certain arrangements. Such arrangements may include primarily entering into a compromise or arrangement between the company and its creditors or any class of them, or between the company and its shareholders (or any class of them) upon the application of the company, or any creditor or member of the company.

Funding in Bankruptcy Proceedings

There are no specific provisions under Egyptian law for lending in bankruptcy proceedings. However, it is possible for a company to obtain financing from a willing lender when it is under bankruptcy proceedings pursuant to contractual arrangements. It is not uncommon for a liquidator to obtain financing from creditors to conduct investigations or litigation.

Priority Ranking for Post-Liquidation Borrowing

Where a lender is willing to provide new funds for the purpose of preserving and realising the assets of a company, such post-liquidation borrowing of the company is treated as an expense properly incurred by the liquidator and has priority over any other pre-liquidation debts.

In addition, although the general principle of *pari passu* distribution applies to unsecured creditors, Egyptian law provides that where a creditor has undertaken a substantial risk when giving the liquidator an indemnity for costs in litigation, the court may grant the creditor in question a greater share of the particular assets recovered than would be normal under the *pari passu* principle.

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