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Small Business Bankruptcy Reform in the Arab World: Two Steps Forward, One Step Back

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Abstract

This article assesses a series of recently adopted bankruptcy laws in the Arab world, situating them within three historical phases of global bankruptcy reform. It introduces recently released recommendations from international standard-setting organisations for best practices in the bankruptcies of small and medium enterprises (SME) and applies them to evaluate the key details of recent bankruptcy reforms in Saudi Arabia, the United Arab Emirates, Egypt, Morocco, Tunisia, Oman, and Bahrain. Seeking an explanation for the persistent absence of an especially crucial element of effective SME rescue policy, it recalls the Islamic law relating to debt distress and recovery. Finally, it reveals a revolutionary new approach to this controversial topic, adopted by one Arab state to produce a bankruptcy law that is truly and exceptionally responsive to the needs of SMEs.

Keywords

bankruptcy laws – global bankruptcy reform – small business – Saudi Arabia

1 Introduction

Exuberant headlines have announced a recent spate of bankruptcy reforms around the Arabian Peninsula and North Africa, heralding a boost to business and investment in the region.[1] One in particular anticipated that Saudi Arabia's

1 See, *e.g.*, T. Arnold, R. Shamseddine & K. Paul, 'In boost to reform, Saudi Arabia's cabinet approves bankruptcy law', *Reuters*, 18 Feb. 2018, available at: www.reuters.com/article/us-saudi

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new 'landmark bankruptcy law' would 'help SMEs thrive'.[2] While these new laws will doubtless provide a more rational and organised procedure for big business restructuring of mega-conglomerates like Ahmad Hamad Algosaibi & Brothers,[3] a very different sort of reform is in fact necessary to aid the recovery of the countless small and medium enterprises (SME) that make up the base of these states' diversifying economies.[4]

The Arab world has made notable and admirable progress in adopting these bankruptcy reforms, but it has actually just arrived at the mid-point of a three-phase process of historical bankruptcy law development. The final phase is powerfully and uniquely inhibited in the Islamic world, though authoritative voices have offered a rationale for taking the third, crucial step toward meaningful small business bankruptcy reform. One state has responded to this call, showing the way forward for others. Only after this final, indispensable element is adopted will bankruptcy law in the Arab world be truly poised to reinvigorate the energy and entrepreneurial spirit of the vital SME sector.

This article charts the lead up to these Arab world bankruptcy law reforms (Section 2) before situating them within the three historical phases of global bankruptcy reform of the past two millennia (Section 3). The most recent phase concentrated on SMEs and the unique purposes and approaches of bankruptcy as an effective small business rescue mechanism. This phase witnessed the release of SME-specific best-practice recommendations by international experts and standard-setting organisations. Section 4 applies these

-bankruptcy/in-boost-to-reform-saudi-arabias-cabinet-approves-bankruptcy-law-idUSKCN1G20PJ, accessed 18 Feb. 2018; I. John, 'Why the UAE's new bankruptcy law is a boon for business', *Khaleej Times,* 1 Mar. 2017, available at: www.khaleejtimes.com/business/economy/uae-bankruptcy-law-boom-bust-bonanza, 5 Aug. 2020; A. Alsharif, 'Egypt approves bankruptcy law to spur investment', *Reuters,* 4 Jan. 2017, available at: www.reuters.com/article/egypt-economy-bankruptcy-idUSL5N1EU27U, 5 Aug. 2020; M. Magdy, 'Long-awaited bankruptcy law sparks optimism in Egypt', *Al-Monitor,* 20 Feb. 2018, available at: www.al-monitor.com/pulse/originals/2018/02/egypt-bankruptcy-law-foreign-investments-economy.html, 5 Aug. 2020.

2 D. Saadi, 'Saudi Arabia approves landmark bankruptcy law', *The National,* 22 Feb. 2018, available at: www.thenational.ae/business/economy/saudi-arabia-approves-landmark-bankruptcy-law-1.707236, (reasserting that 'SMEs are expected to benefit the most from the law'), 5 Aug. 2020.

3 See Arnold *et al.*, *supra* note 1 (noting AHAB's $22 billion default and debt proposal, which had collected two-thirds creditor support).

4 See Saadi, *supra* note 2 (noting 'SMEs are the backbone of the economy in Saudi Arabia and the wider Arabian Gulf region'); World Bank Group, *Report on the Treatment of MSME Insolvency* (2017): 4 [hereafter, World Bank *MSME Report*] (noting MSMEs account for 60% of private labour force employment and more than half of value added).

recommendations to assess the details of recent bankruptcy reforms in Saudi Arabia, the United Arab Emirates, Egypt, Morocco, Tunisia, Oman, and Bahrain (with a glance at pre-reform laws in Qatar and Kuwait). Seeking an explanation for the persistent absence of one especially crucial element of effective SME rescue policy, Section 5 recalls the Islamic law relating to debt distress and recovery, and it reveals a revolutionary new approach to this controversial topic. One Arab state has adopted this approach and incorporated the crucial final element in its new law, demonstrating that Islamic law need not inhibit, but can be reconciled with, effective SME bankruptcy reform.

2 The Road to Reform of Bankruptcy Law in the Arab World

Governments in the Middle East and North Africa (MENA) region have long been concerned that their antiquated bankruptcy laws had fallen behind late-20th and early-21st century world developments. In both technical content and on-the-ground implementation, these laws were not up to the task of addressing modern business financial failure. To maximise national business productivity and innovation, build sustainable, diversified economies, and attract international investment, MENA-region lawmakers understood that they needed to modernise their local business climates. They also understood that reforming bankruptcy laws would be an essential aspect of that effort, to address effectively and responsibly the inevitable casualties of healthy business competition and global economic volatility.

Egypt was among the first to undertake a serious, critical evaluation of its business law. From the mid-1970s, a blue-ribbon committee headed by Egypt's most prominent expert on commercial law, Mohsen Shafiq, developed a wholesale revision of the country's Commercial Code of 1883. That committee's final proposals were largely embraced by lawmakers, although a proposed revision of the voluminous bankruptcy provisions proved to be particularly controversial. Consequently, the Minister of Economy engaged expert consulting assistance on this topic in 1998. The expert consultant's report[5] stressed a number of themes that would continue to reverberate throughout similar studies in the MENA region in the coming years.

5 J. Regan, *Final Report: On the Proposed Amendments to the Egyptian Commercial Code of 1883* (15 Sept. 1998) (prepared in conjunction with the Development Economic Policy Reform Analysis Project, a contract project of the USAID Office of Economic Analysis and Policy in Cairo, Egypt).

First, the report emphasised that, first and foremost, the law should provide a path to financial rehabilitation and a fresh start for failed individual business people. Current laws offered no such path, instead concentrating on punishing debtors for failing to honour their financial commitments. It left individual entrepreneurs to languish in a state of perpetual over-indebtedness, additionally held down by legal restrictions on activity, never able to rise to their feet again and resume productive entrepreneurship. A modern solution to this problem, the report proposed, would be to make available to individuals a procedure by which a court imposed a legal discharge of unserviceable debt, forcing an at least partial forgiveness of creditors' claims, lifting artificial restrictions on future business activity, and freeing struggling entrepreneurs to return to productive activity.[6] The report also heartily endorsed a related (and also controversial) reform proposal to remove the criminal sanction from the standard practice of debtors' complying with creditors' demands to sign post-dated checks as security for defaulted loan repayment. By demanding checks rather than promissory notes, creditors leveraged aggressive enforcement of bad-check laws in the event of default and effectively converted commercial law into criminal law, abusively conflating the distinct purposes of each.[7]

Second, the report underscored that that law should provide an effective procedure for imposing viable business reorganisation plans despite the resistance of minority creditor-holdouts. The current law concentrated on liquidating the assets of failed businesses and distributing the proceeds among creditors. A modern approach would facilitate a rescue, leaving debtors in control of their ongoing operations and preserving companies pursuant to reorganisation plans (also likely involving some degree of debt forgiveness) so long as a majority of creditors agreed. While the committee proposal provided for imposing creditor-supported plans on minority holdouts, the report challenged its requirement of a high threshold of creditor support, a majority of creditors holding at least two-thirds of the claims against the debtor. To achieve significant numbers of successful workout plans, the report endorsed allowing the court to impose plans on creditors so long as they would receive as much under the plan as in a liquidation, and basic notions of fairness were observed.[8]

Third and finally, the report pressed that specialised courts should engage simplified and expeditious procedures to process bankruptcy cases and get individuals and companies back to productivity swiftly and efficiently.

6 Regan, *ibid.*, pp. 3, 6-7, 12, 14, 18.
7 Regan, *ibid.*, pp. 19-20.
8 Regan, *ibid.*, pp. 3-4, 6, 13, 15-16.

Procedures at the time were cumbersome and overly formalistic and overseen by generalist judges with no particular sensitivity or expertise in the area of business or commercial distress recovery. In the especially time- and resource-sensitive context of bankruptcy, efficiency and speed are vital to achieving the goals of value maximisation and viable business rescue and entrepreneurial redeployment.[9]

These sticking points remained unresolved as the overhaul of the Egyptian business law otherwise moved forward. A decade later, the Global Financial Crisis of 2007-2008 would reignite the debate over bad-check enforcement, discharge, and modern business rescue legislation in the entire MENA region. Just as the crisis was heating up, the critical importance of bankruptcy law captured the attention of the Dubai-based Hawkamah Institute for Corporate Governance. In association with the World Bank Group, the OECD, and INSOL International (a bankruptcy industry association), Hawkamah in November 2009 presented the results of an 18-month regional survey of MENA-area bankruptcy laws in conjunction with its Declaration affirming the commitment to modernising regional insolvency regimes.[10]

Like the Egyptian bankruptcy consultant report from a decade earlier, the Hawkamah survey revealed widespread weaknesses in MENA-area bankruptcy laws and practices. Two main deficiencies again took center stage in the report: Regional bankruptcy laws did not offer an appropriate incentive structure for engaging the bankruptcy process, especially for distressed small debtors, and heavy and formalistic requirements interfered with the process's smooth operation. In Saudi Arabia and the United Arab Emirate (UAE), for example, the report noted that both had laws facilitating reorganisation plans, and the UAE law in particular was characterised as 'fairly efficient', but both required rescue plan approval by a majority of creditors holding two-thirds of all claims against the debtor, and (perhaps in part consequently) neither was used at all frequently.[11] The report again specifically criticised the lack of a discharge and fresh start for honest individual debtors, the imposition of legal sanctions (including criminal liability) for simple cases of commercial failure, and the cumbersome (or nonexistent) requirements for adopting reorganisation and rescue plans. These shortcomings inhibited healthy degrees of risk-taking and innovation by entrepreneurs, increasing both the social stigma

9 Regan, *ibid.*, pp. 8-9, 11, 13, 16-17.

10 Hawkamah, *Communiqué on Insolvency and Creditor Debtor Rights Systems Reform in MENA* (2009).

11 Hawkamah *et al.*, *Study on Insolvency Systems in the Middle East and North Africa* (2009): 50-51, 54-55.

and the practical consequences of ordinary business failure.[12] Hawkamah and its survey partners especially emphasised that lawmakers should carefully consider the needs of small businesses and their entrepreneur-owners, which constitute a significant portion of employment and value production in MENA economies.[13]

As the devastating effects of the economic downturn began to be felt, the business community renewed pleas for law reform to respond to the needs of distressed entrepreneurs. This was especially true in Dubai, with its huge expansion strategy and heavy reliance on foreign individual entrepreneurs and investors. The effects of the global downturn were delayed in Dubai, but by early 2009, just as the Hawkamah survey was released, a huge real-estate speculation bubble finally burst, and a market crash soon triggered the cascade of business shutdowns and widespread financial distress experienced earlier in other parts of the world.[14]

While the distress related to the $26 billion debt of Dubai World and its construction subsidiary, Nakheel, prompted the rapid development of a special process and tribunal to restructure that enormous debt burden,[15]hundreds of thousands of small businesses and individuals struggled with much smaller but, for the individuals involved, equally significant financial crises. These debtors received no special attention from lawmakers. To the contrary, a new Mortgage law in 2008 led to the first residential mortgage foreclosure in Dubai in January 2010.[16]

Thousands of foreign Dubai residents flocked to the airport, leaving their cars abandoned in the parking lot.[17] Losing one's home is bad, but, in light of the bad-check practices identified in the Egyptian consultant's report,[18] missed payments became bounced checks, which would lead not just to collections but to jail. In 2008, authorities reportedly estimated that 40% of jail inmates were incarcerated for failure to pay debts, one-fifth of whom on dishonoured check charges.[19] One British entrepreneur, previously listed among Dubai's

12 N. Saidi, 'MENA Insolvency and Creditor Rights: A Call for Reform', in Hawkamah, *ibid.*, pp. 3-5; O. Helmy, 'The Need for Insolvency Systems Reform in the MENA Region', in Hawkamah, *ibid.*, pp. 15-18.

13 Helmy, *ibid.*, pp. 16-17.

14 C. Cummins *et al.*, 'Dubai: A High Rise, Then a Steep Fall', *The Wall Street Journal,* 4 Dec. 2009, pp. A1, A22; 'Crisis spawns loan defaults in once boomtown Dubai', *AFP*, 30 Mar. 2009.

15 See Decree No. 57 of 2009 (14 Dec. 2009) [Dubai].

16 Z. Fattah, 'Dubai: The First Foreclosure', *Bloomberg Businessweek,* 25 Jan. 2010, p. 26.

17 *Ibid.*; 'Crisis spawns loan defaults', Cummins *et al.*, *supra* note 14 (noting 3,000 cars left at the airport by departing expatriates).

18 See Regan, *supra* note 7 and accompanying text.

19 S. Karr, 'Insolvency laws face test', *Financial Times*, 7 Jan. 2009.

'100 hot entrepreneurs', wrote an open letter apologising to his creditors but explaining he had fled the country for fear of imprisonment for defaulting on his debts to suppliers as a direct consequence of the economic downturn in Dubai.[20] Another was not so fortunate, as his passport was confiscated by police, and he was relegated to sleeping first in his car and then on the street in the Dubai summer heat.[21]

Rather than extending relief to these collateral casualties of global economic turmoil, Dubai authorities doubled down on the Gulf-wide practice of pursuing the hapless issuers of business bankruptcy-related not-sufficient-funds (NSF) checks. In August 2010, the Dubai Criminal Courts established a special court to handle the large influx of bad-check cases, announcing 'a criminal judge is not concerned about what circumstances the check was issued under. [...] you have presented a bond which was not honored'.[22] In the first 4 months of 2010, more than half-a-million checks in Dubai bounced, including a $204,000 check passed by an outdoor advertising company and signed by its British entrepreneur-owner, who was sentenced to 1 year in jail after his mortgage creditor rejected his attempts to negotiate a settlement and repayment plan.[23]

3 Global Bankruptcy Policy Transitions and Modern Best Practices

Dubai's approach to bankruptcy reform, focused exclusively on rescuing a few whales and leaving the millions of smaller fish to fend for themselves, is reflective of the state of the art at the time. By 2009-2010, international standard-setting organisations had embraced a new theme of rescue-oriented bankruptcy policy, but this theme was still discussed and applied almost exclusively in the context of large, often multi-national companies, like Dubai World.[24] The other 99% of small business debtors remained largely relegated to the shadows

20 R. Spencer, 'British entrepreneur flees debts in Dubai', *The Telegraph*, 26 June 2009 (noting an average of 1,500 cars abandoned at the airport 'even in good times' in light of UAE bankruptcy laws).

21 M. al-Arab, 'British man sleeps in the open in the Dubai summer as a result of bank debts', *CNN*, 20 July 2010 (noting hundreds of Pakistani, Indian, and Filipino expatriates in a similar situation).

22 T. Murphy, 'Dubai Criminalization of Bounced Checks Poses More Business Risk in Down Economy', *BNA's Bankruptcy Law Reporter,* 28 Aug. 2010.

23 *Ibid.*

24 World Bank Group, *Principles for Effective Insolvency and Creditor/Debtor Regimes* (1st edn., adopted in 2001); UNCITRAL, *Legislative Guide on Insolvency Law* (1st edn., adopted by the UN General Assembly in 2004).

of a 'traditional' perspective on bankruptcy policy, as described in the Egyptian consultant's report described above.[25] While international bankruptcy policy soon advanced to embrace individuals and small businesses within a new rescue perspective, the following section will reveal that recent reforms in the Arab world progressed only to the mid-point of a three-phase arc of historical bankruptcy policy development.

3.1 *Phase One: Traditional Bankruptcy, Creditor-Oriented Cudgel*

In its earliest forms in China, Ancient Rome, and medieval Italy, bankruptcy law served three principal goals: (1) providing a formal means of collecting unpaid debts (at a time when discrete, independent debt collection procedures were under-developed), (2) allocating losses among the creditors of insolvent debtors whose assets were insufficient to pay all creditors in full, and (3) punishing and constraining debtors who had broken their payment promises and thereby injured creditors, without regard to the causes of the debtor's inability to pay. These systems were entirely creditor-focused, designed to notify and bring together all creditors of a common debtor to equalise the recoveries (and losses) for all creditors who found themselves in a battle for an insufficient pool of remaining asset value. This battle, the purpose and cornerstone of bankruptcy, was and still is often referred to by the Latin term, *concursus creditorum* (battle of creditors).[26]

The plight of the often hapless debtor was at best an afterthought in this process. At worst, debtors suffered varying degrees of social death and disability. The consequences of bankruptcy for debtors in Ancient Rome ranged from infamy (a loss of status amounting to social death), to slavery, and even death. Medieval European debtors were subjected to humiliating public rituals and stigmatising clothing, while Chinese debtors suffered severe public beatings. Debtors were widely barred from serving in positions of trust or of pursuing another business venture. Even in places and times when debtors were offered some measure of relief from the worst effects of bankruptcy, it was beyond question that the law never effected a discharge of the bankrupt debtor's unpaid debts. These could be pursued until paid in full, voluntarily released by

25 See Regan, *supra* note 5 at 5-6.

26 W.W. McBryde, A. Flessner & S.C.J.J. Kortmann (eds.), *Principles of European Insolvency Law* (Deventer: Kluwer Law Publishers, 2003) 66; World Bank Group, *Saving Entrepreneurs, Saving Enterprises: Proposals on the Treatment of MSME Insolvency* (2019): 9-10 [hereafter, World Bank *Proposals*]; J. Kilborn & A. Walters, 'Involuntary Bankruptcy as Debt Collection: Multi-Jurisdictional Lessons on Choosing the Right Tool for the Job', *Am. Bankr. L.J.* 87 (2013): 123, 127-128, 134.

creditors, or the debtor's physical death, and in both Europe and China, even thereafter against the debtor's heirs.[27]

Before the Global Financial Crisis, the Arab world remained at this stage of bankruptcy policy evolution. As the Egyptian consultant's report concluded,[28] the bankruptcy systems (such as they existed) in the Arab world in the 20th century remained decidedly traditional. This is in some sense not surprising, given the powerful influence of Islam and the formal or informal role of Islamic law in the various states of the MENA region. Both the Holy Qur'ān and the Sunnah are quite explicit about the imperative for debtors to fulfill their obligations and the sinful nature of failing to do so.[29] As the Dubai judge reasoned when defending the new bad-check court, traditional attitudes to bankruptcy in the Arab world remained 'not concerned about what circumstances' led to broken payment promises, simply that a debtor had 'presented a bond which was not honored'.[30] The limited degree of temporary respite offered to insolvent debtors will be discussed below, but as is revealed there, even this respite adheres to a traditional model of offering no permanent relief to over-indebted individuals.

3.2 *Phase Two: (Big) Business Rescue, Expensive and Creditor-Controlled*

Since ancient times, creditors have been allowed—if not encouraged—to relieve their debtors of unbearable debt burdens voluntarily. As the ancient Arabic aphorism goes, *al-ṣulḥ sayyid al-aḥkām* (settlement is the lord of judgments).[31] Settlements of unsustainable debt could move the traditional model toward a modern, rescue-oriented approach, but for one major sticking point: each creditor was the master of its own claims. An effective rescue and restructuring required the consent of *every* creditor. And for creditors accustomed to the traditional model of lifelong liability and honouring bonds, there

27 World Bank Group, *ibid.*, pp. 9-10.

28 See Regan, *supra* note 5 at 7, 10 (also noting that bankruptcy was often misused as an individual collection device, rather than a battle among all of a debtor's creditors to allocate assets and losses).

29 See, *e.g.*, Holy Qur'ān 5:1, 17:34, 2:177; Al-Bukhārī 41:582, 41:585, 12:795, 37:486, 37:487; Muslim 4:1218, 10:3796-97; Al-Tirmidhi 14:1312-13; Abū Dāwud 3:879, 22:3336; J. Kilborn, 'Foundations of Forgiveness in Islamic Bankruptcy Law: Sources, Methodology, Diversity', *Am. Bankr. L.J.* 85 (2011): 323, 326, 331-32.

30 See Murphy, *supra* note 22 and accompanying text.

31 Although this idea most likely predates the revelation, see Holy Qur'ān 4:128; A. Othman, "And Amicable Settlement is Best': *Ṣulḥ* and Dispute Resolution in Islamic Law', *Arab L.Q.* 21 (2007): 64, 65; H. al-Humaidhi, '*Ṣulḥ*: Arbitration in the Arab-Islamic World', *Arab L.Q.* 29 (2015): 92, 93.

were few incentives for holdouts to agree to participate in a collective rearrangement of a large business's debts, let alone those of a sole entrepreneur.

Two related developments in the mid-19th century set the stage for a new perspective on business bankruptcy, oriented on maximising value for creditors by rescuing viable businesses. First, to encourage innovation and productive business risk-taking, lawmakers extended the liability shield of corporations to essentially all comers. No longer limited to a few select behemoths like the East India Company, blanket limitations on liability associated with business conducted via corporations became available to all manner of private companies, large and small.[32]

Second, lawmakers' amplified their efforts to encourage workouts. Laws on 'compositions' empowered majorities of creditors to impose reasonable debt restructuring arrangements—up to and including partial forgiveness of debt—on dissident minority creditors. No longer would every creditor have to agree to the debtor's proffered rescue terms so long as a majority concluded that the given terms were preferable to the alternative of a bankruptcy liquidation.[33] The magnitude of the required majority consent (usually measured in terms of value of claims held, in addition to a headcount) varied and shrunk over time, from supermajorities of 75% or more, to two-thirds, and more recently down to simple majorities, often explicitly excluding creditors who failed to participate in the voting process.[34]

These two contemporaneous developments dovetailed to shift the settlement negotiation leverage situation and usher in a new era of corporate workouts and rescues. Composition laws deprived individual creditors of their veto power over debt workouts, and the broad dissemination of corporate limited liability eliminated (for the most part) creditors' possibility of pursuing the business's owner(s) for life. The offer at hand was the only one available, based only on the corporation's asset value—and potentially higher *future* value if the corporation were rescued as a viable operating entity, rather than liquidated at an inevitable, locked-in loss. Owner-investor limited liability reduced incentives for any creditor to refuse a piece of this now limited corporate pie and increased their incentives to agree to a workout arrangement that might allow the corporation to continue to produce revenue and support a sweeter offer of deferred payment.

32 See World Bank *Proposals*, *supra* note 26 at 25.

33 See *ibid.*, pp. 19, 25.

34 See, *e.g.*, 11 USC §1126(c) (two-thirds in claims amount held and majority in number, counting only creditors who have participated in voting; *i.e.*, 'that have accepted or rejected such plan').

This phase was still creditor-focused, as the notion of a court-imposed discharge without a significant degree of creditor consent remained out of the question in most of the world until the turn of the 21st century.[35] And this phase required a great deal of coordination and concentration of resources in plan negotiations. A third aspect of leverage is a practical requirement for success in most business rescue negotiations: size. As an oft-quoted wry observation goes, if you owe the bank $100 thousand, you have a problem, whereas if you owe the bank $100 million, the bank has a problem.[36] Creditors have a powerful incentive to invest attention and resources to negotiate a company rescue and restore at least partial payment on a $100 million distressed loan. Dubai World is a perfect example, threatening to bring down the entire state's finances, so the imperative for arranging a workout settlement was especially salient and worth a significant measure of public and private investment in coordinating a rescue. The same is true a decade later in Saudi Arabia, where a new rescue plan negotiation model met its first test in a case involving the Sa'ad Group and Ahmad Hamad Algosaibi & Brothers, which defaulted on about $22 billion in combined debt in 2009.[37]

The situation is quite different without such grand economies of scale. As a prominent European survey observed, 'procedures that are designed for corporate and/or larger business debtors may be inappropriate' for the overwhelming majority of smaller businesses that comprise the foundations of most modern economies.[38] Creditors have little reason to invest time, much less money, in negotiating over the fate of the much smaller debts that encumber the innumerable small businesses across the globe. For creditors, the downside is a small and bearable loss, and the upside is an unreliable projected return that simply does not justify the resources invested in a workout negotiation. Moreover, the negotiation is too often built on a foundation of sand. Small businesses are often run by sole entrepreneurs, whose margins are thin and sophistication limited. They have neither the funds to retain the types of advisors

35 See World Bank *Proposals*, *supra* note 26 at 10-11.

36 Variants of this quip are variously attributed to famous US oil magnate, John Paul Getty, and to UK economist, John Maynard Keynes. See, *e.g.*, www.brainyquote.com/quotes/j_paul_getty_129274, 5 Aug. 2020.

37 S. Hammad, 'Saudi Arabia', *The Insolvency Review* 7(3) (Dec. 2019), available at: https://thelawreviews.co.uk/edition/the-insolvency-review-edition-7/1211474/saudi-arabia, 5 Aug. 2020; S. Kalin, 'Saudi Arabia's new bankruptcy law faces key test in the courts', *Reuters*, 24 Oct. 2019, available at: www.reuters.com/article/us-saudi-bankruptcy/saudi-arabias-new-bankruptcy-law-faces-key-test-in-the-courts-idUSKBN1X318P, 5 Aug. 2020.

38 G. McCormack *et al.*, *Study on a New Approach to Business Failure and Insolvency: Comparative Legal Analysis of the Member States' Relevant Provisions and Practices* (Leeds: University of Leeds, 2016) 288.

so prominent in large-scale workouts like the multinational AHAB and Sa'ad Group cases nor the sophistication to appreciate the background of their financial distress or to design and pitch a compelling path out of it.

Not only lacking the inherent leverage of size, most small businesses worldwide also continue to lack the key leverage of limited liability. Many are run by individual entrepreneurs who have foregone the benefits of limited liability altogether by pursuing business as sole proprietors or partners, rather than through an entity like a corporation or limited liability company. Even for those who have formed a legal entity, many if not most contractual creditors have wisely sidestepped limited liability by requiring a contractual reversal of that limitation: a personal guarantee (or a post-dated, full-payment check) from the business's owner(s) and/or family members. In the many cases where small business debts *are* the responsibility of an individual, that person can be pursued for life, reintroducing a potential upside to creditors' refusing to agree to a rescue plan. In this context, the momentum is lost in this second, restructuring negotiation phase of bankruptcy evolution.[39]

3.3 *Phase Three: Rescue for the Masses, Imposed Discharge as Leverage and Relief*

Introducing the possibility of debt release via coordinated negotiation with creditor majorities is a solid step toward a modern rescue culture. But a final phase shift is necessary to produce reliable relief for 99% of businesses in the world. Lacking the leverage of either size or limited liability, small businesses need another source of incentive to goad their creditors into seriously considering a workout plan. And more than anything, the individuals running these businesses need relief and a fresh start, to rise back to their feet and continue to apply their energy and entrepreneurial spirit for the benefit of their local and national economies. They need a non-negotiated, law-imposed discharge of debt.

The Global Financial Crisis finally prompted international policymakers to turn their attention to the concerns of financially distressed individuals and micro- and small-business debtors.[40] They recognised that, even though small businesses are not as salient as their larger counterparts, they nonetheless

39 See World Bank *Proposals*, *supra* note 26 at 1, 3; see also World Bank *MSME Report*, *supra* note 4 at 6, 9-17 (enumerating several other hurdles to traditional creditor-controlled negotiation-based models in the small business context).

40 J. Kilborn, 'Reflections of the World Bank's *Report On the Treatment of the Insolvency of Natural Persons* in the Newest Consumer Bankruptcy Laws: Colombia, Italy, Ireland', *Pace Int'l L. Rev.* 27 (2015): 306, 307-308 [hereafter, Kilborn, Reflections].

drive much if not most economic growth and development around the world.[41] Thus, a new focus first on individual debtors generally, and then on individual entrepreneurs and small business entities in particular, emerged in the decade following the Crisis. The World Bank completed its watershed *Report on the Treatment of the Insolvency of Natural Persons* at the end of 2012,[42] followed by two reports and recommendations on micro-, small-, and medium-sized business bankruptcy in 2017[43] and 2019.[44] As a co-standard setter with the World Bank in the field of business insolvency, UNCITRAL also launched a project—still ongoing—to revisit its *Legislative Guide on Insolvency Law* to supplement it with provisions specific to the needs of micro- and small businesses and entrepreneurs.[45]

These reports coalesce around two policy prescriptions for modifying traditional approaches to bankruptcy-as-rescue to effectively accommodate small businesses. The first and most obvious modification is simply to make the restructuring plan negotiation process less complex, cumbersome, and expensive by reducing timelines for plan adoption and scrapping unnecessary formalities, such as creditor committees and complex disclosure statements.[46] To foster successful debtor—creditor negotiation, court scrutiny of plans should be limited, confirming plans binding on all creditors so long as a regular voting procedure was followed in adopting the plan that does not single out any creditor or group for prejudicial treatment. Plans should be adopted by the affirmative vote of creditors representing a simple (not super) majority of the value of claims participating in the voting process; that is, those not participating in the voting process should not be counted in calculating the voting result.[47]

Beyond these relatively minor modifications, a second, vital step is to put the final piece of the puzzle in place. As an alternative to a creditor-adopted settlement plan, a court or other authority should be empowered to impose a discharge (forgiveness) of unpaid debt for 'honest but unfortunate'[48]

41 World Bank *Proposals*, *supra* note 26 at 1.

42 Kilborn, Reflections, *supra* note 40 at 309; World Bank Group, *Report on the Treatment of the Insolvency of Natural Persons* (2013), available at: openknowledge.worldbank.org/handle/10986/17606 [hereafter, World Bank *Natural Persons*], 5 Aug. 2020.

43 World Bank *MSME Report*, *supra* note 4.

44 World Bank *Proposals*, *supra* note 26.

45 See UNCITRAL, Working Group V (Insolvency Law), *Draft text on a simplified insolvency regime*, Doc. No. A/CN.9/WG.V/WP.170 (3 Mar. 2020).

46 World Bank *Proposals*, *supra* note 26 at 1-2, 6, 26.

47 World Bank *Proposals*, *ibid.*, pp. 17-20.

48 A court or administrator generally acts as gatekeeper, preventing abuse by ensuring that only honest debtors who genuinely need relief gain access to the system.

debtors. This beneficence usually is conferred as part of a standard compromise arrangement, in which the debtor pledges to relinquish the next 3 years' 'disposable' income; that is, all value beyond the ordinary and reasonable support needs of debtors, their families, and their businesses.[49] This value must be at least equivalent to what creditors would receive if all of the current available assets of the business/entrepreneur were liquidated and distributed immediately.

The keystone of the current, third phase of bankruptcy policy development is the addition of this officially imposed discharge, as it both influences the second-phase plan negotiation process and operates independently to ensure needed rescue and recovery for small business debtors. In the plan negotiation context, the discharge replicates the leverage of business-entity limited liability, as described above. It sharpens creditors' focus on the offer at hand by depriving them of the potential gains (both financial and emotional) of lifelong pursuit of the individual debtor. The key counterweight of a potential imposed discharge is necessary here to restore balance to the plan negotiation. Reducing complexity and expense in the negotiation platform does little to foster compromise when creditors lack incentive to accept that compromise.

The alternative, statutory standard arrangement provides a foundation for the negotiation, cabining the boundaries of the possible and encouraging creditors and debtors to seek reasonably achievable settlements. Defining the terms on which this discharge will be granted is a sensitive and fraught undertaking, but it is absolutely vital to provide a solid foundation for negotiated solutions or the standard, imposed relief alternative.[50] Given the likelihood of failure of plan negotiation in the small business context,[51] however, the discharge also ensures a baseline measure of ensured relief: honest debtors will obtain a fresh start to be productive again, incentive to return to entrepreneurship and consumption to fuel ongoing economic activity, rather than

49 See World Bank *Proposals*, *supra* note 26 at 3-7; Kilborn, Reflections, *supra* note 40 at 312. These plans are often monitored by an administrator, and the process of reporting to this administrator and turning over excess income is thought to deter abuse, as only honest debtors are likely to undergo this ordeal.

50 See World Bank *Natural Persons*, *supra* note 42 at ¶¶ 220-297 (discussing approaches to extracting value from assets and income and balancing debtors' support needs).

51 See World Bank *Natural Persons*, *ibid.*, at ¶¶ 128-137; J. Kilborn, 'Determinants of Failure [...] and Success in Personal Debt Mediation', *Transnational Dispute Mgmt.* 14(4) (Winter 2017).

being burdened and dissuaded by an inescapable debt overhang.[52] Debtors need incentives, as well, as those who cannot enjoy the fruits of their labour will inevitably reduce or abandon their labour. Modern society cannot afford this loss.

This is not a matter of simple debtor-favouritism. The policy imperative here is to force creditors to internalise the negative externalities of their otherwise quite common refusal to deal reasonably with debtors. Those externalities are otherwise borne by society in the form of both increased costs (*e.g.*, official enforcement action, social services for debtors and their families, crime and illness and related expenditures) and foregone benefits (*e.g.*, lost production and innovation by debilitated entrepreneurs, along with the associated tax revenue). An imposed discharge compromise balances the burdens of business insolvency on debtors, creditors, and society. It achieves a preferable result for *all* of society rather than any single constituency (creditors or debtors), recognising that most small business people will be both creditors and debtors at some point, and all of society depends upon striking the proper balance of their respective rights, responsibilities, and incentives.[53]

4 Progress and Hesitation in Recent Arab World Bankruptcy Reforms

To their credit, MENA lawmakers responded to the need to diversify their economies and recover from the Global Economic Crisis by introducing (or enhancing) more rescue-oriented bankruptcy statutes and supporting administrative infrastructure. In the space of 4 years, a wellspring of new bankruptcy laws burst forth throughout the MENA region. New laws emerged in three waves: In the United Arab Emirates[54] and Tunisia[55] in 2016, Saudi Arabia,[56]

52 World Bank *Proposals*, *supra* note 26 at 10-11.

53 World Bank *Natural Persons*, *supra* note 42 at ¶¶ 76-111; World Bank *Proposals*, *supra* note 26 at 3.

54 Fed. Decree-Law No. 9 of 2016 on Bankruptcy (*Official Gazette*, 29 Sept. 2016, effective 29 Dec. 2016).

55 Law No. 2016-36 of 29 Apr. 2016 on Collective Procedures (*Official Gazette*, No. 38, 10 May 2016, modifying Book IV of the Commercial Code).

56 Royal Decree No. (M/50) of 14 Feb. 2018, the System of Bankruptcy (*Official Gazette*, No. 4712, 22 Feb. 2018, effective with publication of implementing regulations 18 Aug. 2018); see R. Wachman, 'Bankruptcy Reforms to Overhaul the Saudi Economy', *Al-Bawaba.com*, 15 July 2018, (noting confirmation of effective date by Ministry of Commerce and Investment official).

Egypt,[57] Morocco,[58] and Bahrain[59] in 2018, and Oman[60] (and a second law in the UAE[61]) in 2019 (both of which became effective only in 2020). While the rehabilitative potential of these new laws was immediately apparent to mega companies like AHAB and Sa'ad, the attraction was less powerful for smaller businesses, as their specific needs and concerns continued to be largely neglected. Despite a few well-intentioned overtures to simplification of the negotiating procedures to facilitate small business workouts, these new laws mostly exclude the key ingredients of successful SME insolvency regimes and therefore will most likely fail to quench the growing thirst of distressed small businesses.

4.1 *Saudi Arabia*

The path of the bankruptcy reform initiative in the heart of the Arabian Peninsula nicely illustrates both the progress and continuing challenges in the Arab world. The Kingdom of Saudi Arabia invested considerable resources to produce an impressive set of reforms and a sophisticated new multi-stage bankruptcy system. It brought order and unity to a previously disjointed and unpredictably informal cacophony of different laws and procedures.[62] Its elegant new bankruptcy law and associated regulations[63] stand as a milestone and bellwether for other states in the region and beyond, though the conspicuous absence of the final piece of the puzzle is a harbinger of trouble ahead in the Arab approach to small business bankruptcy.

57 Law No. 11 of 2018 promulgating the Law regulating Restructuring, Preventive Compositions and Bankruptcy (19 Feb. 2018, effective on 22 March 2018, 30 days after publication in the *Official Gazette*).

58 Law No. 73-17 on Insolvent Enterprises (*Official Gazette*, No. 6667, 23 Apr. 2018, modifying Book V of the Commercial Code).

59 Law No. 22 of 2018 promulgating the Reorganisation and Bankruptcy Law (30 May 2018, *Official Gazette*, No. 3369, 7 June 2018).

60 Royal Decree No. 53/2019 promulgating the Bankruptcy Law (1 July 2019, effective 1 year after issuance, 1 July 2020).

61 Fed. Decree-Law No. 19 of 2019 on Insolvency (*Official Gazette*, 29 Aug. 2019, effective 29 Nov. 2019, officially launched with implementing regulations 1 Jan. 2020).

62 The Commercial Court Law of 1931 did not provide for any means of rescuing distressed businesses, and while a 1996 Law on Settlement to Prevent Bankruptcy did implement a new procedure for merchant debtors and their creditors to reach debt settlements, it entailed an unwieldly two-step process involving the Chambers of Commerce and the Board of Grievances, aimed at encouraging a super-majority of creditors to agree to a debt release. The procedure was reportedly seldom used. See Hawkamah, *supra* note 11 at 50-51.

63 The law, regulation, and other helpful materials are available on the website of the new Saudi Bankruptcy Commission, bankruptcy.gov.sa, 5 Aug. 2020.

The institutional framework of the new Saudi bankruptcy system is especially impressive. Developments in both policy and practice are fostered and supervised by a new coordinating institution, the Bankruptcy Commission, fully funded by the Ministry of Commerce and Investment.[64] At the case-specific level, individual proceedings are monitored and administered by a new system of officeholders (referenced hereafter by their common English designation, 'trustees'), licensed and overseen by the Commission.[65] Delegating authority from the courts to these focused experts will surely vastly improve the day-to-day administration of the Saudi bankruptcy system. As for the limited matters presented to the courts for resolution, bankruptcy cases have been concentrated before a single judicial authority (the commercial courts), with business sensitivity and experience.[66] Further enhancing system efficiency, all bankruptcy-procedure activity is expressly authorised to be conducted via modern, efficient electronic means.[67]

These authorities regulate a concentrated and carefully circumscribed range of procedures, tailored to debtors' varying states of economic viability. In addition to classic liquidation bankruptcy for non-viable businesses,[68] debtors (and creditors) can negotiate one of two rescue-type arrangements: a less formal mediation procedure called 'protective settlement',[69] along with a more formal 'financial restructuring'.[70] Both are triggered by court filings and a court order commencing the case—to ensure access only by good faith, distressed but viable debtors, and to make the result binding on dissenting minority creditors.[71]

64 Royal Decree No. (M/50) of 14 Feb. 2018, the System of Bankruptcy, Ch. 2, Arts. 9-12 [Saudi Arabia] [hereafter, Saudi Bankruptcy Law]; Implementing Regulation for the System of Bankruptcy, Arts. 85-88 (2018) [Saudi Arabia] [hereafter, Saudi Bankruptcy Regulation].

65 Saudi Bankruptcy Law, Arts. 2(b)–(d); Saudi Bankruptcy Regulation, Arts. 91-94.

66 Saudi Bankruptcy Law, Art. 1.

67 Saudi Bankruptcy Regulation, Art. 95.

68 Saudi Bankruptcy Law, Ch. 5, Arts. 92-126. These proceedings can now be commenced not only if the debtor is bankrupt (that is, debts exceed total asset value), but also if the debtor is simply 'distressed' (having failed to pay debts as they come due, the classic 'cessation of payments' criterion of European bankruptcy law). *Ibid.* Arts. 1, 92. Also, the court can convert either of the rescue proceedings into liquidation if creditors seem unlikely to approve a settlement or restructuring. *Ibid.,* Arts. 41, 90. These reforms reflect an all but universal bankruptcy policy of resolving 'zombie' non-performing businesses quickly to redeploy their assets for productive use.

69 *Ibid.*, Arts. 13-41.

70 *Ibid.*, Ch. 4, Arts. 42-91.

71 Recognising that time is of the essence in these cases, and responding to earlier concerns about delay, a commencement hearing is set for within 40 days of petition filing for both procedures. Saudi Bankruptcy Law. Arts. 14, 47; Saudi Bankruptcy Regulation, Art. 16. At

An effort has been made to entice debtors to engage the process by making the immediate effects less daunting for small business debtors. Traditionally, debtors claiming insolvency were subject to 'precautionary measures' to ensure they had not concealed their property, which usually entailed jailing and periodically interrogating the debtor about assets for a period of as long as 5 years (though usually only a few weeks or months).[72] The new law limits such measures to those set out in the Regulation, which do not include jailing the debtor; they are limited to appointing a trustee or attaching the debtor's assets.[73]

The principal difference between the two rescue regimes is that the preventive settlement is managed entirely by the debtor, while the latter involves a court-appointed trustee. Both further encourage debtors to engage these proceedings and deal with distress openly and timely by leaving the debtor in control of the business (rather than displacing management with a trustee). In a financial restructuring, however, the debtor's management must seek trustee approval for many business activities, along with cooperating with the trustee in assessing claims, inventorying assets, and developing a plan to restructure operations and reschedule payments (perhaps discounted) to creditors.[74]

In either case, a compromise proposal is put to creditor vote, and it is accepted (and made binding by court order on all notified creditors) if creditors holding two-thirds of all scheduled claims cast affirmative votes. Creditors who choose not to participate in the voting meeting are not explicitly excluded from the denominator of the vote total, but nothing in the governing 'Meetings'

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this hearing, the court assesses both the debtor's financial state and good faith, as well as the likelihood of creditors' accepting either the preventive settlement (filed with the petition) or a financial restructuring plan developed with the assistance of a trustee during the pendency of the case. Saudi Bankruptcy Law, Arts. 15, 47, 75. For accepted cases, the court ensures timely progress by setting a date for creditor voting, within 40-80 days on a preventive settlement or an unrestricted court-determined date for a financial restructuring plan. *Ibid.*, Arts. 16, 75. Further expediting the preventive settlement process, disputed claims are estimated for voting purposes, so as to prevent undue delay in resolving these disputes. *Ibid.*, Art. 30.

72 Enforcement System, Royal Decree (M/53), Art. 78 (2012).

73 Saudi Bankruptcy Law, Art. 96; Saudi Bankruptcy Regulation, Art. 5. Also, in any case in which property is to be sold or distributed to creditors, individual debtors are explicitly granted an exemption to retain assets required for financial support for a reasonable standard of living for debtors and their dependents, as recommended by the trustee and confirmed by the court. Saudi Bankruptcy Law, Arts. 66, 100, 102; *cf.* Enforcement System, Royal Decree (M/53), Art. 21 (2012) (exempting two-thirds of debtors' income from seizure by creditors, along with residence, transportation, and personal items, the adequacy of which is determined by the enforcement judge).

74 Saudi Bankruptcy Law, Arts. 50, 55-72, 75, 84-85.

Management Rules' forbids the debtor's proposal from setting forth this rule for calculating votes.[75]

The new Saudi regime also incorporates many aspects of the international recommendations surveyed above for lubricating the rescue plan approval process and making procedures less complex and burdensome for low-value small business cases. First, the new law boldly progresses from historical phase two to phase three by softening the super-majority voting rule and limiting court scrutiny of creditor-endorsed plans. Both preventive settlements and financial restructuring plans may group creditors into classes, so long as a majority of claims in each class are held by creditors unrelated to the debtor.[76] Preventive settlements must still be approved by a two-thirds super-majority of claims held by creditors in each class, but if this threshold is met, further court scrutiny is explicitly restricted: The court must confirm the settlement plan so long as it satisfies a simple, defined 'fairness' factor of having been accepted by the requisite majority of creditors with adequate information on alternatives and equal treatment of similar claims.[77] In a more formal financial restructuring, in contrast, even the two-thirds super-majority is reduced. If not all classes meet the two-thirds approval margin, the court may still confirm a restructuring plan so long as two-thirds of at least *one* class of creditors has approved, creditors holding at least half of the claims in all other classes voted yes, and the court considers the plan to meet the best interests of a majority of all creditors.[78] This new 'cram down' provision is a powerful step toward facilitating more restructuring plans, rescuing companies, and preserving going-concern value, know-how, and jobs.

Second, the new Saudi law reduces case complexity in line with modern recommendations. The appointment of a creditors committee is subject to the court's determination that such a committee is appropriate.[79] This would presumably seldom be true in a low-value case. More broadly, for both natural persons and business entity SMEs,[80] special 'small' versions of all three procedures are instituted to reduce complexity and expense, principally by minimising court (and creditor committee) involvement in 'small' cases.[81] The

75 See Saudi Bankruptcy Regulation, Art. 1, 15, 97(3); Ministry of Commerce and Investment, Resolution No. 13, Rules for Meetings' Management in the Bankruptcy Procedures (17 Sept. 2019).

76 Saudi Bankruptcy Law, Arts. 31, 79.

77 *Ibid.*, Arts. 32-35.

78 *Ibid.*, Art. 80.

79 Saudi Bankruptcy Regulation, Art. 24.

80 Saudi Bankruptcy Law, Art. 4.

81 *Ibid.*, Arts. 2, 5(d), 127-166.

definition of 'small' stops far short of most other contemporary approaches, however. These simplified procedures apply only to debtors with no more than about US$500,000 in debt.[82] Recommendations for 'small business' thresholds in Europe and the US have been much larger, at least $2.5 million and up to $10 million in total debt.[83] The Saudi approach will leave many quite simple and unsophisticated businesses grappling with overly and unnecessarily complex and resource-intensive procedures.

Nonetheless, for businesses that qualify as 'small', no decision by a court is required for case commencement; a small-business debtor simply proceeds with soliciting votes on a preventive settlement proposal or partners with a practicing trustee to develop a financial restructuring proposal.[84] Further reducing time and expense, the debtor and trustee must develop a 'small' financial restructuring plan within 30 days of the bar date for claims submissions (possibly extended at the trustee's request another 30 days).[85] These are very positive developments that situate the Saudi regime firmly in the third, modern phase of bankruptcy policy and practice development.

However, the challenge in the small business context, as emphasised above, is that negotiated workout plans are a seldom-achieved best case scenario. The sober reality is that most small businesses have too little value to offer creditors to entice them to engage in a negotiation, much less to support a restructuring plan, especially if the plan involves, as it almost always must, requesting that creditors forgive at least a part of their debts. And here is where the new law breaks down.

On the one hand, the Saudi law admirably addresses the all-too-common issue of 'no asset' cases, where the debtor's asset value is insufficient even to cover the costs of a liquidation and distribution to creditors.[86] Such 'no asset' cases are assigned to the standing Bankruptcy Commission to perform a simple 'administrative' liquidation, rather than engaging (and paying for) an appointed trustee.[87] And by 'no' assets, this likewise excludes assets whose sale costs exceed their expected sale proceeds, as the regulation explicitly prohibits

82 Bankruptcy Commission Decision No. 12/0218 (29/02/1440 A.H., 7 Nov. 2018) [Saudi Arabia] (setting the 'small debtor' threshold at 2 million Saudi Riyals of total debt).

83 World Bank *Proposals*, *supra* note 26 at 27-28.

84 Saudi Bankruptcy Regulation, Arts. 58, 62; Saudi Bankruptcy Law, Arts. 129, 145-146 (if creditors commence 'small' financial restructuring proceedings, Arts. 148-150 provide for ordinary process).

85 Saudi Bankruptcy Regulation, Art. 64.

86 Saudi Bankruptcy Law, Arts. 99(2)(a)(ii), (b)(iv), 162.

87 *Ibid.*, Arts. 2(i), 123, 167-181.

the trustee or Bankruptcy Commission from wasting time and value attempting to liquidate such items.[88]

On the other hand, while all of these modern efforts at streamlining the negotiated processes and making liquidation more efficient are admirable, this will in most cases likely be quite beside the point. The law stops just short of the finish line by failing to proceed to the crucial culmination of modern bankruptcy reform: It explicitly denies a discharge to individual debtors following closure of liquidation proceedings. If the requisite majorities of creditors cannot be convinced to agree to a partial forgiveness of debt, the law abjures imposing one against their wishes.

Early in the reform process, public pronouncements suggested that the Saudi law would incorporate a discharge to provide a fresh start to honest debtors. In a public release by the Ministry of Commerce and Industry, an introductory policy paper projected that the new Saudi insolvency law would provide a 'fresh start' for individual debtors following liquidation proceedings 'recognising their ongoing ability to contribute to the economy'.[89] It repeatedly suggested that a discharge might 'occur automatically after a period of 12 months' for honest debtors, including those with 'no asset' estates administered by the Bankruptcy Commission.[90]

The final law contained no such provision. Quite to the contrary, the law is explicit that individual debtors are not released (discharged) from any debts not covered by the proceeds of the liquidation, other than debts specifically forgiven by creditors.[91] In an interesting compromise move, however, the law encourages debtors to return to productivity despite the absence of a discharge. No hearing is required before terminating liquidation proceedings,[92] and within 30 days after that point, an individual debtor's name is removed from the bankruptcy registry to allow him or her to undertake trade or professional activities to produce income, free from the trustee's official oversight.[93] The law further prevents creditors from formally pursuing their unpaid claims against debtors during the 24 months following termination of liquidation proceedings.[94] Nonetheless, the implementing regulation clarifies that debtors must report to creditors the commencement of any income-generating activity

88 Saudi Bankruptcy Regulation, Art. 70.

89 Ministry of Commerce and Industry, *The Kingdom of Saudi Arabia Insolvency Law Project, Policy Paper* ¶¶ 4.5 (2015).

90 *Ibid.*, ¶¶ 4.5, 7.23, 7.24.

91 Saudi Bankruptcy Law, Art. 125(2).

92 *Ibid.*, Art. 122.

93 *Ibid.*, Art. 125(1); Saudi Bankruptcy Regulation, Art. 72.

94 Saudi Bankruptcy Law, Art. 125(3).

during this 24-month period, and if income is received during this period, the debtor must submit a petition to the court for distributing this value. The petition must be accompanied by a report (prepared by a licensed bankruptcy expert) evaluating the debtor's household's (and business's) reasonable expenses and proposing a distribution of any surplus income to creditors. The debtor's failure to submit this report allows creditors to petition the court to seize 'their share' of the new funds (presumably taking into account a reasonable exemption for the debtor's support).[95]

Among the law's stated aims is to allow debtors to maintain their business activities to contribute to and support the national economy.[96] But this seems to apply only to the preservation of *current, ongoing, viable* commercial activity, not learning from one's mistakes, abandoning failed ideas, and undertaking other, future activity that might well be even more productive for the national economy. The ghosts of debts past will continue to haunt individual proprietors, encumbering and inhibiting the fresh start and free pursuit of new ventures, using the valuable lessons of failure. This is an opportunity missed.

Unsurprisingly, the new law has not been embraced by the small business community. The Bankruptcy Commission's website lists announcements of case commencement under the various procedures. As of the writing of this article, during the first 1.5 years of the new system, no such announcement heralds the opening of any 'small' preventive settlement procedures, and only two 'small' financial restructurings have been opened. Three cases of 'small' liquidation have been announced, along with fewer than 200 cases of administrative liquidation ('no asset' cases).[97] Even the larger corporate business world has been slow to engage the new rescue system, mostly via liquidation proceedings, though the courts in big-business cases have been delivering encouraging early indications that the system is ready to facilitate rescues for at least those larger businesses with the leverage to compel their creditors to negotiate.[98]

4.2 *United Arab Emirates*

Other states in the region took a similar two steps forward, along with the same critical one step back. The United Arab Emirates did so twice, once in

95 Saudi Bankruptcy Regulation, Art. 21.

96 Saudi Bankruptcy Law, Art. 5(a).

97 See https://bankruptcy.gov.sa/ar/Announcements/Pages/default.aspx, 5 Aug. 2020. The announcements page includes multiple notices per case (*e.g.*, petition filing, case opening decision), including only about 250 total notices related to administrative liquidations.

98 See P. Potter & A. Al-Sarraf, 'Saudi Arabia's New Bankruptcy Law: Analysing the First Cases', *The MENA Business L. Rev.*, 3rd Q. (2019): 29.

modernising their business rescue regime in 2016 and then again in adopting the first-in-the-region consumer insolvency law in late 2019.[99] Both rely on negotiation and creditor consent to release debtors from the pressures of debilitating debt and criminal liability for passing NSF checks; neither takes the final, necessary step of empowering the courts to confer a discharge on over-indebted businesses and individuals.

The UAE's 2016 Federal Bankruptcy Law incorporates a three-track scheme, with two rescue options and liquidation as a last-resort, somewhat similar to its (more or less contemporaneous) Saudi counterpart. But whereas the Saudi law uses carrots to entice debtors to engage the process, the UAE law relies on sticks to goad debtors into it. UAE law requires debtors to file for bankruptcy if, for 30 days, they have ceased making timely payment on their debts or have been balance-sheet insolvent (with debts exceeding fair value of available assets). While failing to file under such circumstances no longer constitutes a crime, various fines and potential imprisonment menace individual entrepreneurs (and company directors) whose behavior the court finds precipitated the bankruptcy, and a new regime of disqualification bars such individuals from serving in a business managerial role for up to 5 years.[100]

Distressed but still solvent debtors can also choose to pursue settlement agreements with creditors in a preventive settlement that, despite its name, largely mirrors the Saudi financial restructuring (not preventive settlement) procedure. All procedures in the UAE involve oversight by a court-appointed trustee, but debtors required to file (or petitioned by creditors into) bankruptcy are displaced from management by the appointed trustee, while debtors choosing a preventive settlement remain in control of their businesses under the supervision of the trustee. In either case, an appointed expert assesses whether a restructuring plan is potentially viable and, if so, an appointed trustee develops a plan with the debtor. If the expert endorses a plan in the context of a bankruptcy filing, that process also can conclude with a trustee-developed settlement plan (avoiding liquidation). Creditors vote on a plan developed in either proceeding, and the voting rules are the same, with the consent of a head-count majority of creditors holding two-thirds of claim value required for adoption of a plan. Unlike in the Saudi law, a UAE judge has no power to 'cram down' a viable plan on more than one-third of dissenting creditors in any case.[101]

99 Both laws are available on the Ministry of Finance's website, www.mof.gov.ae, in the 'Rules and Policies' menu, under the heading 'Financial and banking sector', 5 Aug. 2020.

100 Clifford Chance, *New UAE Bankruptcy Law: Analysis and Highlights*, 5-6, 8 (7 Dec. 2016).

101 *Ibid.*, pp. 5-7.

The UAE law makes no provision for simplified 'small' cases, and rather than scrapping the creditors committee in the many cases where this burden serves little purpose, it doubles down, calling for the appointment of a supervisory creditors committee to oversee the implementation of a preventive composition (without compensation).[102] This law thus lacks the principal modifications and techniques recommended by international policymakers and adopted in the Saudi law for accommodating smaller businesses.

But the principal shortcoming in the UAE law is the same as in the Saudi law: It lacks a discharge of debt other than in the context of a super-majority creditor-supported restructuring plan. While the UAE law was touted as responding to the need for small businesspeople to escape the rigors of criminal liability for failed business dealings, it can hardly be expected to serve this purpose with any frequency. Theoretically, the law abrogates criminal liability for failing to file for bankruptcy within the requisite 30 days of becoming insolvent, and it provides for the suspension of criminal proceedings for bad-check charges as soon as the court opens proceedings for a preventive composition or rescue within bankruptcy. Practically, however, business failure will inevitably to be tied to a now-NSF check, opening either kind of settlement proceedings requires an expert to pass on the likely viability of a restructuring plan, and success ultimately depends upon the consent of a super-majority of creditors. For the reasons discussed above, these prerequisites are quite unlikely to be met in the small business context. Even if a plan is approved by creditors, bad-check criminal proceedings remain in suspense until the debtor successfully completes the plan, at only at that point may the debtor apply to have the criminal case permanently stayed or terminated.[103] This is a very substantial set of hoops through which debtors must leap to obtain relief from criminal prosecution.

Unless the economic conditions that led to their bankruptcy have abated, few small business debtors will have any hope of successfully completing a settlement plan and deriving any lasting benefit from the new UAE bankruptcy regime. Since the new law's effective date at the end of December 2016, it has 'only been anecdotally applied to a fairly small number of low profile insolvencies'.[104]

102 *Ibid.,* pp. 5-6.

103 *Ibid.,* p. 9.

104 K. Morrison, R. Pellerin & C. Sioufi, 'The UAE Bankruptcy Law: Stepping up to the challenges raised by the COVID-19 crisis', available at: www.jdsupra.com/legalnews/the-uae-bankruptcy-law-stepping-up-to-99272/, accessed 9 Apr. 2020.

The same shortcoming undermines the latest, otherwise revolutionary development in the UAE: the first Arab bankruptcy law that applies not to merchants, but to ordinary consumers and their non-business debts.[105] While the 2019 UAE Insolvency Law is a landmark piece of Arab legislation in extending some measure of relief to non-merchant debtors, it suffers from the same deficiencies and weaknesses as the 2016 business bankruptcy law. Like the business bankruptcy law, it provides a platform for consumers facing financial difficulties[106] to negotiate 'financial settlement' with creditors. Opening such proceedings leads to a stay of criminal proceedings for passing an NSF check. But here again, the suspension is lifted if the debtor fails to convince creditors to settle.[107]

Creditors holding at least two-thirds of the debtor's total verified debts must attend a plan voting meeting for it to be considered valid, which all but ensures that creditor apathy will prevent even well-intentioned attempts to seek relief.[108] Even if this quorum takes the time to attend the meeting, a plan must be approved by creditors representing a majority of those voting, who hold at least two-thirds of all verified debts.[109] For the reasons discussed above, plan approval is extremely unlikely, especially in the context of low-value consumer insolvency cases.[110]

Liquidation follows an unsuccessful settlement plan process,[111] and that process concludes not with a discharge and relief for the debtor, but with explicit and express authorisation for 'any creditor […] whose debt has not been fully paid […] to execute against the Debtor's Funds to obtain the remainder of his debt'.[112] In addition, the opening of liquidation proceedings imposes certain enumerated restrictions on the debtors' management of their property, including income beyond basic needs as determined by the court.[113] The law includes a 'rehabilitation' chapter that allows the debtor to apply for a lifting of these inhibitions, but only after a waiting period of up to 3 years after the

105 Merchants are excluded from this new law, as they are covered by the 2016 Bankruptcy Law. UAE Insolvency Law, Art. 2.

106 The standard here is quite permissive, allowing access to those 'facing current or anticipated financial difficulties'. *Ibid.*, Art. 3.

107 *Ibid.*, Art. 67.

108 *Ibid.*, Art. 15(1).

109 *Ibid.*, Art. 18. While non-attending creditors can be deemed to have approved the plan, the quorum requirement ensures that a large percentage of creditors must affirmatively support the plan in any case for it to be adopted.

110 See Kilborn, *supra* note 51.

111 UAE Insolvency Law, Arts. 20, 27.

112 *Ibid.*, Art. 46(4).

113 *Ibid.*, Arts. 39, 50.

closure of liquidation proceedings.[114] Creditors are invited to object at a hearing, after which the court seems to be free to deny even this small measure of relief for unstated reasons.[115] This is certainly *not* a 'discharge' in the sense used in international commentary on that key notion, despite the misleading commentary in some internet reports.[116]

4.3 *North Africa: Egypt (and Oman), Tunisia, Morocco*

The Egyptian bankruptcy reform process initiated so long ago[117] finally culminated in a new law on restructuring, preventive compositions, and bankruptcy in early 2018. The controversies that delayed the reform process continue to plague the end product, a law that continues to reflect a powerful dedication to a punitive tradition at the expense of both small business debtors and broader Egyptian society.

On the plus side, the Egyptian law inaugurates a special Bankruptcy Department in each commercial court to administer petitions related to the new bankruptcy law, and it establishes a roster of restructuring and asset management experts to assist in the preparation of restructuring plans. Oddly, an expert-underwritten restructuring plan requires the assent of *all* affected creditors, making the restructuring process amount to little more than a court-sponsored mediation. This promises little relief to overburdened small businesses.[118] On the other hand, preventive compositions work very much like in other Arab laws analyzed above, with an appointed composition trustee supervising debtors who remain in control of their businesses, and a settlement adopted by a majority of creditors holding two-thirds of the verified debts (expressly binding even on creditors who did not participate in voting or who voted against the plan). The Egyptian law admirably incorporates the recommended technique of not counting creditors (and the amount of their claims) who fail to participate in the voting process, though conversely it also allows the judge to refuse confirmation of a settlement even without objection from any party based on 'the public good or the interest of creditors'.[119]

114 The purgatory period varies by creditor claim satisfaction: It is reduced to 2 years if 50% of claims are paid off, and to 1 year for 75% payment. *Ibid.*, Art. 55.

115 *Ibid.*, Arts. 59-60.

116 See, *e.g.*, J. Farn, 'UAE Personal Insolvency Law' (15 Dec. 2019), available at: www.hadefpartners.com/News/417/UAE-Personal-Insolvency-Law, 5 Aug. 2020.

117 See *supra* notes 5-9 and accompanying text.

118 Law Regulating Restructuring, Preventive Composition and Bankruptcy, Arts. 13, 18, 21, 24, 29 (2018) [Egypt] [hereafter, Egyptian Bankruptcy Law].

119 Egyptian Bankruptcy Law, Arts. 41, 46, 60, 65, 68.

Unfortunately for small businesses, especially those for whom economic volatility cut short their best-laid plans, preventive settlements and (mediated) restructuring plans are available only to businesses who have been active for at least the preceding 2 full years, and restructuring additionally requires the debtor-company to have at least a million Egyptian Pounds (about US$63,000) of capital (perhaps in an implicit acknowledgment that debtors with fewer assets than this have no hope of attracting the attention, much less the required acquiescence, of *any*, let alone *all,* creditors).[120] Bankruptcy remains the most likely end game for most distressed small business entrepreneurs in Egypt, and here as elsewhere, bankruptcy offers not relief, but continuing burden.

While the law is explicit that a preventive settlement can include a discharge of 'a part of [the debtor's] debt and interest',[121] it is equally explicit that, without creditor consent, no discharge is possible. Closure of bankruptcy liquidation proceedings for lack of asset value to finance the trustee's fees and expenses 'shall result in restituting to each creditor the right to take proceedings and assume the individual cases against the debtor'.[122] The same is true following the completion of the creditors committee's work distributing asset value in a bankruptcy case, after which 'every creditor regains the right to enforce against the debtor the remainder of his debt'.[123] Moreover, debtors remain subject to post-bankruptcy prohibitions on membership in commercial or industrial chambers or labour unions and management of any business until they are 'rehabilitated'. Like in the UAE Insolvency Law,[124] this rehabilitation and restoration of rights occurs upon the debtor's application after the third anniversary of closure of bankruptcy proceedings (or upon the unanimous consent of his creditors), and creditors are invited to oppose this rehabilitation.[125] This is not the equivalent of discharge. Restoring participatory rights is quite distinct from releasing debtors from liability for unpaid debts.

Moreover, the law contains no provision suspending criminal prosecution for passing a dishonoured check. Several other punitive provisions on 'bankruptcy by negligence' menace debtors with criminal liability for causing losses to creditors 'due to [...] lack of stringency or gross negligence', including maintaining a household with 'exorbitant' expenses, failure to keep complete, regular books of accounts, and failure to announce bankruptcy within 15 days of

120 *Ibid.*, Arts. 15, 31.
121 *Ibid.*, Art. 66.
122 *Ibid.*, Art. 175.
123 *Ibid.*, Art. 208.
124 See *supra* notes 113-115 and accompanying text.
125 Egyptian Bankruptcy Law, Arts. 111, 239, 241, 245-249.

ceasing to make timely payments to creditors.[126] While the UAE decriminalised 'bankruptcy by default' for failing to timely announce cessation of payments, Egypt doubled down on this highly criticised rule. The controversies of the late 1990s appear to have been resolved largely in favour of retaining the traditional, punitive approach.

The very latest Arab bankruptcy law is an only slightly modified carbon copy of the Egyptian law: Oman's Bankruptcy Law, adopted in July 2019 and effective 1 July 2020,[127] tracks the Egyptian law almost word for word, with less detailed and slightly reordered provisions in various places. The Omani law does contain a few salient variations on the Egyptian theme. First and most notable, preventive settlements can be adopted even during the bankruptcy process by a majority of creditors holding two-thirds of claims—far fewer than the unanimous vote required in Egypt, though still more creditor engagement and support than can be reasonably anticipated in the small business context.[128] Second, the Omani law conspicuously omits any mention of a preventive settlement including a partial discharge.[129] Third, mediated restructuring proceedings (binding only signatory creditors) are available to small business debtors without a minimum capital threshold.[130] Fourth, the Omani law omits the long list of civil disabilities imposed on debtors in the 3-year post-bankruptcy period. And fifth and finally, a false distinction: Though the Omani law mentions only two bases for criminally penalising individual debtors, in contrast to the long list of offenses in the Egyptian law,[131] the Omani Penal Law reproduces most (though not all) of the penal provisions of the Egyptian Bankruptcy Law.[132]

126 *Ibid.*, Arts. 77, 254, 257.

127 Royal Decree No. 53/2019 promulgating the Bankruptcy Law (1 July 2019, *Official Gazette*, 7 July 2019) (per Art. 4, effective 1 year after issuance; that is, 1 July 2020). The law is available on the Omani internet law repository, http://qanoon.om/p/2019/rd2019053/#more-34588, 5 Aug. 2020.

128 *Cf.* Omani Bankruptcy Law, Art. 167, Egyptian Bankruptcy Law, Art. 179. (Art. 60 allows a majority holding two-thirds of claims to adopt a settlement only in preventive settlement proceedings proper.)

129 *Cf.* Omani Bankruptcy Law, Art. 60 (mentioning only extensions of time to pay), Egyptian Bankruptcy Law, Art. 66. The provisions explicitly denying a discharge, confirming that creditors regain their right to enforce their claims following closure of the bankruptcy case, are the same. *Cf.* Omani Bankruptcy Law. Arts. 163, 186, Egyptian Bankruptcy Law, Arts. 175, 208.

130 *Cf.* Omani Bankruptcy Law, Art. 6, Egyptian Bankruptcy Law. Art. 15 (requiring 1 million pounds).

131 *Cf.* Omani Bankruptcy Law, Art. 241, Egyptian Bankruptcy Law, Art. 254.

132 See Penal Code, Arts. 384, 386, 389 (2018) [Oman]; Omani Bankruptcy Law, Art. 239 (expressly referencing the applicability of the Penal Code on bankruptcy crimes).

Returning to North Africa and continuing further west, Tunisia and Morocco also recently adopted rescue provisions to balance their liquidation bankruptcy laws, though unlike other Arab world reforms, these predictably reflect a distinctive and powerful influence from French law. Tunisia was the first Arab state to adopt a rescue regime in April 2016, modifying Book Four of the Tunisian Commercial Code.[133] Moroccan lawmakers likewise revised Book Five of their Commercial Code along very similar lines in 2018.[134] Both tracked the French commercial insolvency law, with its fairly unique menagerie of out-of-court conciliation and court-driven restructuring pathways.[135]

In broad strokes, both states' provisions resemble those of the other Arab nations discussed here and share their shortcomings in the small business context. The Tunisian Code provides for settlement plans adopted by two-thirds creditor vote (or majority vote for court-imposed plans, though these may not discharge the principal of any single debt without that creditor's explicit consent), and it explicitly denies a discharge to individual debtors following the closure of liquidation proceedings.[136] The Moroccan law allows a judge to impose a limited, full-payment 'safeguard' plan on creditors, but a full-fledge restructuring plan (with partial debt discharge) requires assent by at least creditors holding a majority of claims participating in the voting process (that is, those not voting in person or by proxy are not counted).[137] Also in Morocco, debt remaining unpaid after liquidation is not discharged; rather, the law explicitly empowers creditors to request reopening of proceedings at any time upon discovery of new asset value belonging to the debtor.[138]

Thus, none of the North African (or Omani) laws has implemented the most important small business provisions recommended by international policymakers, most notably a non-consensual discharge. While the Egyptian and Moroccan laws exclude non-voters, and the Moroccan law reduces the creditor support threshold necessary to adopt a restructuring plan, none of these laws provide for simplified and less cumbersome rescue proceedings for

133 Law 2016-36 of 29 April 2016 on Collective Procedures (*Official Gazette*, No. 38, 10 May 2016).

134 Law No. 73-17 on Insolvent Enterprises (*Official Gazette*, No. 6667, 23 Apr. 2018). For general commentary, see A. Al-Sarraf, 'The wave of insolvency reform across the region: Analysing the new bankruptcy laws in Morocco and Bahrain', *INSOL Technical Paper Series* No. 43 (2019).

135 See B. Zouaoui, 'Law No. 2016/36 of 29 April 2016 on Collective Insolvency Proceedings (A Comparative Study of Tunisian and French Law)', *Int'l Bus. L.J.* 597 (2016).

136 See Commercial Code, Arts. 428, 456, 585-586 (2016) [Tunisia].

137 See Commercial Code, Arts. 562, 570, 601, 611, 630 (2018) [Morocco].

138 *Ibid.*, Art. 669.

smaller companies or individual entrepreneurs.[139] Indeed, the content and even phrasing of the 'new' Egyptian and Omani laws are virtually identical to the bankruptcy provisions of the Commercial Laws of Kuwait[140] (1980) and Qatar (2006), both of which provide for settlements adopted by the same super-majorities of creditors (and explicitly authorise a partial discharge in such settlements).[141] The Egyptian and Omani laws, in particular, thus do not represent significant advances of regional bankruptcy rescue policy, especially for small businesses.

4.4 *Bahrain*

Saving the best for last, the highlight of this journey through the MENA region occurs upon circling back to the Arabian Peninsula to the tiny island 'kingdom of the two seas'. In May 2018, Bahrain decreed its Law on Reorganisation and Bankruptcy[142] with all the virtues of the just-released law in neighbouring Saudi Arabia,[143] but with a distinguishing enhancement: Bahrain's law is the only one in the Arab world to offer individual entrepreneurs (natural persons) a discharge of unpaid debt upon the conclusion of liquidation-bankruptcy proceedings.

This court-ordered release is not automatic and not entirely assured, but upon the debtor's application before the closure of bankruptcy proceedings, the Bahraini law provides that the court 'may' (*yaǧūz*) release the debtor from liability for debts not covered by the liquidation proceeds so long as the debtor fulfills four conditions: (1) adequately explains the financial distress and the insufficiency of assets to meet obligations, (2) cooperates with the trustee, including relinquishing available assets, (3) did not commit any act to defraud

139 The Egyptian law (along with the similar Omani and Qatari laws) contains a provision simplifying *liquidation* proceedings of especially small companies (with assets worth less than 500,000 Egyptian Pounds, about US$31,000), but these modifications do nothing to advance the cause of small business recovery. Rather, they simply allow the court to make liquidation more expeditious by reducing timelines for trustee reports and claims submission and disputes, eliminate all non-jurisdictional appeals, and exclude the appointment of a controller for the bankrupt company and replacement of the appointed trustee by creditors. Egyptian Bankruptcy Law, Art. 209.

140 Kuwait has been developing a US Chapter 11-style reorganisation law since at least 2015, a project that remains in progress.

141 Law 27/2006, Arts. 735-762 (judicial composition-settlements), 792-833 (preventive settlement) [Qatar]; *cf.* Law 68 of 1980, Arts. 743-787 [Kuwait].

142 Law No. 22 of 2018 promulgating the Reorganisation and Bankruptcy Law (30 May 2018, *Official Gazette*, No. 3369, 7 June 2018). The law is available on the website of the Bahraini Legislation and Legal Opinions Commission, www.legalaffairs.gov.bh, 5 Aug. 2020.

143 See *supra* Section 4.1.

creditors in the preceding 4 years, and (4) complies with the duties imposed by the bankruptcy law. A few debts are excepted from discharge, as is common in all world discharge provisions,[144] including those related to fraud, intentional torts, criminal restitution liability, and family support.[145] Of course, it remains to be seen whether and how Bahraini judges will actually use the new discharge powers bestowed on them by this new law. But by taking the bold step of adopting the Arab world's only discharge provision, Bahrain wins the prize for the Arab law that most completely incorporates international recommendations for a key best practice most needed by small business owners trying to recover and return to productive entrepreneurialism.

Moreover, this is just the jewel in a graceful crown of a law studded with other brilliant examples of best practices for small business bankruptcy. One provision responds directly to the needs of small business debtors by decreeing a series of modifications to the ordinary rules appearing earlier in the law. The definition of 'small' debtor takes an interesting approach. Rather than basing this on debt levels, as is common elsewhere,[146] the Bahraini law orients this decision on the value of the debtor's inventoried assets. If this is less than 10,000 Bahraini Dinars (about US$26,500),[147] the law implies the case does not warrant expensive, full-blown procedures and empowers the court to invoke a series of simplifying modifications along the very lines recommended by international policymakers:

(1) halving timelines for consideration and challenge of case-opening petitions,
(2) eliminating non-jurisdictional appeals,
(3) not appointing a trustee or convening a creditors committee,
(4) shortening timelines for resolving claims disputes,
(5) empowering reorganisation plans to be adopted by a simple majority of creditors (eliminating the ordinary requirement of two-thirds in claim value, and noting that creditors who do not participate in the vote are, as usual, excluded from these calculations),[148] and

144 See World Bank *Natural Persons*, *supra* note 42 ¶¶ 367-371.

145 Reorganisation and Bankruptcy Law art. 150 (2018) [Bahrain] [hereafter, Bahraini Bankruptcy Law]. Another provision also expressly discharges the debtor from all liabilities arising before adoption of a reorganisation plan, making explicit a notion that is implicit in reorganisation laws elsewhere. Bahraini Bankruptcy Law, Art. 116(c)–(d).

146 See World Bank *Proposals*, *supra* note 26 at 27-28.

147 This figure can be modified, presumably upward, after 2 years by the Ministry of Justice and Supreme Judicial Council. Bahraini Bankruptcy Law, Art. 190(b).

148 See Bahraini Bankruptcy Law, Art. 114(d).

(6) empowering the court to impose (cram down) a plan even if a majority of creditors rejects it, so long as the court concludes the plan is in the best interests of the estate (*i.e.*, puts the debtor's assets to their best use).[149]

Even better, the law invites the Ministries of Justice and Trade to convene a committee to provide financial support to small business debtors to cover the fees and expenses of bankruptcy administration, funded by contributions from the Labour Fund, the Bahrain Chamber of Commerce and Industry, and any other sources approved by the Council of Ministers.[150] These provisions meet and significantly surpass international best-practice benchmarks for small business bankruptcy. Bahrain's new law is detailed and thoroughly modern. It has set a high bar and a useful precedent for emulation by other states both in and beyond the region.

5 Why Stop Short? The Islamic Background (and Potential Way Forward) for Discharge

Other than Bahrain, no state in the Arab world has accepted the most imperative recommendation of international insolvency experts: a discharge of most unpaid debt following closure of bankruptcy proceedings. Without this negotiating lever, small business debtors can offer little incentive—positive or negative—to persuade their creditors to engage in debt negotiation, much less to convince a super-majority to agree to extend at least partial debt forgiveness. With neither negotiating leverage nor a last-resort form of officially imposed relief, small business debtors will likely fare no better under the new MENA region bankruptcy laws than they did under the traditional laws.

Why have these states almost unanimously rejected the single most important ingredient in an effective SME insolvency regime? Aside from traditional cultural attitudes that remain deeply suspect of those who fail to honour their commitments (which attitudes remain widespread in other parts of the world, as well), the Arab world likely has an even more powerful and notable explanation: Islamic Law. The Prophet (PBUH) was a trader in a very challenging and hostile desert environment, and he and his companions were very well

149 *Ibid.*, Art. 190(b). In assessing the final 'best use' provision, consider the 'objectives' provision, which assigns primacy to preserving asset and 'maximization of the value of the bankruptcy assets to the maximum extent possible'. *Ibid.*, Art. 2.

150 *Ibid.*, Art. 191.

aware of economic disruption and the ensuing financial distress. Both the Holy Qur'ān and the Sunnah contain explicit references to debt and distress, and the all but unanimous view is that, while these references strongly encourage creditors to be lenient with their debtors and offer forgiveness, they flatly forbid any non-consensual, imposed discharge.

This topic has been explored and explained in detail elsewhere,[151] but the basics of the Islamic Law of debt distress and discharge are worth recalling briefly here. The heart of the topic is a particularly beautiful but enigmatic verse of the Holy Qur'ān: 'And if [the debtor] is insolvent, there shall be a respite until [the debtor returns to] solvency, and to forgive [the debt as a form of non-obligatory charity] is better for you, if you only knew'.[152] While the reader will please forgive the extremely awkward translation, the core idea is manifest: Creditors are required to await payment while an insolvent (bankrupt) debtor regains minimal financial stability, but creditors are *not* required (and by extension cannot be forced) to relinquish their rights and forgive the unpaid debt. It would be better for them in the grand scheme of things if they were to see fit to forgive the debt, perhaps by acceding to a settlement proposal from the debtor (as repeatedly featured in Arab bankruptcy-rescue laws), but the word used in the governing verse is *ṣadaqah*, not *zakat*—voluntary charity, not obligatory.

While the Sunnah is both more promising and even more ambiguous, with *aḥādīth* extolling the virtues of debt forgiveness and reporting on the Prophet (PBUH) seeming to direct his companions to relinquish part of their monetary claims,[153] no school of Islamic law seems to have construed these authorities as supporting the notion of discharging debts without the consent of creditors.[154] With a non-consensual discharge out of the question, debtors' only leverage to convince creditors to accept partial-forgiveness debt settlements is an invocation of the verse just cited and a reminder that such forgiveness 'is better for you, if you only knew'. The problem, of course, is that this negotiating leverage has been in place for nearly 1,400 years, and yet creditors are seldom convinced that the proper prerequisites for such forgiveness are present (creditors almost always suspect the availability of hidden assets and untapped

151 See, *e.g.*, A. Awad & R. Michael, 'Iflas and Chapter 11: Classical Islamic Law and Modern Bankruptcy', *Int'l Lawyer* 44 (2010): 975; J. Kilborn, 'Foundations of Forgiveness in Islamic Bankruptcy Law: Sources, Methodology, Diversity', *Am. Bankr. L.J.* 85 (2011): 323.

152 Holy Qur'ān 2:280.

153 See Kilborn, *supra* note 151 at 333-335.

154 *See* Awad & Michael, *supra* note 151 at 997, 999; Kilborn, *supra* note 151 at 347.

income-producing potential, again in both the Arab world and elsewhere).[155] The Qur'ānic imperative to forgive unserviceable debt has long been of little or no avail for small business debtors, and therefore so too will be the new Arab bankruptcy laws without a discharge provision.

But in light of this Islamic law background, how does a pious state like Bahrain justify its position of extending a law-imposed discharge to debtors, depriving creditors of their rights? It is not clear what precise justification or thought process stands behind the Bahraini law, but a public pronouncement from a prominent authority on Islamic financial law offers an intriguing clue. It provides both a potential explanation and a potential basis for other Arab states (and non-Arab states wishing to conform their laws to Islamic law) to embrace the officially sanctioned court-imposed discharge.

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) is arguably the most prominent and certainly an exceptionally persuasive authority on standards for the global Islamic finance industry.[156] Its goal is to harmonise such standards to solidify and expand the foundations of the rapidly expanding world market for Sharīʿah-compliant financial instruments. To this end, AAOIFI convenes a large group of especially well-respected authorities on Islamic Law to develop and issue public guidance on finance-related Islamic law doctrine. It has issued scores of Sharīʿah Standards related to accounting, auditing, ethics, and governance, including standards on insolvency/bankruptcy.[157]

AAOIFI's Sharīʿah Standard No. (43) on Insolvency threads the needle between the modern, secular need to reinvigorate economic productivity by offering small businesses a legal debt discharge and fresh start, on the one hand, and on the other hand, the sacred right of creditors to choose forgiveness or to hold debtors to their obligations. Its ingenious approach is to separate the secular—legal effect of a law-imposed debt discharge from the sacred—moral residual outstanding obligation: 'After distribution [of the debtor's assets in

155 Note a potential distinction here between settlement (*ṣulḥ*), which Abū Ḥanifah argued was inappropriate where the debtor admitted the claims against him, see Othman, *supra* note 31 at 85, and charitable forgiveness (*ṣadaqah*). Accepting Abū Ḥanifah's position, perhaps 'preventive settlements' in the bankruptcy context should not be referred to as *ṣulḥ*, since most if not all debts are usually acknowledged, but rather workout arrangements on the basis of *ṣadaqah*. In either case, creditors still must ultimately be convinced that the debtor's situation warrants clemency.

156 'About the AAOIFI', http://aaoifi.com/about-aaoifi/?lang=en, 5 Aug. 2020.

157 AAOIFI, *Sharīʿah Standards* (2017), available at: http://aaoifi.com/download/24233/?land=en, accessed date?.

bankruptcy], creditors have no legal right to demand any unpaid debt from the debtor. However, the debtor has a moral obligation in Sharīʿah to pay all debts in full'.[158] That is, the state will neither lend assistance to nor tolerate creditors in pursuing claims discharged for the greater good of the national economy and society, but it acknowledges the (non-state enforced) religious duty of debtors to fulfill their obligations unless specifically forgiven by creditors. Whether any particular state finds this reasoning persuasive or not is, of course, up to state leaders.

Why might Bahraini leaders have been singularly persuaded? Perhaps because the AAOIFI's reasoning is backed by careful analysis by exceptionally distinguished experts, but also perhaps, at least in part, due to the fact that the AAOIFI is headquartered in Manama, the capital of Bahrain. In any case, the legal basis for a Sharīʿah-compliant bankruptcy discharge has been developed, and it now has official backing and the force of law in one Arab state. Time will tell whether this controversial notion successfully takes root in Bahrain and how its growth might affect—for good or ill—the national economy and social environment in the Kingdom.

6 Conclusion

It is thus most likely untrue that recent Arab world bankruptcy reforms will benefit SMEs, much less that SMEs will be the *principal* beneficiaries of these initiatives.[159] SMEs' negotiating position with creditors is as weak as it was before, and all or most of the ameliorations in the new laws depend upon small businesspeople successfully negotiating solutions with super-majorities of creditors. AHAB and Sa'ad group can retain expensive advisers and credibly threaten to pull down billions of dollars of investments with them if creditors allow them to fail. In stark contrast to this, without the threat of a law-imposed discharge of at least part of their debts, SMEs have little to offer, and creditors have little to lose. Small business entrepreneurs are unlikely to persuade their creditors even to engage in a negotiation, let alone extend necessary relief. These businesses and their owners will likely continue to languish under the

158 AAOIFI *Sharīʿah Standard* No. 43, Art. 5/8 (2010). This same distinction between legal and moral effects of debt discharge is drawn in the Qatari Commercial Law in providing that a creditor-agreed preventive settlement 'may also provide for discharging the debtor of part of the debt; however the debtor shall remain liable for this discharged part as a natural debt'. Commercial Law, Art. 819 (2006) [Qatar].

159 See Saadi, *supra* note 2.

weight of debt burdens that economic volatility (and world pandemic) have made unserviceable, through no fault of the individuals affected. Islamic law experts and state authorities in Bahrain have shown that there is a respectable, pious path to enjoining rejuvenating relief for these debtors for the benefit of all of society. SMEs and their entrepreneur owners are left to hope that in the next round of bankruptcy reform, other Arab world legislatures will follow.[160]

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