“No Way Out”

The Lack of Efficient Insolvency Regimes in the MENA Region

Mahesh Uttamchandani
Abstract

This paper provides a comparative summary of the payout phase of insolvency systems in the MENA Region. Countries in the region generally have weaker restructuring and liquidation systems than those in most other regions. The paper summarizes many of the weaknesses common across the region.

This paper is a product of the Financial and Private Sector Development Unit, Middle East and North Africa Region; and the Investment Climate Department, Financial and Private Sector Development Network. It is part of a larger effort by the World Bank to provide open access to its research and make a contribution to development policy discussions around the world. Policy Research Working Papers are also posted on the Web at http://econ.worldbank.org. The author may be contacted at muttamchandani@worldbank.org.
“No Way Out”: The Lack of Efficient Insolvency Regimes in the MENA Region

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Table of Contents

1. Introduction ........................................................................................................................................ 1
   1.1. Insolvency and the Debtor-Creditor Regime ................................................................................. 2
   1.2. Methodology ................................................................................................................................. 3
   1.3. Scope of chapter ............................................................................................................................. 3

2. Insolvency Proceedings .................................................................................................................... 4
   2.1. Accessibility .................................................................................................................................... 4
   2.2. Avoidable transactions/fraudulent conveyances/Contract cancellation ........................................ 6
   2.3. Priority of creditors: clearly delineated, and protected, security interests preserved .................. 7
   2.4. Stay on Creditor Action ................................................................................................................. 8
   2.5. Liquidation ..................................................................................................................................... 9
   2.6. Reorganization ............................................................................................................................. 13

3. Informal/Out of Court Reorganization and Workouts .................................................................. 19
   3.1. Formal support for out-of-court, non-insolvency workouts and restructuring ............................... 19
   3.2. Alternative Dispute Resolution ..................................................................................................... 23

4. Institutions Implementing the Insolvency System ....................................................................... 25
   4.1. Courts: Specialized courts, judges trained in bankruptcy .............................................................. 25
   4.2. Insolvency Administrators ........................................................................................................... 26

5. Roadmap to Reform ......................................................................................................................... 27
   5.1. State of liquidation and reorganization, respectively ..................................................................... 27
   5.2. Reform Priorities ............................................................................................................................ 28
   5.3. Out-of-court restructuring ........................................................................................................... 28

Tables

Table 1: Mapping of Liquidation Procedure ......................................................................................... 9
Table 2: Mapping of Reorganization ................................................................................................... 15
1. **Introduction**

The **insolvency systems in the MENA region are by and large underdeveloped**. One of the main shortcomings is the approach to debtors as wrongdoers, even criminals, rather than economic actors in distress. Legal provisions rely heavily on criminal law, for enforcement, though the rate of imprisonment varies widely among countries—it is rare in some, but alarmingly common for a modern society in others—see Text Box—Checks, Commerce and the Criminalization of Debt. Several countries in the region have laws that punish debtors with civil penalties such as loss of the right to manage a company, restriction of movement (seizure of passport), and even prison. The approach to a debtor as an entity to be rehabilitated is rare in spirit, and still more rare in practice, as across the region, reorganization is rare, even when legal provisions may allow it. Such reorganization provisions tend to be heavily creditor-driven, providing little flexibility to debtors. Even liquidation procedures, which are perhaps better understood, are considered ineffective. Provisions in the laws are dated. Many of the laws have not been revised and modernized for a decade, or several decades. None of the countries in the regions have laws that comply with modern international best practice standards. There is an urgent need to decriminalize bankruptcy, to focus on reorganization to rehabilitate debtors in financial distress, and modernize the laws so that they serve the needs of the growing economies in the region.

**However, reforming laws will not be sufficient. Even more than the legal provisions, the main reason for the lack of effectiveness appears to be inefficient enforcement and implementation.** Court systems tend to be slow, and very formalistic and bureaucratic. Procedures are expensive, drawn out and inefficient. After the expense and delay, usually only a small amount remains for distribution to creditors. This lack of effectiveness, and the institutional inefficiencies and obstacles, seem to lead many creditors to opt out of the system and resolve their disputes with creditors through informal means. Systemically, this leaves a gap in the ability of creditors to engage in collective resolution of debt and ensure fairness and maximization of asset recovery. There is a need in the MENA region for significant, serious investment in training of professionals and developing institutional infrastructure for insolvency.

**In DoingBusiness 2010, the regional results for Closing a Business reflect the underdevelopment of insolvency in the MENA region.** For MENA, the recovery rate on debt when closing a business is 29.9 cents on the dollar, compared to 68.6 cents for OECD countries. The time it takes to close a business is 3.5 years in MENA, compared to 1.7 in OECD, almost twice as long. Many MENA countries report even longer time periods than 3.5 years. It also costs, on average, twice as much to close a business in MENA as in OECD—it costs 14.1 cents on the dollar in MENA, as opposed to 8.4 cents in OECD states. This is a reflection of, amongst other things, a region that has not made insolvency reform a policy priority.
Insolvency and the Debtor-Creditor Regime

Insolvency and Secured Transactions systems are intrinsically related areas of a country’s commercial legal regime. Both secured transactions and insolvency support predictability in credit markets. Secured transactions law provides an individual creditor protection by allowing the creditor to insure repayment through access to collateral. Insolvency protects the entire pool of creditors, ensuring fair treatment through collective resolution of all debts held by creditors of a particular debtor, when that debtor is in financial distress. The way that insolvency treats a secured lender’s claim can either support or undermine the effectiveness of a secured transaction system. If insolvency effectively eliminates the security interest of the creditor, then lenders will not consider collateral to be a reliable safety net for protecting their interests while lending. On the other hand, the inclusion of secured creditors’ collateral in the insolvency proceeding is often necessary to allow rehabilitation of debtors. The balance between strengthening the secured transactions regime and allowing debtor sufficient flexibility and relief from creditor demands to reorganize, is important in designing or redesigning the insolvency system during reform.

Insolvency is a vital part of the creditor-debtor regime in a country and, in many countries, developed as a counterweight to systems of secured credit. Historically, in many countries, secured creditors would enforce their rights against a debtor in financial distress, bilaterally. Insolvency proceedings would then deal with the remaining assets and creditors in a collective process. Over time, insolvency proceedings have come to be understood as much more complex than this, principally in the
area of reorganization of the debtor so that it can emerge from financial distress in a more viable state. Today, a healthy insolvency system provides predictability to debtors and creditors in case of financial distress while balancing liquidation and reorganization.

While it is important to note that insolvency is, emphatically, not simply a mechanism for secured creditor enforcement (indeed, in most economies, unsecured trade credit is, by far, more likely to be the lifeblood of commerce), it is important that an insolvency regime recognizes and supports continuation of pre-insolvency rights of creditors in relation to their collateral. While political and social considerations will always be a factor, the ability to unwind secured transactions in an insolvency proceeding should be minimized. This is particularly important in relation to secured creditors. It is important that their collateral is a reliable source of collection, even in the case of insolvency. At the same time, secured creditors need incentives to support reorganization of viable companies. To the extent possible within the context of allowing debtor rehabilitation and maximization of return on assets, the insolvency regime should maintain claims based on commercial bargains, including secured transactions, and should avoid assigning priority to claims that are not.

1.2. Methodology

*World Bank Principles for Effective Insolvency and Creditors’ Rights Systems*

The analysis in this chapter considers MENA countries’ insolvency systems in the context of the World Bank Principles’ articulated best practice standards. The World Bank Principles for Effective Insolvency and Creditors’ Rights Systems (“World Bank Principles”) were developed in 2001 and revised in 2005 and are the global standards for insolvency and debtor-creditor systems. Partner organizations, international experts, and the international community were all consulted, so that the World Bank Principles represent an international consensus on best practices in insolvency and creditor rights. The World Bank uses them for, *inter alia*, benchmarking the effectiveness of countries’ insolvency and creditors’ rights system. In addition, they offer guidance to policymakers who want to establish a functional system for healthy debtor-creditor relations. The UNCITRAL Legislative Guide on Insolvency Law provides further supporting details for implementation and design of systems.

*Sources of information, gaps*

Several sources were consulted in the preparation of this chapter. The information contained in this report consists largely of information gathered from a May 2009 survey, coauthored by the World Bank, together with the Hawkamah Institute, the OECD and INSOL International, with the significant assistance of international expert, Neil Cooper. Field research was also conducted by the author of this report in Jordan, Saudi Arabia, Morocco, Egypt and the UAE between 2008 and 2010. Other written information that was available on individual countries is cited herein where used.

1.3. Scope of chapter

This chapter covers non-bank, non-household, commercial insolvency. The focus is on the way that MENA countries address companies who are in financial distress, those who cannot pay their debts. There is a discussion of features of legal infrastructure that may prevent insolvency filings, and the
procedures that ensue once an insolvency case, most often referred to as bankruptcy, is filed. Reorganization within bankruptcy, which is an important part of modern international best practice, is also explored.

The purpose of this chapter is to provide a broad overview of the region, rather than individual country-by-country analysis. As a result, the focus of this chapter is on drawing region-wide observations about some of the strengths and weaknesses of insolvency regimes and is not intended to obviate the need for detailed, in-country diagnostic review to better inform the policy reform process.

2. Insolvency Proceedings

In the MENA region, there is varying use and understanding of insolvency. In countries that have had an insolvency regime in place, the most developed practice seems to be as a tool for collection by creditors, and for winding up companies. In some countries, there is very little if any use of the insolvency system. In other countries, there is no insolvency law to be used.

There are countries that do not have an insolvency law. Yemen, Iran and Iraq fall in that category. Jordan does not have a cohesive bankruptcy law but there is a significant practice in winding up companies that draws on provisions from several laws and which has developed piecemeal over many years, and broader reform is underway. Winding up of companies in Jordan relies on the provisions for liquidation in the Jordanian companies’ legislation, along with other provisions in other laws, causing significant conflict and difficulty for judges. Palestine, Qatar, UAE and Saudi Arabia report very low usage of their bankruptcy systems. In Palestine, the “Hanafi Fekh”, a school of Islamic jurisprudence, constitutes the civil law and is regarded as more reliable and enforceable than regular courts, and thus more widely used. In Qatar, the provisions were only promulgated in 2006 and there has been no judicial consideration of them so far. In Saudi Arabia, neither debtors nor creditors use the system due to its inefficiencies and investigation procedures that vary widely from one district to another.

There has been movement to modernize bankruptcy regimes. Jordan has a draft insolvency law. Egypt undertook bankruptcy law reform in recent years. Morocco and Tunisia were described by the authors of an IMF working paper to have made the most progress in the Maghreb (Algeria, Libya, Mauritania, Morocco and Tunisia) in moving toward modernization of bankruptcy regimes, by adding commercial courts with insolvency training for judges.

2.1. Accessibility

An insolvency procedure should be widely accessible. Debtors should be able to file easily and obtain legal protections swiftly. Ideally all commercial enterprises are eligible, including state-owned enterprises. Creditors should also be able to file, with appropriate opportunity for debtors to object in order to protect debtors from inappropriate creditor harassment. In addition, all types of businesses, including micro and small businesses, should have access to the insolvency law. Micro and small enterprises play an important role in the region and a significant number of these enterprises are so small, perhaps household enterprises and sole proprietorships, that they may not be incorporated as limited-liability entities. To the extent that a bankruptcy law is part of the ‘companies law’ regime and therefore
requires a business to be a ‘company’ in order to be covered by the law, many enterprises, and a significant portion of economic activity and employment will operate without any access to insolvency procedures to exit the market efficiently. The lack of efficient exit mechanisms, particularly regarding individual entrepreneurs, inhibits market entry as such entrepreneurs cannot be released from debts relating to previous failures.

The unilateral right of all debtors to access the insolvency law is generally found throughout the region. The requirements for filing, and the entities that may file a bankruptcy petition against/on behalf of a company vary among countries. Kuwait appears to have broad access for debtors other than state-owned companies. In Yemen, though there is no insolvency law, either debtors or creditors may file for winding up of a company by obtaining an order of the Attorney General. In Saudi Arabia and in Egypt, a corporate debtors’ application requires the consent of shareholders, who must apply to the court. In Jordan, the General Assembly of the company takes the decision to liquidate (there is no full bankruptcy proceeding). DIFC allows all companies and limited liability partnerships in the jurisdiction of the Dubai International Financial Centre to avail themselves of bankruptcy procedures. Debtors and creditors can file easily.\textsuperscript{xii} In Kuwait and Lebanon, a judge or Public Prosecutor may also initiate a bankruptcy filing against an entity.\textsuperscript{xiii}

Dubai World and Decree Incorporating DIFC Modern Insolvency Law Demonstrates the Importance of Insolvency Law

The DIFC is an interesting laboratory for the importance and operation of insolvency law. Recently Dubai World, a sovereign wealth fund, became insolvent, unable to service its debts. The Dubai government has passed a Decree that creates a special tribunal for the Dubai World restructuring. It will apply DIFC law, even though Dubai World was created outside of DIFC jurisdiction. The Dubai government’s extraordinary action indicates that it recognizes the value of using a system based on international best practice that is familiar to international investors and creditors, but may raise concerns about predictability and transparency.

Several MENA countries’ laws allow “traders” or “merchants” to file, whether they are companies or individuals, thus expanding access beyond corporate entities. For example, Oman, Egypt, and Morocco, allow traders, or merchants, to file, whether they are individuals engaged in commercial activity, or companies.\textsuperscript{xiv} Interestingly, Morocco also includes “artisans” in the list of those commercial entities eligible for bankruptcy.\textsuperscript{xv} In Jordan, access to the bankruptcy system is through the Companies Control Department (CCD), so that companies that are not subject to CCD supervision likely will not participate in the insolvency system.\textsuperscript{xvi} However, the new draft law in Jordan, which is proposed to be a comprehensive bankruptcy law, includes merchants, registered/incorporated and unregistered/unincorporated, and thus if passed will provide broad access to an insolvency regime created for a modern economy.
State-owned companies, however, are frequently excluded from bankruptcy proceedings. Egypt, Kuwait, Saudi Arabia, and UAE exclude state-owned companies from bankruptcy proceedings. There may be valid policy reasons for excluding state-owned enterprises from ordinary corporate insolvency regimes, particularly in respect of strategic industries such as mining, defense and aviation. Nevertheless, the distortive market impact of excluding such businesses from ordinary commercial laws should be acknowledged in the policy-making process.

Creditors can file in most of the MENA countries. Historically, in many developing countries, and particularly where reorganization and other advantages to debtors have not yet been developed in the law, creditors initiate bankruptcy filings, as a collection tool. By contrast, in countries such as the U.S., the vast majority of filings are by the debtor, and creditor filings are rare. Creditors can file freely in court in UAE, Kuwait, Morocco, Egypt, Lebanon and- Oman. Saudi creditors must apply to the Ministry of Commerce or the Diwan Al Mazalan Board of Grievances to initiate insolvency proceedings. In Qatar, there are no provisions allowing creditors to file. Creditors do not enjoy the same freedom to file in Jordan as in other MENA countries, where creditor-initiated filings have generally been the norm. For creditor-initiated filings in Jordan, the Companies Control Department (CCD) commences the compulsory liquidations, and other creditors do not appear to have the right to commence a bankruptcy proceeding, though they may bring the debtor’s situation to the CCD’s attention.

2.2. Avoidable transactions/fraudulent conveyances/Contract cancellation

The ability to unwind inappropriate pre-filing transactions effectively is an important aspect of preventing fraud and abuse by creditors and debtor management alike. In many developing countries, there is a significant public policy concern expressed by reformers and lawmakers that the law should prevent asset stripping and prevent abuse of bankruptcy process for illicit gain. The trustee and court should have the ability to set aside transactions that were intended to defraud creditors, or that constitute an unfair favoring of one creditor over another, in violation of his priority rights. This is a significant tool in the fight to reduce asset stripping or ‘tunneling’ out of a company on the eve of insolvency. International best practice standards also prefer that contracts that have not been substantially performed, and leases, should be cancellable in a bankruptcy proceeding, if they are not in the economic interest of the debtor.

Preferences and fraudulent conveyances

In most bankruptcy regimes, there is a suspect period, during which payments are presumed to be preferential and may be set aside/cancelled. This period should be reasonably short in respect to general creditors, and should avoid disrupting normal commercial and credit relations. Transfers of assets that prevent fairness to creditors and/or render the debtor insolvent, or are done while it is insolvent, also called fraudulent transfers or conveyances, should be avoidable/cancellable.

One of the issues that can slow down cases in some countries is that the date from which the suspect period is calculated is not the date of filing, but the date of cessation of payments. The date of cessation can be a matter of controversy in a case, and thus determining it not only slows down the proceeding, but adds a fair amount of uncertainty as to the preference period. In contrast, in countries like the U.S. where the filing date is the point of determination for the preference period, the time frame
will be immediately apparent as soon as the case is filed. There is an added certainty and predictability to a more firm date from which to go backward to unwind transactions.

**Making the preference period more predictable would contribute to the effectiveness of the bankruptcy system.** Using the date of filing, or clarifying simple standards for determining the date the preference period begins, would add to the efficiency and effectiveness of the bankruptcy procedure in ensuring creditor rights are protected from inappropriate payments that unfairly prefer a creditor out of his priority order. Uncertainty in the process, as shown in table 3, is one of the biggest weaknesses in the region. In Jordan, for actions undertaken ‘with the intent to defraud’, there is no time limit, though such actions to unwind fraudulent conveyances are rarely investigated. In Morocco and Lebanon, the suspect period is from the date of cessation of payments to the date of the court decision ordering the commencement of proceedings, not to exceed eighteen months. Egypt and Kuwait follow a similar formula, though their suspect periods may last up to two years. In Qatar, the court may go back two years from the commencement of bankruptcy. UAE allows transactions to be avoided and set aside as preferences. Saudi Arabia does not have preference actions, but fraudulent transactions may be cancelled. Yemen has no provisions for the setting aside of transactions.

_Treatment/Cancellation of Contracts_

Cancelling contracts is a part of the bankruptcy law of several of the countries. The DIFC allows the court to set aside transactions contrary to creditors interests, and the liquidator may terminate unperformed contracts. Qatar, Saudi Arabia, UAE and Kuwait also allow the administrator to terminate onerous contracts.

2.3. **Priority of creditors: clearly delineated, and protected, security interests preserved.**

The rights of creditors and priorities of claims established prior to insolvency should be upheld in order to preserve the legitimate expectations of commercial actors. Security interests should be preserved. While there will be some new claims in an insolvency that take priority due to compelling interests, such as costs of the administration of the estate, in general, the insolvency process should not subvert ordinary creditor priorities as they would exist outside of bankruptcy. Such subversion introduces a level of uncertainty in day-to-day commercial transactions. At the same time, it must be recognized that bankruptcy, by its nature, is a public and collective process that will involve the imposition of public policy priorities on what were previously private transactions. It is conceivable, for example, that a country that privileges the private sector with favorable tax treatment may wish to make up for the lack of public funds available to support unemployed workers by privileging such workers in insolvency. The over-arching issue of importance is that the priority rules be clear, predictable and transparent. Many OECD countries provide for the priority of certain very specific claims, such as employee social security contributions deducted at source by employers. This reflects public policy that recognizes the importance of some social claims as being greater than the need to ensure secured creditor primacy. As such, the notion of ‘absolute priority’ is a rarity, even in wealthy countries.

The pre-bankruptcy rights of secured creditors are often not well protected in the region. Rights that are most often given priority as a matter of public policy over pre-bankruptcy creditors’ rights are costs of the court, taxes, costs of the estate, and employee/servant debts. Morocco, Jordan, Egypt,
Qatar and Kuwait prioritize the public policy exceptions over creditors’ rights, including secured creditors. Saudi Arabia prioritizes only liquidation costs, employee wages, rent and wife’s dowry. Egypt also gives rent a priority. However in Saudi Arabia secured creditor rights are not subordinated to the public policy exemptions; the funds from their collateral are held in trust by the administrator and paid to the secured creditor after the collateral is sold. Clarity of priority is a problem in Jordan, where the Companies Law sets out liquidation expenses, employee payments, taxes and rents as being first in priority over other creditors, seemingly secured creditors, though the issue is not clear, and subject to debate. It is also unclear in Palestine whether or not the stay on creditor action restricts secured creditors from executing on collateral; thus it is not clear if the secured creditors’ rights and priority in proceeds of collateral are preserved in insolvency.

2.4. Stay on Creditor Action

To prevent premature dismemberment of the estate, upon commencement of bankruptcy unauthorized disposition of the debtor’s assets should be automatically prohibited, and creditor actions to enforce their rights or remedies against the debtor’s assets should be suspended. Such a period is often referred to as a stay, a moratorium, or suspension of proceedings. Ideally, the stay should be as wide as possible to maximize the value of asset recoveries, but there should be a procedure to lift the stay in case of deterioration of secured creditors’ protection/asset value. Some commentators argue that secured creditors should be excluded from any such stay. International standards, however, recommend inclusion of secured creditors for at least a limited time, to potentially reorganize or maximize the recovery through sale of the entire business, with corresponding quick transitions into liquidation if the rescue of the business is shown to be unlikely. Indeed, it would be unlikely that a company could be successfully restructured if there was not a comprehensive stay, if even for a brief time. The right of secured creditors vis a vis such a stay can be balanced by giving them the legal right to seek the lifting of the stay, if they can show risk of severe economic harm.

The moratorium is used widely in many MENA jurisdictions. Jordan, Morocco, DIFC, Egypt, Kuwait, Lebanon, Saudi Arabia, UAE, and Yemen prohibit unauthorized disposition of assets after the commencement of liquidation. Morocco, Jordan, Egypt, Kuwait, Qatar, Palestine, Saudi Arabia and Yemen impose a stay all creditor action, with certain exceptions for secured creditors. In Jordan, the stay lasts 3 months unless the liquidator extends it. In Morocco, creditors recover the ability to act on the assets affected if there is not action by the insolvency administrator three months from the date of commencement of liquidation, or if the proceeding is closed for inadequacy of assets.

Application of Stay/Moratorium to Secured Creditors

When liquidation occurs, it is desirable for secured creditors to be able to enforce directly against the assets over which they have security. In Egypt, UAE, Oman, Kuwait secured creditors are allowed to proceed directly against their collateral. In Egypt secured creditors must exercise their rights, otherwise, if the estate sells the collateral, the secured creditor is paid after the privileged creditors described above in Section 3.3 Priority of Creditors. The liquidator may also restrict secured creditors’ exercise of their rights in order to sell the business as a going concern, though the secured creditor may appeal the delay if they are not adequately protected against loss. In Qatar, applying the stay to secured creditors is possible but requires court approval. DIFC protects secured creditors’ rights to
the extent that collateral cannot be sold unencumbered without the secured creditors’ permission. Palestinian law does not appear clear on this point.\textsuperscript{xi}

By contrast, in Morocco\textsuperscript{xli}, Saudi Arabia, Jordan and Yemen, secured creditors will be prohibited from disposing of their collateral once proceedings commence.\textsuperscript{xlii}

2.5. Liquidation

### Table 1: Mapping of Liquidation Procedure

<table>
<thead>
<tr>
<th>Country</th>
<th>Stay on creditor action</th>
<th>Stay on secured creditor action</th>
<th>All companies eligible\textsuperscript{1}</th>
<th>Sale/auction procedure flexible\textsuperscript{3}</th>
<th>Secured creditor rights preserved</th>
<th>Priority of creditors preserved\textsuperscript{4}</th>
<th>Right to recover preferences and fraudulent transfers</th>
<th>In no country are there reasonably swift liquidation procedure</th>
<th>In no country are insolvency administrators competent and effective\textsuperscript{4}, adequately supervised and accountable</th>
<th>In no country is the suspect period for reviewable transactions clearly defined</th>
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</table>

The original, and currently still the most frequent use of bankruptcy is as a means to liquidation. Assets of a non-viable company in financial distress need to be redistributed into the economy, and human capital (owners, employees) redeployed as soon as possible to economic productivity.

\textsuperscript{1} Yes if there are no exclusions for state-owned companies, no other broad exclusions, and all registered companies may file.

\textsuperscript{2} Yes if sale is not restricted to court/public auction. The overall effectiveness or experience on the ground is not a part of this criterion.

\textsuperscript{3} Yes if priority does not exceed the common priorities of court/legal costs, taxes, employee payments, and debtor’s sustenance expenses.

\textsuperscript{4} Yes if the insolvency administrators are not widely described as competent, and they are not considered an important obstacle to effective bankruptcy implementation, or described as largely lacking integrity.
Conversion to liquidation, if reorganization is not viable, should be swift and efficient.

If reorganization is attempted, but fails, the conversion to liquidation should be swift, preferably automatic. In MENA countries, reorganization is rarely attempted in the formal system. Therefore, this criterion is not often invoked. Nevertheless, in most of the countries that allow reorganization, conversion to liquidation is swift, often triggered automatically. Triggers are the failure to reach a composition, settlement or agreement, or fraud or negligence (failure to keep adequate financial records, for example) of the debtor being uncovered. In Kuwait, creditors must petition for conversion. Where the judiciary is slow, conversion can face the same delays as any other aspect of the bankruptcy procedure. The majority of bankruptcies in the MENA region are liquidations.

No MENA country can claim an efficient liquidation process by international standards. Despite being the most commonly used procedure in the region, liquidation is a painstaking process in most, with varying degrees of speed involved. An efficient liquidation procedure involves swift appointment of the administrator, maximum recovery on assets, inclusion of all assets in the estate, prevention of deterioration of assets, safeguards to prevent asset stripping and fraud, a market for assets, swift procedure to sell assets, and fair, swift distribution of proceeds. Delay severely deteriorates the value of the assets and the rights of the creditors.

Delay and inefficiency plague the insolvency systems of most of the MENA countries. Sales procedures for assets are not efficient, often requiring auctions with cumbersome procedures, such as in Kuwait and Egypt, or other detailed, time-consuming procedures to “protect” debtor’s assets such as in Lebanon. They are often subject to appeal by recalcitrant parties and delays in finalization. Among MENA countries, efficient recovery and maximization of assets is not the norm. Bankruptcy is a last resort. Creditors often expect little or no recovery and use a bankruptcy declaration (and the liquidation consequences to debtor, and attendant loss of civil rights) as a threat to motivate payment. Bankruptcy then becomes a tool for creditor collection, essentially a bilateral dispute over continuation or dismissal of the bankruptcy based on satisfying a debt.

Criminalization of insolvency/bankruptcy, and the fraud suspicion toward debtors, also serves to slow down proceedings. Bankruptcy in many MENA countries can lead to criminal prosecution, and civil penalties such as loss of freedom of movement (the court can take a debtor’s passport) or loss of ability to manage a company. The laws and systems tend to view debtors as wrongdoers, rather than economic actors in financial distress. There is a fear of fraud and abuse of the system, based on the criminal view of insolvency, but also based on asset-concealment, asset stripping, and defrauding of creditors that has occurred in many developing countries. Many times, the fear of such fraud/abuse can lead to scrutiny of sale prices, cumbersome, inefficient auction procedures, and the over-availability of appeals of transactions within the bankruptcy (described above). These procedural obstacles slow down the bankruptcy, but often fail to effectively prevent fraud—rather, they lead to delay and loss of asset value.

The MENA Report findings support the conclusions drawn. In the report, Egypt and Kuwait report slow, protracted procedures. Oman, Palestine, Qatar, Saudi Arabia, and UAE report low usage of the bankruptcy system. Yemen and Iran do not have formal insolvency laws. DoingBusiness provides further evidence of slow systems in the region.
business and levels of recovery for countries not covered by the MENA Report are reported in the table below:

<table>
<thead>
<tr>
<th>Country</th>
<th>Average Time for Closing a Business</th>
<th>MENA</th>
<th>OECD</th>
<th>ECA (Europe and Central Asia)</th>
<th>LAC (Latin American and Caribbean)</th>
<th>South Asia</th>
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</table>

The DoingBusiness results show some anomalies, which bear further analysis. The DoingBusiness results suggest that some countries, such as Bahrain with a 2.5 year timeframe for closing a business, which compares favorably to the OECD average of 1.7 years, may be more advanced than other sources on MENA countries would suggest. It is important to remember, however, that this metric tracks secured creditor recoveries and that even the seemingly positive results may mask a bankruptcy system that returns little or nothing to unsecured creditors.

There are several countries that fare particularly poorly compared to the averages of other regions, and even in comparison to fellow MENA countries. One of the main reasons for the lag in ratings for MENA countries, both individually and generally, seems to be, simply, that there has been less reform in the insolvency area in these MENA countries than in many others. Especially in OECD countries laws are continually revised in response to their performance in the market. In many ECA countries, as well, there have been extensive attempts at reform over the last two decades that helped to modernize their laws and improve recovery rates and shorten the time involved in proceedings. Many of the MENA country insolvency laws date back a decade, or even several decades. As noted, some, such as Jordan, Yemen, Iran, do not have comprehensive bankruptcy laws. As previously discussed, they do not meet international standards for best practices. Those that have undertaken significant reform, such as Morocco and Tunisia, fare better in the rankings in the Doing Business report.
Additionally, the courts in many MENA countries have not been modernized to the same degree as others, so that case backlogs, and cumbersome procedures slow down proceedings, which also lowers recovery, as assets deteriorate over time. Lack of experience with successfully and efficiently resolving bankruptcy cases, among judges, and sometimes, among the professionals responsible for the cases, also appears to be another impediment to efficiency. Reforming laws is a long-term proposition, and modernizing courts with sufficient resources, and modern case management procedures is an even longer-term proposition. In much of MENA, the process has hardly begun.

**Debtor protection: Can debtor object to creditor filing?**

**In order to ensure debtor’s rights, the debtor should have a chance to object to filing.** In MENA, where bankruptcy is often a collection tool, insolvency filings are often by the creditor against the debtor. Especially given the severe consequences of bankruptcy filing in most of the MENA countries—a bankruptcy declaration often imposes restriction on debtor’s civil rights has been likened to “death” by commentators in Egypt—a check on creditor’s ability to put the debtor in bankruptcy is necessary. Generally, the court certifies the insolvency by whatever test is provided in the law: cessation of payments, balance sheet (assets vs. liabilities), etc.

Many countries either explicitly allow debtor to object, or try to protect debtor through an assessment of his insolvency before initiating the case. Kuwait explicitly allows debtor objection to a filing. In the other countries, while information is not available as to an explicit right to object to the filing, since the determination of insolvency needs to be reached by the court, and debtor provides the information, that process should provide some protection for a debtor against an unjustified bankruptcy filing. In Jordan, with the myriad laws governing the insolvency system, there is not a clear right of a debtor to object to a filing. The Jordanian Companies Control Department (CCD) controls the access to insolvency proceedings, and government entities, in addition to the courts, control accessibility. Jordan’s arrangement is unusual, both in the region and worldwide. In Palestine, though the bankruptcy procedure is rarely used, there is no formal test of insolvency, and it is not clear if and based on what standards the debtor could object. Saudi Arabia also has no clear test; competent administrative bodies are required to investigate debtor’s estate, and there is no consistency in practice. Consequently, insolvency procedures are rarely used in Saudi Arabia. In Qatar, as previously stated, creditors cannot file, which is unusual for the region, and indeed, worldwide.

2.6. **Reorganization**

Reorganization is one of the most important features of a modern insolvency regime. In many countries bankruptcy has historically been synonymous with liquidation. In a modern system, the insolvency system allows a potentially viable debtor company to attempt to reorganize and survive its financial distress in order to continue operations. Reorganization can help to keep companies that are productive but only need time and some legal protections to survive, to continue operating productively in the economy. However, many companies will not be able to rise above their financial troubles and reorganize. When a reorganization fails, the conversion to liquidation and ensuing liquidation should be swift and fair.
Improving the Efficiency of Liquidation in MENA

Liquidation is not considered efficient in most of the region. In order to improve the speed and efficiency of the procedure as well as maximize return, countries in the region should consider:

- Simplifying the procedure to open a case, so that any review is done within a very short time frame, no more than two weeks so that liquidation can begin
- Simplify the procedures to dispose of assets, emphasizing the need to maximize value, with appropriate, but not overzealous concern for preventing fraud.
- Enact reasonable, yet efficient time deadlines for the bankruptcy case, for the overall liquidation and for disposal of assets
- Enhance the capacity of relevant professionals, such as judges, attorneys and businesspeople, through training in the economic principles of bankruptcy and insolvency, valuation and maximization of assets
- Professionalize insolvency administrators through appropriate training and supervision (discussed further in Part 4 Institutions Implementing the Insolvency System)

Both the 2005 World Bank’s *Principles for Effective Insolvency and Creditor Rights Systems*, and the 2004 UNCITRAL *Legislative Guide on Insolvency Law* provide further detailed guidance on designing systems in accordance with international best practice standards.
### Table 2: Mapping of Reorganization

<table>
<thead>
<tr>
<th>Country</th>
<th>Reorganization in the law?</th>
<th>Only 3 countries have reorganizations in practice</th>
<th>Available to all companies?</th>
<th>Mandatory trustee?</th>
<th>Easy conversion to liquidation?</th>
<th>Creditors’ Committee/creditor voting on plan</th>
<th>Stay applies to secured creditors?</th>
<th>Supportive environment for reorganization?</th>
<th>Are debt for equity swaps permissible?</th>
<th>There are no publically articulated OCWI guidelines?</th>
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<td>-</td>
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1. No if debtor management is allowed to stay in place during reorganization
2. The question presumes a stay, if there is no stay on creditor action, No
There are few reorganizations in MENA countries, despite the fact that many MENA countries have reorganization provisions in their laws. The provisions are mostly in the form of conciliation procedure that allow a delay in the declaration of bankruptcy in order to attempt an amicable settlement with creditors. There is a lack of expertise on corporate rescue, and often a lack of capacity in the courts to make the reorganization processes that are in the laws effective. Moreover, within these provisions, many of the key elements of modern reorganization systems, such as realistic timelines, provision for preparation of plans and adequate disclosure of debtor financial information, adequate provision for and encouragement of creditor participation and negotiation, and provision for operating funds through priority for post-petition financing, are missing. In France, French law contains similar provisions. However, new, more detailed provisions passed in 2005, that took effect in 2006 added a more sophisticated “safeguard” reorganization proceeding to the law, which stimulated more reorganization. Immediately upon implementation the safeguard process allowed a high-profile restructuring of Eurotunnel, the undersea rail operator; others continue to follow suit. No such modernization of provisions to encourage reorganization has been successfully undertaken in the MENA countries. While many countries’ laws were originally modeled on the French law, they have not been revised to keep pace with the changes the French have found necessary to effectuate reorganization.

The other, perhaps most important shortcoming in MENA countries that inhibits reorganization is lack of institutional capacity. For reorganization to be successful, the professionals involved, such as administrators, insolvency practitioners, judges, must not only be knowledgeable about restructuring, they need to be flexible. Institutions, particularly courts, in MENA are not flexible, as previously stated, they tend to be bureaucratic and formalistic. They inhibit rather than support a process that by its nature requires flexibility and dynamism. Nor does there appear to be a body of professionals—restructuring experts, trustees/insolvency professionals experienced with creditor negotiation and debt restructuring, or judges—that can compensate for the institutional inertia. In short, the lack of experience with reorganization, seems to be reinforcing the lack of its practice.

Several MENA countries have some provision in the law for coming to agreement with creditors in order to prevent a bankruptcy. Morocco, Egypt, DIFC, Kuwait, Lebanon, Oman, allow conciliation (often called “composition”) or settlement procedures starting the day of the commencement of the proceedings. The declaration of bankruptcy is delayed while the conciliation is attempted. In Morocco a four-month period (analogous to the French law) is allowed during which the debtor attempts to reach an amicable settlement with creditors. Egypt has a similar conciliation procedure. Jordan allows the liquidator to reach agreement with creditors of a public company, including the power to bind dissenting creditors, and also has a composition procedure for non-corporate traders/merchants that allows a debtor to propose a settlement to creditors. Tunisia is reported to have reorganization provisions, without specific time guidelines, and without the ability of dissenting creditors to appeal, though further information on the structure of the provisions is not readily available. In Saudi Arabia and UAE there are seldom-used procedures by which a settlement with the debtor and creditors may be reached. In Saudi Arabia the process is controlled by an appointed government agent. UAE also has such a procedure but
the provisions surrounding such a “deed of arrangement” are not clear. Yemen does not have reorganization provisions.\textsuperscript{lxv}

**Ultimately, however, the core elements of a modern restructuring law are missing, even from these conciliation provisions.** Such missing key elements include: provisions for the preparation of a plan of arrangement and the ability to obtain financing during the reorganization. As a result, the conciliation procedures across the region are rarely used to successfully rehabilitate distressed companies.

*Debtor management remaining in place vs. an insolvency administrator*

**Leaving the management of the debtor company in reorganization in place can be a controversial issue.**

In the U.S. there is a strong practice of leaving debtor management in place, as the current management is most likely to understand the business well enough to reorganize it. Other approaches are to either cede total control to an independent insolvency representative administrator/receiver, or to have the debtor management continue under the supervision of an insolvency representative administrator/receiver. In the case of incompetent or negligent management, or fraud on the part of management, management should be shifted to the insolvency representative.\textsuperscript{lxvi}

**The debtor is allowed to participate in management of the company during reorganization in many MENA countries.** Perhaps this is accepted, despite the suspicion culturally shown debtors, because a potential insolvency is not a “bankruptcy”, with all the attendant consequences. Nor is it as formal as a reorganization procedure in a more modern law. It is a “preliminary” procedure while the bankruptcy declaration is postponed to try conciliation/reorganization among debtor and creditors. However, none of the countries leave the debtor completely in charge without the supervision of a trustee/insolvency administrator. In Jordan, Egypt, Kuwait and Lebanon, debtor management and an insolvency administrator in a supervisory role manage a company in the process of a conciliation/reorganization. The degree of powers of each varies.\textsuperscript{lxiii} In Jordan, the court will enumerate the division of powers in the order appointing the trustee before a liquidation decision, and the powers of the liquidators after the decision are well-enumerated. Interim trustee appointees (before the liquidation decision) must post a bond to the court.\textsuperscript{lxiv}

**Some countries remove debtor management from company operations.** Oman and Saudi Arabia appear to leave no role for debtor management once the case has commenced.\textsuperscript{lxv} In Morocco, from information available it appears that the trustee/insolvency administrator has complete control of a company in the process of reorganization.\textsuperscript{lxvi}

*Does the stay apply to secured creditors in a reorganization?*

If secured creditors all claim their collateral, the debtor’s most valuable assets could be decimated, making a recovery from financial distress and successful reorganization impossible. In a reorganization, the viability of the business is the focus. If the secured creditors’ collateral is necessary for
reorganization, a stay on that creditors’ execution would maximize the chances of reorganization for the company (see earlier comments regarding stays of proceedings).\textsuperscript{lxvii}

**Application of the stay to secured creditors in reorganization varies across the region.** It appears that Jordan, Lebanon and Egypt affirmatively apply the stay to secured creditors in reorganization.\textsuperscript{lxviii} In Morocco, the stay applies to secured creditors during a liquidation, but it is not clear if it applies during a reorganization. In other countries, information is not available as to whether the stay applies differently in a reorganization, as opposed to a liquidation (see Section 3.3.1 Stay/Moratorium).

*Creditors input: participation, creditors’ committee, voting on plan, monitoring?*

**Creditor participation is the key to an effective reorganization.** They are stakeholders in the debtor’s estate, and therefore their agreement to a reorganization plan is crucial for its success. Creditors should be able to effectively participate in the reorganization process. In large cases with multiple creditors, a creditors’ committee is the preferred mechanism to ensure the creditors’ voice is heard. The law should specify the composition, voting, and monitoring rights of the creditors’ committee.

Despite the fact that the reorganization procedures are seldom used in most countries, many of the reorganization provisions in the region’s laws do explicitly allow for creditor input. The most common formula is to require approval of a majority of creditors representing 2/3 of debtors’ liabilities is needed, as in Egypt, Lebanon, Saudi Arabia, Oman and UAE. In Jordan, creditors representing 75% of the debt owed and the general meeting of the company must approve. Secured creditors do not vote in either Jordan or Lebanon.\textsuperscript{lxix} In Morocco, there is no creditor vote, but creditors have the ability to make offers to settle during the four month conciliation period, and are bound by those offers if accepted.\textsuperscript{lxx} In DIFC, despite having the most modern insolvency laws, creditor voting procedures are vague, and a plan cannot bind preferential or secured creditors to accept a reduction in their rights.\textsuperscript{lxxi}
**Bringing Reorganization to the MENA Region: First Steps**

By and large, reorganization is not widely practiced in the region. In order to promote rehabilitation of viable companies, MENA countries’ immediate reform priorities should focus on:

- Decriminalizing bankruptcy
- Shifting the focus from punishing the debtor and uncovering wrongdoing to rehabilitating debtors in financial distress
- Developing more detailed, modernized provisions for the reorganization procedure, in accordance with international best practice standards, including more specific procedures for reorganization plan formation and distribution, financial disclosures of debtor, and creditor participation.
- Enhancing the ability of creditors and debtors to negotiate, through the development of alternative dispute resolution, particularly in cases where a debtor is dealing with a singular creditor
- Cultivating a “culture of reorganization” by developing expertise among professionals, judges and attorneys in restructuring, and the economics of overcoming financial distress
- Providing training to insolvency administrators on the economic and legal aspects of successful restructuring of debt and rehabilitation of debtors.

Both the 2005 World Bank’s *Principles for Effective Insolvency and Creditor Rights Systems*, and the 2004 UNCITRAL *Legislative Guide on Insolvency Law* provide further detailed guidance on designing systems in accordance with international best practice standards.

### 3. Informal/Out of Court Reorganization and Workouts

#### 3.1. Formal support for out-of-court, non-insolvency workouts and restructuring

Financial crises often prompt countries to provide a framework for out-of-court workouts for distressed companies, to prevent bankruptcy filings. Out of court workouts can be undertaken when a company is in financial distress, but may have a chance of recovery, without a bankruptcy filing, if appropriate arrangements can be made among its major creditors. Out of court workouts can come in many forms, including bi-lateral negotiations between debtor and creditors under an agreed, non-binding set of guidelines. This approach is often called the “London Approach”. Major lenders such as banks...
agree to a standstill on payment and collection for a period of collective negotiation. Participation in the scheme is voluntary, though banks in the UK did commit to the scheme, and a significant practice has evolved since the 1970s and through various financial crises through the 1990s.\textsuperscript{lxxi} Other forms can include government sponsored negotiations or negotiations facilitated by third parties (both of which will be discussed below).

The London Approach works best for debtors that have multiple institutional lenders (primarily banks) at a senior level. Creditors must believe that negotiating will produce a better result than an insolvency filing, in order to motivate them to negotiate. It is also more effective when the debtor does not need relief from trade debts, or the benefits of formal insolvency.\textsuperscript{lxxii} In order to support such a system, the legal and business regime should allow debt-for-equity swaps, and tax laws should not penalize debt restructuring or debt forgiveness. Additionally, the stronger the country’s overall creditors’ rights and insolvency regime, the more incentive the debtor will have to come to the table to negotiate. The parties will be more motivated when the legal system provides the credible threat of debt collection by creditors, or referral to liquidation, if there is not a collective resolution.\textsuperscript{lxxiv}

In response to the Asian financial crisis in the 1990s, Indonesia, Korea, Malaysia and Thailand promulgated out-of-court workout frameworks, with variations such as the “Bangkok Rules” and the “Jakarta Initiative”.\textsuperscript{lxxv} One major difference between these initiatives and the London Approach is that in these countries, the government/authorities took a more active role in the workout process than the London Approach.\textsuperscript{lxxvi} All four countries created central bodies that had the authority to identify companies in distress and monitor and encourage restructuring. All provided some form mediation and arbitration of disputes that arose during the negotiation procedure. The London Approach is much more hands-off; any alternative dispute resolution employed will be undertaken at the initiative of the private parties, not the government. Moreover, in these Asian countries, unanimous consent of creditors was not required for a restructuring plan, a 75% vote was enough.\textsuperscript{lxxvii} The authors of a recent study of corporate debt restructuring during financial crises found that all countries had mixed success with restructuring.\textsuperscript{lxxviii} After reviewing the experience in current systems, including the four born of the Asian crisis, the authors concluded that approaches that involved government support, and the establishment of public entities to facilitate and/or mediate the corporate restructuring process, were the most likely to produce results.\textsuperscript{lxxix}

Use of out of court restructuring is not widespread in MENA, though the most recent financial crisis has led to high-profile restructurings of large firms. The economic context in some of the MENA countries renders the process too complex for ordinary companies. As an example, in Saudi Arabia, a significant number of companies have one major financial institution as a credit source, rather than multiple institutional creditors.\textsuperscript{lx} Moreover, there does not seem to be a cultural practice of admitting looming financial disaster for a company, in order to initiate negotiations with its creditors. Therefore, in some MENA countries, informal negotiations between debtors and creditors are not the norm.\textsuperscript{lxxi} Kuwait has recently bucked the norm and begun to encourage multi-creditor workouts in response to the global financial crisis.
Kuwait is specifically encouraging London Approach-style out-of-court restructuring, as evidenced by high profile debt restructurings in 2009-2010. In order to facilitate the restructurings, in 2009 the Kuwaiti government passed a stimulus package in response to the global financial crisis. The plan aims to protect companies from creditors if they file a viable business plan, and the central bank approves the advisers for any foreign financial restructuring. The government support appears to have worked; Kuwait had more than one high-profile restructuring in 2009-2010. Global Investment House K.S.C (c), a Kuwaiti investment house listed on both the Kuwaiti and London stock exchanges finalized its restructuring in early 2010, which included three year amortizing facilities with each of its 53 lending banks. Kuwait's Investment Dar (TID.KW), the Islamic firm that co-owns British luxury carmaker Aston Martin, received approval from almost 80% of creditors for a five-year plan to restructure about one billion dinars ($3.5 billion) of debt. The government support appears to have worked; Kuwait had more than one high-profile restructuring in 2009-2010. Global Investment House K.S.C (c), a Kuwaiti investment house listed on both the Kuwaiti and London stock exchanges finalized its restructuring in early 2010, which included three year amortizing facilities with each of its 53 lending banks. Kuwait's Investment Dar (TID.KW), the Islamic firm that co-owns British luxury carmaker Aston Martin, received approval from almost 80% of creditors for a five-year plan to restructure about one billion dinars ($3.5 billion) of debt.

There is some monitoring of companies in other countries in MENA, and some countries’ policies and practices support consensual resolution of disputes. In Jordan, the Companies Control Department (CCD) does monitor companies through a special insolvency unit, and may meet with creditors and request an informal standstill, though this is informal, and a part of the CCD’s financial supervisory power, rather than a legal framework designed to encourage negotiation. Saudi Arabia has recently developed legal provisions to encourage consensual arrangements to resolve liquidity problems, but as of mid-2009, the provisions were not yet in use. In Yemen, as well, out-of-court restructuring is seldom used.

Dubai World, Dubai’s high profile state-owned conglomerate that faced insolvency in 2009, agreed to a restructuring deal with its leading creditors in May 2010. On May 20, 2010, Dubai World announced that it had reached a tentative deal with a broad array of 90 lenders, including HSBC, Royal Bank of Scotland and Bank of Tokyo-Mitsubishi UFJ, to reschedule about 23.5 billion U.S. dollars of debt. The agreement effectively extends the length of the conglomerate’s loans, giving it time to cut costs and sell assets and put itself in a better position to pay. A restructuring expert from the UK was brought in to head the effort. The bank coordinating committee involved in the negotiations represents about 60% of Dubai World’s debt. The deal proposal involved converting 8.9 billion USD of Dubai government debt owed by Dubai World to equity, with the Dubai government subordinating its position to other creditors. Moreover, the government (the owner of Dubai World) committed to fund up to $500m of SG&A (selling, general and administrative) expenses and an interest facility of up to $1.0 billion while maintaining 100% ownership. Creditors of about 14.4 billion USD of debt were being offered repayment of their debts in two tranches, the first tranche covering 4.4 billion USD, and the second, 10 billion USD, with five and eight year maturity, respectively. Creditors were offered a choice among three plans that addressed the method of payment of their funds in the second tranche. Options available to lenders were based on the currency in which they hold the debt, and their other preferences, such as whether they valued shortfall guarantees or higher payments in kind and cash. At the time of the announcement, the approval of the rest of the lenders, beyond the 60% that were in agreement, remained to be sought in finalizing the deal.
Are the proper incentives in place to encourage restructuring and workouts?

The success or failure of any regime that purports to promote out of court reorganizations of
distressed companies will depend on the incentives, or disincentives, as the case may be, that are
built into the system. MENA Countries vary at enabling corporate workouts through specific policies
regarding debt treatment. In the Dubai International Financial Centre (DIFC), an investment/industrial
free zone within the UAE, the economic environment encourages consensual arrangements to resolve
financial issues. There are no adverse tax consequences to debt forgiveness, and debt-for-equity swaps are
allowed, though subject to Dubai Financial Services Authority (DFSA) oversight. Qatar, Egypt, Saudi
Arabia also allow debt-for-equity swaps. Some MENA countries impose significant tax consequences for
debt forgiveness, inhibiting a major out-of-court workout mechanism, including Egypt. However, others,
such as Lebanon, DIFC, and Qatar do not impose tax penalties on debt forgiveness. Saudi Arabia allows
deductibility of bad debts from Zakat. Table 4 shows that no country in the region is known to have
articulated out of court workout guidelines, but that most permit debt-for-equity swaps.

An informal process is far more likely to be sustained where there are adequate creditor remedies
and insolvency laws. There is more incentive for negotiation among parties when each one has
recourse to effective remedies to enforce his position—the debtor to an insolvency proceeding that
protects his rights, and the creditor to his remedies in case of default. Moreover, parties are more likely to
abide by an agreement if it is enforceable.

In the MENA region, creditor rights and insolvency laws are not compliant with international
standards, nor are they considered particularly effective by the users. However, many countries
such as Egypt, Kuwait, Oman, Palestine and Saudi Arabia report an enabling environment for informal
workouts, and particularly bilateral arrangements between creditor and debtor. The enabling environment
referred to is based on culture and bank practice. Some of the motivation for negotiation between
debtors and creditors is the very ineffectiveness of the system that could support workouts if it functioned.
Indeed, it is often said that informal workouts can succeed in only two environments: Those in which the
formal system is so perfectly calibrated as to allow debtors and creditors to accurately estimate their best
alternatives to a negotiated settlement and those where the formal system is so inadequate as to
incentivize debtors and creditors to resolve disputes on their own. Debtors do not want the severe
consequences from bankruptcy, which often include restriction of their civil rights. Creditors know that
they likely will not recover through a bankruptcy, so they are motivated to settle with the debtor in order
to recover something at all. In countries where bankruptcy is a collection tool, this ‘carrot-and-stick’
describes the role of both the debtor and creditor—the threat of bankruptcy and ability to dismiss it vs. the
desire to avoid bankruptcy incentivizes negotiation.

Post-Commencement Finance: Is there encouragement of lending to distressed enterprises?

Companies trying to reorganize typically require the provision of ongoing financing during the
reorganization, but the concept of lending to distressed enterprises is not widespread in the region.
In particular, the notion of ‘post commencement financing’ is almost nonexistent. Nor does it appear there
is a strong practice of lending to companies in financial distress, as recovery chances are low. In
developed insolvency systems, post-petition financing is often provided to a company that is already in a formal insolvency proceeding. Lenders are incentivized by being granted a priority position in repayment—this can occur in a formal insolvency proceeding, or during an out-of-court restructuring proceeding that is conducted under guidelines such as in the London Approach. The system works because lenders find that being first in priority provides a relatively high chance of repayment, and so a practice has developed based on the legal regime. To promote such financing to insolvent companies in MENA, in arms-length transactions (as opposed to extensions of funds based on relationships), would require shifts in the attitude toward debtors, the legal system, and banking practice.

**Kuwait stands out from the crowd in responding to the 2008-2009 crisis by supporting lending to distressed enterprises.** In response to the recent financial crisis, Kuwait enacted a financial stability stimulus package that incentivized lending by banks to enterprises that includes wide-ranging state guarantees for bank loans and assistance to troubled investment firms to repay their debts. Legislation passed in the first half of 2009 stipulates that the state would guarantee 50 percent of an estimated four billion dinars (13.8 billion dollars) of new credit facilities to be granted by banks to local companies. Other Gulf countries have taken measures in response to the crisis, such as UAE’s bond guarantee stimulate lending to distressed businesses.

**The need for liquidity post-petition is recognized in MENA countries, but response varies in type and extensiveness.** In Jordan, while there is no post-petition financing in the absence of a reorganization law, pursuant to the Deposit Insurance Corporation Law, when a bank is in liquidation priority is accorded to loans obtained “after the liquidity decision”, so that the concept is in the law, albeit currently limited to banks in distress. In Qatar and Saudi Arabia, shareholders are expected to contribute capital to a distressed company.

3.2. **Alternative Dispute Resolution**

Is alternative dispute resolution, such as mediation or conciliation available to resolve disputes between debtors and creditors to prevent insolvency filing?

**As previously stated, many of the countries in the region base their bankruptcy laws on the French model, thus its preventative provisions which utilize alternative dispute resolution to prevent insolvency, may be instructive.** In France, under a relatively new procedure, the commercial court president may appoint a mediator to assist the debtor in resolving 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. The court, at the debtor’s request, appoints a mediator, normally an experienced insolvency trustee, to assist the debtor in negotiating with his creditor(s) to overcome his temporary financial distress. The French mediator’s role is purely advisory, he has no authority over the debtor. He brings his skills in mediation and business understanding to assist, but not control debtor. The debtor enjoys no special protection such as a stay or any other elevation of his rights above those of creditors. Nor does it harm him reputationally, or inhibit his ability to obtain credit, as it is not published. 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 power to negotiate agreements with creditors than the ad hoc mediator, including the
authority to propose restructuring plans. 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 French law allows for financing obtained after filing of the case to be repaid on a priority basis.

It is worth considering whether or not French bankruptcy preventative provisions are a worthy model upon which to build a local foundation in Algeria, Egypt, Jordan, Kuwait, Lebanon, Mauritania, Morocco, Oman, Syria, and Tunisia—all Francophone countries significantly influenced by the French legal system. Granting the court the ability to appoint, or even refer properly trained mediators, may be worthwhile, especially in cases where the bankruptcy is filed by one creditor seeking to collect a specific debt, and is essentially a two-party dispute. In order for the system to be effective, it would have to be flexible, as in the French system. Moreover, it would require experienced mediators, skilled at negotiating, who also have the business skills to successfully assist the debtor in negotiations with creditors. Given the lack of capacity, and propensity for delay and bureaucracy in the courts in the region, the courts would have to adopt a hands-off policy. Their job would be to provide a mediator, perhaps from a roster of approved mediators, to a company that requests such assistance. If mediators could be trained to be skilled in debtor/creditor negotiations, and the system could be created without imposing the current bureaucracy onto it, debt-resolution mediators may be a viable option to rehabilitate companies in the early stages of financial distress, before legal proceedings have begun.

There are other procedures for preventing insolvency based on French law that have influenced MENA Francophone countries. In Morocco, the President of the court may give a third party a mandate to reconcile partners and counterpart positions, similar to the French provision allowing for appointment of a mediator. During a conciliation procedure the court can also order a stay on creditor action when requested by the conciliator. Although court-controlled, the purpose of the procedure is to prevent an insolvency filing. The procedure in Morocco is markedly similar to the conciliation provisions in the French law. In addition, the Moroccan law contains amicable settlement procedure provisions aimed at preventing insolvency, which last four months, and are conducted by a conciliator, not an administrator, appointed by the court. If agreement is reached with creditors, it is confirmed by the court. The extent of use of conciliators during these procedures in Morocco is not clear.

Banking practices seem to have provided somewhat of a supervisory/workout process in Jordan. In Jordan the role of financial supervisors in informal workouts has assumed greater prominence in the case of the largest Jordanian companies. The Companies Control Department (CCD) may be “triggered” to report on a company in trouble, and may meet with company managers and creditors to request a standstill and take other measures to promote restructuring. In meetings with Bank staff in 2009, the CCD reported that it was monitoring 30 companies.

Arbitration is an alternative dispute resolution method used in the region. Arbitration conducted by the Chamber of Commerce is the main method of informal or out-of-court restructuring in Saudi Arabia. Arbitration under the London International Court of Arbitration (LICA) model is available in the DIFC to promote workouts.
Shari’a influence on informal workouts

The prohibition on interest is one of the most well-known facets of Shari’a law as it relates to finance. Interest issues are reported to inhibit workouts in UAE, Yemen, Saudi, Oman, and in Qatar in relation to enforcement of claims, according to the MENA Report. When a disputed amount involves what can be perceived to be interest, if Shari’a is influential, the dispute can change from a straightforward contractual dispute to one that is subject to interpretation. The influence of Shari’a varies. In Saudi Arabia, shari’a compliant financing is widespread. Courts enforce shari’a, which leads to effective rewriting of commercial contracts. This undermines commercial certainty. The prohibition on interest can hamper typical remedies during financial distress, such as when a loan term is extended in exchange for higher interest—interest is not available as compensation in shari’a. Conversely, in Egypt, shari’a compliant financing is not significant in the markets, according to experts there.

4. Institutions Implementing the Insolvency System

4.1. Courts: Specialized courts, judges trained in bankruptcy

Judges trained specifically in bankruptcy and its procedures should hear and oversee bankruptcy cases, pursuant to best practice standard for implementation. Insolvency is a complex procedure, distinct in its characteristics from general civil cases. Doing Business 2009 concluded that recovery rates in insolvency cases were much higher in countries that have specialized bankruptcy courts. Doing Business reports include a broad mix of economies, both developed and developing, and also with broad ranges of bankruptcy experience. It is important to note, however, that the successful deployment of commercial courts requires significant commitment beyond their mere creation. Creation of commercial courts with insufficient training of personnel, and where the new commercial courts absorb the deficiencies of the general courts, has been shown to be ineffective at improving insolvency processes.

In most of the MENA countries, there is a significant institutional capacity gap due to the lack of insolvency knowledge on the part of the judges. Several factors prevent specialization. When a general court hears cases, judges do not receive the critical mass of insolvency cases needed to build expertise. In some countries, judges are rotated between different courts, with different subject matter, so that any specialized training, or expertise gained from experience, ceases to be applied to insolvency cases once the judge rotates out of the court where he is hearing insolvency cases.
Commercial courts are one form of reform undertaken in some MENA countries to promote specialization, with varying success in improving institutional knowledge and performance. Among the countries surveyed, Morocco, Tunisia and Egypt have recently created commercial courts, and provided specialized training. While there are still complaints about judge expertise, the situation improves as training continues. In Saudi Arabia, there is not a commercial court per se, but a two-tier court system, the shari’a courts, and the Diwan al Mazalim, which has a commercial circuit. The training of the judges appears to be in shari’a principles, rather than statutory law or commercial principles. Due to the requirements that transactions follow shari’a principles, the courts in Saudi Arabia may examine the entire transaction for compliance with shari’a and rewrite it, which makes parties apprehensive to use these courts. In DIFC, Oman and Lebanon, there are specialized insolvency judges that hear bankruptcy cases. In Kuwait, judges are also specialized and cases are heard by a bankruptcy circuit. Given the number of countries such as Oman reporting low usage of the bankruptcy system, the number of countries reporting that there are designated insolvency experts, or commercial courts, to hear cases may sound curious. But as stated above, the designation of special courts, while a step in the right direction, does not in itself ensure an efficient bankruptcy system.

4.2. Insolvency Administrators (Trustees): adequate selection and supervision procedures to ensure competence and integrity; sufficient powers to effectively administer estate.

Insolvency administrators play a central role in a bankruptcy case. They are also called trustees, administrators, receivers, liquidators, insolvency representatives. Insolvency Administrators are usually given control over assets and significant authority to decide how and when assets are distributed. It is essential that insolvency administrators be skilled, efficient, and credible/trustworthy. The Doing Business 2009 report also highlighted the fact that countries that had instituted certain minimum qualifications for trustees had higher recovery rates in an insolvency proceeding. This element of the insolvency system is underdeveloped in many less developed insolvency systems, crippling them at a critical point in the implementation infrastructure.

The reputation of insolvency administrators in MENA is weak. They are by and large not viewed as competent, skilled or efficient. In addition to a lack of qualification standards and training, they have incentives to prolong procedures. These incentives include the vast range of responsibilities and the potential for liability for intended or unintended negligence, and their ability in many cases to charge more fees by prolonging the insolvency proceedings. Moreover, the methods by which insolvency administrators calculate their fees is not closely regulated and can sometimes lead to incentives, for the administrators, to needlessly prolong proceedings. As such, a clear framework for the basis on which fees will be calculated should be included as part of a regulatory framework.

In the MENA region, there are no countries, other than DIFC, that report that insolvency administrators receive training in the economics, or legalities of the insolvency process. Nor are there significant qualifications necessary to become an insolvency administrator. In Morocco and Egypt, the insolvency administrators have law degrees or are accountants, and are appointed by the court but
there is no insolvency-specific qualification. In Morocco they are court employees, civil servants, and in Egypt, they are members of the private sector, generally members of the legal community.\textsuperscript{cxiv} In Yemen, UAE, Qatar, Jordan, Lebanon, Oman and Saudi Arabia, there is no regulation of the insolvency practitioners at all.\textsuperscript{cxv} Neither do any of the countries report a need for insolvency practitioners to carry insurance for negligence liability, despite their responsibility for safeguarding financial assets and managing complex matters.

**DIFC may be an exception.** In DIFC, the region’s insolvency law laboratory, insolvency administrators are regulated by the state, and there are required qualifications. Registration as an insolvency practitioner requires the insolvency practitioner to accept any appointment made by the Dubai court. The Registrar who is charged with insolvency administrator supervision has authority to make supervisory orders.\textsuperscript{cxvi} The DIFC scheme to regulate insolvency administrators appears to be the most developed in the region.

Reform of insolvency administrators in MENA is only beginning.

**5. Roadmap to Reform**

**Countries in the MENA region have begun to undertake insolvency system reform.** Though there are not yet modern laws in most countries, there are draft laws being developed or being considered in some that would mark a closer move toward international best practice. There has been tangible, realized progress in the development of commercial courts. There appears to be substantial interest in reorganization/rehabilitation of companies.

**5.1. State of liquidation and reorganization, respectively**

**Liquidation and reorganization are not yet considered effective in MENA.** Delays are the major challenge, as court systems are notably inefficient, slow, and overly formalistic and bureaucratic rather than focused on the economic issues of insolvent companies. Delay in a case where economic assets are at stake, diminishes the value of the assets and value of the proceeding. Cumbersome procedures, along with court inefficiency and institutional inertia, often lead to very low recovery for creditors in liquidation cases. In reorganization, though some countries, particularly those that base their law on the French model, have had quasi-reorganization provisions in their laws for years, reorganizations are rare, almost nonexistent in practice. The reasons are inadequacy of the legal provisions, a lack of expertise, a lack of practice in using them, and lack of supporting mechanisms such as financing or support of experts in corporate rehabilitation. Faced with such ineffective systems, debtors are not motivated to seek out the reorganization procedures.
5.2. Reform Priorities

a. **Decriminalize insolvency; allow a fresh start after insolvency.** The criminalization of insolvency can be a serious inhibitor of risk-taking in the economy. It also inhibits debtors from filing bankruptcy even when a bankruptcy is in the best interests of the creditors, for fear of prison. The most harmful aspect of criminalization of bankruptcy may be cultural. It fosters a culture where the debtor is viewed with suspicion, and is scrutinized for possible wrongdoing rather than assisted in rehabilitation. The economic aspects of a case can become lost if the focus is to find fault with debtor’s actions. After the bankruptcy case is properly completed, through reorganization or liquidation, individual debtors should be discharged, i.e., freed from debt to allow a fresh start as an economic actor.

b. **Modernize the laws.** Many of the region’s insolvency laws have not been revised in over a decade, or even several decades. The inability of antiquated bankruptcy laws to serve the needs of modern, sophisticated economies has been noted. More efficient procedures for both liquidation and reorganization are needed. Overall, more effective reorganization procedures are needed, and liquidation procedures should be made more efficient and less formalistic, cumbersome and prone to delay. Specifics have been noted in the chapter after the discussions of liquidation, and reorganization.

c. **Improve court function and efficiency.** One of the major obstacles to efficiency of liquidation, and effectiveness of reorganization, in most of the countries, is court systems that are slow and ineffective. If the judicial system remains ineffective in implementing laws, then modernizing the text of the law will be ineffective. International best practice standards suggest specialized courts to hear insolvency cases. However, the benefits of specialization will not be realized by merely creating a bankruptcy court or a commercial court, if the courts will absorb the dysfunction of the general court system. Real reform for the judicial system, to promote efficiency, and a substantive and economic, rather than formalistic approach to cases, will be necessary to promote efficiency.

d. **Enhance the capacity of professionals involved in the system.** In insolvency, the insolvency practitioner/administrator is the gatekeeper for all significant actions taken in the case, from identification of assets, and claims, to collection and disposition of assets, to proper distribution of the proceeds. Most countries in the region do not have sufficiently competent administrators to efficiently carry out these duties. Countries should overhaul their regimes for insolvency practitioners to ensure adequate training, qualification, and supervision to insure integrity and proper performance of the insolvency administrator function. In addition to insolvency practitioners, other professionals involved in the system would benefit from capacity building as well. For an effective insolvency system, judges, attorneys and accountants, and any other relevant professionals, must understand the economics of distressed companies and distressed assets. Similar capacity-building is necessary to impart the knowledge, skills and strategies involved in successful reorganization of companies.

5.3. Out-of-court restructuring

Recent experience suggests that some countries in the region are ready to implement an out-of-
court restructuring scheme analogous to the London Approach. Due to the recent financial crisis, both Dubai and Kuwait have taken steps to enable out-of-court restructuring to prevent the bankruptcy filings of large companies important to their economies. The efforts have led to some initially successful restructurings. For countries where there are significant numbers of corporate entities with multiple institutional creditors, developing such schemes, with rules tailored to a country’s needs, may be prudent. Financial crises can provide a laboratory to test and refine the rules, while allowing distressed companies to survive the financial storm.

In countries where debtors do not have multiple creditors, developing reliable alternative dispute resolution services may be an effective tool to promote resolution of creditor-debtor disputes and avoid bankruptcy. The French model, which makes a mediator available to assist debtors in negotiations with creditors, may serve as a partial roadmap to MENA countries, particularly those with a Francophone tradition. Alternative dispute resolution may be particularly effective in two-party disputes, those between a debtor and a single creditor. Arbitration is already used in some MENA countries. Since many MENA countries report that debtors and creditors prefer informal resolution and negotiations to court, the market for alternative dispute resolution appears to exist. Developing effective, reliable access to mediation and perhaps arbitration may help some debtors and creditors resolve their disputes before resorting to an insolvency filing.

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1 MENA Report, Chapter 5, page 15.
2 MENA Report, Chapter 5, page 15, and observations of reformers in MENA countries.
4 Additional in-country research was not conducted to supplement available materials. Therefore there are gaps in the information. Information on insolvency systems in Algeria, Libya, Bahrain, Syria, Tunisia, Iran and Iraq, particularly seems to be lacking. Identifying such gaps in available information, however, may be useful to policy makers. It allows them to design appropriate diagnostic programs to determine their needs in developing and implementing a modern insolvency system.
5 Jordan interviews with stakeholders. The laws include the Companies Law, the Civil Code and the Commercial Code.
6 MENA Report, Chapter 8 Jordan
7 MENA Report, Chapter 12 Palestine, Chapter 13 Qatar, Chapter 14 Saudi Arabia, Chapter 15 UAE
8 Interviews with reformers working in the region.
10 World Bank Principles, C3
11 MENA Report, Chapter 6 DIFC.
12 MENA Report, Chapter 9 Kuwait, Chapter 10 Lebanon.
14 Commercial Code of Morocco Article 560
15 Jordan stakeholder interviews. There is an insolvency procedure for merchants provided-for in the Commercial Code though a judge commented that the provisions are deficient and of little use in a modern economy, and it is not clear how much it is used, if at all. Personal insolvency is covered by the Civil Code.
16 MENA Report, Chapter 7 Egypt, Chapter 9 Kuwait, Chapter 14 Saudi Arabia, Chapter 15 UAE
17 MENA Report, Chapter 7 Egypt, Chapter 9 Kuwait, Chapter 10 Lebanon, Chapter 11 Oman, Chapter 14 Saudi Arabia. For Morocco information, Commercial Code of Morocco Article 563.1.
From discussions of reformers in several countries, this is a common theme.

World Bank ICR Principle C10

World Bank ICR Principle C11.

Observation by practitioners and reformers in the region.

Jordanian Companies Law Article 255.

MENA Report, Chapter 7 Egypt, Chapter 10 Lebanon, Chapter 9 Kuwait, Chapter 13 Qatar. For Morocco information, Commercial Code of Morocco, Articles 679-685.

MENA Report, Chapter 9 Kuwait, Chapter 14 Saudi Arabia, Chapter 16 Yemen.

MENA Report, Chapter 14 Saudi Arabia, Chapter 15 UAE, Chapter 16 Yemen.


Commercial Code of Morocco, Article 575.

MENA Report, Chapter 7 Egypt, Chapter 8 Jordan, Chapter 9 Kuwait, Chapter 13 Qatar, Chapter 14 Saudi Arabia.

Jordan Civil Code Sections 1322 et seq, Commercial Code Article 331(3), Bureau of Law Interpretation decision No. 1, 2007, Jordanian Constitution Article 123/4, which gives the Bureau of Law Interpretation decision the force of law.

MENA Report, Chapter 12 Palestine.


World Bank ICR Principle C5.3

For Morocco information, Commercial Code of Morocco Article 653. For Jordan information, Jordan Companies Law Articles 255, 267(d). MENA Report, Chapter 6 DIFC., Chapter 7 Egypt, Chapter 9, Kuwait,, Chapter 13 Qatar, Chapter 14 Saudi Arabia, Chapter 12 Palestine, Chapter 16 Yemen.

Jordan Companies Law Articles 255, 267(d).

Commercial Code of Morocco Article 628.

MENA Report, Chapter 7 Egypt, Chapter 9 Kuwait, Chpater 11 Oman, Chapter 15 UAE

Egypt Report, page 17 footnote 69.

MENA Report, Chapter 7 Egypt.

MENA Report, Chapter 6 DIFC, Chapter 13 Qatar.

Commercial Code of Morocco Article 653

MENA Report, Chapter 8 Jordan, Chapter 14 Saudi Arabia, Chapter 16 Yemen


MENA Report, Chapter 10.

Kuwait reports such problems in its auction procedures, applicable to movable and immovable assets. MENA Report, Chapter 9 Kuwait. Such procedural problems are common across underdeveloped bankruptcy systems, and have been observed in Egypt by reformers as well.

Observations of reformers in the region; the Egyptian law contains such provisions and reformers confirm that such personal penalties for bankruptcy exist in the region.

Observations from reformers working with bankruptcy laws in numerous developing countries.

MENA Report, Chapter 7 Egypt, Chapter 9 Kuwait, Chapter 11 Oman, Chapter 13 Qatar, Chapter 12 Palestine, Chapter 14Saudi Arabia, chapter 15 UAE.

Observations of experts and reformers in the region.

MENA Report, Chapter 9 Kuwait

Jordan interviews with stakeholders.

MENA Report, Chapter 12 Palestine, Chapter 13 Qatar, Chapter 14 Saudi Arabia

Out of Court Workout

Anker Sorensen, Andrew Tetley, “Making France a More Attractive Forum for Restructuring in Europe: Part 1”, American Bankruptcy Institute Journal, XXVIII ABI Journal 7, 46-47, 61, September 2009. Eurotunnel filed immediately after the new provisions took effect and was successfully restructured a year later; reorganizations seem to be increasing in practice.

Commercial Code of Morocco Article 579.
en debtors and creditors are tab

E Egyptian Trade Law Articles 662-683 and 725-767.

2 Jordan Companies Law Article 262, Jordan Commercial Code Articles 290-325.

x Legal Benchmarks for Monitoring Implementation of Euro-Mediterranean Associate Agreements, by IRIS Center, University of Maryland, UNPUBLISHED DRAFT, August 2004, page 48.

xi MENA Report, Chapter 14 Saudi Arabia, Chapter 15 UAE, Chapter 16 Yemen

xii World Bank Principles C6.2.

xiii MENA Report, Chapter 7 Egypt, Chapter 8 Jordan, Chapter 9 Kuwait, Chapter 10 Lebanon.

xiv Jordan Companies Law Articles 261(a), 267(b), 268(a), 269.

xv MENA Report, Chapter 11 Oman, Chapter 14 Saudi Arabia.

xvi The Commercial Code of Morocco provisions on bankruptcy vest significant powers in the trustee, the Syndics. They appear to be governed by Book V of the Commercial Code.

xvii UNICITAL Legislative Guide on Insolvency Law, C.1. Reorganization Proceedings, recommending an automatic stay for a short time on all claims as a provision of an effective reorganization law.

xviii MENA Report, Chapter 7 Egypt, Chapter 8 Jordan, Chapter 10 Lebanon.

xix MENA Report, Chapter 7 Egypt, Chapter 8 Jordan, Chapter 10 Lebanon, Chapter 11 Oman, Chapter 15 UAE.

xx Commercial Code of Morocco, Articles 582 and 585.

xxi MENA Report, Chapter 6 DIFC.


xxix Laryea, Thomas, “Approaches to Corporate Debt Restructuring in the Wake of Financial Crises”, IMF Staff Position Note, January 26, 2010, page 9-10. Laryea calls government participation through a public entity to support restructuring an “intermediate approach” and states that it provides the best results among universally mixed results.

xxx Kingdom of Saudi Arabia, interviews with stakeholders.

xxxi MENA Report, Chapter 7 Egypt, Chapter 9 Kuwait, report that negotiations between debtors and creditors are widely employed. Chapter 5, The Need for Insolvency Systems Reform in the MENA Region, informal negotiations are the norm between creditors and debtors in MENA countries. Comments by experts in the region suggest that is the preferred approach in other MENA countries and within bank practice as well.


The fact that cultural issues or Shari’a considerations inhibit out-of-court restructuring is in contrast to the rest of the MENA countries in the *MENA Report*, most of which report that there are no cultural or Shari’a barriers and that consensual agreements are supported by the business environment.


The Zakat (a form of tithe) is paid annually by Saudi individuals and companies within the provisions of Islamic law as laid down by Royal Decree No. 17/2/28/8634 dated 29/6/1370 H. (1950). The Zakat is an annual flat rate of 2.5 percent of the assessable amount. http://www.the-saudi.net/business-center/regulation-tax.htm.


Observations by experts and reformers on the ground. For example, in Egypt, commercial courts, or circuits have been created, but some of the judges that received donor-sponsored training on commercial subjects were subsequently transferred out of the commercial circuits.


World Bank Principles D1.2


*MENA Report*, Chapter 5 The Need for Insolvency Systems Reform in the MENA Region

Commercial Code of Morocco Article 568.3; observations of a reformer working in Egypt regarding current trustee system.