A Review of the Libyan Insolvency and Restructuring Laws Informed by Insolvency Law Theory and International Benchmarks

By

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Abstract

The research aims to evaluate the adequacy of the insolvency system in Libya to support the national desires and objectives identified in the country to enhance the national economy and to maintain social stability. The thesis considers the need for reform in the current business insolvency and rescue framework taking into account the country's domestic circumstances. To conduct this evaluation, the research reviews the Libyan insolvency law by examining the theoretical approaches to corporate insolvency laws in order to understand the role that should be played, or the goal that should be reached, by the insolvency law. This is important to identify whether the insolvency and rescue laws should be concerned only about maximising economic interests or should be concerned also about wider societal interests and objectives. The study also undertakes an in depth evaluation of the current business insolvency and rescue framework by using the international benchmarks with particular reference to the UNCITRAL *Legislative Guide on Insolvency Law*. The thesis establishes that the current insolvency law is insufficient to promote the economic and social goals of the country because of both the deficiency of the legislative framework and inefficient institutions. The investigation reveals also that an application of the social justice theory as traditionally perceived by the Civil Code 1953 (as manifested in property law and contract law) that is primarily designed to achieve social goals (for example, the priority given to the wide-ranging category of privileged creditors over secured creditors) prevents the insolvency law from achieving the sought-after objectives leaving much to be desired for a reform. The research builds on these foundations to identify challenges and impediments to the development of the insolvency and rescue regime of Libya.

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"All Praise is Due to Allah, by Whose Grace Good Deeds are Accomplished"
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Table of Legislations

Libya

Other Jurisdictions

Sale and Pledge on a Going Concern Act 1940 (Egypt)

UK Enterprise Act 2002

UK Insolvency Act 1986

US Bankruptcy Code 1978

List of Cases

United Kingdom

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Fibrosa Spolka Akcyjna v Fairbairn Lawson Combe Barbour Ltd [1943] AC 32

Lloyds Bank Ltd v Bundy [1975] QB 326

Re Atlantic Computer Systems plc [1992] Ch 505

Libya

Supreme Court of Libya, Civil Cassation No 75/19J. Decision issued on 21 Apr 1974 [1974] 10 (4) Journal of Supreme Court

Musrata First Instance Court, Initial Commercial Chamber, Civil Case No 25/3J. Decision issued on 12 Feb 1957

Other Jurisdictions

In re Johns-Manville Corp, (1984) 36 BR 727 (United States of America)

Case C-110/03 *Belgium v Commission* [2005] ECR I-2829 (European Court of Justice)

Table of Abbreviations

General

ACM	Authentic Consent Model
Art	Article
CBL	Central Bank of Libya
CBT	Creditors' Bargain Theory
CC 1953	Civil Code of 1953
CCA 2010	Code of Commercial Activity 2010
CCPs 1954	Code of Civil Procedures 1954
CERs 2010	Code of Employment Relationships 2010
Chap	Chapter
DIP	Debtor in Possession
EA 2002	UK Enterprise Act 2002
EBRD	European Bank for Reconstruction and Development
EFI 2003	Encouraging Foreign Investment Act 2003
f.n.	Footnote
FLA 2010	Financial Lease Act 2010
IA 1986	UK Insolvency Act 1986
IMF	International Monetary Fund
MENA	Middle East and North Africa
MVs	Multiple Values Theory
Obj.	Objective
Para	Paragraph
Paras	Paragraphs
PIA 2010	Promotion of Investment Act 2010
Rec	Recommendation
Sch	Schedule

Sec	Section
SMEs	Small and Medium Sized Enterprises
SOEs	State Owned Enterprises
SSN	Social Safety Net
TPT	Team Production Theory
UK	United Kingdom
UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law
UNDP	United Nations Development Programme
USA	United States of America
USAID	US Agency for International Development
WB	World Bank
WWII	World War II

Journals and Publishers

AJS	American Journal of Sociology
Am Bankr Ins L Rev	American Bankruptcy Institute Law Review
Am Econ Rev	American Economic Review
Arab Law Q	Arab Law Quarterly
Ariz J Int'l & Comp L	Arizona Journal of International and Comparative Law
BC Int'l & Comp L Rev	Boston College International & Comparative Law Review
Berkeley Bus LJ	Berkeley Business Law Journal
Brook J Corp Fin & Com L	Brooklyn Journal of Corporate, Financial & Commercial Law
Brook J Int'l L	Brooklyn Journal of International Law
Cap UL Rev	Capital University Law Review
CLJ	Cambridge Law Journal
CLP	Current Legal Problems

CoUP	Columbia University Press
Colum Bus L Rev	Columbia Business Law Review
Colum L Rev	Columbia Law Review
Com Lending Rev	Commercial Lending Review
CUP	Cambridge University Press
ECFR	European Company and Financial Law Review
Emerg Mark Rev	Emerging Markets Review
Emory LJ	Emory Law Journal
EUP	Edinburgh University Press
Eur Bus Org Law Rev	European Business Organization Law Review
Eur Econ Rev	European Economic Review
Eur J Law Econ	European Journal of Law & Economics
Fordham L Rev	Fordham Law Review
Harv L Rev	Harvard Law Review
HUP	Harvard University Press
IFC	International Finance Corporation
IJELS	International Journal of English Literature and Social Sciences
IJLMA	International Journal of Law and Management
IJME	International Journal of Management Excellence
Insolv LJ	Insolvency Law Journal
Insolvency & Restructuring Int'l	Insolvency and Restructuring International
Int'l Ins Rev	International Insolvency Review
Int'l Law	International Lawyer
Int'l Org	International organization
Int'l & Comp LQ	International & Comparative Law Quarterly
J Afr L	Journal of African Law
J Bus & Tech L	Journal of Business & Technology Law
J Corp L	Journal of Corporation Law

J Corp Law Stud	Journal of Corporate Law Studies
J Fin	Journal of Finance
JBF	Journal of Banking & Finance
JBL	Journal of Business Law
JFSR	Journal of Financial Services Research
JL Econ & Org	Journal of Law, Economics, & Organization
KJLL	KLRI Journal of Law and Legislation
L&Soc Inq	Law & Social Inquiry
LAP	Lambert Academic Publishing
Law&Contemp Probs	Law and Contemporary Problems
LiT	Law in Transition
LQR	Law Quarterly Review
LUP	Leiden University Press
McGill LJ	McGill Law Journal
ME&NASP	Middle East & North African Studies Press
Mich L Rev	Michigan Law Review
Minn L Rev	Minnesota Law Review
Mod L Rev	Modern Law Review
NCL Rev	North Carolina Law Review
NIBLeJ	Nottingham Insolvency and Business Law e-Journal
Nottingham LJ	Nottingham Law Journal
OJLS	Oxford Journal of Legal Studies
OSJ	Open Science Journal
OUP	Oxford University Press
Oxford Rev Econ Policy	Oxford Review of Economic Policy
Regul&Gov	Regulation & Governance
Rev Econ Stat	Review of Economics and Statistics
Rev Intl Droit Comp	Revue internationale de droit compare
RLE	Review of Law & Economics
S Cal L Rev	Southern California Law Review
SELP	Sellier European Law Publishers

SJLS	Singapore Journal of Legal Studies
SUP	Stanford University Press
Tex Int'l LJ	Texas International Law Journal
Tex L Rev	Texas Law Review
TJL	Tripoli Journal of Law
Tul L Rev	Tulane Law Review
UChiL Rev	University of Chicago Law Review
U Ill L Rev	University of Illinois Law Review
UPittL Rev	University of Pittsburgh Law Review
UBJLS	University of Banghazi Journal of Legal Studies
UCLA L Rev	UCLA Law Review
UCP	University of California Press
UNSW L J	University of New South Wales Law Journal
UPL Rev	University of Pennsylvania Law Review
UTJLS	University of Tripoli Journal of Legal Studies
UTP	University of Toronto Press
Va J Int'l L	Virginia Journal of International Law
Va L Rev	Virginia Law Review
Vand L Rev	Vanderbilt Law Review
Wash U Global Stud L Rev	Washington University Global Studies Law Review
Wash ULQ	Washington University Law Quarterly
Wash&Lee L Rev	Washington and Lee Law Review
Yale LJ	Yale Law Journal
YUP	Yale University Press

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Chapter 1 Introduction and Overview of the Research

1.1. Introduction

Companies and their businesses are important in market-based economies because they play a significant role in promoting investment and stimulating economic growth. But, at the same time, they are exposed to the market risk in which insufficient and uncompetitive businesses are eliminated and replaced by more competitive ones.[1] This potentially leads to a more efficient use of resources and to a healthy market. The legal response to this scenario is to facilitate exit from the market for the uncompetitive companies though insolvency laws.[2] From a legal point of view, business failure implies that companies are experiencing financial distress or insolvency. The occurrence of business failure or insolvency may lead the companies to exit the market and this will potentially have a negative impact on the market stability and growth. Given the important role that companies play in promoting economic growth and stability, it is necessary to provide effective legal mechanisms to mitigate the impact of such scenarios when they arise. There is no doubt that the existence of an effective insolvency law is essential to enhance economic growth and stability.[3]

However, it should be noted that the insolvency law is not supposed to ignore or intervene with the function of the market. Indeed, its role is to provide collective measures and a non-destructive process designed to eliminate only economically nonviable companies from the market by means of liquidation procedures while viable

[1] Philippe Frouté, 'Theoretical Foundation for a Debtor Friendly Bankruptcy Law in Favour of Creditors' (2007) 24 Eur J Law Econ 201, 204

[2] Michelle White, 'The Corporate Bankruptcy Decision' (1989) 3 Journal of Economic Perspectives 129; Christopher Frost, 'Bankruptcy Redistributive Policies and the Limits of the Judicial Process' (1995) 74 NCL Rev 75

[3] Frouté (n 1) 201-02

companies may be rescued.[4] This is desirable and should not be intervened with because failed companies will be replaced by businesses that are capable of meeting the requirements of market economies and correspond to the desires of consumers and community. This will also provide certainty in the market especially among stakeholders like investors and creditors who are affected by the insolvency of their debtor company.[5] It is admitted that an effective legal framework within which citizens can plan is a vital requirement for economic growth. This is because the economic performance and enhancement of investment which are necessary for healthy markets can be influenced by sound laws.[6]

Historically, insolvency laws were dominated by the liquidation process reflecting the economic theory which supposes that uncompetitive and unproductive businesses should be eliminated from the marketplace because this would promote healthy market economies.[7] This perception and treatment of distressed businesses took a long time to shift towards rescue or reorganisation of troubled businesses instead of the employment of liquidation.[8] Business failure has recently attracted more attention within domestic jurisdictions and insolvency laws have increasingly become an important topic in jurisdictions around the globe. During the past decades, reforms and reform plans of domestic insolvency laws have taken place in many countries around the world.[9] Insolvency has proven to have a wider social impact not only on debtor companies and their creditors but also on other stakeholders such as the employees, suppliers and

[4] Vanessa Finch and David Milman, *Corporate Insolvency Law: Perspectives and Principles* (3rd edn, CUP 2017) 117; White (n 2)
[5] Frouté (n 1) 201-02
[6] Terence Halliday, 'Architects of the State: International Financial Institutions and the Reconstruction of States in East Asia' (2012) 37 L&Soc Inq 265, 273
[7] White (n 2)
[8] David Ehmke and others, 'The European Union Preventive Restructuring Framework: A Hole in One?' (2019) 28 Int'l Ins Rev 1, 1-2
[9] Rebecca Parry, 'Introduction' in Katarzyna Broc and Rebecca Parry (eds), *Corporate Rescue: An Overview of Recent Developments* (2ed edn, Kluwer Law International 2006) 1; Gerard McCormack, *Corporate Rescue Law--an Anglo-American Perspective* (Edward Elgar 2008) 1

customers and the economy in which those companies operate. It can also traverse all sectors of the economy.[10] Therefore, it has become necessary and legitimate to design a framework within which interests of such parties must not be overlooked.[11]

An approach that employs social objectives[12] as a response to business failure and distress justifies the implementation of a rescue system whose policy objectives are tailored to avoid the social costs that may be caused by liquidation and to preserve the distressed companies as a going concern. Rescue procedures have the potential to achieve a number of positive outcomes including the preservation of insolvent but viable businesses that have a going concern value greater than if they are sold in a piecemeal basis,[13] the preservation of jobs, the maximisation of returns to creditors, the avoidance of harms that may be caused to suppliers, customers and tax authorities, and the economy at large.[14]

Further, rescue procedures are also important because they can alleviate the detrimental consequences of business distress and may even prevent systematic financial crises. For example, the lack of adequate insolvency systems in East Asian countries exacerbated the Financial Crisis hit the region in 1997 since it was impossible for distressed businesses to reorganise their affairs in the face of the crisis.[15] It has recently been realised by State governments and international bodies around the world

[10] Bruce Carruthers and Terence Halliday, *Rescuing Business: The Making of Corporate Bankruptcy Law in England and the United States* (Clarendon Press 1998) 1; Vanessa Finch, 'The Measures of Insolvency Law' (1997) 17 OJLS 227, 227

[11] Sir Kenneth Cork, *Insolvency Law and Practice: Report of the Review Committee* (Cmnd. 8558, 1982) para 204 (hereinafter the Cork Report)

[12] See for example the discussion on the communitarian theory below in Sec 2.2.2.1

[13] Unless the business is economically distressed where its assets will have more value in a break-up basis than they would if they are kept together. See: Rebecca Parry and Yingxiang Long, 'China's Enterprise Bankruptcy Law, Building an Infrastructure towards a Market-based Approach' (2020) 20 J Corp Law Stud 157, 160

[14] Finch and Milman (n 4) 201-02; Parry, 'Introduction' (n 9) 2

[15] Rebecca Parry and Haizheng Zhang, 'China's New Corporate Rescue Laws: Perspectives and Principles' (2008) 8 J Corp Law Stud 113, 125; David Burdette, Rebecca Parry and Adrian Walters, 'The Global Financial Crisis and the Call for Reform of Insolvency Law Systems' (2010) 4 Insolvency & Restructuring Int'l 13, 13

that attempts to create and promote more animated market economies require insolvency laws to facilitate rescue mechanisms for distressed but viable businesses as an alternative to liquidation.[16]

The global financial crises of 1997 and 2007-2008 indicated that the global financial architecture could be vulnerable to the regional and global collapse and highlighted the importance of insolvency law reform for business activities in national states in developed and developing economies alike.[17] The focus on reforming domestic insolvency systems has increased and various international institutions were compelled to view financial stability on a global scale.[18] The period of 1998 to 2005 witnessed intensive international reform efforts to develop international benchmarks for insolvency systems in an attempt to develop domestic insolvency laws. In response to the Asian Financial Crisis of 1997, the international community, through the G-22,[19] encouraged the international financial institutions and international organisations to push for reforming domestic corporate insolvency systems and develop global models and guidelines for efficient and effective insolvency systems as a first step towards

[16] Parry, 'Introduction' (n 9) 1; Nathalie Martin, 'The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation' (2005) 28 BC Int'l & Comp L Rev 1, 76

[17] Burdette, Parry and Walters (n 15) 13; Elena Cirmizi, Leora Klapper and Mahesh Uttamchandani, 'The Challenges of Bankruptcy Reform' (2012) 27 World Bank Research Observer 185, 199-200; Jenny Clift, 'Choice of Law and the UNCITRAL Harmonization Process' (2014) 9 Brook J Corp Fin & Com L 29, 44

[18] Susan Block-Lieb and Terence Halliday, *Global Lawmakers: International Organizations in the Crafting of World Markets* (CUP 2017) 121-22

[19] The G-22 comprised of finance ministries and central bank governors of 22 countries shortly after the Asian crisis and issued an expansive report on the need to enhance the global financial architecture. See: 'Report of the Working Group on International Financial Crises' (5 Oct 1998) <www.imf.org/external/np/g22/ifcrep.pdf> (hereinafter G-22 Report) accessed 29 Jun 2018. The G-22 charged the international financial institutions and international organisations with the task of examining how to increase the stability of the international financial architecture and to encourage the effective functioning of global capital markets in order to prevent national and regional financial downfall. See: Terence Halliday, 'Legal Yardsticks: International Financial Institutions as Diagnosticians and Designers of the Laws of Nations' [2011] Center on Law and Globalization Research Paper no 11-08, at 5 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1928829> accessed 29 Jun 2018

preventing systemic financial crises.[20] The G-22 constantly stressed the importance of effective insolvency and debtor-creditor regimes as "crisis prevention, crisis mitigation and crisis resolution".[21]

International organisations such as the World Bank (WB), International Monetary Fund (IMF) and United Nations Commission on International Trade Law (UNCITRAL) have considered reforming local insolvency laws towards more effective corporate or business rescue[22] objectives as an important part of strengthened international financial architecture. Particular attention was paid to the reform of national corporate insolvency systems of developing and transitional countries.[23] The international organisations have now become advocates of domestic law reforms in the field of insolvency and believe that an effective insolvency system can provide national financial systems with a safety net to minimise their vulnerability to business failure during global financial crises as well as to provide assurance to investors as to what will happen in the event of insolvency.[24]

Several initiatives were created for that purpose. For example, the Asian Development Bank's Policy Reform, the European Bank for Reconstruction and Development's (EBRD) legal transition surveys, the IMF's report of Orderly and Effective Insolvency Procedures 1999, and the WB's Principles and Guidelines for Effective Insolvency and Creditor Rights Systems in 1999. These guidelines were further complemented by the issuance of the UNCITRAL Legislative Guide on

[20] Block-Lieb and Halliday (n 18) 121
[21] The G-22 Report, 14-15. Also see: Terence Halliday and Bruce Carruthers, 'The Recursivity of Law: Global Norm Making and National Lawmaking in the Globalization of Corporate Insolvency Regimes' (2007) 112 AJS 1135, 1157
[22] Corporate rescue is a term used to refer to the situation where the distressed company as an entity emerges from insolvency intact, while business rescue refers to the situation where only the business of the company or part of it is rescued. For details see below Sec 1.6.3
[23] Parry, 'Introduction' (n 9) 6
[24] Halliday and Carruthers (n 21) 1137

Insolvency Law (hereinafter 'the Legislative Guide')[25] in 2004.[26] These international initiatives were combined in a unified set of guidelines to ensure complementarity and collaboration in practice and avoid duplication.[27]

It should be noted that the insolvency benchmarks, especially those provided in the UNCITRAL Legislative Guide, reflect that fact that national insolvency laws and policies differ from one jurisdiction to another as a one-size-fits-all approach is impossible to achieve.[28] The UNCITRAL took consideration of the difference in cultures and unique circumstances of every country in its Legislative Guide and admitted that it is not designed to provide a single set of model solutions to address the issues that are central to insolvency law. Rather, its Legislative Guide is designed to assist domestic legislatures to evaluate different approaches available and decide which one is the most suitable for their domestic contexts.[29] As such, national states would benefit from those initiatives as they have the flexibility to consider their unique circumstances and cultures. Besides, the praise of such international benchmarks is that they are intended to promote economic efficiency, help to improve transition to market economy, promote economic stability and raise the living standards of community.[30]

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[25] UNCITRAL, *Legislative Guide on Insolvency Law* (United Nations 2005)

[26] Parry and Zhang, 'China's New Corporate Rescue Laws' (n 15) 125; Gerard McCormack, 'Criticising the Quest for Global Insolvency Standards' (2018) 8 KJLL 1, 4

[27] In 2005, the World Bank posted on its website a revised document of its *Principles for Effective Insolvency and Creditor Rights Systems* and explained on the site that the Insolvency and Creditor Rights Standards (ICR Standards) are based on a combination of the World Bank *Principles for Effective Insolvency and Creditor Rights Systems* and the UNCITRAL *Legislative Guide* which together represent the international consensus on best practices for evaluating and strengthening national insolvency and creditor rights systems. See: World Bank brief on *Principles for Effective Insolvency and Creditor/Debtor Regimes*, (*World Bank*, 19 Nov 2015) <www.worldbank.org/en/topic/financialsector/brief/the-world-bank-principles-for-effective-insolvency-and-creditor-rights> accessed 18 Jul 2018. Also see: Block-Lieb and Halliday (n 18) 365-66

[28] McCormack, 'Criticising the Quest for Global Insolvency Standards' (n 26) 28

[29] UNCITRAL Legislative Guide, Introduction, para 3 and Part One, Chap I, para 17

[30] McCormack, 'Criticising the Quest for Global Insolvency Standards' (n 26) 1

1.2. Background to the Libyan Context

Historically, the Libyan insolvency law has been implemented throughout three different periods since independence in 1951 up until the time being. Each of these periods has had distinct economic, political and social features that noticeably influenced the application and the function of insolvency law. Therefore, a general background regarding the Libyan context will be outlined below.

1.2.1. Insolvency Law after Independence (1951-1969)

The first insolvency law in Libya was enacted in 1953 when the country introduced its legal system after its independence in 1951.[31] The Libyan legal system, in particular the insolvency framework, is traceable to the colonial legacy of Italy from 1911 to 1943 during which time Italy transplanted its legal system in the country including the Commercial Code (in which the insolvency law was included) displacing the Ottoman legal Islamic system (known as the *Majalla*).[32] The enacted Libyan legal system of 1953, although slightly modelled on compliance with Islamic Law principles, preserved much of the influence of the Italian Codes.[33]

It should be noted that the economy of Libya when it enacted its legal system was in an extremely deteriorated condition.[34] The country was even in urgent need for foreign

[31] Libya gained independence in 24 Dec 1951 by the resolution No 289 of 21 Nov 1949 of the General Assembly of the United Nations.

[32] Edward Evans-Pritchard, *The Sanusi of Cyrenaica* (2ed edn, CUP 1954) 203

[33] With the exception of the Civil Code of 1953 which was influenced by the old Egyptian Civil Code of 1948, which was in turn influenced by the French Civil Code. See: Waniss Otman and Erling Karlberg, *The Libyan Economy: Economic Diversification and International Repositioning* (Springer 2007) 63. Also see: International Legal Assistance Consortium, 'Rule of Law Assessment Report: Libya 2013' [2013] at 18 <www.ilacnet.org/blog/2013/05/09/ilac-assessment-report-libya-2013/> accessed 23 Oct 2017

[34] A chief economist and the UN envoy to Libya in 1950, Benjamin Higgins, described the economic situation of Libya after independence writing that: "… the hard fact that the whole Libyan economy operates at a deficit; the country does not produce enough to maintain even its present low standard of living". Benjamin Higgins, *The Economic and Social Development of Libya* (United Nations 1953) 3

aid.[35] Most Libyans were very poor and could hardly live at a subsistence standard of life and they were even unqualified to run the newly independent country. There was an almost total lack of credit and banking facility services. The capital formation was below a level necessary to run the economy.[36]

The legal system and laws, particularly the Commercial Code and the insolvency regime, were considered more complex than the simple lifestyle of the citizens at the time and therefore they were absolutely meaningless to the locals as those laws had no tangible influence on the real life of people and the society where custom, as a natural law, regulated all their aspects of life.[37] Local leaders in the country, through leaders of Tripolitania province, had previously expressed their rejection of the Italian legal system when Italy enacted its laws during its colony of Libya because those laws would contradict the Islamic Law principles on which the society was founded.[38] In addition, the country was even not technically ready to apply its enacted legal system. And in order to apply this newly enacted system, the government had to hire legal experts from abroad to put such a system into effect because of the lack of lawyers amongst Libyan citizens.[39] Therefore, courts in Libya depended on foreign experts and judges for a long time from neighbouring countries such as Tunisia and Egypt and even from European

[35] On 15 Aug 1950, the UN Economic and Social Council issued a resolution declaring that Libya was still in urgent need of aid to help improve its economy. Shukri Ghanem, 'The Libyan Economy before independence' in E Joffe and Keith McLachlan (eds), *Social and Economic Development of Libya* (ME&NASP 1982) 156-58

[36] Ibid 150-58. Also see: World Bank, 'The Economic Development of Libya' [1960] Johns Hopkins Press, at page 27 <http://documents.worldbank.org/curated/en/573751468757209997/The-economic-development-of-Libya> (hereinafter World Bank, Libya 1960) accessed 15 Sepr 2017; Adrian Pelt, *Libyan Independence and the United Nations: A Case of Planned Decolonization* (YUP 1970) 395

[37] Bleuchot Hervé, 'The Green Book: Its Context and Meaning' in John Anthony Allan (ed), *Libya Since Independence: Economic and Political Development* (Routledge 2014) 148; Nathan Brown, *The Rule of Law in the Arab World: Courts in Egypt and the Gulf* (CUP 2001) 20, 224-25

[38] Pelt (n 36) 18-19

[39] Ibid 576; Gamal Badr, 'New Egyptian Civil Code and the Unification of the Laws of Arab Countries' (1955) 30 Tul L Rev 299, 303-04

countries such as Italy and the United Kingdom.[40] All of this illustrates the degree of inconsistency of those laws to the situation of Libya at the time as they did not stem from the domestic circumstances and culture.

The adoption of the Italian laws may be justified by the desire of the country to energise its devastated economy by maintaining a familiar legal system to the Italian businesses and investors[41] which still remained in operation in the country,[42] indeed dominating the investment and business activities in the economy.[43] In Tripolitania province, for example, large and prosperous Italian farming businesses that remained in operation, contributed significantly to the economic life in the province and to Libya's exports in general. Moreover, the industrial sector, which alone contributed one-tenth to the output of the country,[44] was almost entirely owned and managed by Italian investors. Further, many other economic activities, such as medical services, management of hotels, commerce and so on, were taken over by Italian investors. The skills and the experience, professionals and workers that the Italian settlers offered to help run the Libyan economy were considerably valuable assets to the national economy at that time.[45]

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[40] See: International Legal Assistance Consortium (n 33) 18; Marwan Al-Tashani, Abdul Fattah Ibrahim and Tareq Al-Wesh, 'Libya' in Euro-Mediterranean Human Rights Network, *The Reform of Judiciaries in the Wake of Arab Spring* (Sida & Danida 2012) 73; Pelt (n 36) 576; Badr (n 39) 303-04

[41] Besides, the country was driven by the widespread trend in the mid-twentieth century amongst most of the Arab nations at the time when they modelled their legal systems on the European-inspired legal codes, especially by the French model of law (the Commercial and Civil Codes of 1804 and 1807) and Libya had no choice but to follow suit. See: Otman and Karlberg (n 33) 63

[42] The United Nations in its resolution of 15 Dec 1950 No 388(V) Economic and Financial Provisions Relating to Libya, required that all property, rights and interests of Italian, including natural or juridical persons, to be protected and respected. Art VI(1) of the resolution stated that: "The property, rights and interests of Italian nationals, including Italian juridical persons, in Libya, shall, provided they have been lawfully acquired, be respected. They shall not be treated less favourably than the property, rights and interests of other foreign nationals, including foreign juridical persons."

[43] The government after independence also kept other Italian pre-existing legislations in effect to serve that goal including the law (Royal Decree no 1207 of 1921) regarding land tenure, a legislation regarding fish manufacturing and preserved vegetables. For more details see: World Bank, Libya 1960. 131 and 459

[44] Ibid 33

[45] Ibid 22 and 191

Maintaining and honouring the Italian investment and businesses in Libya was more than necessary to the national economy. The UN Commissioner to Libya, Adrian Pelt (1949-1952),[46] forcefully recommended the Libyan government to persuade and incentivise the Italian settlers and investors to stay in the country because encouraging such investment and businesses would have the potential to contribute to the economic development of the country.[47] It can be concluded therefore that the decision of the Government in Libya at that time to model its commercial code, and insolvency law in particular, on the colonial legacy of law mainly was to serve the interests of foreign demand.

It should be stressed, however, that those imported legal codes to Libya were incompatible with pre-existing principles of the society and they were not responsive to its demand and culture. Rather, they were transplanted from a country with different circumstances and realities in various aspects. As pointed out, for laws to be effectively functioning as expected, the population and participants, such as law enforcing agencies and institutions and other legal intermediaries responsible for enforcing and developing the formal legal principles, should be familiarised with the new adopted legal principles.[48] Effective transplantation could be expected only when the borrowing country adopts the law in a way that is well responsive to its domestic conditions and realities. Not only that, but even law enforcement institutions can be more effective when the enacted law systems are broadly compatible with the pre-existing legal orders and principles or when they are adopted to match local demands and realities.[49] All of this, however, was lacking resulting in the laws being non-functional or less effective

[46] See: United Nations Archives, 'United Nations Commissioner in Libya (1949-1952)' <https://search.archives.un.org/united-nations-commissioner-in-libya-1949-1952>

[47] LaVerle Berry, 'Historical Setting' in Helen Metz (ed), *Libya: A Country Study* (4th edn, Library of Congress 1989) 36

[48] Daniel Berkowitz, Katharina Pistor and Jean-Francois Richard, 'Economic Development, Legality, and the Transplant Effect' (2003) 47 Eur Econ Rev 165, 167

[49] Ibid 174

than they were meant to be.[50] As will be seen in the following two sections, this problem of legal mismatch was not resolved and continued to apply throughout the whole periods of the economic and social development in the country.

1.2.2. Insolvency Law under the Socialist Economy (from 1969 to Late 1980s)

The situation in Libya changed dramatically when the country adopted the socialist economic system in 1969.[51] The Government in the Constitutional Proclamation of 1969[52] clearly expressed that the State would implement a socialist system as an ideology to govern the social and economic life in the country.[53] This newly adopted political system had a direct impact on the private sector and rights of individuals as it encouraged equity in distribution using public rather than private ownership to be the engine for the economic life in the country. The aim of the State at the time was to achieve socio-economic stability and to improve the living standards among Libyan citizens by eliminating inequality and differences between social classes.[54]

The State believed that such social objectives cannot be attained unless private ownership and private businesses were restricted to be functioning alone or dominating business activities in the country.[55] As a result of this change and to effectuate the country's full control of its economy, the State depended heavily in achieving its objectives on the operation of the State Owned Enterprises (SOEs), monopolisation and

[50] The author could obtain only one insolvency case that was dealt with by Musrata First Instance Court in 1957. See: Musrata First Instance Court, Initial Commercial Chamber, Civil Case No 25/3J. Decision issued on 12 Feb 1957 (Personal communications)
[51] Toyin Falola, Jason Morgan and Bukola Oyeniyi, *Culture and Customs of Libya* (Abc-clio 2012) 112
[52] The Constitutional Proclamation of Libya of 1969 (promulgated in 11 Dec 1969)
[53] The Constitutional Proclamation of Libya of 1969 in Articles 6, 7 and 8 stated that the aim of the socialist State was to achieve social justice while the public ownership was the basis of the economic and social development in the country.
[54] Otman and Karlberg (n 33) 64
[55] Ibid 64; Kirsten Doty, 'Economic Legal Reforms as a Necessary Means for Eastern European Transition into the Twenty-First Century' (1999) 33 Int'l Law 189, 189

nationalisation.[56] During the socialist economy in the country, the insolvency regime was practically irrelevant since businesses, particularly the SOEs, received full financial support in the form of bailouts from the government when there was a problem of distress. This is because if such businesses were allowed to fail, the State would not be able to accomplish its social and economic objectives when the country depended mostly on SOEs as the sole or the primary participants in the economy.[57]

1.2.3. Insolvency Law under the Transition Economy (from Late 1980s up to date)

Later on and because of the economic decline that Libya had witnessed in the 1980s, the Government adopted a strategy to transition to a greater role for the market in the Libyan economy and society. This economic transition required legal reform to promote the process. Between late 1980s and the early 1990s, the private sector received attention by the Government and some reforms were witnessed to encourage the private sector to take an active role in promoting economic growth.[58] This resulted in the introduction of the privatisation programme in the country supported by the introduction of the Doing Business Activities Act of 1992.[59] To further progress the economic reform process in the country, important legislation to attract foreign investment and to increase credit and capital inflows was also introduced (Encouraging Foreign Investment Act 1997).[60] The aim of the reform was to promote the economic

[56] Several sectors and industries, including the hydrocarbon industry, insurance, communication and transportation sectors and the banking sector, were affected by the nationalisation policy of the State. For details see: Otman and Karlberg (n 33) 217

[57] Dennis Hui, 'The State and the Development of Corporate Insolvency Law in China and Russia: A Comparative Perspective' (2013) 2 Asian Education and Development Studies 212, 212-15; Michael Kim, 'When Nonuse is Useful: Bankruptcy Law in Post-Communist Central and Eastern Europe' (1996) 65 Fordham L Rev 1043, 1044 and 1068

[58] Hervé (n 37) 144; Falola, Morgan and Oyeniyi (n 51) 112

[59] Doing Business Activities Act (no 9/1992) introduced in 02 Sep 1992

[60] Encouraging Foreign Investment Act 1997. This legislation was reformed and replaced later by the law no 7 of 2003 (Encouraging Foreign Investment Act 2003) (EFI 2003)

and social development for the citizens and to enhance the competitiveness of the national market of Libya in general.[61]

During this period, however, the State and the public sector still dominated the economy at a significant degree and no genuine progress was seen in the privatisation programme.[62] This was attributed to the fear that the privatisation of SOEs would affect the working class and would leave employees at a socially disadvantageous situation. Therefore, the plan of the State was to encourage the workers and employees of SOEs, especially small and medium-sized, to apply for a privatisation scheme so that the ownership of the enterprises would be transferred to them. This scheme was not considered a genuine change towards the privatisation and it did not even succeed as a market-driven reform. This is because such transferred businesses operated under the influence of the State and they could also be bailed out when they became insolvent.[63]

In an important report, the WB acknowledged that the legal system governing business activities including the insolvency regime was underdeveloped and therefore recommended the Libya government to make reforms so as to ensure consistency with the market-oriented economy. The judiciary system was also under examination since it lacked the capacity to resolve business disputes.[64] The insolvency law of Libya accommodated the outdated features of the insolvency systems that were available in the 19th century. The design of the regime focused mainly on liquidation and this

[61] Ibid, Art 1

[62] Dirk Vandewalle, 'The Libyan Jamahiriyya since 1969' in Dirk Vandewalle (ed), *Qadhafi's Libya, 1969-1994* (St Martin's Press 1995) 38

[63] François Burgat, 'Qadhafi's Ideological Framework' in Dirk Vandewalle (ed), *Qadhafi's Libya; 1969-1994* (St Martin's Press 1995) 55

[64] World Bank, 'Libya - Country Economic Report' [2006] World Bank, at page 60 <http://documents.worldbank.org/curated/en/918691468053103808/pdf/30295.pdf> accessed 10 Dec 2018 (hereinafter World Bank, Libya Economic Report 2006)

process was complicated and extremely time-consuming.[65] It is argued that both the inefficiency of the insolvency law and of the institutions in the country have been the reason behind investors and creditors' frustration in enforcing their claims.[66]

Indeed, several legal committees were established by the Government to reconsider and reform the legal system in the country for that end. This was followed by the introduction of the legal reform in 2010 which was the widest reform process seen in the country since the gaining of independence in 1951. The aim was to keep up with the economic reform process and to establish an attractive business and investment environment. This indicates clearly how policymakers in Libya became aware of the importance of attracting foreign investment to promote national economic growth and the welfare of citizens.[67]

To achieve the above objectives, the Government in 2010 introduced, for example, the Law of Stock Market[68] and the Promotion of Investment Act 2010 (PIA 2010).[69] The latter legislation was very important as it was designed in compliance with the government's intention of enhancing economic growth and competitiveness of the national economy.[70] The 2010 reform resulted also in the introduction of the Code of Employment Relationships 2010 (CERs 2010).[71] Moreover, the lawmakers reformed the laws regarding the secured transactions system by reforming the Commercial Code

[65] For more details see: Mahesh Uttamchandani, 'No Way Out: The Lack of Efficient Insolvency Regimes in the MENA Region' (2011) 1 World Bank Policy Research Working Paper No 5609, at 1 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1794914> accessed 4 Jan 2019

[66] For more details see: Aburawi Gabgub, 'Analysis of Non-performing Loans in the Libyan State-Owned Commercial Banks: Perception Analysis of the Reasons and Potential Methods for Treatment' (PhD thesis, Durham University 2009) 205-24

[67] Mustafa El Hamoudi and Nagmi Aimer, 'The Impact of Foreign Direct Investment on Economic Growth in Libya' (2017) 2 IJELS 144, 147

[68] The Law of Stock Market (no 11 of 2010) promulgated in 28 Jan 2010, which superseded the decree regarding the Establishment of the Libyan Stock Market (no134 of 2006) promulgated in the National Gazette in 03 Jun 2006

[69] Promotion of Investment Act 2010, promulgated in 28 Jan 2010, which replaced the EFI 2003.

[70] This intention was clearly stated in Art 3 of PIA 2010

[71] The Code of Employment Relationships 2010 (no 12 of 2010) promulgated in the National Gazette in 27 Jan 2010 (hereinafter CERs 2010)

of 1953 which led to the introduction the Code of Commercial Activity 2010 (CCA 2010)[72] and also by introducing the Financial Lease Act 2010 (FLA 2010).[73] This reform, according to the Deputy Minister of Industry and Trade of Libya in 2011, commenting on the enactment of FLA 2010, attempts to improve standards of secured transactions in order to create an attractive business environment, by improving the credit-oriented environment and facilitating access to credit, and to enhance the social and economic development in the country.[74]

The insolvency system was not included in the reform agenda in 2010 although it was highly demanded to promote the transition of economic reform[75] and to deal with the series of insolvencies that occurred in the country caused by the economic depression of the late 1980s.[76] The deeply-rooted social situation of the country may have had its impact on the options of the government in choosing the type of insolvency system that would suit its domestic situation. For instance, the unemployment issue in Libya was one of the major political barriers that faced the government that was first tasked with privatisation of the economy in 2003. This was because the privatisation and its immediate consequences on employment go against the principles of the unique governance system of Libya as "the State of the Masses".[77] In 2007, the government in order to proceed with the privatisation programme established a programme to liquidate

[72] The Code of Commercial Activity (no 23 of 2010) promulgated in 28 Jan 2010 (hereinafter CCA 2010)
[73] The Financial Lease Act (no 15 of 2010) promulgated in 28 Jan 2010 (hereinafter FLA 2010). This Act is the first legislation regulating financial leases in the country.
[74] 'Financial Lease Act 2010 will Make a Shift in Small and Medium Sized Businesses' (*Libya2020*, 24 Jan 2011) <https://libya2020.wordpress.com/2011/01/24/> accessed 25 Jan 2018
[75] Experts and officials in Libya, such as Farhat bin Gadara the former Governor of the Central Bank of Libya, called for insolvency reform so as to contribute to enhance the national economy and encourage investors doing business in the country. See: Farhat bin Gadara, 'Improving and Restructuring Commercial Banks in Libya' (Central Bank of Libya) at page 12 <www.cbl.gov.ly/pdf/09X3V96mnc4gaQ3kSDK.pdf> accessed 17 May 2017
[76] Alafi Abdourhim, Abouazoum Alafi and Erik de Bruijn, 'A Change in the Libyan Economy: Towards a More Market-Oriented Economy' (Management of Change Conference, University of Twente, Lüneburg, Nov 2009) at 6-7 <http://purl.utwente.nl/publications/76014;> accessed 25 Nov 2017
[77] Alison Pargeter, 'Libya: Reforming the Impossible?' (2006) 33 Review of African Political Economy 219, 223 and 231

the insolvent nonviable SOEs. But because the government was reluctant to expose its insolvent enterprises to the pure insolvency and market rules due to the fear of social instability of potential unemployment, it adopted a compulsory programme, called the Liquidation of State-Owned Enterprises, to deal with the exit of the insolvent SOEs from the market. By this programme, the government stressed that the laid-off State employees because of the liquidation programme must be offered an early retirement pension scheme or re-employment in other State departments to absorb any potential unemployment.[78]

Such treatment is inappropriate partly because of the lack of efficient insolvency and rescue laws and institutions that are responsible to apply such laws in the country. Therefore, reform in this field has become more than necessary and there is a need to reinvigorate the thinking that is influencing the Libyan insolvency regime for the country to proceed with its economic transition policy towards the market economy in an appropriate manner. This is important because an efficient insolvency regime is crucial to promote business and create an inviting investment environment in the country. Also, an efficient and effective insolvency law with sound rescue mechanisms can help mitigate the social instability witnessed in the country after the Arab Spring events in 2011.[79]

But the lack of such insolvency and rescue regimes would be detrimental to the achievement of such objectives because it can affect the decisions regarding investment in the country and it would also slow or frustrate the transitional process of the economy. Moreover, particular attention should be regarded to the development of the

[78] Resolution of the Prime Ministry Council (no 104 of 2007) regarding Liquidation of State-owned Companies Fund, Art 3(z) (promulgated in 28 Feb 2007)
[79] Elena Lanchovichina, Lili Mottaghi and Shantayanan Devarajan, *Inequality, Uprisings, and Conflict in the Arab World* (World Bank 2015)

rescue system because functional rescue systems have the potential to mitigate the social consequences caused by insolvency. It is unfortunate that the current Libyan insolvency framework has been static since its first introduction in 1953 and as a result has long been unable to meet the needs for promoting the business environment in the country. According to the WB *Doing Business* 2018 report, Libya ranks 185th out of 190 economies on their ease of doing business with the insolvency law (having considered various measures ranging from the average time the procedures take; the average cost of the procedures on the insolvency estate; the average recovery rate to the creditors), Libya ranks 168th worldwide for resolving insolvency cases.[80] Policymakers and reform committees in Libya can benefit from such valuable evaluations offered by such a report to indicate the extent to which the current insolvency laws and institutions are sufficiently adequate to support or discourage the investment climate in the country and therefore they can respond accordingly.

Libya may have had no choice in the past but to adopt colonial legal rules, but to retain the same rules in force today though with different circumstances voluntarily may be regarded as total failure. Reforming the insolvency system in Libya has become crucial especially because credit is now expected to be used more extensively in the market after the reform of the secured transactions system. Accordingly, there is a need to structure the flow of credit and to deal with the financial and economic distress that inevitably occurs as a result of promoting credit in the market.[81] This fact is acknowledged worldwide. For example, the Cork Report in the UK stated that where a

[80] World Bank, *Doing Business 2018: Reforming to Create Jobs* (World Bank 2018) 174
[81] Martin, 'The Role of History' (n 16) 5

credit system is encouraged, the adoption of an efficient insolvency law is correlatively required to deal with potential causalities that may be caused by the flow of credit.[82]

It is pointed that an effective and efficient insolvency law is necessary to mitigate the impact of business failure and to limit its duration.[83] Further, the social implications of business failure must be considered when designing an adequate business rescue regime that goes beyond the focus on a pure economic objective that primarily promotes wealth maximisation for creditors as the primary goal of insolvency law. As the situation has changed in the country, keeping the old insolvency system in operation would not serve the national needs and would probably extend the problem of legal mis-transplantation previously mentioned. As the government recently established several committees to review the existing laws and legislations,[84] including the CCA 2010 in which the insolvency law is embodied, this research is timely and will offer to policymakers and reform committees in Libya a valuable and comprehensive evaluation for reforming the existing insolvency and restructuring laws. The research will be aware of all circumstances underpinning the country as well as insights from theories of insolvency law and international benchmarks.

1.3. Research Questions

As the research seeks to examine the adequacy of the insolvency and rescue system for dealing with business failure, it seeks to answer the following main question:

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[82] The Cork Report, para 198(a)

[83] Rebecca Parry and Haizheng Zhang, 'Introduction' in Rebecca Parry, Yongqian Xu and Haizheng Zhang (eds), *China's New Enterprise Bankruptcy Law: Context, Interpretation and Application* (Ashgate 2013) 15

[84] Several committees were established in Libya to review and reform the existing laws. As recent as 2015, a committee was established by resolution (no 25 of 2015) issued by the President of General National Congress to review the laws and to amend legislations in accordance to principles of Islamic Sharia'.

- How should the insolvency law of Libya be reformed taking into account the current economic and social circumstances in the country?

This question is followed up by sub-questions, drawing upon insolvency theories and international benchmarks:

1. How may theories of insolvency be regarded from a Libyan perspective so as to inform decisions regarding the role that should be played by the insolvency law in Libya?
2. In light of theoretical perspectives, what approach should be taken in insolvency regarding affected stakeholder interests, in light of the social and economic circumstances of Libya?
3. Do the insolvency and rescue laws, supported by the existing institutions, in Libya presently promote desirable objectives, as defined by the theories and international benchmarks of insolvency?
4. What is the relationship between the insolvency law and secured transactions system in Libya in relation to the objectives that should be protected by the insolvency law?
5. Drawing upon the evaluation of both theory and the international benchmarks, how can the Libyan system and institutions best achieve the protection of the affected interests and the promotion of the objectives identified as important for the Libyan context?

In addressing the research questions, the thesis will, at a macro-level, use theories of insolvency law and, at a meso-level, the international guidelines as embodied in the UNCITRAL Legislative Guide to evaluate, at a micro-level, the Libyan systems of insolvency and secured transactions. This represents an original approach to insolvency reform in Libya, geared towards Libya's social and economic circumstances and not merely relying on the transplantation of approaches from mature insolvency systems. The combination of these evaluative tools will contribute to the thesis, and thus to

human knowledge, in establishing whether the Libyan insolvency system is compliant or noncompliant with the insolvency law theory and international guidelines. This thesis will also aim to establish for the first time whether or not the current Libyan legal system is coherent in itself.[85] Further, the thesis will set out whether or not the Libyan system is suitable for use within the Libyan society. This will therefore be the engine and bridgehead from which the research will progress.

1.4. Research Objectives

This research evaluates whether the current insolvency law in Libya is adequate to support economic development and social stability in the country. The thesis explores the theories of insolvency law that are widely used to evaluate the objectives of national insolvency laws worldwide. The examination of the insolvency law theories is important to inform whether the insolvency law implements desirable and achievable objectives. The thesis also evaluates the international benchmarks of insolvency law, with a particular reference to the UNCITRAL Legislative Guide, to consider the alternative mechanisms that are available to deal with the insolvency of businesses as these benchmarks provide multiple alternatives and choices for countries to establish an effective and efficient framework for an insolvency system that best works for each countries' circumstances. The thesis, however, establishes that the conduct of both the insolvency theories and the international benchmarks is closely influenced by the desires and circumstances underpinning the national community. In light of both insolvency theories and the international benchmarks, the research aims to establish objectives which are:

[85] It will be established in this thesis that there is an ideological divide shaping the Libyan legal system across different areas of the commercial law, given the existence of which the insolvency and rescue systems will be unable to deliver adequate resolutions to business failure.

- To determine the purposes that the insolvency law of Libya should serve.
- To define how these purposes can best be pursued through insolvency law reform.

1.5. Research Method

This research employs principally a doctrinal research method which is a library-based approach. It conducts a comprehensive review of primary sources, authoritative international law sources and academic commentary as secondary sources on the subject of insolvency law. Primary sources include laws and regulations related to the insolvency regime in Libya (with some reference to law of other jurisdictions when appropriate). The research also examines laws and legislations related to the secured transactions system that are scattered in separate codes and legislations in Libya (such as the CCA 2010, the Civil Code of 1953 and the FLA 2010). Authoritative international 'grey law' sources consist of reports from international organisations such as the UNCITRAL, the World Bank and the IMF. Secondary sources consist of monographs, chapters in edited books and journal articles.[86] The resources are collected through the electronic database available via Nottingham Trent University (NTU) such as HeinOnline, LexisNexis and Westlaw. Sources are also collected in hard copies available in or provided by NTU library and through personal communications.

As a doctrinal research, this thesis promises to be analytical as well as synthetic.[87] It promises to offer a comprehensive and critical analysis of the insolvency and rescue system in Libya in light of the international benchmarks on insolvency law and

[86] Mike McConville and Wing Chui, 'Introduction and Overview' in Mike McConville and Wing Chui (eds), *Research Methods for Law* (2ed edn, EUP 2017) 3-4

[87] Terry Hutchinson, 'Doctrinal Research: Researching the Jury' in Dawn Watkins and Mandy Burton (eds), *Research Methods in Law* (Routledge 2013) 9-12. Doctrine has been defined as "a synthesis of various rules, principles, norms, interpretive guidelines and values. It explains, makes coherent or justifies a segment of the law as part of a larger system of law". Trischa Mann (ed), *Australian Law Dictionary* (OUP 2010) 197. "In this method, the essential features of the legislation and case law are examined critically and then all the relevant elements are combined or synthesised to establish an arguably correct and complete statement of the law on the matter in hand". Hutchinson, ibid 9-10

academic analysis of insolvency system with particular reference to the UNCITRAL Legislative Guide to evaluate the adequacy of the insolvency law of the country. It also promises to synthesise the objectives of insolvency law as identified in both theoretical approaches of insolvency law and the international benchmarks and guidelines within the national context in order to make a coherent examination of what is desired to establish a functional legal system of insolvency as part of a larger legal system in the country.

While this research does not undertake a comparative study, reference to experiences of other jurisdictions (such as the UK, USA and others) will be made with the aim of highlighting how objectives of insolvency law are implemented to fit the unique domestic situation of a particular jurisdiction. It should be stressed, however, that reference to other jurisdictions' experiences in adopting functional insolvency and rescue systems is not intended to be used for comparative purposes. Rather, they are used to evaluate lessons as to how insolvency law objectives are implemented to suit unique domestic situations of a particular jurisdiction. This is useful for the study for two main reasons. Firstly, it confirms that national insolvency laws differ from each other as they might have different objectives and different public policy imperatives because the level of development and circumstances of each country are different. This is to emphasise that although key objectives of efficient and effective insolvency law may be agreed worldwide, especially in developed countries, the implementation of those objectives may differ in one jurisdiction to another. Secondly, this will demonstrate how various jurisdictions around the world implement different responses to a particular issue. While in some countries there is a well developed professional and judicial force and a system of institutions which are available for the implementation of an insolvency reform, in other countries the establishment of these institutions must

form an aspect of any such reform process. Insolvency law reform in Libya should, therefore, take this fact into consideration in order to come up with an appropriate framework that is suitable to the social, economic, legal and cultural realities unique to the country. In addition to this, borrowing fixed legal regimes from other nations with different contexts would in most cases result in undesirable outcomes.[88]

1.6. Key Terms and Concepts

1.6.1. Stakeholder Interests

Stakeholders are usually classified into narrow and wider categories. The first category group of stakeholder refers to those which are vital of the business to exist and or which have formal contractual relationship with the business. This includes owners or shareholders, the employees, creditors, customers and suppliers. The second group is as wide as to include those stakeholders with social and political interests in the business. This includes the local communities and governments.[89] In this thesis, the term 'stakeholder' will refer to the first category of stakeholders[90] as the following;

- **Creditors**

Creditors are those parties who extend credit to the debtor either by a loan agreement (usually banks) or by providing goods or services on credit (trade creditors/ suppliers). Creditors are either secured or unsecured. Secured creditors are those who have a legal right against the debtor's property over which they have a security (proprietary rights). Unsecured creditors are those who have no legal rights against the debtor's property but

[88] Thomas Waelde and James Gunderson, 'Legislative Reform in Transition Economies: Western Transplants—A Short-Cut to Social Market Economy Status?' (1994) 43 Int'l & Comp LQ 347, 369; Parry, 'Introduction' (n 9) 18

[89] Silvia Ayuso and others, 'Maximizing Stakeholders' Interests: An Empirical Analysis of the Stakeholder Approach to Corporate Governance' (2014) 53 Business & Society 414, 419-20

[90] As will be discussed later, this group of stakeholders contributes to the firm-specific investment. See: Lynn LoPucki, 'A Team Production Theory of Bankruptcy Reorganization' (2004) 57 Vand L Rev 741

they have only a legal right against the debtor (personal rights). Therefore, they receive no payment unless all higher ranking creditors are paid in full.[91] In addition to the secured creditors, it must be added in the Libyan context there is a class of unsecured creditors who are given privileged rights[92] against the debtors' assets. These privileges include privileges of judicial expenditures, the privilege of unpaid wages for the employees, and the privilege of taxes owed to the public treasury (the Government), the privilege of expenses spent for maintaining the debtor's movables. The privilege system, as it operates in Libya, includes some more unusual privileges such as the privilege for supplies of agricultural businesses, the privilege of the lessor of land for unpaid rent, the privilege of the vendor for the purchase price of goods, the privilege of contracts and architects, and it may therefore be regarded as unusually wide.[93]

- **Investors**

The term 'investors' includes people who, by their input of capital, have investment in any business regardless of the legal form it takes.[94] This includes shareholders in companies and partners in partnerships. Shareholders and partners under the Libyan law are those who enter into agreement to share profit from the business they make,[95] and they only have the residual claims in liquidation.[96] Therefore, investors categorically are distinguished from creditors.

[91] CCA 2010, Art 1120(4)
[92] It is worth noting that the literal translation of the term privileged creditors from Arabic is 'excellent' creditors. This appears to reflect the political imperatives in Libya that has an exceptional treatment for such claims. However, the thesis will use the term privilege because of its common use.
[93] These privileges will be examined in detail later in Chapter Five (Sec 5.3.7)
[94] See: Art 1 of PIA 2010
[95] The Civil Code of 1953, promulgated in the National Gazette in 28 Nov 1953, Art 494 (hereinafter CC 1953)
[96] Ibid, Art 534. Traditionally, shareholders and partners are considered residual claimants because they are repaid only after all other contractual claimants (such as secured creditors, employees, customers and suppliers) are paid.

- **Employees**

The employees are stakeholders by their input of labour and their interests can be affected by the insolvency of their employer.[97] The economic well-being of the employees in terms of job security and wages will possibly be interrupted by the insolvency of their employers. The worst case scenario occurs when their employer is liquidated which means that they will lose their jobs permanently.[98] The protection of the employees against the situation of insolvency is a main objective of the employment law. Employees in the Libyan law have two types of recognised interests in the insolvent business. Under the Civil Code 1953, they have direct interest with regard to the unpaid wages for which they are considered creditors. Under this category, they enjoy preferential right (privileged right).[99] Employees also have an interest in the future of the business with regard to the continuation of their jobs. They enjoy protection under the Libyan law against their employer in the event of insolvency by which the employer has limited powers to make employment redundancy under the CERs 2010.[100]

1.6.2. Financial Distress vs Economic Distress

By and large, distress refers to the situation when a company faces difficulty in repaying debts. An efficient insolvency law does not necessarily function to save all distressed companies from failure. Some companies should be safeguarded by means of rescue procedures while some should be eliminated from the market by liquidation.[101]

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[97] Yuval Bar-Or, 'Human Considerations in Turnaround Management: A Practitioner's View' in Jan Adriaanse and Jean-Pierre Van der Rest (eds), *Turnaround Management and Bankruptcy* (Routledge 2017) 191

[98] Ibid 179-80; Melvin Stephens, 'The Long-Run Consumption Effects of Earning Shocks' (2001) 83 Rev Econ Stat 28

[99] CC 1953, Art 1145

[100] CERs 2010, Art 77(2). This will be discussed later in Sec 4.7

[101] Rebecca Parry, *Corporate Rescue* (Sweet & Maxwell 2008) 13

The insolvency law's strategies employed regarding these two situations vary depending on the level of distress that a company encounters (economic distress or financial distress). An economically distressed company is one that is unable to pay its debts as they fall due and its business's going concern value is less than the value of its assets. Companies in such a situation are worth more if their assets are sold on a break up basis than if the business is kept together. In other words, they are nonviable due to fundamental problems regarding their going concern which has a low or negative value. A financially distressed company is economically viable as a going concern but it is unable to pay its debts when they fall due because of a cash flow issue.[102] Accordingly, attempts to save an economically distressed company would be at the expense of all claims against the company as a group especially creditors. This means that liquidation would be the best option because it would save the remaining value of the company's going concern.[103] In contrast, when the company is only financially distressed, rescue attempts are preferable because the piecemeal sale of the business's assets would not be in the interests of the creditors since the value of the business is greater if kept together.[104]

1.6.3. Corporate Rescue vs Business Rescue

Following from the above, a company that is only financially distressed should normally be a candidate for rescue processes. Rescue procedures may result in saving either the company as a whole or, when that is not possible, its business as a going

[102] Douglas Baird, 'Bankruptcy's Uncontested Axioms' (1998) 108 Yale LJ 573, 580-81; John Armour, 'The Law and Economics of Corporate Insolvency: A Review' (2001) ESRC Centre for Business Research, University of Cambridge Working Paper No 197, at 4 <www.cbr.cam.ac.uk/fileadmin/user_upload/centre-for-business-research/downloads/working-papers/wp197.pdf> accessed 8 Nov 2019

[103] McCormack, *Corporate Rescue* (n 9) 9; Finch and Milman (n 4) 117

[104] Rizwaan Mokal, 'Administration and Administrative Receivership-An Analysis' (2004) 57 CLP 1, at 4-5 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=466701> accessed 23 Jul 2019

concern.[105] Rescuing the company as a whole would imply that the company as an entity would emerge from the process substantially intact with the same workforce and ownership. This is described in literature as 'pure rescue'.[106] On the contrary, business rescue would imply that only the business of the company or viable parts of it would be rescued as a going concern. And if the business was sold as a going concern to a third party, this form of rescue would lead to the business continuation under new ownership and, commonly, the reduction of workforce.[107] This latter form of rescue is the most likely outcome in practice as seen in the UK.[108]

1.6.4. Informal Workouts

Financially distressed businesses may have two rescue approaches to resolve their dilemmas. Beside the formal insolvency procedures, which are normally regulated by the insolvency law and carried out through court collective procedures, there are informal out of court approaches. Informal workouts or restructurings involve voluntary negotiations between the debtor and some or all of its creditors away from the formal procedures that are offered by the State insolvency law's collective procedures.[109] The purpose of these procedures is to restructure the capital structure of the insolvent company typically by the reduction of the debt volume or postponement of payment date of the debt.[110] Informal workouts are termed as out-of-court proceedings yet the court can be involved in the informal workouts as potential arbiter.

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[105] Ibid 5

[106] Sandra Frisby, 'In Search of a Rescue Regime: the Enterprise Act 2002' (2004) 67 Mod L Rev 247, 248-49

[107] Ibid 248-49; Finch and Milman (n 4) 197-98

[108] Although the rescue of the company (corporate rescue) is a primary objective of the law under the administration procedures in the UK, business rescue is far more common in reality. See: Kayode Akintola and David Milman, 'The Rise, Fall and Potential for a Rebirth of Receivership in UK Corporate Law' (2019) 20 J Corp Law Stud 99, 119. Also see: Mokal (n 104) 7

[109] UNCITRAL Legislative Guide, Part Two, Chap IV, para 76

[110] Régis Blazy, Jocelyn Martel and Nirjhar Nigam, 'The Choice Between Informal and Formal Restructuring: The Case of French Banks Facing Distressed SMEs' (2014) 44 JBF 248, 249

Informal workouts are based on the contract law and can involve individual bargaining between the debtor company and its creditors or can be collectively by creditor consensus, such as the London Approach.[111]

1.6.5. Debtor-in-Possession vs Practitioner-in-Possession

Debtor-in-Possession system (DIP) is a distinct feature of the US Chapter 11 of Bankruptcy Code 1978. By this system, the management of an insolvent company retains their full day-to-day controlling position to take ultimate decisions regarding the business affairs during rescue procedures without the appointing of an insolvency practitioner.[112] In the contrary, Practitioner-in-Possession (PIP) is a traditional feature of the UK insolvency regime by which the existing management of the company is displaced by an external insolvency professional or practitioner to take control of all the assets and business of the company.[113]

1.6.6. Insolvency System

The insolvency system is a collective procedures system which is designed to provide mechanisms for both rescue/ reorganisation and liquidation to take place, subject to court supervision.[114] While rescue might lead to the continuation of the business or part of it as a going concern as discussed above,[115] liquidation means that all measures that are taken to realise the assets of the company on a piecemeal basis in order to terminate

[111] For details see: Parry and Long (n 13)
[112] Nathalie Martin, 'Common-law Bankruptcy Systems: Similarities and Differences' (2003) 11 Am Bankr Ins L Rev 367, 397
[113] Vanessa Finch, 'Control and Co-ordination in Corporate Rescue' (2005) 25 Legal Studies 374
[114] Andrew Keay and Peter Walton, *Insolvency Law: Corporate and Personal* (4th edn, LexisNexis 2017) 41-42
[115] See above Sec 1.6.3

its business activity and subsequently distribute the sale outcomes proportionately between creditors.[116]

1.6.7. Secured Transactions

Secured transactions in Libya are mostly covered by the CC 1953 (property law) under Book IV and known as the Accessory Rights in *Rem* or *in rem* securities (proprietary rights). A secured transaction is a transaction that creates a security by which a creditor obtains a right that is exercisable against the property of the security grantor (debtor) to enforce the obligations of the latter to the creditor.[117] Secured transactions in Libya can be classified as consensual securities which are created by an agreement between the contractual parties. This includes transactions like the mortgage,[118] the pledge[119], the pledge of debts[120] and the pledge on a going concern.[121] Secured transactions can also be classified as non-consensual security which is created by the operation of the law which exclusively includes the privilege rights[122] or by the judge like the judicial mortgage.[123] Security can be classified also as real security and quasi-security. Real security covers the consensual and non-consensual securities mentioned earlier. Quasi-security[124] includes title-based transactions such as the conditional sale[125] and the financial lease.[126]

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[116] Mohamed Al-badawi, 'Legal Provisions of Company Liquidation in Libya' (2003) 2 TJL 8, 10
[117] Ulrich Drobnig, 'Present and Future of Real and Personal Security' (2003) 11 European Review of Private Law 623, 625
[118] See below Sec 5.3.1
[119] See below Sec 5.3.2
[120] See below Sec 5.3.3
[121] See below Sec 5.3.4
[122] See below Sec 5.3.7
[123] See below Sec 5.3.1
[124] Generally, quasi-security transactions are not classified as real security however they have the same function by using ownership to secure the creditor's right. See: Hugh Beale and others, *The Law of Security and Title-Based Financing* (OUP 2012) 1.20
[125] See below Sec 5.3.5
[126] See below Sec 5.3.6

1.6.8. Post-commencement Finance and Super-priority

Post-commencement finance is a new fund provided, either by existing or by potential lenders, to the insolvent company to be used to fund the rescue process. The provider of post-commencement finance will be granted a priority over the existing creditors by means of super-priority system.[127]

1.7. Thesis Structure

This thesis is structured in seven chapters. In Chapter One (current Chapter), the thesis gives an introduction to the topic of insolvency and definition of concepts. It briefly outlines a background to the insolvency law development through various periods in Libya. This was necessary to introduce the thesis to the reader by outlining how a reform of the insolvency law has become necessary in the country to enhance the national objectives that were set up by the government to shift the economy towards a market economy. This Chapter explains the importance of having meaningful and effective insolvency law and procedures to the society and the national economy.

Chapter Two explores the theories and foundations underpinning the insolvency law scholarship. Exploring the insolvency law theories is necessary to understand what objectives an insolvency system should serve, whether it is to promote the interests of one particular group of stakeholders (mainly the creditors) or to have a wider role to include the interests of other stakeholders that are affected by the event of insolvency. This discussion then examines whether the insolvency law should consider rescue process for failed businesses and for what purposes. This Chapter furthers the discussion to explore how the insolvency law theories can be applied to the

[127] Mahesh Uttamchandani, 'The Case for DIP Financing in Early Transition Countries: Taking a DIP in the Distressed Debt Pool' [2004] LiT <www.ebrd.com/downloads/research/law/lit042.pdf> accessed 01 Dec 2017

circumstances of Libya as a developing and transitional economy. It explores which theoretical approach best suits Libya bearing in mind all the domestic circumstances and realities. The Chapter demonstrates that Libya needs to accommodate a theory that can promote objectives of economic growth and can maintain social stability. The Chapter concludes that a theory like the Team Production Theory would be appropriate not only to achieve those objectives but it is also a suitable approach to address the incoherence within the legal system that is caused by adopting conflicting ideologies within the different branches of the commercial law in Libya.

Chapter Three undertakes an evaluative analysis of the present Libyan insolvency law and procedures by reference to key objectives as set by the international guidelines of insolvency law particularly those offered by the UNCITRAL in the Legislative Guide. This Chapter will examine the UNCITRAL Legislative Guide principles that are related to insolvency matters in general whereas principles concerning business rescue and secured transactions issues will be dealt with in the following two chapters. This Chapter aims at assessing the insolvency framework in Libya to learn about what is desired to boost a reform project from the standpoint of enhancing investment and economic growth. This Chapter contends that the insolvency law of Libya is lagging behind as it offers no satisfactory response to insolvency and business failure and it thus leaves much to be desired for a reform.

Chapter Four deals with the current composition scheme as a rescue system in Libya. This chapter examines whether the available rescue mechanisms are adequate to support business rescue. This is measured against the principles of the UNCITRAL Legislative Guide with reference to principle Three.[128] The Chapter will examine what

[128] Principle Three is about 'Striking a balance between liquidation and reorganization'. See: UNCITRAL Legislative Guide, Part One, Chap I, para 6

objectives and interests the composition system is designed to promote. It contends that rescue procedures in Libya are outdated and inadequate to offer a reasonable pathway for rescue. The system is geared towards promoting the interests of secured creditors only at the expense of other stakeholders by excluding secured creditors from the process as they are not bound by a composition plan even after the court's approval. In regarding the institutional level, courts and insolvency practitioners (known as syndics/ trustees) are not prepared and trained to deal with business failure and insolvency cases. All of such features associated with the insolvency law in Libya would frustrate any rescue endeavours.

Chapter Five explores the secured transactions system in Libya and its relationship with the insolvency law. The exploration is carried out in light of the UNCITRAL Legislative Guide with reference to Objective Eight[129] and UNCITRAL *Legislative Guide on Secured Transactions*[130] (hereinafter 'the ST Guide'). This is necessary because both systems regulate debtor-creditor relationships and because they may implement different objectives, therefore, harmonisation between these two fields of law must be sought in order to achieve a proper balance between the interested parties. The objective of a secured transactions law is to protect the economic value of the secured creditors' property rights against their debtor's assets by ensuring effective enforcement of the rights of individual creditors when the debtor business becomes insolvent.[131] This Chapter will explore whether the Libyan secured transactions system achieves this objective and whether or not the design of this system supports an effective application of the insolvency and business rescue procedures in the country. It contends that the secured transactions system in Libya is based on principles that

[129] Objective Eight is about 'Recognition of existing creditor rights and establishment of clear rules for ranking of priority claims'. See: Ibid, Part One, Chap I, para13
[130] UNCITRAL, *Legislative Guide on Secured Transactions* (United Nations 2010)
[131] Ibid, Chap XII, para 2

contradict the principles of the insolvency and rescue law by building upon a theory of 'social justice' to primarily achieve social objectives.

Chapter Six examines how a reform can synthesise the objectives of an efficient and effective insolvency system into the domestic system. This Chapter explores what measures are to be taken on board by the policymakers before, or in parallel with, reforming the insolvency law in Libya. It first examines what the Libyan legal system needs to accommodate to align with the objectives identified by theory and international benchmark and what the Libyan insolvency law should consider for a reform.

Chapter Seven concludes the research. It highlights the main insights of every chapter of the research. The Chapter also states the original contribution to human knowledge this thesis claims to have made. It also states the research limitation and suggests further research.

Chapter 2 The Theoretical and Functional Aspects of the Insolvency Law

2.1. Introduction

The insolvency situation of a business touches the interests of a wide range of different stakeholders in the business. These stakeholder interests will conflict when the insolvency scenario occurs because the distressed business cannot meet all stakeholders' demands.[1] The problem in the insolvency situation is financial because assets are insufficient to meet all liabilities, so the law has to choose who to pay. This implies that the law must decide who bears the risk of insolvency which also means that there will be winners and losers in insolvency; some creditors may be paid in full where as other creditors may be paid only partially or even paid nothing.[2]

This has been subject of debates in the academic literature and in practitioner commentaries regarding what approach should be employed to resolve the problem, or, more specifically, what interests the insolvency law should take into account. As such, should the insolvency law take into account all affected stakeholders or should it be confined to the interests of some particular stakeholders?[3] Should the primary concern of the insolvency law solely be to maximise returns to the creditors and to protect their interests? Or should the insolvency law be concerned about the wider interests to achieve goals such as job preservation and maximising community welfare? This

[1] Janis Sarra, *Creditor Rights and the Public Interest: Restructuring Insolvent Corporations* (UTP 2003) 57-58

[2] Philip Wood, *Principles of International Insolvency* (Sweet & Maxwell 1995) 1

[3] John Armour, 'The Law and Economics of Corporate Insolvency: A Review' (2001) ESRC Centre for Business Research, University of Cambridge Working Paper No 197, at 8 <www.cbr.cam.ac.uk/fileadmin/user_upload/centre-for-business-research/downloads/working-papers/wp197.pdf> accessed 8 Nov 2019

Chapter will examine how these questions should be addressed under the Libyan law, taking account of the circumstances of the Libyan society.

These questions have been approached by various scholars representing different theoretical normative approaches to corporate insolvency law. The theoretical approaches to insolvency law were divided by Baird into two main camps which are referred to as proceduralists and traditionalists.[4] As will be discussed in this Chapter, the proponents of these camps hold completely different ideological views and responses in respect to the corporate or business insolvency. Proceduralists, driven by their economic view of insolvency, limit the insolvency law on pre-existing contractual entitlements. They believe that the insolvency law should exclusively deal with creditor distribution questions so as to maximise the creditors' returns as the ultimate goal of the insolvency law.[5] This theoretical camp builds their view on the fact that the insolvency law historically assumes that a property law is in existence and then solves the disputes arisen in insolvency between the various stakeholders in accordance with the provisions as provided by the property law. The result depends on the adopted approach which either respects or undermines the secured transactions law.[6]

On the contrary, there are the traditionalists who adopt a wider focus to include social justice. They criticise the approach offered by the proceduralists for what they believe as its failure in fostering goals and values that are necessary to achieve social justice. They believe that limiting the goals of insolvency law on contractual terms ignores the effect of business failure upon various stakeholders far beyond those of

[4] Douglas Baird, 'Bankruptcy's Uncontested Axioms' (1998) 108 Yale LJ 573, 576

[5] Thomas Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain' (1982) 91 Yale LJ 857

[6] Jackson, the originator of the Creditors' Bargain Theory (see below Sec 2.2.1) argues that all what the insolvency law should do is to respect the secured transactions law (property law) and the derived rights from it (non-insolvency entitlements). Ibid 871-72

creditors such the employment and the welfare of the community and therefore the insolvency law choices should be inclusive.[7]

These theoretical debates are important to explore because they have influenced developments in insolvency policies and influenced decisions of both policymakers and courts in different jurisdictions. It must be noted that these long-standing debates arise from different ideologies and, thus, they have yet to generate consensus.[8] It should be noted that there is a quite extensive literature on both sides of the debates, and the thesis will strictly investigate the prominent views on the matter. Literature in the USA has been enriched by the function and the philosophy of corporate and business insolvency law since the introduction of the US Bankruptcy Code in 1978. Reviewing the literature on theory is important because they set out normative principles that should be borne in mind when designing an insolvency system. However, the review of the literature of theory in this thesis does not assume that such literature will necessarily be suitable to the Libyan context as a developing country with different legal culture and different circumstances (represented by the lack of a functioning market system with weak property rights and inefficient institutions). Therefore, it is important to note that examining the theory literature must be read in light of the domestic circumstances and in the context of the Libyan legal system more generally. It is important to note that the discussion of theories, at the end of this Chapter, will evaluate which theory best meets the Libyan desires and circumstances.

This Chapter aims at analysing and exploring the insolvency law in order to understand why it contains certain principles, and how these principles are justified,

[7] Robert Rasmussen, 'An Essay on Optimal Bankruptcy Rules and Social Justice' [1994] U Ill L Rev 1, 5. Also see: Ziad Azar, *Guidelines for Efficient Bankruptcy and Creditor's Rights Reform* (LAP 2013) 2

[8] Samuel Etukakpan, 'The Lost Voice in Insolvency: Theories of Insolvency Law and their Implications for the Employees' (2014) 23 Nottingham LJ 34, 39-40

and what objectives it serves or should serve. In doing so, it will discuss and explore the theoretical approaches to the insolvency law. The discussion in this Chapter will be extended to analyse the views and objectives of insolvency as set forth in the international benchmarks particularly the UNCITRAL Legislative Guide.[9] Finally, this Chapter will examine the application of those theories in Libya taking into account the domestic situation and desires in the country as a transition economy.

2.2. Corporate Insolvency Law Theories: An Ideological Divide

As has been mentioned in the introduction of this Chapter, in answering the question of what interests the law should serve in the insolvency, there are two main groups of theories that have responded to this question, characterised in literature as proceduralists and traditionalists. The former group's approach is influenced by their economic view of insolvency while the latter group in contrast is driven by a wider social view of the issue.[10] These two groups of theoretical schools offer distinct perspectives regarding the role that the insolvency law plays or should play. The basic contention between the two schools of thought stems from the concern whether the insolvency law's role should be extended to serve the interests of stakeholders as well as creditors.[11]

Professor Baird describes proceduralists as a theoretical group which consists of almost entirely academic scholars whose main focus is on procedures. They believe that a coherent insolvency law must recognise how to be consistent with the rest of the legal system and how to function in a vibrant market economy.[12] The other camp,

[9] UNCITRAL, *Legislative Guide on Insolvency Law* (United Nations 2005)
[10] Baird, 'Bankruptcy's Uncontested Axioms' (n 4) 576
[11] John Pottow, 'Procedural Incrementalism: A Model for International Bankruptcy' (2004) 45 Va J Int'l L 935, 940-42
[12] Baird, 'Bankruptcy's Uncontested Axioms' (n 4) 577

termed as traditionalists by Professor Baird, is described as scholars as well as bankruptcy practitioners and lawyers whose views largely reflect the traditional school that focuses on the rich store of bankruptcy cases that have developed over time. The basic approach they claim stems from a conviction that the bankruptcy laws play special roles in the legal system and advance substantive goals that are important and distinctively sensible.[13]

The proceduralists view insolvency law as a part of the law of civil procedures. The insolvency law accordingly serves the substantive law; i.e. to apply and enforce the substantive law principles and satisfy the interests of holders of legal entitlements as it finds them under a non-insolvency law.[14] Proceduralists believe that insolvency law is a response to the debt-collection problem and it should solely be employed as a debt-collection device.[15] Therefore, the law should play a role mainly to maximise the estate value for the benefit of creditors when the company is insolvent.[16] The insolvency law, according to this group, should focus mainly on respecting and enforcing the claims of parties with legal rights and entitlements to the debtor's property (non-insolvency entitlements) while other entitlements should not be a concern of the insolvency law unless doing so would maximise the value for creditors.[17]

According to this group, the insolvency law should not result in addressing issues that are beyond the collective imperatives such as redistributions of entitlements and modifications to non-insolvency creditor interests such as job preservations and the

[13] Ibid 576-77
[14] Thomas Jackson, 'A Retrospective Look at Bankruptcy's New Frontiers' (2018) 166 UPL Rev 1867, 1873
[15] Thomas Jackson, *The Logic and Limits of Bankruptcy Law* (HUP 1986)
[16] See: Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements' (n 5); Thomas Jackson, 'Avoiding Powers in Bankruptcy' (1984) 36 Stanford Law Review 725, 728; Douglas Baird and Thomas Jackson, 'Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy' (1984) 51 UChiL Rev 97, 100-01; Alan Schwartz, 'A Contract Theory Approach to Business Bankruptcy' (1998) 107 Yale LJ 1807, 1814
[17] Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements' (n 5); Schwartz (n 16)

community's economic prosperity.[18] Because that will be detrimental to the parties with legal rights against the debtor's property (creditors) and it has even been described as tantamount to "prima facie theft" and a "corruption of civil justice".[19]

On the other side, there are the group of traditionalists who reject the concept that the sole purpose of the insolvency law is to serve the interests of creditors. For them, the insolvency law is a response to the problem of business failure which is wider than the collective action problem as advocated by the proceduralists. The insolvency law according to this group should therefore be to address such a wider problem. According to them, business failure affects a wide range of diverse interests including not only the creditors', but also other interests such as the shareholders, employees in preserving their jobs and social welfare as well as the community. Therefore, they believe that all affected stakeholders should be afforded an "equal"[20] regard of consideration in corporate or business insolvency.[21]

Further, the theoretical divide between the proceduralist and traditionalist approaches is extended to the issue regarding corporate or business rescue. As the proceduralists view the insolvency law's sole role is to maximise returns to creditors, they believe that collective procedures should be supported only when they are likely to increase the aggregate pool of assets for the benefit of creditors.[22] Therefore, individual actions by

[18] Christopher Frost, 'Bankruptcy Redistributive Policies and the Limits of the Judicial Process' (1995) 74 NCL Rev 75, 83. See also: Schwartz (n 16) 1809; Hamiisi Nsubuga, *Employee Rights in Corporate Insolvency: A UK and US Perspective* (Routledge 2019) 28

[19] Charles Mooney, 'A Normative Theory of Bankruptcy Law: Bankruptcy as (is) Civil Procedure' (2004) 61 Wash&Lee L Rev 931, 964-65

[20] However, they are very cautious when referring to the term "equal". A right to equal concern is not intended to mean "equality" in the strict sense. Rather, it is intended to mean equal respect and concern should be regarded to all affected parties. Similarly, equal respect does not mean the same as equality of treatment. See: Rizwaan Mokal, 'Contractarianism, Contractualism, and the Law of Corporate Insolvency' (2007) SJLS 51, 87-90

[21] Donald Korobkin, 'Contractarianism and the Normative Foundations of Bankruptcy Law' (1993) 71 Tex L Rev 541, 572-7; Elizabeth Warren, 'Bankruptcy Policymaking in an Imperfect World' (1993) 92 Mich L Rev 336; Frost (n 18) 76-77

[22] Gerard McCormack, *Corporate Rescue Law--an Anglo-American Perspective* (Edward Elgar 2008) 23

creditors should be avoided only because it leads to a disorderly piecemeal dismantling of the debtor's business and decreasing the asset value.[23] They believe that insolvent companies must "live or die in the market" and, accordingly, the insolvency law may restrict creditors' actions against their debtor, but this is not to avoid the liquidation as much as to ensure that the race of creditors to collect their interests does not accelerate a disorderly liquidation.[24] Reorganisation per se is not and should not be an insolvency law's independent objective because, as their argument goes on, rescue does little to maximise the creditors' diverse interests besides there is no guarantee that the process would result in a positive going concern value that creditors would benefit from.[25]

By the account of traditionalists, the rescue of financially troubled businesses is one of the important goals of the insolvency law.[26] For them, enhancing rescue procedures to effectively take place is beneficial to maintaining the going concern value of distressed yet viable businesses unlike an immediate liquidation which leads to negative effects for stakeholders far beyond those of the creditors. Because of this, rescue should be facilitated to take place as an alternative to liquidation as much as possible.[27]

Accordingly, the discussion in this Chapter will start by exploring the pro-proceduralist camp mostly represented by the Creditors' Bargain Theory[28] and then it

[23] Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements' (n 5) 864
[24] For details see: Baird, 'Bankruptcy's Uncontested Axioms' (n 4) 578
[25] Sarra (n 1) 37; Frost (n 18) 92-94
[26] Baird, 'Bankruptcy's Uncontested Axioms' (n 4) 577
[27] Donald Korobkin, 'Rehabilitating Values: A Jurisprudence of Bankruptcy' (1991) 91 Colum L Rev 717, 772-74; Douglas Baird, 'The Uneasy Case for Corporate Reorganizations' (1986) 15 Journal of Legal Studies 127, 133-34
[28] The Creditors' Bargain Theory was the first theory that offered a framework for a normative evaluation of the insolvency law since it was devised by its generator Thomas Jackson in 1982. See below Sec 2.2.1. It should be borne in mind that this theory inspired much scholarship and debates have advanced in subsequent years and as a result it has been extensively criticised for its narrow approach for insolvency law as a response to the traditional collective action problem. More recent debate on this theory has been conducted by Professors David Skeel and George Triantis in their more recent article ('Bankruptcy's Uneasy Shift to a Contract Paradigm' (2018) 166 UPL Rev 1777).

will focus on the pro-traditionalist group of theories including the Communitarian Theory,[29] Authentic Consent Model,[30] Team Production Theory,[31] Multiple Values Theory[32] and the Forum Theory.[33] As the thesis uses the principles and objectives of the UNCITRAL Legislative Guide as a guideline for a reform alongside the theories, the discussion will be followed by elucidating the theoretical choices as reflected in the Legislative Guide.[34] This will be followed by evaluating the merits and relevance of the theoretical approaches.[35] The discussion of these theoretical choices indeed is important as it can be very informative for a law reform in a country. However, reviewing literature on theory will be carried out from the Libyan perspective because these theories are not necessarily relevant to Libya without consideration of the country's context.[36]

2.2.1. Proceduralist Approach

The Proceduralist approach to insolvency is represented by the Creditors' Bargain Theory (CBT) which was the earliest and most widely debated theory of normative distributional principles that dominated the insolvency law scholarships for the past decades. The CBT was devised by Professor Thomas Jackson through his writing in the 1980s.[37] This model was further developed by co-writers with Thomas Jackson like Douglas Baird and Robert Scott who strongly supported his view of the creditors'

Notwithstanding the debate, which may be counted valid to a great extent, Jackson's theory remains useful as a theoretical framework for consideration because it has some relevance for Libya and because it offers clarity and simplicity as to how an insolvency law should function in the insolvency situation. (Further discussion is found in Sec 2.4 below)

[29] See below Sec 2.2.2.1
[30] See below Sec 2.2.2.2
[31] See below Sec 2.2.2.3
[32] See below Sec 2.2.2.4
[33] See below Sec 2.2.2.5
[34] See below Sec 2.3
[35] See Sec 2.4
[36] This evaluation will be in Sec 2.5 (Application of the Theoretical Debate to Libya) and Sec 2.6 (Application of the Team Production Theory to Libya)
[37] In an article he published in 1982: Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements' (n 5)

bargain theory.[38] This theory was influenced by principles derived especially from the law and economics approach to law development that was generated in the United States in the mid-1970s.[39]

The creditors' bargain model offers a normative approach as to what insolvency law should be. This model is anchored on a hypothetical bargain, as Professor Jackson argues that the primary role of the insolvency law should be to address one single concern; i.e. to resolve the collective action problem of the debtor's limited assets for the collective benefit of creditors.[40] The insolvency of a debtor would create a problem where creditors dismember the debtors' estate by the race to collect their rights individually on the basis of 'first come, first served' which results in the assets of the debtor being sold off piecemeal and then the dismemberment of the business.[41] But when the business was worth more as a going concern, the creditors would find themselves faced with a classic 'prisoner's dilemma'.[42]

The CBT assumes that creditors cannot effectively solve this problem unless they act under a mandatory collective system, whether in the form of reorganisation or liquidation, to prevent the suboptimal outcomes of piecemeal liquidation, thereby eliminating the prisoner's dilemma. This is advantageous because it increases the

[38] Jackson, *The Logic and Limits* (n 15); Baird and Jackson (n 16); Thomas Jackson and Robert Scott, 'On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors' Bargain' (1989) 75 Va L Rev 155. Also see: Roy Goode, *Principles of Corporate Insolvency Law* (4th edn, Sweet & Maxwell 2011) 70

[39] Korobkin, 'Rehabilitating Values' (n 27) 717; Andrew Keay and Peter Walton, *Insolvency Law: Corporate and Personal* (4th edn, LexisNexis 2017) 27

[40] Korobkin, 'Rehabilitating Values' (n 27) 717; Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements' (n 5). Also see: Armour (n 3) 11

[41] Schwartz (n 16) 1840; Jackson and Scott (n 38) 159-60; Douglas Baird, 'A World without Bankruptcy' (1987) 50 Law&Contemp Probs 173, 184

[42] The prisoner's dilemma is a problem of choice in which everyone is in a worse-off situation. It arises in the absence of cooperation between individual creditors when their debtor becomes insolvent as each creditor has an incentive to act individually to promote its self interests. This leads to a less efficient outcome for the collective creditors by disorderly liquidation of the debtor's business than if the creditors acted collectively. Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements' (n 5) 862

aggregate pool of assets for the benefit of the creditors as a group.[43] Insolvency law, according to Jackson, exists to solve the distribution problem of 'first come, first served' among creditors and this is the advantage and justification for having, and an answer to the question of why do we have, corporate insolvency law in the first place?[44]

The CBT rests on the argument that the creditors would realise that such an individualist behaviour is disadvantageous to the group as a whole and they would agree to participate in a collective manner and cooperate with each other to avoid such collective disadvantages under a mandatory collective regime.[45] The CBT believes that this is the bargain creditors would make *ex ante* if they had the opportunity to do so before they enter into transactions with their insolvent debtor and the insolvency law is seen by this theory as a product of this hypothetical bargain.[46] Uunder the hypothetical bargain, creditors would be operating under a "veil of ignorance" and so would not know in advance what sort of creditor they would be.[47]

The hypothetical bargain of creditors assumes that the sole role of insolvency law should be to protect the non-insolvency entitlements[48] of secured creditors, particularly property rights. The insolvency law, therefore, should not permit distributional objectives among different classes of interests in insolvency unless such distributions

[43] Jackson, *The Logic and Limits* (n 15) 14-16
[44] See Jackson's newly published article: Jackson, 'A Retrospective Look' (n 14) 1870-71
[45] Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements' (n 5) 861-63; Jackson and Scott (n 38) 159-60
[46] Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements' (n 5) 860; Jackson and Scott (n 38) 173; Keay and Walton (n 39) 27-28
[47] Jackson justifies his hypothetical creditors' bargain in insolvency using social contract theory as an application of Rawlsian "veil of ignorance". On his reference to the work of (John Rawls, *A Theory of Justice*) see: Jackson, *The Logic and Limits* (n 15) 17 at f.n. 22
[48] 'Non-insolvency entitlements' refers to the entitlements or rights that exist by the operation of law, contracts or by any other source of law unconnected with the insolvency regime. See: Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements' (n 5) 858

are necessary to increase net asset distributions to the creditors as a group.[49] This is because, from the collective point of view, the distributions will undermine the primary concerns of the collectivisation; i.e. to protect the creditors' property rights, and will reduce the relative attractiveness of security to secured creditors.[50]

The CBT rejects the consideration of non-contractual entitlements of stakeholders such as the employees, the local government or the community beyond their entitlements as creditors in the process. Such interests, accordingly, are considered only to the degree that such stakeholders are creditors and hold enforceable legal rights or claims against the debtor's property recognised by non-insolvency laws.[51] Beyond that point, however, such stakeholders would have non-creditor claims. Therefore, concerns such as the benefits arising from continuance of the business to employees as employees, or the local community of suppliers and consumers as such, should be considered neither by lawmakers nor insolvency courts. Rather, they should be dealt with outside of the insolvency procedures because that to consider these matters in insolvencies would create conflicts with the collective goal of maximising asset value.[52]

Regarding the issue of rescue, Jackson argues that rescue procedures may be allowed to take place but to the extent that they are necessary to maximise values for the existing creditors.[53] As has been discussed, the CBT justifies having a mandatory collective system of insolvency by arguing that interested people would cooperate with

[49] Jackson and Scott (n 38) 164, f.n. 17. See also: McCormack, *Corporate Rescue* (n 22) 22; David Skeel and George Triantis, 'Bankruptcy's Uneasy Shift to a Contract Paradigm' (2018) 166 UPL Rev 1777, 1779

[50] Jackson and Scott (n 38) 178; Robert Scott, 'Through Bankruptcy with the Creditors' Bargain Heuristic' (1986) 53 UChiL Rev 690, 707

[51] Jackson and Scott (n 38) 177-78; Jackson, *The Logic and Limits* (n 15) 28; Mooney (n 19) 943; Goode (n 38) 72-73

[52] Mooney (n 19) 959; Baird, 'A World without Bankruptcy' (n 41) 185; Keay and Walton (n 39) 28

[53] Jackson, *The Logic and Limits* (n 15) 2

each other if they knew that they would be better off as a group if they did so than if they reacted on an individual basis.[54] But what Jackson rejects about corporate or business rescue is that when the purpose behind the rescue process is to achieve goals beyond maximising returns to creditors. Accordingly, if rescue is undertaken to keep a business alive to implement policies like job preservation or maintaining community welfare, this should not be implemented within the province of the insolvency law but rather in non-insolvency laws.[55] This is because, according to Jackson, objectives and policies of rescue to preserve non-creditor stakeholder interests are not independent insolvency law policies and should not be thought of as the legitimate concern of the insolvency law.[56]

The CBT's model for insolvency law analysis has been very influential, not least in inspiring thought by others. Debates and theories of insolvency scholars have begun by either arguing within the CBT's assumptions or by making its assumptions their first and sometimes their primary subject of debate. It is even acknowledged by those who fundamentally reject its model that the approach of CBT is the only sustained principled-analysis theory of law governing insolvent businesses.[57] Its perspectives can be seen reflected even in some jurisdictions that are known as creditor-friendly systems like the German Insolvency Code of 1994[58] and the UK insolvency regime.[59]

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[54] CBT is a version of social contract theory applied not to a society but to a discrete area of law and it depends on a thought of experiment. See: John Rawls, *A Theory of Justice* (HUP 1972)

[55] Scholars recently argue that insolvency law is different from restructuring law. While the insolvency law responds to a common pool problem and protects the common pool of the limited assets from individual enforcement actions, restructuring law deviates from this and is not confined to the common pool problem. Rather, it facilitates restructurings governed by contract law rules and principles. See: Stephan Madaus, 'Leaving the Shadows of US Bankruptcy Law: A Proposal to Divide the Realms of Insolvency and Restructuring Law' (2018) 19 Eur Bus Org Law Rev 615

[56] Jackson, *The Logic and Limits* (n 15) 209-10; Baird, 'A World without Bankruptcy' (n 41) 184-86

[57] Rizwaan Mokal, *Corporate Insolvency Law: Theory and Application* (OUP 2005) 33-34

[58] Bo Xie, *Comparative Insolvency Law: The Pre-pack Approach in Corporate Rescue* (Edward Elgar 2016) 10

[59] The UK insolvency law prioritises the interests of creditors over all other stakeholder interests in insolvency. However, the UK system employs a more wealth maximisation goal than the CBT which

It should be noted that what CBT is concerned about regarding rescue is the way the reorganisation procedures are set up under Chapter 11 of the US Bankruptcy Code 1978. The CBT rejects the redistributive purpose as set up under the Chapter 11 reorganisations because this will affect the *ex ante* rights and priorities of secured creditors. For example, the reorganisation system under Chapter 11 allows for conversion of debt into equity shares and it also enables the new lender to have a priority over the existing creditors by the super-priority system.[60] From the CBT's perspectives, such features are objectionable because they undermine the substantive rights of secured creditors. The CBT accepts rescue when its purpose is only to maximise returns to secured creditors. If business rescue procedures lead to the rights and the priorities of secured creditors being affected, then the CBT is more likely to be concerned. That is why Baird and Jackson argue that the alternative procedure under Chapter 7 of the US Bankruptcy Code, under which going concern sales are permissible, is consistent with their theory insights because it does not interfere with the non-insolvency rights of creditors.[61] Also, CBT objects to giving the controlling power in the procedures to parties other than secured creditors. The CBT rejects that on the basis that creditors' priorities and rights will be affected by other parties controlling the process.[62] Therefore, the CBT can be less hostile to business rescue models under which *ex ante* agreed rights and priorities of secured creditors would be protected because this is what parties would agree to if they could do so *ex ante*.

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focuses on maximisation of returns solely to secured creditors. This can be seen by, for example, the priority of some preferential creditors, the employment of the rescue of distressed businesses as a going concern which go beyond maximisation of creditor's return, and the duty of the administrator to maximise the returns for the unsecured creditors. For details see: Armour (n 3) 12-13; John Armour, Audrey Hsu and Adrian Walters, 'The Costs and Benefits of Secured Creditor Control in Bankruptcy: Evidence from the UK' (2012) 8 RLE 101, 106-07

[60] McCormack, *Corporate Rescue* (n 22) 288-92

[61] David Webb, 'An Economic Evaluation of Insolvency Procedures in the United Kingdom: Does the 1986 Insolvency Act Satisfy the Creditors' Bargain?' (1991) 43 Oxford Economic Papers 139, 154-55

[62] See generally: ibid

Moreover, the CBT shows that the market appreciates an insolvency system that is capable of promoting efficiency of resource management and ensuring predictable outcomes of the process. It is said that the perspectives of this theory offer a very simple and clear answer to an essential question about the role of the law in the event of insolvency, which is to maximise creditors' returns. The CBT argues that reorganisation process, for example, may lead to prolonging the life of nonviable businesses with no assurance for successful outcomes and this may likely lead to the depletion of the creditors' entitlements.[63] It assumes that the insolvency law corresponds to a significant degree with efficient market hypothesis. Under this hypothesis, the market will decide if the company should live or die. Therefore, they view the insolvency law as a system that should lead to increased efficiency by facilitating the re-allocation of resources and capital to their highest and best use. If the assets of failed businesses are reallocated to more succeeding businesses, this will result in better outcomes; i.e. jobs and prosperity will continue to flow.[64]

The approach of the CBT is also simple as it focuses primarily on maximising the interests of contractual creditors. The CBT offers a more informed and sophisticated approach to determine when and to what extent to intervene with the contractual rights and when and to what extent insolvency law should derogate from the contract law rules and principles. As will be discussed later, the traditionalist view about the role of the insolvency law allows account to be taken of a wide range of stakeholder interests in the scenario of insolvency to ensure fair distribution in insolvency, yet they suffer

[63] Hamiisi Nsubuga, 'The Interpretative Approach to Bankruptcy Law: Remedying the Theoretical Limitations in the Traditionalist and the Proceduralist Perspectives on Corporate Insolvency' (2018) 60 IJLMA 824, 829 f.n. 8

[64] Thomas Jackson and David Skeel, 'Bankruptcy and Economic Recovery' (2013) University of Pennsylvania Law School, Institute for Law and Economics Research Paper no 13-27 <http://ssrn.com/abstract=2306138> accessed 8 Mar 2020. Also see: Sarah Paterson, 'Rethinking Corporate Bankruptcy Theory in the Twenty-first Century' (2016) 36 OJLS 697, 699

from weakness as they provide no clear answer as to how to balance these various interests against each other[65] despite the fact of their limitlessness.[66]

However, what elicits the debate about CBT mostly is its central assumption and consideration only for hypothetical contract creditors; that is the creditors' bargain is merely to take into account those who have legal claims against the debtor's assets. Therefore, the insolvency law's primary concern should be to maximise pre-insolvency agreed rights of creditors as it finds them under non-insolvency law. This account fails therefore to consider the legitimacy of other interests in the community such as the employees and the community at large which do not qualify as contract creditors.[67] Professor Warren argues that the important objective of corporate insolvency and rescue laws is to function to maximise the assets value not only for the benefit of creditors but also for the benefit of all stakeholders who are affected by the insolvency of the debtor.[68] For example, business failure will have a negative impact on stakeholders such as "employees who will lose jobs, taxing authorities that will lose ratable property, suppliers that will lose customers, nearby property owners who will lose beneficial neighbors, and current customers who must go elsewhere".[69]

Similarly, Professor Finch points out that the CBT's vision fails to respect the continuation of business relationships that are not formalised in contracts and also it neglects to consider the interests of those who suffer the greater hardships caused by

[65] Nsubuga, *Employee Rights* (n 18) 36

[66] It could be argued that the traditionalist approach provides a less simple story to tell. However, the story of the traditionalists is responding to a real complexity in the situation of insolvency which is the impacts that the insolvency or the business rescue has upon various stakeholders within the society. This in itself is a more far difficult story to tell and insolvency law should therefore be responsive to this fact and attuned to the affected stakeholders. See: Rasmussen, 'An Essay' (n 7) 5

[67] Karen Gross, 'Taking Community Interests into Account in Bankruptcy: An Essay' (1994) 72 Wash ULQ 1031, 1033

[68] Warren, 'Bankruptcy in an Imperfect World' (n 21) 354-55; Elizabeth Warren, 'Bankruptcy Policy' (1987) 54 UChiL Rev 775, 787. Also see: Lynn LoPucki, 'A Team Production Theory of Bankruptcy Reorganization' (2004) 57 Vand L Rev 741, 765-66

[69] Warren, 'Bankruptcy in an Imperfect World' (n 21) 355. Also see: Warren, 'Bankruptcy Policy' (n 68) 787-88

business failure.[70] The CBT's strict adherence to its perspectives of maximising creditors' returns during the insolvency process is likely to lead to unfairness vis-à-vis other stakeholder interests because most returns will be enjoyed by secured creditors.[71] As such, the CBT was attacked on the ground that its assumptions are not reflective to what is claimed to be an application of the John Rawls *A Theory of Justice*. Rather, it consists of many features that contradict the aspects of the Rawls's theory. The CBT does not redress the issue of inequalities in bargaining power because, in the CBT, the people that are protected are the most powerful parties in the bargaining table, which is unfair.[72]

In addition, the assumptions of this theory are said to be far from reality because it suggests that all creditors are equal in terms of knowledge, experience and influence. However, creditors are not uniform as some are stronger than others. Creditors like tort victims and employees may not agree to the hypothetical *ex ante* bargain which the CBT posits.[73]

Finally, a major criticism to the CBT has recently been advised by Professors Skeel and Triantis. The hypothetical bargain in the CBT was built on the assumption that creditors are so dispersed that they are unable to make actual contracting therefore the need for extrapolation of a consensus based on hypothetical bargaining between creditors *ex ante*. They argue that what the CBT failed to acknowledge is that creditors now in practice can and do make actual bargains both *ex ante* and *ex post*.[74] Skeel and

[70] Vanessa Finch, 'The Measures of Insolvency Law' (1997) 17 OJLS 227, 234
[71] Warren, 'Bankruptcy Policy' (n 68) 800, 803; Nsubuga, 'Interpretative Approach to Bankruptcy Law' (n 63) 829
[72] Mokal, *Corporate Insolvency Law* (n 57) 36-54. John Rawls in his Theory of Justice made considerable efforts to move from a hypothetical contract to a fair and ethical contract. See: Rawls, *A Theory of Justice* (n 54). But the CBT's assumptions lead to unfair contracts (inequalities in bargaining power).
[73] Keay and Walton (n 39) 28-29. See also: McCormack, *Corporate Rescue* (n 22) 24
[74] For details see: Skeel and Triantis (n 49) 1779

Triantis argue that insolvency law is less mandatory in nature; shifting towards implementing a more contractarian framework and even encourages contracting during insolvency than before at the time when the CBT was devised. According to them, the traditional collective action problem is no longer a core objective in the current insolvency practice thus maximising returns to creditors is also no longer the sole objective of the insolvency law.[75] Because in reality, insolvency law gives no special respect to non-insolvency entitlements and it functions almost exclusively by adjusting and interfering with those non-insolvency entitlements by facilitating an *ex post* structured renegotiation framework (*ex post* bargain).[76]

2.2.2. Traditionalist Approaches

The starting point of traditionalist theories is that the focus on maximising returns to creditors, as advised by the proceduralists, oversimplifies the issues to which the insolvency law responds. The insolvency law rather exists as a response to more complex problems that shape real life and implicate various moral, political, social as well as economic considerations.[77] The traditionalist approaches are in agreement that the role that should be played by the insolvency law should be beyond only maximising returns to creditors. It should be noted, however, that there are variations in these different traditionalist approaches as to how the various stakeholder interests affected by the insolvency can be defined by the insolvency law and only selected approaches will be discussed in this chapter. The thesis will discuss selected traditionalist theories

[75] For details see: ibid

[76] Anthony Casey, 'Chapter 11's Renegotiation Framework and the Purpose of Corporate Bankruptcy' [2020] Colum L Rev, 2-3 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3353871> accessed 06 Apr 2020. Also see: William Bratton and David Skeel, 'Foreword: Bankruptcy's New and Old Frontiers' (2018) 166 UPL Rev 1571, 1589

[77] Korobkin, 'Rehabilitating Values' (n 27) 719-25

before discussing towards the end of this Chapter the approach that arguably best suits the Libyan context.[78]

2.2.2.1. Communitarian Theory

The communitarian theory was generated in dissatisfaction with the model offered by the CBT and it has put a vision forward to explain the role that the insolvency law should play, distinctively from CBT. This theory's proponents offer a potential solution with an emphasis on a variety of constituent interests to be considered and their attention has largely focussed on the public law and policy rather than solely on private rights and wealth maximisation of creditors.[79] The communitarians argue that the insolvency laws have simultaneously competing objectives including not only maximising returns to creditors, but also preserving the going concern value of viable businesses, preserving jobs and community welfare that may be affected by business failure and also enhancing the credit system generally. All such competing objectives are legitimate and worth preserving, but the sole focus on asset value maximisation will lead to dismissal of such objectives.[80]

Therefore, the communitarians suggest that the welfare of the community should be very much central to the corporate insolvency law because this will achieve a better life for all by distributing responsibilities fairly among all participants in the community impacted by the insolvency.[81] The communitarians advocate that in the distribution of asset value in the insolvency the wider interests of stakeholders, including the community, should be taken on board, allowing them to share the value of the insolvent

[78] This will be discussed in Sec 2.6 (Application of the Team Production Theory to Libya)
[79] Gross, 'Taking Community Interests into Account' (n 67) 1042-44
[80] Sarra (n 1) 51
[81] Gross, 'Taking Community Interests into Account' (n 67) 1041-43

company with higher priority claimants.[82] The redistribution scheme according to this theory is an unavoidable objective of the insolvency law which is designed to redistribute losses and costs amongst those at risk.[83]

The communitarians argue that there is no justification why issues caused by insolvency, and for no other reason, should be governed away from the insolvency law. Professor Warren expressed her frustration with the economic approach on which theories such as the CBT are based and argued that the collective theory sees the collective pool as a tool that is used as "an excuse to impose a distributional scheme without justifying it, and, incidentally, a way to work in a damn good deal for secured creditors"; an approach that "eliminates without discussion or proof any other values that may be served by bankruptcy".[84]

The communitarianism vision considers that individuals share common interests and they are obliged to act in the best interests of the welfare of their community at large, even if this would reduce or prejudice some of their individual freedoms.[85] Professor Warren firmly affirms that the law, by accepting the rescue of insolvent businesses, acknowledges the losses of those parties affected by the insolvency of the debtor and distributes some of that loss caused by the default. The insolvency law, according to Warren, may allow for delay in liquidation of the business, even if this is inevitable, in order to allow all parties affected by the insolvency more time to accommodate the new circumstances as a way of redistribution.[86]

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[82] Vanessa Finch and David Milman, *Corporate Insolvency Law: Perspectives and Principles* (3rd edn, CUP 2017) 35-36
[83] Warren, 'Bankruptcy Policy' (n 68) 790; McCormack, *Corporate Rescue* (n 22) 21
[84] Warren, ibid 803
[85] Gross, 'Taking Community Interests into Account' (n 67) 1036-37; Keay and Walton (n 39) 30
[86] Warren, 'Bankruptcy Policy' (n 68) 788

As far as the welfare of the community is concerned, this theory, furthermore, favours the rescue of insolvent businesses over liquidation.[87] This objective is very central to this theory as communitarians claim that the rescue objective should be regarded as an important consideration in insolvency objectives. Under this approach, corporate or business rescue should always be permitted where, by doing so, the community at large would be better off even if this would have unfavourable results for other parties.[88] This is contrary to the CBT attitude to rescue which, as noted previously, is not considered an independent objective of the insolvency law unless the process would maximise values for the creditors.[89]

2.2.2.2. Authentic Consent Model

Unlike the CBT, the Authentic Consent Model theory (ACM)[90] has developed a wider concern about the interests that the insolvency law should serve. Mokal, the originator of the theory, argues that the insolvency law's substantive goal is in fact based on a just disposition to all affected stakeholders in the insolvency process. The ACM rejects the exclusive approach offered by the CBT which restricts participation in the *ex ante* hypothetical agreement only to those parties who have contracted for legal rights to the debtor's assets upon the occurrence of insolvency.[91] He, therefore, rejects the notion of the CBT because it creates a problem of bargaining advantages and imbalances which stronger parties (secured creditors) would exploit and overwhelm the weak such as the employees and unsecured creditors in insolvency, which is considered

[87] It should be noted that the communitarians believe that rescue should not take place where businesses are economically nonviable. See: Gross, 'Taking Community Interests into Account' (n 67) 1032-35
[88] Karen Gross, *Failure and Forgiveness: Rebalancing the Bankruptcy System* (YUP 1999) 95
[89] Jackson, *The Logic and Limits* (n 15)
[90] The ACM is a contractarian theory rested on the hypothetical consent of the bankruptcy participants. See: Mokal, *Corporate Insolvency Law* (n 57) 68
[91] Ibid 69

arbitrary. Based on the principle of justice, Mokal argues that his model would redress the bargaining advantages problem in contrast to the CBT which only reflects them.[92]

The ACM demands that the interests of all stakeholders affected by the insolvency of the debtor should be granted equal weight of concern and respect in insolvency procedures.[93] The ACM adopts a broader answer in that affected parties are not restricted to those who have contractual legal rights to the debtor's property. Rather they include those with interests that may be damaged or undervalued by the event of the insolvency and therefore they should also have a choice to select the principles governing their interests or alternatively have their interests fairly respected.[94]

The ACM advocates for an inclusive approach that offers participation to a wide range of stakeholders which would be excluded by a theory like CBT. However, it should be noted that this theory limits its breadth only to those parties who can prove that their interests are affected in a way peculiar to the insolvency of the company. Accordingly, any issues related to business failure but which are not peculiar to insolvency are to be settled out of insolvency law.[95]

This contractualist approach from which the ACM has developed is anchored on the philosophy of the early social contracts which assumes that if citizens are given the opportunity to submit to procedures and principles, they would agree in advance on those procedures and principles to which they have to submit.[96] The ACM assumes that the insolvency law lays down the terms of fair cooperation between all parties in the

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[92] Rizwaan Mokal, 'The Authentic Consent Model: Contractarianism, Creditors' Bargain, and Corporate Liquidation' (2001) 21 Legal Studies 400, 414

[93] Etukakpan, 'The Lost Voice in Insolvency' (n 8) 53

[94] Mokal, *Corporate Insolvency Law* (n 57) 68-69; Mokal, 'Authentic Consent Model' (n 92). Also see: Etukakpan, 'The Lost Voice in Insolvency' (n 8) 51

[95] Mokal, *Corporate Insolvency Law* (n 57) 69-70

[96] Thomas Nagel, 'Rawls on Justice' in Norman Daniels (ed), *Reading Rawls: Critical Studies on Rawls' A Theory of Justice* (SUP 1989) 4

insolvency.[97] The character of co-operation on which the ACM is based is influenced by Rawls's theory of "Political Liberalism"[98] which defines co-operation as:

> "a. … Cooperation is guided by publicly recognized rules and procedures that those cooperating accept and regard as properly regulating their conducts.
>
> b. Cooperation involves the idea of fair terms of cooperation: these are terms that each participant may reasonably accept, provided that everyone else likewise accepts them".[99]

Accordingly, the ACM-type of justice is based on the notion that in the insolvency scenario co-operation between all stakeholders is facilitated amongst them as moral equals. And co-operation, according to this theory, implies that those who are affected by issues (whether social, commercial or legal circumstances) that are peculiar to insolvency, and triggered only by insolvency, should work together and "co-operate by each being guided by just insolvency law principles in pursuing their own self interest, and thereby allowing all others similarly to pursue their self-interest guided by the same principles" because this is "a fair cooperative venture for mutual advantage".[100]

2.2.2.3. Team Production Theory

The Team Production Theory (TPT), as its name suggests, was originally prevalent in economics literature trying to apply economic analysis by outlining a framework for justifying economic efficiency of business organisations.[101] It was later approved and developed by the corporate law scholars notably Margaret Blair and Lynn Stout in their

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[97] Etukakpan, 'The Lost Voice in Insolvency' (n 8) 51
[98] John Rawls, *Political Liberalism* (CoUP 1996)
[99] Ibid 16
[100] Mokal, 'Authentic Consent Model' (n 92) 421
[101] Armen Alchian and Harold Demsetz, 'Production, Information Costs, and Economic Organization' (1972) 62 Am Econ Rev 777; Margaret Blair and Lynn Stout, 'Team Production in Business Organizations: An Introduction' (1999) 24 J Corp L 743. Also see: Etukakpan, 'The Lost Voice in Insolvency' (n 8) 47

article entitled 'A Team Production Theory of Corporate Law'.[102] This theory has had its influence on the theories and debates of corporate insolvency laws. Professor LoPucki approved the TPT and applied its foundations on insolvency law theory. Through his theory 'Team Production Theory of Bankruptcy Reorganization',[103] LoPucki has contributed to the theoretical debates on corporate insolvency law and developed it into an alternative normative theory of explaining and justifying the corporate insolvency law.[104]

It should be mentioned here that literature on corporate governance systems was dominated for decades by the notion that the purpose of the company was to increase its profits or to maximise the wealth for the benefit of the common shareholders. Such theorists, accordingly, believe that the managerial accountability to the company's shareholders is the only corporate law problem while consideration of the stakeholder interests is not, and they should therefore be considered by other legal systems.[105] The agency theory assumes that the company exists only to serve its shareholders simply because they have made a financial contribution to it. Therefore, the other corporate stakeholders are considered mere hired hands to serve the owners as their agents.[106] This approach's main focus is on the assets of the debtor and those parties with legal entitlements to those assets in insolvency. This perceived view seems to tie in with the basis of a theory like the CBT which considers only hypothetical contract creditors and

[102] Margaret Blair and Lynn Stout, 'A Team Production Theory of Corporate Law' (1999) 85 Va L Rev 247
[103] LoPucki (n 68)
[104] Etukakpan, 'The Lost Voice in Insolvency' (n 8) 47
[105] Milton Friedman, 'The Social Responsibility of Business is to increase its Profits' New York Times, (Sep 13, 1970) Section 6 (Magazine) 32; David Millon, 'New Directions in Corporate Law: Communitarians, Contractarians, and the Crisis in Corporate Law' (1993) 50 Wash&Lee L Rev 1373, 1374; Lawrence Mitchell, 'Groundwork of the Metaphysics of Corporate Law' (1993) 50 Wash&Lee L Rev 1477, 1485; Gregory Crespi, 'Maximizing the Wealth of Fictional Shareholders: Which Fiction Should Directors Embrace?' (2007) 32 J Corp L 381, 386-87. Also see: Sarra (n 1) 46
[106] Lynn Stout, 'Bad and Not-so-bad Arguments for Shareholder Primacy' (2001) 75 S Cal L Rev 1189

views the assets of the debtor accordingly as being subject only to the creditors' claims in insolvency.[107]

The Team Production Theory of corporate law has been established on a ground completely opposed to the corporate agency theory and it posits a different account of what corporate law should achieve. The advocates of the TPT believe that a company owes its going concern value that exceeds the value of its mere assets to its general body of stakeholders who constitute the team members who include the creditors, suppliers, managers and employees, not only the shareholders.[108] Such going concern contributions made by the team members are also valuable to the corporate entity and should therefore be considered and preserved by the law.[109]

It follows that the TPT's response to the question of what interests should be served by the insolvency law is that the insolvency law should take into account the interests of all stakeholders that contributed to the company's going concern, not only those who made the financial contributions.[110] This is because, as justified by the TPT, team members have made their contribution to the aggregate value of the company and therefore they have various degrees of economic interests in it. According to this approach, all corporate obligations to all members who made firm-specific investments to the company should be honoured when they cannot protect their investments in any other ways. Put this in context, parties who made a human capital investment, particularly long-term employees, could also be protected by preserving their jobs

[107] Etukakpan, 'The Lost Voice in Insolvency' (n 8) 48

[108] Blair and Stout list team members of the firm-specific investment as shareholders, directors, employees and other groups such as creditors. Blair and Stout, 'A Team Production Theory of Corporate Law' (n 102) 253

[109] Alchian and Demsetz (n 101) 779; Richard Butler and Scott Gilpatric, 'A Re-examination of the Purposes and Goals of Bankruptcy' (1994) 2 Am Bankr Ins L Rev 269, 280-82; Blair and Stout, 'Team Production in Business Organizations' (n 101)

[110] LoPucki (n 68) 769-70

rather than being made redundant.[111] This would also mean that in order to facilitate a company honouring its obligations and commitments to its members in the insolvency situation, legal entitlements of some creditors would be altered or reduced to be redistributed to other team members.[112]

Such an inclusive approach of the TPT favours rescue over liquidation in order to preserve the going concern value that is made by team members. They view preservation of the debtor company and the maintenance of the going concern of the business as the top priority of the societies even though it is at the expense of some individual rights of insolvency participants because this is what team members intended at the time of contracting.[113] If an insolvent company with a going concern surplus is forced into liquidation, that going concern value will be lost because such relationships will stop contributing to the company as they will collapse by liquidation. One of the TPT objectives is to allow the insolvent debtor to remain operating in times of distress if this would benefit the team members more than if the debtor's business is liquidated.[114]

2.2.2.4. Multiple Values Theory

The main proponents of the Multiple Values Theory (MVs) are Warren[115] and Korobkin.[116] In his response to the CBT, Professor Korobkin in his theory, which he labelled the 'value-based account', offers a normative explanation of insolvency law rejecting the economic account of the CBT that limits the role of the insolvency law as

[111] Ibid 764-67
[112] Butler and Gilpatric (n 109) 280-85
[113] LoPucki (n 68) 769. LoPucki in this article refers to the work of Peter Drucker (*Concept of the Corporation*) and quotes his writing "Society must insist on the maintenance of the "going concern" and must if necessary sacrifice to it the individual rights of shareholders, creditors, workers, and, in the last analysis, even of consumers". Peter Drucker, *Concept of the Corporation* (John Day 1946) 21
[114] LoPucki (n 68) 764
[115] Warren, 'Bankruptcy Policy' (n 68)
[116] Korobkin, 'Rehabilitating Values' (n 27)

a tool to collectivise debt recovery for the benefit of creditors.[117] On her account, Professor Warren believes that the insolvency law's distributional objective should not be limited to the debt-collection and priority issues but should encompass wider issues reflecting the range of values and interests that may be hurt by a business collapse.[118] Professor Korobkin argues that the insolvency law should be viewed as a response to the various aspects of business failure that include moral, political, social and also, but not limited to, the economic aspect of distress. He disapproves the idea of viewing the insolvency estate of an enterprise as only a pool of assets. Instead, it should be viewed as "an evolving and dynamic enterprise, capable of having diverse aims".[119]

In response to the question asked by Professor Baird issuing a challenge to explain why an insolvency law exists at all, the value based theory argues that the insolvency law exists as a response to the problem of financial and economic distress which has an effect on various interests and values. The insolvency law's response to this problem, therefore, should be by providing a forum in which those competing interests and values, such as of the employees, managers and the community, affected by business distress are expressed and sometimes recognised and this is what makes the insolvency law distinct.[120]

As an inclusive approach, this theory differs completely from the perspectives on which the CBT has been based. It acknowledges that the insolvency law is unique from non-insolvency laws and thus has a broader role to play because it exists in reaction to the financial and economic distress, by which diverse interests and values are affected,

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[117] Ibid 721

[118] Warren, 'Bankruptcy Policy' (n 68) 796. Also see: Korobkin, 'Rehabilitating Values' (n 27) 769

[119] Korobkin, 'Rehabilitating Values' (n 27) 721-22

[120] Ibid 764-66 and 789. Korobkin argues that no law other than the insolvency law responses to the problem of financial distress. The insolvency law is not simply a response to the debt collection problem which could be addressed under non-insolvency laws. Ibid 766

rather than to the debt collection problem that concerns only with creditors' returns. As a response to business failure, the insolvency law should establish a balance between all affected interests; establishing priority of creditors and serving the interests of parties who do not have legal entitlements to the debtor's assets but who have interests in the continuation of its business such as the employees and the community.[121]

2.2.2.5. Forum Theory

The forum theory was published by Professor Flessner who advocates a traditionalist approach in responding to the Creditors' Bargain Theory.[122] It conceptualises the insolvency process in procedural terms rather than in terms of substantial objectives.[123] It claims that various parties that have concerns about the business cannot be limited merely to creditors and shareholders. The scenario of insolvency affects wider stakeholder interests beyond those of the creditors and shareholders. Therefore, the law should consider such interests though they may not immediately represent monetary claims, yet they are real. Accordingly, the function of the insolvency law and procedures should be to establish a forum in which to consider all those interests and rights affected by business failure.[124] For Flessner, the established forum would offer a practical resolution for the interested parties as it would enable them "either to adjust gradually and more easily to the inevitable closure of the firm, or, if it is feasible, to agree on a rescue plan and on the contributions necessary to support it".[125]

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[121] Ruzita Azmi and Adilah Abd Razak, *Theories, Objectives and Principles of Corporate Insolvency Law: A Comparative Study between Malaysia and UK* (3rd International Conference on Management, Penang 2013) 670-71

[122] Axel Flessner, 'Philosophies of Business Bankruptcy Law: An International Overview' in Jacob Ziegel (ed), *Current Developments in International and Comparative Corporate Insolvency Law* (Clarendon Press 1994) 24

[123] Finch and Milman (n 82) 38

[124] Flessner (n 122) 24

[125] Ibid

2.2.2.6. Remarks on the Traditionalist Approaches

From the above discussion, the traditionalist theories agree with the CBT that the priority given by property law to secured creditors is important and should be respected by the insolvency law. However, where they disagree with the CBT is that they view the priority of secured creditors as not sacrosanct and they consider that it should not displace the aims of the insolvency law which might desire to respond to other valuable interests such as the employees, local community and other stakeholders. Secured creditors from the traditionalist point of view should accept the redistributive goals of insolvency law and they should make a sacrifice for other valuable social imperatives in the insolvency system.

The discussion provided by the traditionalist theories offered elegant debates for the role of insolvency law as an alternative to the narrow approach of the CBT. However, they suffer from a number of weaknesses for which they have been criticised. The common criticism to the inclusive approach of the traditionalists is that they, unlike the CBT, lack the degree of focus necessary for the design of insolvency law.[126] The inclusive approaches are criticised that they represent unlimited interests in insolvency because the stakeholder interests at stake in insolvency are potentially indeterminate which would create uncertainty regarding to order of priority in insolvency. As the UNCITRAL Legislative Guide recommends, the insolvency law should set out clearly the priority of claimants in the insolvency procedures.[127]

It is argued that such an inclusive approach will face practical difficulty or even impossibility as to how courts will measure all affected stakeholders or weigh them

[126] This is significant in theories like the Communitarian Theory, the ACM, the MVs and the Forum Theory.
[127] UNCITRAL Legislative Guide, Rec 187

against each other.[128] This is because courts are not necessarily the best placed party to decide what should, or should not, be a community issue, or what should be considered as best interest of the community.[129] Further criticism is addressed to a theory like the ACM. This theory supposes that all parties are free and equal in the negotiation process which makes the principle chosen fair and just. However, this is unrealistic as creditors' behaviour in the real life is not homogeneous and creditors' actions are not always motivated by economic rationality but also by wider considerations and, therefore, relevant creditors do not and cannot behave and act rationally at all times.[130] As criticised by Professor McCormack, parties in real life negotiations may not be pleased with such ideal qualities. In fact, individuals may have dramatically different conceptions about fairness or justice depending on their political, philosophical or religious beliefs.[131]

The criticism raised against such inclusive approaches may drive one to conclude that a theory that offers a clear response to insolvency and practicable implementation of the law may be desirable. A theory like the CBT definitely subscribes to such concerns as its response to the insolvency is very clear and easily applicable where at least one type of interests will be well-protected.

Although the arguments against the traditionalist approach may be counted valid, this approach is still commendable. Its normative explanation for the function of the insolvency law as a response to financial and economic distress rather than as a debt collection problem provides better solutions to the impact of business failure as it

[128] Barry Schermer, 'Response to Professor Gross: Taking the Interests of the Community into Account in Bankruptcy-A Modern-Day Tale of Belling the Cat' (1994) 72 Wash ULQ 1049, 1050-52; LoPucki (n 68) 766
[129] Armour (n 3) 12-13; Azmi and Abd Razak (n 121) 671
[130] Goode (n 38) 78; McCormack, *Corporate Rescue* (n 22) 29-30
[131] McCormack, *Corporate Rescue* (n 22) 29

contributes towards the recognition of a wide range of interests that are affected by business failure and the recognition of rescue as an alternative to liquidation.

The inclusive approaches are welcomed by many constituencies in the society because their interests are given equal weight and respect in the insolvency proceedings. Employees, for example, will potentially gain advantage from such an approach because their jobs can be preserved.[132] As Professor Warren argues, the distributional effect of a business failure on non-creditor parties should attract more attention by the insolvency law because the impact of insolvency is not limited to those who are classified as creditors.[133] Such a perspective is valuable in considering reforms in a developing country like Libya where the interests of a wide range of people must be accommodated specially for social considerations. As will be discussed later,[134] the inclusive approach of the traditionalists can contribute to mitigation of social injustice and instability and this has been a popular demand of citizens in the country especially since the social uprising took place in 2011. Under this approach, various important interests can be protected. Potentially the employees would retain their jobs, the welfare of the community can be enhanced and the local suppliers can continue trading by ensuring that distressed businesses are supported to continue their activities and emerge from their distress.

The Cork Report in the UK, which influenced the objectives of the Insolvency Act 1986 (IA 1986) and the Enterprise Act 2002 (EA 2002), encourages the adoption of an approach that goes beyond achieving the economic concerns of creditors. It states that the aims of a good insolvency law should be to, *inter alia*, "… recognise that the effects of insolvency are not limited to the private interests of the insolvent and his creditors,

[132] Etukakpan, 'The Lost Voice in Insolvency' (n 8) 54
[133] Warren, 'Bankruptcy in an Imperfect World' (n 21) 354-55
[134] See Sec 2.5

but that other interests of society or other groups in society are vitally affected by the insolvency and its outcomes, and to ensure that these public interests are recognised and safeguarded;".[135] The Cork report also affirmed that "… a concern for the livelihood and well-being of those dependent upon an enterprise which may well be the lifeblood of a whole town or even a region, is a legitimate factor to which a modern law of insolvency must have regard. The chain reaction consequent upon any given failure can potentially be so disastrous to creditors, employees and the community that it must not be overlooked".[136] This demonstrates a clear endorsement of an inclusive approach.[137] A closer to home example is Tunisia where insolvency laws were reformed in 1995, influenced by its French insolvency laws of 1984 and 1985, geared towards rescuing distressed businesses, preserving employment and eliminating business's liabilities.[138]

Regarding the indeterminacy problem that is addressed to the traditionalist theories, a theory like the TPT arguably provides an adequate response to this criticism. Under this theory, the interests of variety of stakeholders can be defined and limited specifically to the group of people who have contributed to the necessary firm-specific investment to the company. According to Blair and Scout, team members to the firm-specific investment includes "… shareholders, managers, rank and file employees, and possibly other groups, such as creditors".[139] By using the notion of a firm-specific investment, people whose human or financial firm-specific investment that cannot be separated

[135] The Cork Report, para 198(i)
[136] The Cork Report, para 204
[137] Although the UK insolvency system has changed to include multiple interests by means of the EA 2002, the UK system is still considered a pro-creditor system. For details see: Kayode Akintola and David Milman, 'The Rise, Fall and Potential for a Rebirth of Receivership in UK Corporate Law' (2019) 20 J Corp Law Stud 99
[138] Art 1 of the Tunisian law regarding Rescuing the Economically Distressed Enterprises Act no 34 of 1995 promulgated in the National Gazette in 17 Apr 1995 (year no 138 vol 33)
[139] Blair and Stout, 'A Team Production Theory of Corporate Law' (n 102) 253. See also: LoPucki (n 68) 749

from the going concern of the business will be counted in as a team member and then should be served by insolvency law. The firm-specific investment so recognised might include the long-term skilled employees because they are important to the continuance of the business. It might also justify protection to long-term suppliers of specialist goods and products to the business and have a business relationship with the debtor business for a long time by which the two businesses become dependent on each other.[140]

2.3. Insolvency Theory in the UNCITRAL Legislative Guide

International benchmarks, as embodied into the UNCITRAL Legislative Guide, have integrated insolvency choices in response to the question of whose interests the insolvency law should cater for. The UNCITRAL Legislative Guide's central underlying philosophy is to promote business rescue with providing an appropriate balance between rescue and liquidation.[141] The Legislative Guide also consists of high-order principles, termed as key objectives,[142] that are designed to reduce concerns that the Legislative Guide is solely concerned with protection of the creditor interests, or alternatively the interests of the debtor, and it explicitly committed at the beginning to achieve a balance between the different economic interests in the insolvency process.[143]

The UNCITRAL Legislative Guide employs a more friendly approach towards business rescue and reorganisation than a theory like the Creditors' Bargain does.[144] The UNCITRAL Legislative Guide justifies rescue as it would achieve multiple

[140] For details see: LoPucki (n 68) 765-70
[141] Terence Halliday, Susan Block-Lieb and Bruce Carruthers, 'Missing Debtors: National Lawmaking and Global Norm-Making of Corporate Bankruptcy Regimes' in Ralph Brubaker, Robert Lawless and Charles Tabb (eds), *A Debtor World: Interdisciplinary Perspectives on Debt* (OUP 2012) 265
[142] Rec1 of UNCITRAL Legislative Guide identified eight key objectives.
[143] Gerard McCormack, *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (Edward Elgar 2011) 154-55
[144] The CBT accepts corporate or business rescue only when purpose behind such a process is entirely to maximise the returns to secured creditors. See above Sec 2.2.1

purposes that go beyond merely maximising returns to secured creditors to encompass advantages such as preserving jobs for employees and trade for suppliers by preserving viable businesses and their going concern value.[145] The UNCITRAL Legislative Guide enhances this objective by the imposition of a moratorium on the creditors' actions to collect their debts or repossess their property that are essential to the operation of the business. By employing this strategy, the Legislative Guide seems to be founded upon maximising wealth for the benefit of the many interests affected by business failure.[146]

The central principle of business rescue, however, is not prioritised above all others in the Legislative Guide. The proprietary rights of creditors may be affected to ensure successful outcomes of the process, but they are not sacrificed to attain other goals of the rescue.[147] The UNCITRAL Legislative Guide is more friendly with the property rights of creditors than the traditionalist approaches mostly are, as it considers the maximisation of returns to creditors an overriding objective of the insolvency law.[148] The UNCITRAL Legislative Guide accepts and encourages business rescue but while it does so, it minimises the risk associated with business rescue by subordinating business rescue to the value of the insolvency estate, thereby prioritising the economic value of the security interests and contractual rights of creditors ahead of the needs of distressed businesses and other stakeholders in general.[149] While UNCITRAL Legislative Guide does not guarantee that all stakeholders will be wholly protected under the rescue or

[145] UNCITRAL Legislative Guide, Part Two, Chap IV, para 3. See also: Bruce Carruthers and Terence Halliday, 'Institutionalizing Creative Destruction: Predictable and Transparent Bankruptcy Law in the Wake of the East Asian Financial Crisis' in Meredith Woo (ed), *Neoliberalism and Institutional Reform in East Asia: A Comparative Study* (Palgrave Macmillan 2007) 244

[146] McCormack, *Secured Credit and the Harmonisation of Law* (n 143) 161

[147] Ibid 155-161

[148] See: UNCITRAL Legislative Guide, Part Two, Chap II, para 27

[149] This is what the UK system and culture of business rescue basically incline for. For example, the sale of the business as a going concern though the pre-pack is encouraged provided that doing so maximises returns to the creditors by ensuring the best price for the assets. This is to ensure that the failure of business rescue is not born by the creditors. In contrast, the US reorganisation system under Chapter 11 internalises the risk of failure within the company which eventually leads to the creditors being the risk bearers. See: Webb (n 61) 153-56; McCormack, *Corporate Rescue* (n 22) 306

reorganisation procedures, it emphasises that rescue has to ensure that the creditors will eventually receive more than they would if the debtor were first liquidated.[150]

This is because the UNCITRAL Legislative Guide attaches the highest importance to the commercial bargains rather than the social and political ones.[151] Consideration of the interests of employees and the community in the continuance of the business is viewed in the UNCITRAL Legislative Guide as a social and political issue which should be dealt with outside the insolvency law.[152] This is because affording priority to such claims in insolvency law may render the insolvency procedures less effective, and, besides, it is regarded as an incomplete and inadequate solution[153] for the social problem.[154] Although the Legislative Guide allows for some social and political interests to be recognised and included in the insolvency law and have effect in the process, the Legislative Guide insists that the inclusion of such interests is clearly defined and stated in the insolvency law so as to ensure that the process is sufficiently transparent and predictable to the creditors.[155]

The UNCITRAL Legislative Guide recommends national policy makers when designing an insolvency law to take the importance of providing protection, especially to the interests of secured creditors in the insolvency process, as a high consideration. Recommendation 7 of the UNCITRAL Legislative Guide states that the insolvency law should consider features of, *inter alia*, "Protection of the insolvency estate against the actions of creditors, the debtor itself and the insolvency representative and, where the

[150] UNCITRAL Legislative Guide, Part One, Chap II, para 25
[151] Ibid, Part One, Chap I, para 13
[152] Susan Block-Lieb and Terence Halliday, 'Legitimation and Global Lawmaking' [2006] Fordham Law Legal Studies Research Paper No 952492, at 65-66, <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=952492> accessed 28 Jul 2018
[153] The UNCITRAL Legislative Guide refers to the practice in some countries of establishing a wage guarantee fund or insurance scheme that provides a separate source of funds for claims of the employees where a State provides no priority to such claims. See: Part Two, Chap V, para 73
[154] Ibid, Part Two, Chap V, para 68
[155] Ibid, Part Two, Chap V, para 68

protective measures apply to secured creditors, the manner in which the economic value of the security interest will be protected during the insolvency proceedings".[156] This is a general principle that should be applied to any measures or procedures for any purpose whether rescue or liquidation.

Such a recommendation can be seen as reflective through the UNCITRAL Legislative Guide in various issues. For example, the Legislative Guide advocates for the imposition of the moratorium in the procedures for a number of reasons, including the achievement of equitable treatment to creditors and the maximisation of the debtor's assets value for the benefit of creditors as a whole.[157] However, it does apply the above mentioned approach regarding the protection of the secured creditors by stating that the insolvency law should clearly specify that (where secured assets are included in the insolvency estate) secured creditors are not deprived of their rights in the secured assets even if a moratorium is in effect.[158] Therefore, secured creditors should be entitled to request the court to have the effect of moratorium lifted where the secured assets are not necessary to the procedures (in rescue or the sale of the business) or where the value of the secured assets are deteriorating as a result of the commencement of the procedures.[159] The UNCITRAL Legislative Guide justifies the protection of the secured creditors' interests on their secured assets on the ground that this is what secured creditors bargained for (*ex ante*).[160]

Another example that suggests the Legislative Guide's approach regarding prioritising the interests of creditors is the attitude towards the Debtor-in-Possession

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[156] Ibid, Rec 7(e)
[157] Ibid, Part One, Chap II, para 35
[158] Ibid, Part One, Chap I, para 10, and Part Two, Chap II, para 8
[159] Ibid, Rec 51(a)(b)
[160] Ibid, Part Two, Chap II, para 37. "For that reason, the introduction of any measure that will diminish the certainty of the secured creditor's ability to recover debt or erode the value of security interests, such as applying the stay to postpone enforcement, may need to be carefully considered".

(DIP) rescue procedures. Although the UNCITRAL Legislative Guide permits DIP system, it employs no presumption in favour of it.[161] This is because the debtor may, as the Legislative Guide justifies, take advantage of this system to pursue its own agenda at the expense of the overriding objective of maximisation of creditors' returns.[162] The same approach is applied in regard to the issue of post-commencement finance where secured creditors should always be protected.[163]

From the above discussion, one can argue that the UNCITRAL Legislative Guide employs neither a proceduralist nor a traditionalist approach in a precise manner. Actually, there is an overlap in the Legislative Guide between these two approaches. On the one hand, the Legislative Guide has an emphasis on protecting and prioritising the rights secured creditors have bargained for *ex ante*. It also has no favour on public policy concerns which should not be dealt with by the insolvency law. These features obviously reflect the approach that is offered by the proceduralist camp. On the other hand, the Legislative Guide employs features that deviate from the proceduralist view to lean towards the other camp of traditionalists. For example, business rescue is viewed by the Legislative Guide as an independent objective of the insolvency law that should be encouraged to take place as much as possible. This is because the Legislative Guide builds this objective not only on secured creditors' standpoint (where rescue is permitted only when it achieves returns to creditors), but also on the aim of wealth maximisation that goes beyond simply maximising returns to creditors to benefit other stakeholder interests such as the employees and suppliers.

[161] McCormack, *Secured Credit and the Harmonisation of Law* (n 143) 156
[162] UNCITRAL Legislative Guide, Part Two, Chap III, para 7
[163] See Rec 66 and 67 of UNCITRAL Legislative Guide

2.4. Policy Choices on the Insolvency Law Framework

Insolvency theories are very essential because they provide a wide understanding of the role that should be played in the case of insolvency and business failure. Policymakers can be enlightened by the critical analysis of the legislative objective offered by these theories when considering a reform process.[164] However, it should be acknowledged that insolvency theories discuss the foundations of insolvency laws taking into account various issues including the level of economic development, institutional capacity and social reality of the community in which those insolvency laws operate. Therefore, they are not necessarily suitable for adaptation to suit the variety of economic development levels worldwide, including on account of factors such as court capacity and social security provision. Literature in America, for example, discusses the insolvency law theories in light of the role that courts should play to address important issues arising in insolvency cases.[165] These theories are not therefore suitable for countries where courts suffer from case backlog or where there are not specialist courts, and it would take time for these institutions to be developed.

Furthermore**,** a theoretical approach is most appealing when its foundation and utility are kept constant with the variables of real life and, also, the strength or the attractiveness of any legal rules will be determined by their compatibility with theory.[166] Nations around the world vary in terms of social and political contexts and the levels and types of economic development and their insolvency laws, accordingly,

[164] Hamiisi Nsubuga, 'Corporate Insolvency and Employment Protection: A Theoretical Perspective' (2016) 4 NIBLeJ <www4.ntu.ac.uk/nls/document_uploads/191390.pdf> accessed 19 Jul 2019
[165] See: Frost (n 18)
[166] Lawrence Ponoroff, 'Enlarging the Bargaining Table: Some Implications of the Corporate Stakeholder Model for Federal Bankruptcy Proceedings' (1994) 23 Cap UL Rev 441, 452-53

should vary reflecting their own existing circumstances.[167] Policy discussion becomes meaningful only in a specified factual context because, as asserted by Warren, constraints by the real world necessarily inform insolvency policy.[168] Jurisdictions, like China, captured this fact and introduced its bankruptcy law reflecting China's own characteristics of a socialist market economy.[169]

It is important therefore to note that policymakers in Libya should demonstrate that the national insolvency law takes account of the various domestic circumstances rather than building on foreign legal systems.[170] This is because complete adherence to the mature systems of insolvency of the developed world would not result in adopting a functional legal system in the context of a developing nation without considered and appropriate modifications.[171] And any attempt to transplant a foreign insolvency law to the country borrowed from a foreign model is expected, regardless of how successful the model is, to fail if the conflicts between the model and the domestic circumstances are not worked out.[172] Nonetheless, foreign theoretical approaches and experiences on how to implement the law in an effective and efficient manner can always be instructive to evaluate a domestic law.[173] It offers the means by which to access

[167] Terence Halliday, 'Lawmaking and Institution Building in Asian Insolvency Reforms: Between Global Norms and National Circumstances' (5th Forum for Asian Insolvency Reform, Apr 2006) at 33 <http://siteresources.worldbank.org/GILD/Resources/Halliday5.pdf> accessed 02 Aug 2018

[168] Warren, 'Bankruptcy in an Imperfect World' (n 21) 378

[169] Huimiao Zhao, *Government Intervention in the Reorganisation of Listed Companies in China* (CUP 2019) 61-63

[170] As will be developed later (in Sec 2.6 and more in Sec 5.4), the Libyan legal system employs unique ideologies particularly in the contract law, under which the freedom of contract has limited efficacy, and the property law, under which property is characterised to play a more social function in the society. These unique features have to be considered in any comparison with the insolvency law theories.

[171] Rebecca Parry and Haizheng Zhang, 'China's New Corporate Rescue Laws: Perspectives and Principles' (2008) 8 J Corp Law Stud 113, 125

[172] Curzio Giannini, 'Promoting Financial Stability in Emerging-market Countries: the Soft Law Approach and Beyond' (2002) 44 Comparative Economic Studies 125, 137

[173] This perspective will be developed later in detail when discussing the contractual basis and the social function of property in Libya. See below Sec 5.4 and Sec 6.2

different foreign patterns of thoughts that have been developed in different cultures, institutions and jurisdictions.[174]

As has been discussed in this Chapter, the philosophy and foundations of insolvency regimes have been developed through a diversity of approaches to the role that should be played by the insolvency law in a response to the question: whose interests should the insolvency law be concerned with? Insolvency law theories vary from a narrow approach with the focus only on maximisation of returns to the benefits of creditors, as advocated by the CBT,[175] to expansive approaches offered by the traditionalist camp, according to which the insolvency law should play a wider role to accommodate a wider range of stakeholder interests beyond only maximising returns to creditors.[176]

It may be essential to stress that, as Scott acknowledges, all camps of theory contribute something useful to know about the situation of business failure.[177] The economic account of the CBT, for example, informs us something useful to know by its focus on protecting the non-insolvency entitlements of secured creditors. The starting point of this model is its focus on the property law which explains the focus of this model on secured creditors. They argue that if secured creditors are advantaged by values of non-insolvency law such as the property law, the insolvency law should not change this non-insolvency value without a good solid reason.[178] Therefore, the objective of maximising returns to secured creditors and protecting their pre-insolvency

[174] Edward Eberle, 'The Method and Role of Comparative Law' (2009) 8 Wash U Global Stud L Rev 451, 456

[175] See for example: Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements' (n 5); Jackson and Scott (n 38); Jackson, *The Logic and Limits* (n 15); Mooney (n 19); Baird, 'A World without Bankruptcy' (n 41). See also: Goode (n 38) 68-70

[176] See for example: Mokal, *Corporate Insolvency Law* (n 57); Mokal, 'Authentic Consent Model' (n 92); Korobkin, 'Contractarianism' (n 21); Warren, 'Bankruptcy in an Imperfect World' (n 21); LoPucki (n 68)

[177] Robert Scott, 'Sharing the Risks of Bankruptcy: Timbers, Ahlers, and Beyond' (1989) Colum Bus L Rev 183, 185-68, f.n. 7

[178] The CBT allows interference with those pre-insolvency rights only to the extent necessary to maximise collective returns for the benefit of creditors. See: Jackson, 'A Retrospective Look' (n 14) 1872-73.

entitlements by the CBT is very important to be recognised as an overriding objective of the insolvency law.[179] The approach offered by CBT has informative features and thus it is a useful reference and worthy of examining,[180] although with a limit,[181] even though scholarship has since moved the debate forward considerably.[182] Further, the CBT's view of insolvency is welcomed because it assures that creditors will not bear the risk of insolvency and their security will not be interfered with when the insolvency occurs. Such protection is important to promote certainty of the law among investors and creditors which will in turn encourage investment decisions and lending confidence.

However, the CBT's central concepts; that the insolvency law should solely cater for those interests with legal entitlements to the debtor's assets, are very controversial. It is argued that the insistence by the CBT on solving the collective action problem of creditors may limit the role of the law to be a debt collection device whereas the law

[179] This CBT feature is recognised by UNCITRAL Legislative Guide as an overriding objective of the insolvency law. See: UNCITRAL Legislative Guide, Part Two, Chap II, para 27. According to Professor Goode, the role of the insolvency law is not to affect pre-insolvency entitlements of creditors. Rather, its role is to organise a collective system designed to ensure those entitlements are preserved to the maximum extent possible and it is only to this extent that business rescue is a legitimate function of the law. See: Goode (n 38) 39. See also: Rebecca Parry and Stephen Gwaza, 'Is the Balance of Power in UK Insolvencies Shifting?' (2019) 7 NIBLeJ 2, at f.n. 9 <https://www.ntu.ac.uk/__data/assets/pdf_file/0026/941417/2.pdf> accessed 31 Mar 2020

[180] Therefore, the study will examine the property law (secured transactions law) of Libya in Chapter Five.

[181] Jackson himself recognises the limitations of his theory. See his newly published article 'A Retrospective Look at Bankruptcy's New Frontiers' (2018) 166 UPL Rev 1867, 1872 noting that "In a move I came to regret—somewhat—I labeled it a "*creditors'* bargain" … In retrospect, I might have better labeled it a "claimants' bargain" or something broader".

[182] Literature on Creditors' Bargain Theory decades ago focused the debate of the objective of the insolvency law on the collective action problem. But scholarship moved the debate far beyond this issue. Professors Skeel and Triantis argue that *ex post* coordination problems among creditors nowadays stands at odds with the standard account of the traditional collective action problems noting that collective action problems "are much less pressing" these days. Therefore, solving the collective action problems is no longer the central objective of corporate insolvency law. See: Skeel and Triantis (n 49) 1817. Recently, scholars argue that the CBT is not a purpose theory because of its unnecessary limitation of welfare maximisation to the *ex ante* rights of secured creditors. Yet this theory is a necessary limitation on an insolvency system "which has a purpose of solving the collective action problem among creditors". Casey (n 76) 8-15

should also consider other legitimate interests and groups in the community.[183] The CBT's justifications of the insolvency law were focused almost exclusively on the advantages provided under the property law which explains its view of the law's role to be limited to the creditors' bargain. Therefore, its approach is not a completely adequate response to the problem because the insolvency law should be intended to solve other bargaining problems related to business failure.[184]

On the other side, the counter approaches tell us something else which is useful to know. The traditionalist approaches acknowledge that business failure in itself is not a simple story as it leads to more life complexity than the CBT envisions. The wider approach of the traditionalist group focuses not only on promoting the private rights but it also pays more attention to the significance of social impacts of insolvency in the society. Social repercussions that are caused by insolvency require the law to recognise the effected stakeholder interests which are vital and important to the society as well as the business.[185] The rationale is that the effect of insolvency is not limited to the private interests of the debtor and its creditors, but it vitally spreads over the interests of the community and other parties in the society. Therefore, such wide interests must be recognised and safeguarded.[186]

It should be noted, however, that which theoretical approach is to be preferred is, and will remain, a contentious issue and what is considered effective and efficient insolvency or rescue procedures will vary depending on what normative choice is set out to be achieved in a given State. This is because there are multiple objectives against which an insolvency system can be measured; for example by the value returned to the

[183] Nsubuga, *Employee Rights* (n 18) 35
[184] Casey (n 76) 11-16
[185] Ponoroff, (n 166) 455
[186] The Cork Report, para 198(i)

creditors, by preserving jobs, by the process costs and by the ability of the rescued business to endure in the future and countries are different on the optimal choices to which they subscribe.[187] For example, states may agree that economically distressed businesses should be liquidated while those are suffering only from financial distress are to be rescued. However, national insolvency laws differ as to how to implement that objective.[188]

For example, French and UK corporate insolvency systems are both in favour of preserving distressed businesses, yet they differ about the choices of how to implement such an objective. While the French system implements rescue procedures, rescue is associated with a prime goal of maintaining employment. As a result, insolvency courts in France are given control over the insolvency procedures whereas creditors are entitled only to an advisory role in the process.[189]

In the UK, although the IA 1986 mentioned three authorised purposes of the administration[190] with a primary objective to rescue the company as a going concern,[191] rescue procedures in the UK have always had an emphasis on providing protection for secured interests.[192] This approach was legislatively mitigated by the substantial abolition of the administrative receivership by the EA 2002 in order to loosen the effect

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[187] Sarra (n 1) 51

[188] Irit Haviv-Segal, 'Bankruptcy Law and Inefficient Entitlements' (2005) 2 Berkeley Bus LJ 355, 355; Robert Rasmussen, 'Resolving Transnational Insolvencies through Private Ordering' (1999) 98 Mich L Rev 2252, 2253

[189] Sergei Davydenko and Julian Franks, 'Do Bankruptcy Codes Matter? A Study of Defaults in France, Germany, and the UK' (2008) 63 J Fin 565, 566

[190] IA 1986, Sch B1, Para 3(1) states that "The administrator of a company must perform his functions with the objective of:
(a) rescuing the company as a going concern, or
(b) achieving a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being in administration), or
(c) realising property in order to make a distribution to one or more secured or preferential creditors".

[191] IA 1986, Sch B1, Para 3(1)(a)

[192] Davydenko and Franks (n 189) 566. Also see: Ian Fletcher, 'UK Corporate Rescue: Recent Developments–Changes to Administrative Receivership, Administration, and Company Voluntary Arrangements–The Insolvency Act 2000, the White Paper 2001, and the Enterprise Act 2002' (2004) 5 Eur Bus Org Law Rev 119, 120

caused by the focus on secured creditors.[193] The Government White Paper *Insolvency – A Second Chance* in reviewing administrative receivership stated that by placing control and outcomes of the process on the hands of secured creditors, administrative receivership is seen to be outdated because it fails to consider many other important stakeholders in the distressed company, including the unsecured creditors, shareholders and employees.[194]

2.5. Application of the Theoretical Debate to Libya

As has been mentioned before, a sound insolvency law should be reflective of the variety of domestic situations and desires in a country. In a response to what choice Libya should subscribe to, some issues must first be acknowledged.

As has been mentioned, Libya witnessed an economic reform process to move from a socialist economy towards a market economy. To that end, reforms in the legal infrastructure were introduced from the 1990s till 2010 with an aim of promoting economic growth and attracting foreign investments.[195] However, the foreign direct investment inflows to Libya have been small, indicating the failure of the reform adopted in the country.[196]

For Libya to attract foreign direct investment, the importance of providing incentives to create a desirable business environment must be stressed. There is a growing awareness among developing countries of the importance of insolvency reform as part of the financial architecture needed to attract and facilitate foreign investment and to

[193] McCormack, *Corporate Rescue* (n 22) 54
[194] Department of Trade and Industry, *Productivity and Enterprise: Insolvency - A Second Chance* (Cmnd 5234, 2001) at Foreword.
[195] For details see above Sec 1.2.3. Also see: Naser Tawiri, 'Domestic Investment as a Drive of Economic Growth in Libya' (International Conference on Applied Economics, Athens, Aug 2010) 759, 762 <http://i-coae.com/?p=389> accessed 31 Dec 2019
[196] United Nations Conference on Trade and Development (UNCTAD), *World Investment Report 2019: Special Economic Zones* (United Nations 2019) 212, Annex Table 1

structure the flow of credit.[197] This is because an effective insolvency law can reassure outsiders as to predictability and enforceability against insolvent companies and the ability to recover investment through the realisation or the sale of the assets.[198] As Libya became aware of a need for attracting foreign investment in the country,[199] it may be argued accordingly that an approach provided by the CBT proponents would be desirable because it provides desirable protection and certainty for secured creditors necessary to attract foreign investment.

Furthermore, the circumstances in Libya are not limited only to the need to attract investment. As Libya has been under pressure of social uprising since 2011,[200] there is a desirability to consider also the approach offered by the traditionalists. Under the inclusive approach of the traditionalist, various interests that are important for the society and for the business can be protected. This includes the employees, with regard to job preservations, the community, which will be negatively impacted when a large business ceases trading, and the local suppliers, with regard to the effect of the insolvency on their businesses. Therefore, the role of the insolvency law should not be limited to maximise returns to creditors but it should also be concerned with the welfare of community.

Such inclusive approaches would be desirable because they offer solutions that would meet the need for improving the economic system and promoting a better life for

[197] Nathalie Martin, 'The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation' (2005) 28 Boston College International & Comparative Law Review, 1, 5

[198] Mahesh Uttamchandani, 'The Case for DIP Financing in Early Transition Countries: Taking a DIP in the Distressed Debt Pool' [2004] LiT, at 07 <www.ebrd.com/downloads/research/law/lit042.pdf> accessed 06 Dec 2017

[199] Abdulhakim Abushhewa and Tarek Zarook, 'The Effects of Foreign Direct Investment on Economic Growth in Libya: A Causality Analysis' (2016) 1 OSJ 1, 2; Mustafa El Hamoudi and Nagmi Aimer, 'The Impact of Foreign Direct Investment on Economic Growth in Libya' (2017) 2 IJELS 144, 147

[200] See above Sec 1.2.3

all citizens in the country.[201] In the Libyan context, the employees, for example, have always been in consideration for social reasons and such considerations must still be stressed especially nowadays as the country has been through social and political instability since the Arab Spring events in 2011.[202] Ignoring social considerations, such as the interest of maintaining jobs for employees[203] may lead to more dilemmas in the community and may eventually lead to ineffective implementation of the law, especially with the absence of effective social safety protections.[204] The employment issue in Libya has always been seen sensitively as a political issue.[205] Therefore, any endeavours towards reforming the insolvency system should take this situation in mind.

Furthermore, the traditionalist approaches would be in keeping with the domestic legal culture and desires that have long prevailed in the country. As will be discussed later,[206] the legal system and society have long been influenced by the objective of prioritising 'social justice' in the community in the light of which the law and courts may intervene in parties' private relationships. Such a social justice ideology was further influenced in the country by the adoption of the socialist economy since 1969. In measuring ideology against the theoretical debate of insolvency law, it may be argued therefore that the situation in Libya may require policymakers to not ignore the societal realities that have been in existence for decades. Put differently, the philosophy

[201] Gross, 'Taking Community Interests into Account' (n 67) 1041-42; Goode (n 38) 73
[202] See above Sec 1.2.3
[203] The number of public employees in Libya is very large with a total of 1.7 million employees accounting for a salary bill of US$ 21.6 billion, annually equivalent to 42 percent of the state budget. See: Pietro Calice and others, 'Simplified Enterprise Survey and Private Sector Mapping: Libya 2015' (2015) 1 World Bank Policy Research Working Paper No 99458, at 42 <http://documents.worldbank.org/curated/en/910341468191332846/Simplified-enterprise-survey-and-private-sector-mapping-Libya-2015> accessed 30 Mar 2018
[204] This will be discussed in Chapter Six. See below Sec 6.6.1
[205] See: Alison Pargeter, 'Libya: Reforming the Impossible?' (2006) 33 Review of African Political Economy 219
[206] See below Sec 2.6 and more details are found in Sec 5.4

on which a theory like the CBT has been rested may not be suitable to be fully implemented in the country, despite its previously outlined merits.

In addition, unlike the narrow approach provided by the proceduralists, the inclusive approach of the counter camp of traditionalists offers fair treatment by considering the wider stakeholders interests in insolvency. This has been acknowledged worldwide. Even the most creditor-oriented insolvency regimes in the world, such the UK insolvency regime,[207] have recently reformed their approach in order to include other interests in the procedures. The UK insolvency system pre-Enterprise Act 2002 had an excessive focus on the secured creditors. In the administrative receivership procedures, the receiver was obliged primarily to achieve the interests of the floating charge holder whereas the interests of other stakeholders were disregarded. Also, the floating charge holder was allowed to exercise significant powers to block the appointment of an administrator in administration by appointing an administrative receiver.[208] This approach has changed towards considering more stakeholders in the insolvency procedures by the substantial abolition of the administrative receivership procedures by the EA 2002 in an attempt to protect more stakeholders in the process.[209]

As the discussion encourages the adoption of the inclusive approaches offered by traditionalists because of their fair perspectives in relation to the situation of insolvency, it is desirable now to define which approach would be appropriate to adopt in Libya. This is because the traditionalist approaches have been criticised for being unable to offer a practical application. The response is that the TPT approach seems to be appropriate for some reasons. First, it seems to respond well to the criticism arisen

[207] John Armour and Sandra Frisby, 'Rethinking Receivership' (2001) 21 OJLS 73, 73
[208] Fletcher (n 192) 124
[209] Rizwaan Mokal, 'Administration and Administrative Receivership-An Analysis' (2004) 57 CLP 1, 6-7 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=466701> accessed 23 Jul 2019

against the other approaches. Second, the view of the TPT seems to align well with the domestic situation and culture of Libya. This will be discussed below.

2.6. Application of the TPT to Libya

Unlike other traditionalist approaches, the Team Production Theory (TPT) responds well to the criticisms of the traditionalist approaches.[210] First, under the perspectives of the TPT, the indeterminacy problem can be solved because what is considered a stakeholder interest can be clearly defined in the law. This theory sets an approach that is geared only towards stakeholders who made firm-specific investment in the business and are important for the business to succeed, such as the employees, the suppliers and the shareholders/ partners as well as the creditors. This approach of the TPT is a more just and socially responsible view than CBT. This is because it is not based only on contractual terms but also on business relationships and continued personal investment that made the going concern of the business. Therefore, the contributions of each team member to investment will be considered as relevant in an insolvency or business rescue regime.[211]

Second, the approach of the TPT provides a natural approach for business rescue because it leads to fair considerations of all the key stakeholders needed for a successful rescue. The TPT has a position where the team contracts have to continue during insolvency which allows for rescue of the business and also supports the retention of important interests such as those of the employees should the business be sold to a new owner. Maintaining the employees in their jobs will help the business continue its activities during the process because otherwise the business will struggle. Suppliers are also important because without taking into account their interest in the

[210] See above Sec 2.2.2.6
[211] Nsubuga, 'Corporate Insolvency and Employment Protection' (n 164)

business and without their support during the process, rescue may likely fail.[212] All such interests are identified in the TPT to have crucial roles in a successful business and they have crucial roles in a successful business rescue too and it therefore makes sense for the insolvency law to consider all these groups in the process.[213]

Third, the TPT approach in the insolvency context and the emphasis upon ongoing relationships comes to some extent in line with the policy imperatives that underpin the Libyan legal system which, for 'social justice'[214] and considerations, drives excessively towards the realisation of businesses to be based on personal relationships rather than purely contractual. Illustrations can be seen in the relationships of parties participating in the collective partnerships institution (*tasharukiyya*), discussed in the next paragraph, and in the nature of the relationship between the workers and the business owners as governed under the Code of Employment Relationships 2010 (CERs 2010).

Driven by the need to apply the sociological theory to the contractual relationship between the shareholders and workforce in the country, the Government introduced the collective partnership institution which was grounded in the doctrine of the socialist regime in the 1980s. This was known as '*tasharukiyya*'[215] by which the policymakers intended to apply the above philosophy to ensure that parties of this institution, mainly workers and owners, are equally treated.[216] It should be noted that this theoretical approach was an application of the theory of social justice, or social function of

[212] For details see: LoPucki (n 68)

[213] The TPT offers protection to all team members but it makes so without privileging one party over the other. See: Etukakpan, 'The Lost Voice in Insolvency' (n 8) 63

[214] The CC 1953 was based on a theory of social justice as proposed by its draftsman Professor al-Sanhuri. This theory has its, direct or indirect, effect on the relationships of creditors and debtors. This theory will be explored later in Chapter Five. See below Sec 5.4

[215] This kind of partnership is unique to Libya as they were based on the socialist philosophy by which workers are treated equally to the owners for the purpose of participation in management and profit. See: Bleuchot Hervé, 'The Green Book: Its Context and Meaning' in John Anthony Allan (ed), *Libya Since Independence: Economic and Political Development* (Routledge 2014) 144

[216] A notable example to this institution in the UK is the John Lewis Partnership where the business is employee-owned. See: John Storey and Graeme Salaman, 'Employee Ownership and the Drive to Do Business Responsibly: A Study of the John Lewis Partnership' (2017) 33 Oxford Rev Econ Policy 339

property,[217] offered by the draftsman of the Libyan Civil Code 1953 Professor al-Sanhuri.[218] In his very popular and most influential book series *Commentary on the Civil Law* (known as *Al-Wasit*), he called for equality in distribution between business owners and workers stating that: "Individual ownership vs ownership of the enterprise: Social structure in the community must exist but it must be based on the equality in the distribution. This is because the production system does not belong solely to the owner. Rather, workers contribute to it and thus they also should be partners in that system. This would entail, accordingly, that profit should be distributed on a fair and just basis between the owner and workers. .... This is because they contribute to the production system and management. … So, the production does not belong to the ownership of capital, but rather to the enterprise ownership".[219] Such a philosophy can be seen reflected in the CERs 2010 which defines the nature of the employment relationships to be based on equal considerations between the contractual parties. Article 1(1) of the CERs 2010 asserts that "The employment relationships between citizens in Libya are independent with a purpose of eliminating the wage-slavery relationships while implementing partnership basis in the economic entity they make up …".[220] All of these examples clearly are an application of principles of social justice that form the personal relationships between business parties in Libya.

Moreover, to achieve social justice in the community, the law in Libya is driven towards protecting the weak party in the community. This is reflected in property law

[217] As will be discussed later in Chapter Five, the theory of social justice and social function of property has an effect on the rights and priorities of secured creditors by the application of the privilege system. See below Sec 5.3.7 and Sec 5.4

[218] The Libyan Civil Code was modelled on the Egyptian Civil Code of 1948 both of which were drafted by the famous Egyptian jurist Professor Abdulrazzaq al-Sanhuri. See: Nabil Saleh, 'Civil Codes of Arab Countries: The Sanhuri Codes' (1993) Arab Law Q 161, 162

[219] Abdulrazzaq al-Sanhuri, *General Commentary on the Civil Law: Property Right*, Vol 8 (2ed edn, Arab Heritage 1967) 567. (hereinafter *Property Right*)

[220] Art 1(2) of the CERs 2010 states that "Exceptionally, the employment on a wage-basis … may be permitted".

(by given some parties such as the employees a privileged position) and in contract law which gives the court powers to intervene in contractual relationships to correct the bargaining inequalities. As will be discussed,[221] there are some preferential debts, such as the judicial expenses, taxes and money owed to the public treasury and employees' entitlements, which are given statutory priority over other creditors.[222] The intention of supporting the weak party in the community resembles the account of the TPT which advocates for the interests of weak members of the team (like the employees) that often struggle to protect their interests against their strong team member counterparts (secured creditors) to be balanced in business failure scenario.[223]

Further, the CC 1953 does not limit its protection to the pre-insolvency rights of secured creditors, as the CBT advocates for. Rather, these priorities reveal that it employs an approach that is concerned with rights of other stakeholders in insolvency driven by the objective of social justice which accepts more loss distribution among parties.[224] Besides, by giving the court power to intervene in contractual relationships, the Libyan legal system implements a less contract bargain-based approach that dramatically deviates from what a theory like the CBT was based on. For social justice, the law does not always allow the contractual parties to live with the bargains they have made. Rather, courts in some circumstances are given power to intervene to adjust the contractual obligations when an economic imbalance between parties occurs.[225]

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[221] See below Sec 5.3.7

[222] Preferential creditors in the UK are paid in priority to all other unsecured debts including holders of floating charges. IA 1986, Sec 175(1) and 175(2)(b). The preferential debts in the UK are the unpaid employees' wages and accrued holiday entitlements, unpaid contributions to state and occupational pension schemes and the unpaid levies on coal and steel production. IA 1986, Sch6, Categories 4, 5 and 6

[223] Etukakpan, 'The Lost Voice in Insolvency' (n 8) 59

[224] Abdulrazzaq al-Sanhuri, *General Commentary on the Civil Law: Theory of Obligation in General*, Vol 1 (2ed edn, Arab Heritage 1967) 650

[225] The application of the theory of social justice will be explored in Chapter Five. See below Sec 5.4

It is argued accordingly that the above discussion would support the instinct that Libya will be a more natural home for a theory like TPT for some reasons. First, the Libyan legal system supports the protection of the wider interests in the society to achieve social justice and social stability by supporting the weak, which matches the basis of the TPT. Second, Libya has the tradition and culture where the relationships between parties are based on personal relationships, which also comes in line with the perceptions advocated by the TPT. Third, the Libyan legal system is based on principles that contradict the notion on which a theory like the CBT is based. In the Libyan law, contracts can be intervened with when the contractual balance is disrupted in order to address the problem of inequalities of bargaining power.

2.7. Conclusion

The theoretical approaches that have been discussed in this Chapter differ on what the ultimate aim of insolvency law is, or should be, in a legal system. The proceduralist camp advocates that the insolvency law responds to the common pool problem and should be concerned at heart with collecting debts and therefore its focus is, or should be, exclusively on maximising returns to creditors. According to them, corporate and business rescue is not, and should not be, an objective of the insolvency law unless it leads to equivalent or better returns to secured creditors or creditors overall including secured creditors.

However, this exclusive approach has limitations. This is because if such a narrow approach was applied to insolvency cases, it would cause potentially unfair outcomes for some creditors and other non-creditor stakeholders who have interests in the

debtor's business.[226] The other camp, represented by the traditionalists, believes that the insolvency law responds to the problem of business failure which can have wider externalities and therefore its role should be extended to serve a wider set of interests beyond those of creditors. Rescue procedures in this view should be one of the key objectives of the insolvency law.

In addition, this ideological divide illustrates that insolvency laws and policies cannot be identical in every country because each jurisdiction has preferences depending on what choice the policymakers in a given jurisdiction would subscribe to. Despite what approach and objectives are inclined to, national policymakers should realise that the scope of the insolvency law should not be restricted to the private rights of the creditors since business failure can cause a widespread impact on various interests. Adoption of specific objectives may reflect the domestic realities and circumstances of a community. An insolvency law can be designed to achieve competing objectives such as maximising the creditors' returns, preserving businesses' going concern value through rescues or liquidations, maintaining jobs, promoting the community welfare and enhancing the credit system. As previously discussed, the focus on maximising the private rights of the creditors, and in particular secured creditors, fails to capture these objectives.[227]

Policymakers in Libya should, therefore, look through the merits of all insolvency theories and align them with the reality and situation of the community. An insolvency law reform may take into account the desires of the country to attract foreign investment and encourage the credit system for the prospective economic transition. Therefore, an insolvency law must be designed in a way which will not impede or

[226] The CBT model prohibits in principle any diminution of the returns of secured creditors regardless of potential gains to unsecured creditors because this is what corresponds to the bargain secured creditors have made. Obviously, the CBT is a rights based discourse not welfare maximising.
[227] Sarra (n 1) 51

restrict credit availability and investment. Besides, social considerations and challenges, such as unemployment, that exist in the community are also important for social and political stability. These may be captured by expanding the objectives to include the interests of the community and other stakeholders such as the employees, by saving jobs, and the insolvent viable businesses, by facilitating effective rescue procedures. Such various and competing interests in insolvency require the insolvency law to achieve the right balance between them. Therefore, social significance requires the insolvency law to respond beyond the enforcement of private rights. As has been argued in the Chapter,[228] the Team Production Theory arguably best captures the desires and realities that exist in the Libyan society by the recognition of the contributions of all important stakeholders to the business.

In a nutshell, insolvency laws differ from one jurisdiction to another depending on the choices adopted and the aims to be achieved. The UNCITRAL has been aware of this fact and took consideration of the difference of cultures and circumstances of every country in the Legislative Guide. It stressed that this Guide is to assist domestic legislatures to evaluate different approaches available and decide which one is the most suitable for their domestic contexts.[229] The positive point from referring to the international benchmarks (which will be discussed in the next Chapter) is the flexibility they offer to the national policymakers to choose principles and rules that can fit appropriately into the domestic legal system and culture.[230] Policymakers in the country can be informed by both the flexibility of the UNCITRAL Legislative Guide and the approach of the TPT which can be used to inform the choices made in applying the principles of the Legislative Guide.

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[228] See above Sec 2.6
[229] UNCITRAL Legislative Guide, Introduction, para 3
[230] See: Block-Lieb and Halliday (n 152) 1-2

Chapter 3 In Depth Analysis of Libyan Insolvency Law Considering the UNCITRAL Key Objectives of Insolvency

3.1. Introduction

A well-functioning insolvency system is among the laws that are believed to be very significant to promote economic growth by encouraging the business environment and credit market. Insolvency laws have particular importance in developing and transition market economies where businesses often are important participants in the economy. Efficient and well-balanced insolvency systems are vital to attract foreign direct investment and are considered a prerequisite for any positive investment decision in transitional markets because they can reassure predictability and the enforceability of obligations.[1]

Reforming the insolvency law is one of the preconditions for the transition towards the market economy that Libya has engaged in. This is because in market-led economies as well as in transition economies businesses will be subject to the market rules and consequences in which they are expected to experience financial and economic distress. Libya has been under international pressure to reform its insolvency law to cope with the situations when businesses are insolvent or near insolvency.[2]

Lawmakers in the country can gain guidance from international benchmarks and guidelines of insolvency law as to how best to implement an insolvency reform. The merits of the international benchmarks are highlighted by the flexibility that national states would enjoy in designing their insolvency laws in a way that suits their domestic

[1] Philippe Frouté, 'Theoretical Foundation for a Debtor Friendly Bankruptcy Law in Favour of Creditors' (2007) 24 Eur J Law Econ 201; Mike Falke, 'Insolvency Law Reform in Transition Economies' (PhD thesis, University of Berlin 2003) 67

[2] World Bank, Libya Economic Report 2006, 32

context. The UNCITRAL, for example, stressed that its Legislative Guide should consider flexible approaches including a discussion of the possible alternative approaches and the possible advantages and disadvantages of any approach.[3] It should be noted that the international benchmarks and initiatives are broad but this Chapter limits the discussion to those benchmarks as offered by the UNCITRAL in its Legislative Guide for the reasons mentioned below. Also, this Chapter focuses on the analysis of the Legislative Guide' principles and key objectives in general leaving a more detailed examination of principles identified as having high importance to Chapter Four (which will focus on the application of these benchmarks regarding business rescue) and Chapter Five (which will examine their application to secured transactions law).

3.2. Why the Legislative Guide?

The benchmarks that are embodied in the UNCITRAL Legislative Guide have been recognised as the most influential international text to promulgate global norms.[4] They were based on wide representation of participants representing expert organisations, governments, non-state organisations, practitioners and academic figures from all levels of economic development around the world.[5] Such a representation process resulted in a remarkable degree of consensus among the participants with very few exceptional cases where the Legislative Guide recommends no more than two alternative options for every topic.[6] This approach enabled the UNCITRAL's guidelines to attain global acceptability and legitimacy, that other international benchmarks lacked, and enabled

[3] UNCITRAL Legislative Guide, Preface.
[4] Gerard McCormack, 'Criticising the Quest for Global Insolvency Standards' (2018) 8 KJLL 1, 2
[5] Mahesh Uttamchandani, 'The Case for DIP Financing in Early Transition Countries: Taking a DIP in the Distressed Debt Pool' [2004] LiT, at 10 <www.ebrd.com/downloads/research/law/lit042.pdf> accessed 08 Apr 2018. Also see: Terence Halliday and Pavel Osinsky, 'Globalization of Law' (2006) 32 Annual Review of Sociology 447, 460
[6] Terence Halliday and Bruce Carruthers, 'The Recursivity of Law: Global Norm Making and National Lawmaking in the Globalization of Corporate Insolvency Regimes' (2007) 112 AJS 1135, 1185

the UNCITRAL to exercise much influence in affecting national insolvency laws.[7] The guidelines as set out in the UNCITRAL Legislative Guide have gained consensus and approval even by other international organisations, such as the WB and the IMF, to be used as global guidance for evaluating domestic insolvency laws around the world.[8]

The UNCITRAL Legislative Guide is seen as offering more sophisticated benchmarks by offering alternatives and minimal principles to allow national states to accommodate whatever option that suits their domestic desires and situations. Therefore, they are believed as suitable for bringing genuine real improvements in this field of law.[9] It is asserted in the first place in the Legislative Guide that the insolvency law that is launched from these key objectives "must be complementary to, and compatible with, the legal and social values of the society in which it is based and which it must ultimately sustain".[10] This approach offers alternative options for national reforms by being cognisant of domestic divergence and the differences in political regimes and states of economic development. The UNCITRAL Legislative Guide rejects a one size fits all approach that is used by other international bodies such as the World Bank in its Doing Business Resolving Insolvency framework which it has been suggested is biased towards absolute and rigid approaches.[11]

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[7] Susan Block-Lieb and Terence Halliday, *Global Lawmakers: International Organizations in the Crafting of World Markets* (CUP 2017) 322-24; Gregory Shaffer, 'Transnational Legal Process and State Change' (2012) 37 L&Soc Inq 229, 250-51

[8] Terence Halliday and Bruce Carruthers, *Bankrupt: Global Lawmaking and Systemic Financial Crisis* (SUP 2009) 160-61. Also see: Jenny Clift, 'Choice of Law and the UNCITRAL Harmonization Process' (2014) 9 Brook J Corp Fin & Com L 29, 32, f.n. 11; Terence Halliday, Josh Pacewicz and Susan Block-Lieb, 'Who Governs? Delegations and Delegates in Global Trade Lawmaking' (2013) 7 Regul&Gov 279, 295

[9] McCormack, 'Criticising the Quest for Global Insolvency Standards' (n 4) 1-2

[10] UNCITRAL Legislative Guide, Part One, Introduction, para 3

[11] McCormack, 'Criticising the Quest for Global Insolvency Standards' (n 4)

This soft law approach[12] adopted by the UNCITRAL in its Legislative Guide is favourable to national states because it offers greater flexibility and it allows them to preserve their sovereign[13] authority when reforming their national insolvency systems.[14] As a developing nation seeking to adopt a meaningful and functional insolvency law, Libya would benefit more by measuring its reform against such international benchmarks than by borrowing from a foreign system. It is believed that borrowing even from well-established developed insolvency systems would not necessarily result in the borrowed system functioning in the same way. This is because every nation has its own unique circumstances as they may be influenced by dissimilar socio-economic contexts or they may have different levels of institutional development.[15]

Further, UNCITRAL promoted the adaptability of its benchmarks by offering national policymakers the opportunity to engage in more cooperation with its established technical assistance resource.[16] It has been submitted that legal technical assistance provided by the international institutions, such as the UNCITRAL, has

[12] Hard law, as a term opposed to soft law, is used to refer to legally binding obligations between international actors, whereas soft law, which falls within the realm of international treaty-making or conventions, is used to refer to non-binding norms and benchmarks set forth in regulations, model laws, legislative guides, best practices, and the like. The latter is often easier to achieve than the former especially when the actors are states that are jealous of their autonomy and when the state sovereignty is challenged by the issues included in such laws. For more details see: Kenneth Abbott and Duncan Snidal, 'Hard and Soft Law in International Governance' (2000) 54 Int'l Org 421, 421-23

[13] Sovereignty, as Professor McCormack comments, is "the relationship between law and national culture and, more generally, the connectedness of law with a country's history and development. Law is valuable as a facilitator of contractual, commercial and corporate relationships but also as a protector and shaper of traditions, an expression of shared beliefs and ultimate values, and in much less definable ways, as an expression of national expectations, allegiances and emotions". McCormack, 'Criticising the Quest for Global Insolvency Standards' (n 4) 23

[14] Susan Block-Lieb and Terence Halliday, 'Harmonization and Modernization in UNCITRAL's Legislative Guide on Insolvency Law' (2007) 42 Tex Int'l LJ 475, 511-12

[15] Rebecca Parry and Haizheng Zhang, 'China's New Corporate Rescue Laws: Perspectives and Principles' (2008) 8 J Corp Law Stud 113, 125. Also see: Thomas Waelde and James Gunderson, 'Legislative Reform in Transition Economies: Western Transplants—A Short-Cut to Social Market Economy Status?' (1994) 43 Int'l & Comp LQ 347, 371

[16] UNCITRAL, 'Technical Assistance and Coordination' <https://uncitral.un.org/en/content/technical-assistance-and-coordination> accessed 20 Sep 2018

become an essential part of economic development around the world.[17] It can provide developing countries with various means of support ranging from policy advice to assist in law drafting, introducing and implementing the legal reforms, providing judicial training and other forms of legal education for law and business students as well as professions, offering public information campaigns, supporting professional development at the institutional level, advice in streamlining the legal regulation of businesses and alternative dispute resolution.[18] Besides, reports provided by such organisations are important as they will influence foreign investors' decisions in a country.[19] Libya, therefore, has a chance to achieve appropriate implementation of the international guidelines into the local context if such cooperation is reached.

It should be stressed, however, that complete adherence to the international benchmarks does not necessarily lead to the reformed laws functioning effectively. Irrespective of how effective and efficient the options and alternatives, and how desirable the mechanisms that the international benchmarks offer to the world may look, or how successful elsewhere they may be, national reformers should carefully capture a balance when considering those benchmarks. As Professor Halliday argues, "… too rigid an adherence to global norms will contribute to a "transplant effect"[20] of incomplete implementation; … too much local deviation from global norms may

[17] Scott Newton, 'Law and Development, Law and Economics and the Fate of Legal Technical Assistance' in Julia Arnscheidt, Benjamin van Rooij and Jan Otto (eds), *Lawmaking for Development: Explorations into the Theory and Practice of International Legislative Projects* (LUP 2008) 23

[18] Ibid

[19] Jingxia Shi, 'Twelve Years to Sharpen One Sword: The 2006 Enterprise Bankruptcy Law and China's Transition to a Market Economy' (2007) 16 Norton Journal of Bankruptcy Law and Practice 5, 6

[20] According to an empirical study, countries can likely be subject to the transplant effect when the transplanted legal rules were not properly adopted to the local conditions and context or when those rules were not familiar to the public. As such, it would be expected that the demand for the adopted law to be weak. See: Daniel Berkowitz, Katharina Pistor and Jean-Francois Richard, 'Economic Development, Legality, and the Transplant Effect' (2003) 47 Eur Econ Rev 165, 167

reduce flows of capital and trade necessary for economic development".[21] Although there is a growing need among, especially developing, nations around the world to reflect the international guidelines in reforming their laws, risk can still be posed threatening the desired social and economic stability and peace. To encourage more adaptability, it is suggested that the international benchmarks have to be read and analysed in light of both theory, as discussed in the previous Chapter, and domestic context of Libya.

3.3. Overview of the Libyan Insolvency Law and Procedures

Insolvency in Libya is viewed as something that merits blame rather than attention. It is based on the assumption that business failure is caused by mismanagement. Because of that, the concept of insolvency is still heavily stigmatised and socially repressive. Even the preventive composition, which was designed to employ a rescue function, is viewed in a repressive way and is viewed in some occasions as an insolvency declaration. For instance, the Banking Law 2012 mandates a prohibition on anyone who was a director of a company which became insolvent to be a member of board of directors in any national bank in Libya. The strict nature of this prohibition can be seen from the fact that it applies even where the directors have honestly made efforts to rescue the company through the preventive composition procedures.[22]

Further, the insolvency procedures carry criminal perception and the insolvency declaration triggers the application of criminal provisions. The directors and managers of the company may be held criminally responsible for damage caused to the value of

[21] Terence Halliday, 'Lawmaking and Institution Building in Asian Insolvency Reforms: Between Global Norms and National Circumstances' (5th Forum for Asian Insolvency Reform, Apr 2006) at 33 <http://siteresources.worldbank.org/GILD/Resources/Halliday5.pdf> accessed 02 Aug 2018

[22] Art 68(4)(b) of the Banking Law no 46 of 2012 amending the Banking Law no 1 of 2005 (Promulgated in the National Gazette in 05 Jul 2012. Hereinafter Banking Law 2012)

the company's assets by their wrongdoing and also they may be responsible for transactions carried out while the company is in distress. The company's directors may be held criminally liable if they commit 'simple' or 'fraudulent' insolvency crimes.[23] Examples of the former include execution of high risk transactions during the pre-insolvency period, worsening the insolvency situation of the company by the late filing for the procedures or by grossly negligent actions, failure to maintain corporate financial records and documents or failure to properly maintain the records during the last three years prior to the insolvency declaration. And examples of fraudulent insolvency include hiding, damaging or diminishing the assets of the company or declaring non-existing securities in order to prejudice the creditors or falsifying or destroying corporate records and documents.[24] Also, members of the board of directors are not allowed to change their home address without the consent of the court.[25]

The criminal perception of insolvency in Libya is illustrated by the involvement of the Public Prosecutor in the procedures. The public prosecutor can be involved in the composition procedures along with the judge during the examination of the composition,[26] and has the authority to trigger the insolvent liquidation.[27] The involvement of the Public Prosecutor in the procedures historically is justified to observe the public interests and public order.[28]

[23] The imprisonment is for a period up to one year and up to five years respectively. CCA 2010, Art 1169 and 1170
[24] Ibid, Articles 1169, 1170, 1175 - 1177
[25] Ibid, Art 1155
[26] Ibid, Art 987
[27] Ibid, Art 1013
[28] Jan Dalhuisen, *Compositions in Bankruptcy: A Comparative Study of the Laws of the EEC Countries, England and the USA* (A W Sitthoff 1968) 74-75

The available insolvency procedures are two procedures. The first is the composition procedure (preventive and final composition),[29] while the second type of procedure is insolvent liquidation. These procedures are discussed below:

3.3.1. Insolvent Liquidation

The ordinary insolvency proceedings are fundamentally the liquidation proceedings which are available to insolvent debtors who have ceased to pay off debts.[30] By the liquidation procedures, the company is prepared for its ultimate demise by which its assets are realised, its liabilities and debts are paid to the creditors and any remaining surplus assets will be distributed to the shareholders and by the end of the process the company will be dissolved.[31] Insolvency is considered as a matter of Public Order reflecting the disgracefulness associated with it. As a result, the Public Prosecutor and the judge during the examination of an insolvency case are granted *ex officio* power to file for the insolvency of the debtor without a need to recourse to the creditors' approval. The insolvent liquidation process can be initiated by the debtor company, the creditors or the Public Prosecutor. [32] The ultimate aim of this procedure involves the liquidation of the business and realisation of assets, payment of its debts to the creditors and distribution of the remaining assets to shareholders.[33]

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[29] This distinction was inherited down from the Italian Bankruptcy Act 1942 which recognised two types of compositions: compositions for the termination of insolvency proceedings (*concordato fallimentare*) and compositions for the avoidance of insolvency (*concordato preventivo*). Stefan Riesenfeld, 'The Evolution of Modern Bankruptcy Law: A Comparison of the Recent Bankruptcy Acts of Italy and the United States' (1947) 31 Minn L Rev 401, 409

[30] CCA 2010, Art 1012

[31] Roy Goode, *Principles of Corporate Insolvency Law* (4th edn, Sweet & Maxwell 2011), 149; Andrew Keay, *McPherson's Law of Company Liquidation* (2nd edn, Sweet & Maxwell 2009) 6; Gerard McCormack, 'Super-priority New Financing and Corporate Rescue' [2007] JBL 701, 704-5; Mohamed Al-badawi, 'Legal Provisions of Company Liquidation in Libya' (2003) 2 TJL 8, 8

[32] CCA 2010, Art 1013

[33] See: Book IX, Part II, Chapters VI and VII entitled 'The Assets Liquidation' and 'The Assets Distribution' respectively.

As such, this procedure is designed to liquidate the business in the best interests of the creditors and once the insolvency status is declared the debtor company will lose the control over its assets and its business affairs,[34] and the assets will become in the possession of the insolvency trustee.[35] However, the company's business may still be maintained in progress at the discretion and under control of the court if it thinks that the abrupt termination of the business and immediate liquidation would result in the business value being dramatically deteriorated.[36] This if allowed would have a bad effect on the creditors' interests. Therefore, the law allows the court to permit the continuation of the business. However, the business continuation during this procedure is only permitted on a temporary basis and permitted only to the extent that preserves the interests of the creditors. Finally, the creditors' voice regarding the continuation or the resumption of their debtor's business activities does count and the court must consult them about the matter and must not enjoin the continuation of the business activities unless the creditors have approved it.[37]

3.3.2. Final Composition

After the declaration of the insolvency status and the commencement of the insolvent liquidation procedures, the debtor is allowed to apply for a composition. This kind of procedure, known as the final or the simple composition, is aimed at terminating and exiting the insolvency procedures.[38] When the final composition is proposed, the procedures of the insolvent liquidation will be paused so that the composition takes

[34] CCA 2010, Art 1047(1) states that "Once the insolvency status is declared, the debtor shall be prohibited from managing its assets or disposing of them".
[35] Ibid, Art 1097(1)
[36] Ibid, Art 1099 entitled 'Interim Management', stipulates that: 1. "Having the debtor been declared insolvent, the court may enjoin the interim continuation of the debtor's business activities when it thinks appropriate that the immediate termination of the business activities would lead to the value of the business being in a critical destruction that may be irreversible to reconstruct".
[37] Ibid, Art 1099(2)
[38] Ali Younis, *The Bankruptcy* (Arabic Book Library) 58

place.[39] If the final composition was rejected or unsuccessful, the insolvent liquidation will be resumed against the insolvent company.[40]

This type of composition is designed for the debtor and its creditors to reach an agreement with an ultimate aim of satisfying the creditors' interests. The creditors may agree to receive partial payment of their debts and they may agree not to enforce any further legal actions against the debtor after the court's approval of the composition. As a result, the debtor's liability will be discharged completely upon the success of this composition.[41] This procedure can be initiated only by the debtor upon a petition presented to the judge delegate attached with details of the percentage of debt to be paid to the unsecured creditors (the secured creditors are not affected by this composition unless they wish to participate),[42] the payment date and the guarantees of debts payment, the costs of the procedures and the insolvency trustee's remunerations.[43] The judge delegate has to consider the opinion of the insolvency trustee and the voice of the creditors' committee. After the consent of the creditors' committee, the judge shall order that the composition to be communicated to all creditors who must declare their position within 30 days if they wish to refuse.[44] The majority of creditors[45] in number representing at least two thirds in debt value have to

[39] CCA 2010, Art 1134(4) which states that: "The judge delegate may issue an order to suspend the liquidation after the composition being proposed".
[40] Ibid, Art 1148
[41] Younis (n 38) 60
[42] CCA 2010, Art 1136(2)
[43] Ibid, Art 1133(1)
[44] Ibid, Art 1134(1)
[45] The Libyan insolvency law seems to have only one class of creditors who participate in the vote procedures. And if secured and privileged creditors wish to participate, they will be counted as unsecured creditors and they participate in voting as such. Ibid, Art 1002(2)

accept the proposal,[46] and the approved composition will bind the dissenting minority creditors.[47]

3.3.3. Preventive Composition

Unlike the final composition, the preventive composition is a procedure that is available to, and only to, the debtor company[48] before the official insolvency declaration by the court.[49] The debtor's petition for this procedure is required to constitute a credible offer to the creditors with a proposal worth of at least 40 percent of the total debts of unsecured creditors. One of the striking features of the composition is that it is not designed to affect the interests of the secured creditors who can decide not to participate in the process if they think that their interests are not well protected.[50]

3.4. Application of the UNCITRAL Key Objectives[51] to the Libyan Insolvency Law

In its early involvement in the issue of insolvency reform, UNCITRAL's policymakers acknowledged, in the report of 'Possible Future Work on Insolvency Law', that there was "broad agreement on the key objectives" for the design of effective and efficient insolvency regimes.[52] The key objectives emphasise the need for making a balance between the different interests of various stakeholders and the development of an insolvency law that is designed to achieve high order principles

[46] Ibid, Art 1137(1)
[47] Ibid, Art 1144(1)
[48] Ibid, Art 984
[49] Ibid, Art 985(1)
[50] A detailed account of the preventive composition scheme will be subject of discussion in Chapter Four.
[51] As mentioned in the Introduction of the thesis, analysing the Key Objectives of the UNCITRAL Legislative Guide is divided up between Chapter Three (which focuses on the general matters of insolvency and liquidation), Chapter Four (which deals with rescue matters with reference to Key Objective Three) and Chapter Five (which examines the secured transactions law - Key Objective Eight).
[52] UNCITRAL Working Group on Insolvency Law, 'Possible Future Work on Insolvency Law' [1999] UN General Assembly resolution no A/CN.9/WG.V/WP.50, para 24 <https://undocs.org/en/A/CN.9/WG.V/WP.50> accessed 28 Sep 2018

including, as will be discussed in detail below, certainty, predictability and equitable treatment of similarly situated claims, efficient and timely resolution of insolvency and maximisation of the assets value.[53]

The UNCITRAL Legislative Guide provides comprehensive and thoughtful guidelines that vary from key objectives and principles of an effective insolvency law to specific detailed provisions.[54] In Part One, it identifies Key Objectives and high order principles that are designed to direct the reminder of the Legislative Guide and can be used by national legislators as an evaluative framework for of the issues and targets to be achieved. Part Two provides details on core provisions for an effective and efficient insolvency and provides a detailed discussion and analysis of variant options of the core provisions for a model of insolvency law. Each chapter of the Legislative Guide also includes a set of recommendations designed to outline the central issues that the law should consider addressing.[55] The Key[56] Objectives of an effective insolvency law are discussed below. As previously mentioned, the thesis will discuss Objective Three (striking a balance between liquidation and reorganisation) in detail in Chapter Four because this Chapter will examine business rescue in Libya as regulated in the composition system, and Objective Eight (recognition of existing creditor rights and priority) in detail in Chapter Five because this Chapter will focus the examination on the rights and priorities of creditors as regulated in the Libyan secured transactions law. These objectives are regarded as of key importance and a more detailed examination is therefore merited.

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[53] Jenny Clift, 'International Insolvency Law: The UNCITRAL Experience with Harmonization and Modernization Techniques' in Andrea Bonomi and Paul Volken (eds), *Yearbook of Private International Law,* vol 11 (SELP 2009) 419

[54] Block-Lieb and Halliday, *Global Lawmakers* (n 7) 50-51

[55] Clift, 'International Insolvency Law' (n 53) 419

[56] UNCITRAL Legislative Guide, Rec 1 identified eight key objectives.

3.4.1. Obj.1. Provision of Certainty in the Market to Promote Economic Stability and Growth

The classical role of insolvency law is to deal with uncertainty that is associated with insolvency. The nature of insolvency and business failure is that it is associated with uncertainty which affects various stakeholder interests as to how to protect and enforce their rights when such a scenario occurs.[57] In principle, insolvency laws should not transfer the burden of insolvency borne by a stakeholder especially one whose interests enjoy more protection under a non-insolvency system.[58] Returning to the theoretical discussion of the previous Chapter, it was emphasised by the CBT that the insolvency law has to play the role that is only geared towards protecting non-insolvency entitlements of secured creditors and the insolvency law should not lead to a change in those entitlements.[59] The perspectives of such a view are, therefore, important to be recognised to promote certainty needed in the market.

The emphasis on legal certainty is rational as it should be a central principle of the law. Legal certainty, as Professor Otto argues, is a precondition of the implementation of the law and the achievement of development goals; i.e. poverty reduction and eradication, health promotion, raising of education quality and level of living standards, etc.[60] The European Court of Justice well summarised the definition of legal certainty as "… a fundamental principle of Community law which requires, in particular, that

[57] Anthony Casey, 'Chapter 11's Renegotiation Framework and the Purpose of Corporate Bankruptcy' [2020] Colum L Rev, at 18 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3353871> accessed 06 Apr 2020

[58] Thomas Jackson, 'A Retrospective Look at Bankruptcy's New Frontiers' (2018) 166 UPL Rev 1867

[59] See discussion above Sec 2.2.1

[60] Jan Otto, 'Toward an Analytical Framework: Real Legal Certainty and its Explanatory Factors' in Jianfu Chen, Yuwen Li and Jan Otto (eds), *Implementation of Law in the People's Republic of China* (Kluwer Law International 2002) 24-25. Also see: Barbara Oomen and Adrian Bedner, 'The Relevance of Real Legal Certainty – An Introduction' in Adriaan Bedner and Barbara Oomen (eds), *Real Legal Certainty and its Relevance: Essays in Honour of Jan Michiel Otto* (LUP 2018) 10

rules should be clear and precise, so that individuals may be able to ascertain unequivocally what their rights and obligations are and may take steps accordingly".[61]

Maintaining a balance between the need for achieving insolvency law objectives and the need to maintain legal certainty in the market is not an easy task to undertake. This is because objectives of insolvency law and principles of certainty can contradict each other. For instance, in rescue processes, stakeholders like creditors cannot easily anticipate what will happen to the value of their interests by the end of the process. Such concerns are reasonable since any interested party in the community needs to be certain as to what will happen to their interests in various scenarios and this certainty cannot be achieved, as Professor Bell argues, without providing intelligible and precise rules.[62]

The focus on providing rules supporting certainty in the community, according to Professor Otto, should be placed not only on the implementation of the effective rules and laws but also on the effectiveness of institutions responsible for implementing such rules. This is because effective institutions can contribute to the achievement of sound outcomes by ensuring that the gap between the application of the enacted rules and practice is reduced.[63] Particular attention should, accordingly, be paid to adequate education and training for judges since this is particularly important to enhancing the capacity of judges and the court system to administer justice independently, fairly and effectively and promoting legal certainty in the market.[64] In the insolvency context, the successful implementation of an insolvency law and the development of the rescue

[61] Case C-110/03 *Belgium v Commission* [2005] ECR I-2829, para 30
[62] John Bell, 'Certainty and Flexibility in Law' in Peter Cane and Joanne Conaghan (eds), *The New Oxford Companion to Law* (OUP 2008) 110
[63] Otto (n 60) 24-25
[64] International Commission of Jurists, *Challenges for the Libyan Judiciary: Ensuring Independence, Accountability and Gender Equality* (ICJ 2016) 46. Also see: Oomen and Bedner (n 60) 10

culture while maintaining certainty are dependent on the implementation of a sound judicial system and insolvency profession.[65] This is captured by the UNCITRAL Legislative Guide in Objective One emphasising that both laws and institutions are simultaneously important for nations to achieve benefits and avoid the pitfalls of integrating with the international financial system.[66]

It should be noted that insolvency laws should not only be implemented to achieve certainty in the market. But there are also other objectives that should equally be taken into account. Insolvency laws should also be enacted in a way that promotes economic stability and growth.[67] Certainty in itself will not lead to optimal levels of economic growth because the easiest way to be certain is to liquidate insolvent businesses straightaway. This can create certainty for the creditors as they would know for certain what is going to happen in the event of insolvency.

However, the scenario of insolvency requires effective tools to mitigate the impact of such scenarios when they arise. Sound insolvency laws can definitely enhance economic growth and stability by liquidating nonviable businesses and facilitating their replacement by more competitive businesses.[68] However, liquidation is not always the best solution because of its impact on market stability and growth. Rescue procedures can contribute to economic growth and stability. The issue with rescue, as opposed to liquidation, is that it potentially generates more uncertainty and unpredictability among stakeholders because it can reallocate the losses from insolvency onto stakeholders like

[65] Halliday, 'Lawmaking and Institution Building' (n 21) 16. Also see: Parry and Zhang (n 15) 137
[66] UNCITRAL Legislative Guide, Part One, Chap I, para 4
[67] Ibid
[68] Frouté (n 1) 201-04

secured creditors whose interests enjoy more protection under a non-insolvency system.[69]

Despite the recent reform that has been witnessed in Libya, local and foreign investors suffer to a large extent from the uncertainty that exists in the market because of institutional inefficiency and the outdated legal system. As the WB observed, the country would suffer increasing uncertainty which in turn would affect investment in the market if no steps were taken in response to the situation.[70] For instance, a large number of insolvent SOEs are subsidised by means of bailouts by the State to mitigate their distress, regardless of their viability, in order to achieve social considerations.[71] Two issues can be drawn in this regard. First, the political will of the State to support inefficient business is unpredictable and it thus creates a degree of uncertainty in the market. This will affect investors' ability to calculate risk which leads to moral hazard[72] leaving private businesses running at competitive disadvantages.[73] Second, the political support for inefficient businesses is economically wasteful because it is detrimental to

[69] The reason why a theory like CBT does not view rescue as an independent objective of insolvency law is because rescue interferes with pre-insolvency entitlements of creditors. See above Sec 2.2.1

[70] World Bank, Libya Economic Report 2006, 63-64

[71] Until recently, the Government still subsidises its distressed SOEs to cover the employment salaries. In 2016, for example, forty SOEs were bailed out to support their employees. See: The Presidency Council of the Government of National Accord, resolution no 44 of 2016 and resolution no 590 of 2016 regarding the salary payment of employees of financially distressed SOEs. Art 1 of the resolution no 560 of 2016 states that 'Payment of the employees of the distressed state owned companies, according to resolution of the Council of the Government of National Accord no 44 of 2016, shall continue to be effective'.

[72] The term 'moral hazard' problem is used to describe the situation of risk-taking behaviour, but in an inefficient way, by some investors in the market because they know they will be protected against the risk, such as through a bailout by the government. But this will leave other actors incurring the cost and will give incentives to lenders to increase the interest rate of credit to protect themselves against the potential risk. See: Leonard Kostovetsky, 'Political Capital and Moral Hazard' (2015) 116 Journal of Financial Economics 144

[73] Isabel Faeth, 'Determinants of Foreign Direct Investment - A Tale of Nine Theoretical Models' (2009) 23 Journal of Economic Surveys 165, 167; Rebecca Parry and Yingxiang Long, 'China's Enterprise Bankruptcy Law, Building an Infrastructure towards a Market-based Approach' (2020) 20 J Corp Law Stud 157, 162

the market's efficiency and economic growth by prolonging the life of unproductive businesses.[74]

Moreover, the recent reform undertaken in Libya in 2010 did not take into account the importance of the insolvency system for the reform process in the country. The current insolvency law of Libya still accommodates the outdated features of the insolvency systems that were available in the 19th century. The design of the regime focuses mainly on liquidation and it is complicated and extremely time-consuming.[75] Such features of the current insolvency law in Libya besides the institutional inefficiency can result in undermining the investors' certainty. It is argued that both the inefficiency of the insolvency law and institutions in the country have been the reason behind investors and creditors' frustration in enforcing their claims.[76] This is detrimental to the economic environment in the country as it can badly affect the investment decisions among investors. As has been mentioned,[77] according to the WB *Doing Business* 2018 report, Libya ranks 185th out of 190 economies on their ease of doing business while the insolvency law of Libya ranks 168th worldwide.[78] For Libya to promote credit availability and investment and to encourage investment decisions for local and international investors, it is widely emphasised that the legal framework must

[74] Elena Cirmizi, Leora Klapper and Mahesh Uttamchandani, 'The Challenges of Bankruptcy Reform' (2012) 27 World Bank Research Observer 185, 194

[75] For more details see: Mahesh Uttamchandani, 'No Way Out: The Lack of Efficient Insolvency Regimes in the MENA Region' (2011) 1 World Bank Policy Research Working Paper No 5609, at 1 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1794914> accessed 4 Jan 2019

[76] For more details see: Aburawi Gabgub, 'Analysis of Non-performing Loans in the Libyan State-Owned Commercial Banks: Perception Analysis of the Reasons and Potential Methods for Treatment' (PhD thesis, Durham University 2009) 205-24. It should be noted that although there was a legal reform in Libya in 2010, the reform did not affect the institutional or legal foundations of these problems.

[77] See above Sec 1.2.3

[78] World Bank, *Doing Business 2018: Reforming to Create Jobs* (World Bank 2018) 174

provide investors with practical protections and remedies in the scenario of debt default and insolvency.[79]

3.4.2. Obj.2. Maximisation of the Value of Assets

When the company is distressed, secured creditors, generally, tend to prefer to reclaim their assets rather than being restrained by insolvency procedures since this is the cheaper and quicker way to preserve the value of their individual interests. If creditors were prevented from enforcing their claims due to the implementation of objectives to promote, for example, a rescue process, they would press to have the value of their assets well protected during the process.[80]

Maximising the value of the insolvency estate is an overriding objective of the insolvency law which should be sought either in liquidation or rescue proceedings. In liquidation, the emphasis will be on the realisation of the assets in order to satisfy the creditors from the proceeds as quickly as possible.[81] The emphasis on keeping the business operations in business rescue should also be based on maintaining the going concern value of the business.[82] Promoting business continuation will normally result in maximising the assets value as a going concern for all stakeholders including secured creditors, who would usually receive more than they would do if the company was placed into liquidation.[83] It should be remembered that the primary principle sought by

[79] European Bank for Reconstruction and Development (EBRD), *Model Law on Secured Transactions*, (2004) Introduction. (hereinafter EBRD Model Law on Secured Transactions)
[80] Block-Lieb and Halliday, *Global Lawmakers* (n 7) 292
[81] UNCITRAL Legislative Guide, Part Two, Chap II, para 27
[82] Ibid, Part One, Chap I, para 05
[83] Terence Halliday, 'Architects of the State: International Financial Institutions and the Reconstruction of States in East Asia' (2012) 37 L&Soc Inq 265, 274. Also see: Clift, 'International Insolvency Law' (n 53) 419

the UNCITRAL Legislative Guide during the rescue procedures is that it always gives the value of the estate a priority over other objectives of rescue.[84]

The objective of maximising the value of the insolvency estate can practically be achieved through the imposition of moratorium to avoid dismemberment of the estate. Individual debt enforcement remedies that are employed outside insolvency law are different from the remedies offered under insolvency procedures. Under the insolvency law as a collective system of debt enforcement, creditors' claims are, or should be, suspended or prevented from being enforced. This mechanism is termed as a moratorium, or automatic stay, on the creditors' claims. The moratorium is vital as it saves the going concern value of the business by preventing the estate from being dismantled by the individual enforcement of debts which, if allowed, would reduce recovery in liquidation and frustrate any rescue endeavours.[85]

The UNCITRAL Legislative Guide recognised the significance of the moratorium for the insolvency process. It is important for rescue[86] because it encourages distressed businesses to initiate rescue procedures. It is important for liquidation because it ensures a fair and orderly administration of the proceedings by providing the practitioner and the court with adequate time necessary to maximise the value of the assets, potentially by the sale as a going concern where the collective value of the assets are greater than the value of the assets if they were sold on a piecemeal basis.[87]

Insolvency systems in the world differ substantially over the scope of the insolvent estate; i.e. over which property should be included in the estate and be subject to the

[84] For details see above Sec 2.3
[85] Goode (n 31) 64. Also see: Ian Fletcher, *The Law of Insolvency* (4th edn, Sweet & Maxwell 2009) 3
[86] The importance of the moratorium for business rescue will be further discussed in Chapter Four. See below Sec 4.3.5
[87] UNCITRAL Legislative Guide, Part Two, Chap II, para 26 and 27

insolvency procedures.[88] For the purpose of maximising the value of the assets, the UNCITRAL Legislative Guide takes the broad approach of the breadth of the insolvency estate to include the secured assets and thus limiting the right of secured creditors to enforce their security by the application of the moratorium. The UNCITRAL Legislative Guide justifies this approach as it may facilitate the achievement of multiple goals such as ensuring the equal treatment of creditors and increasing the likelihood of rescue efforts where the assets are essential to the business continuation and where the business is to be sold as a going concern in the event of liquidation.[89] The UNCITRAL Legislative Guide recommends that the insolvency law should identify the assets that should be included in the insolvency estate which can include the "debtor's interest in encumbered assets and in third-party-owned assets", the "assets acquired after commencement of the insolvency proceedings", and "assets recovered through avoidance and other actions".[90]

Nonetheless, the inclusion of the secured assets in the insolvency estate must not lead to depriving secured creditors of their rights in those assets and the law should ensure that the rights of secured creditors in the secured assets are well protected. For example, that law may specify situations where the secured assets may be excluded from the insolvency estate.[91] This is important to maintain the value of the secured assets and to ensure certainty for secured creditors about that value because otherwise the lending market will be undermined.

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[88] See: Susan Block-Lieb and Terence Halliday, 'Legitimation and Global Lawmaking' [2006] Fordham Law Legal Studies Research Paper No 952492, at 21 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=952492> accessed 28 Jul 2018

[89] UNCITRAL Legislative Guide, Part Two, Chap II, para 7 and 36

[90] Ibid, Rec 35

[91] Ibid, Part Two, Chap II, para 8

In Libya, in the case of the insolvent liquidation, the CCA 2010 in Article 1056 states that "Unless otherwise stated, it shall not be permitted; the constitution or the continuance of any individual actions on the assets that are included in the insolvency estate". This is advantageous because it facilitates value maximisation of the estate and enhances the equitable treatment of creditors by preventing the business's early dismemberment. However, apart from that, the moratorium in Libya is associated with some deficiencies particularly in the composition system. For instance, secured creditors are not bound by the composition procedures as they are not considered in the majority of creditors required to vote for the composition plan.[92] Therefore, they are enabled to enforce their securities during the process whenever they wish to. This is problematic because setting secured creditors out of the composition procedures would potentially lead to dismemberment of the business and reduction of the value of the insolvency estate. This will consequently lead to the disturbance of the rescue efforts and the sale as a going concern because the total value realised will be less and the sale may no longer be possible.[93]

3.4.3. Obj.3. Striking a Balance between Liquidation and Reorganisation

The UNCITRAL Legislative Guide consciously embraces rescue as an overriding objective of any effective insolvency regime and rejects exclusively liquidation-centred insolvency laws. Thus, it recommends that insolvency laws should "include provisions addressing both reorganization and liquidation of a debtor".[94] The UNCITRAL Legislative Guide justifies its preference for rescue on the ground that keeping the

[92] CCA 2010, Art 1002(1). Art 1002(2) states that "Secured creditors shall not participate in the composition plan voting unless they renounce their securities. Security renunciation may be partially to at least one-third of the total debt …".

[93] The moratorium of the composition system in Libya will be discussed in Chapter Four (Sec 4.3.5)

[94] UNCITRAL Legislative Guide, Rec 2. For more details see: Terence Halliday, Susan Block-Lieb and Bruce Carruthers, 'Missing Debtors: National Lawmaking and Global Norm-Making of Corporate Bankruptcy Regimes' in Ralph Brubaker, Robert Lawless and Charles Tabb (eds), *A Debtor World: Interdisciplinary Perspectives on Debt* (OUP 2012) 265-66

essential components of the business together would lead to a greater value than if the estate is fragmented in a piecemeal sale.[95] This would lead to preserving the going concern value of the business, to achieve goals that go beyond only maximising returns to creditors to promote advantages to other stakeholders in the community like the employees and suppliers which will eventually benefit the community as a whole.[96] Given the importance of this Objective, it will be discussed in detail in Chapter Four.

3.4.4. Obj.4. Ensuring Equitable Treatment of Similarly Situated Creditors

The insolvency law should employ the objective of equitable treatment during the collective proceedings by which similarly situated creditors are treated fairly; in that, they should receive a distribution on their claim in accordance with their relative ranking and interests when liquidation takes place.[97] The implementation of this principle should lead to an equal and rateable distribution of the insolvent company's assets among creditors. It is based on the idea that the loss resulting from insolvency should be shared rateably among those who have claims against the insolvency estate.[98] This objective in Libya is governed in the insolvency system by the operation of the *pari passu* rules.[99] The UNCITRAL Legislative Guide provides a definition for the *pari passu* principle as it is "… the principle according to which similarly situated creditors are treated and satisfied proportionately to their claim out of the assets of the estate available for distribution to creditors of their rank".[100]

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[95] UNCITRAL Legislative Guide, Part One, Chap I, para 6

[96] Bruce Carruthers and Terence Halliday, 'Institutionalizing Creative Destruction: Predictable and Transparent Bankruptcy Law in the Wake of the East Asian Financial Crisis' in Meredith Woo (ed), *Neoliberalism and Institutional Reform in East Asia: A Comparative Study* (Palgrave Macmillan 2007) 244

[97] UNCITRAL Legislative Guide, Part One, Chap I, para 7

[98] Stephan Madaus, 'Leaving the Shadows of US Bankruptcy Law: A Proposal to Divide the Realms of Insolvency and Restructuring Law' (2018) 19 Eur Bus Org Law Rev 615, 623

[99] CCA 2010, Art 1120(4)

[100] UNCITRAL Legislative Guide, Introduction, para 12. *(cc)*, at page 6

The principle of *pari passu* distribution is often said to be the foremost and most fundamental principle of corporate insolvency law as it ensures equality among unsecured creditors in the common pool and provides predictability to investors as to what to anticipate should their debtor company becomes insolvent.[101] The *pari passu* principle is, as explained by Professor Seligson:

> "All persons similarly situated are entitled to equality in treatment in the distribution of the assets of the bankrupt estate. It would be inequitable to disregard what has transpired prior to the filing of the bankruptcy petition".[102]

The principle *pari passu* distribution mandates that, in liquidation proceedings, unsecured creditors shall share rateably,[103] to the extent to their pre-insolvency claims, in the assets of the insolvent company that are available for distribution.[104] The *pari passu* is effectively applied only where there are unencumbered assets of the insolvent company that are available for distribution. Therefore, when the insolvent company has granted security of a particular asset, this asset is available for distribution *pari passu* only to the extent that its value exceeds the sum of the security.[105]

While some acknowledge that the *pari passu* principle is all-pervasive and fundamental to the insolvency process, some commentators, such as Mokal, heavily criticise this principle as it remains only as a theoretical doctrine and it has no significant application in the real world. In overwhelming majority of insolvency cases,

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[101] Goode (n 31) 235; Andrew Keay and Peter Walton, *Insolvency Law: Corporate and Personal* (4th edn, LexisNexis 2017) 505

[102] Charles Seligson, 'Preferences under the Bankruptcy Act' (1961) 15 Vand L Rev 115, 115

[103] According to Professors Finch and Milman, there are two meanings of the term 'rateably'. In its strong version, unsecured creditors as a whole are paid *pro rata* to the extent of their pre-insolvency claims, while in its weak version, *pari passu* means that unsecured creditors share rateably within the particular ranking that they are given on insolvency by the law. Vanessa Finch and David Milman, *Corporate Insolvency Law: Perspectives and Principles* (3rd edn, CUP 2017) 511

[104] Charlotte Cooke, Hamish Anderson and Louise Gullifer, 'National Report for England' in Dennis Faber and others (eds), *Ranking and Priority of Creditors,* vol 3 (OUP 2016) 223

[105] Finch and Milman (n 103) 512

as Mokal goes further, unsecured creditors are left with little if anything to be distributed to them due to numerous exceptions.[106] The Cork Report, having praised the principle of rateable distribution of unsecured assets, acknowledged that this principle is rarely attained in practice.[107]

However, the *pari passu* principle cannot simply be disregarded. Professor Goode, for instance, praises this principle and purports that its practical deficiency cannot undermine its centrality to the insolvency law. But rather, the reason behind its impracticality is attributable to the fact that this principle is applied only to the unencumbered assets of the company which are depleted by the development of extensive range of security interests, hence, the amount of unencumbered assets available for distribution to unsecured creditors became relatively little.[108] Accordingly, the Cork Report in the UK admits that the system of priorities accorded by the law is the cause of this public dissatisfaction because they operate to the detriment of unsecured creditors. The Cork report, therefore, suggested significant reduction and even elimination of the categories of debts with insolvency priority.[109]

The objective equitable treatment of creditors supposes that creditors are categorised into groups with relative rankings and interests.[110] Many creditors enjoy similar situations with respect to their claims they hold on the ground of similar legal or

[106] Mokal identifies these exceptions into five categories which can truly violate the *pari passu* principle; they are namely the insolvency set-off rights, creditors whose claims arise after the winding-up order has been made are given privileged treatment, some types of pre-liquidation creditors, preferential claims and finally some types of debts have been deferred by the statute. For details see: Rizwaan Mokal, 'Priority as Pathology: the pari passu Myth' (2001) 60 CLJ 581, 585-90. Also see: Keay and Walton (n 101) 506

[107] The Cork Report, para 1396

[108] Goode (n 31) 99

[109] The Cork Report, paras. 1397-98. The Cork Report suggested also that a 'Ten Per Cent Fund' "equal to 10% of the net realisations of assets subject to a floating charge should be made available for distribution among the ordinary unsecured creditors". Ibid, para 1538. This proposal was never implemented but it influenced the "Prescribed Part" introduced in Insolvency Act 1986, s 176A, following the EA 2002. See: Kayode Akintola, 'The Prescribed Part for Unsecured Creditors: A Pithy Review' (2017) 30 Insolvency Intelligence 55

[110] UNCITRAL Legislative Guide, Part One, Chap I, para 7

contractual rights. However, other creditors enjoy different treatment by which their claims or rights are superior. Accordingly, those various claims are ranked by the law for the purposes of distribution of the insolvency estate in liquidation according to the creditors' prescribed pre-insolvency priorities.[111] This does not operate against the objective of equitable treatment however. The ranking of creditors' claims is justifiable as creditors usually enjoy distinct situations with the debtor based on commercial bargains which have to be recognised and respected by the insolvency law.[112] For instance, secured assets are, for the purpose of security, not assets of the debtor and therefore they fall outside of the debtor's distributable assets. Accordingly, secured creditors can enforce their claims against the insolvent debtor outside the insolvency procedures or obtain distribution from those assets in liquidation.[113] This, as the UNCITRAL Legislative Guide acknowledges, would achieve broader goals; namely the preservation of legitimate commercial expectations, the promotion of predictability in commercial relations and the equal treatment of similarly situated creditors.[114]

There are other kinds of interests which the law entitles to some kind of priority as an exception to the *pari passu* principle. The justification of such exceptional cases varies depending on social and maybe political considerations. Those can be based on important public interests (employment protection and preference), the desirability to achieve orderly and effective conduct of insolvency process (priority of insolvency professionals and expenses for the insolvency administration) and the promotion of the continuation of the business and rescue (priority for post-commencement fund).[115]

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[111] Cooke, Anderson and Gullifer (n 104) 210
[112] This is what the Creditors' Bargain Theory focuses on. See above Sec 2.2.1
[113] Cooke, Anderson and Gullifer (n 104) 225
[114] UNCITRAL Legislative Guide, Part Two, Chap V, para 52
[115] Ibid, Part Two, Chap V, para 53

However, the application of some rules may have an effect on the achievement of the equitable treatment through the *pari passu* principle. To start with, the rule of set-off of mutual claims[116] is provided by insolvency laws regarding mutual money obligations between the debtor and its creditors to be paid out of the insolvency estate. Critics of insolvency set-off argue that it has an effect on the equitable treatment of similarly situated creditors. For example, where counterparty A has provided the credit to counterparty B without security and A also owes B money then it will be placed in a better position than the insolvent counterparty B's other unsecured creditors with regard to the debt owed to B which is effectively paid to the counterparty A before other unsecured creditors are paid anything.[117]

In Libya, set-off right entitles a counterparty of mutual claims to exercise the right to set-off claims against the insolvent company. Set-off rights under the Libyan law are exercised by creditors without the need for judicial interference.[118] Ironically, the set-off is generally permitted during the insolvency procedures even if the debt is not yet due, unless the undue debt was acquired by a creditor after the insolvency declaration or within one year prior to the insolvency adjudication, then it shall be void.[119] Set-off rights have an impact on the principle of equitable treatment and, therefore, the use of this right should not be left to the full discretion of individual creditors. Set-off rights in countries where they are permitted, are only permitted by the insolvency practitioner or the court in a claims verification and admission process, provided that certain conditions are met, in order to restrain the creditors' race in enforcing their claims.[120]

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[116] Ibid, Part Two, Chap V, para 44
[117] Finch and Milman (n 103) 524
[118] Salma Hamida, *The Concept of Self-help Remedy Justice in the Libyan Civil Law: A Comparative Study* (University of Tripoli 2008) 46-49
[119] CCA 2010, Art 1061
[120] UNCITRAL Legislative Guide, Part Two, Chap V, para 44

Furthermore, secured claims may rationally be subordinated to other claims. First, should the insolvency administrator need to spend some money in maintaining the value of the encumbered assets, secured creditors are meant to contribute to the recovery of those expenses as administrative expenses from the amount that would otherwise be paid in priority to the secured creditor from the sale proceedings.[121] This is reasonable because such costs are spent directly to maintain the creditors' own interests. Secured creditors may additionally be subordinated to other claims when the survival of the distressed company relies on the post-commencement finance with post-commencement lenders being granted super-priority security as long as the effect on the interest of secured creditors of any security granted is set forth clearly at the time finance is provided.[122] A notable example of the super-priority security for post-commencement creditors is the priming lien system of Chapter 11 of the US Bankruptcy Code 1978 as contained in section 364(d) on assets that are already secured by pre-existing liens.[123]

In addition, preferential claims (or as known in Libya as privileged or excellent claims) are originally unsecured claims which are thus supposed to enjoy same treatment with similarly situated unsecured claims and be paid proportionally. However, the law assigns them priority over other unsecured claims.[124] That is why it is

[121] Resources expended by the insolvency representative in maintaining the value of the encumbered assets can be considered as administrative expenses and should be recovered in priority from the assets' sale proceedings. See: CC 1953, Art 1142(1)(2) states that 'The judicial expenses spent for the benefit of all creditors for maintaining and selling the debtor's assets and property are entitled a priority over the price of these assets. And such expenses are paid in priority to any other rights …'. It should be noted that the provision of this Article covers the expenses spent for the benefit of all creditors, secured and unsecured. General administrative expenses, as such, will be prioritised even over the secured creditors. Although such expenses are important to have some statutory priority, they should not be paid ahead of the secured creditors unless they are spent to maintain the value of the secured assets. See: UNCITRAL Legislative Guide, Part Two, Chap V, para 66

[122] UNCITRAL Legislative Guide, Part Two, Chap V, para 65

[123] But subject to the approval of the court. See: George Triantis, 'A Theory of the Regulation of Debtor-in-Possession Financing' (1993) 46 Vand L Rev 901

[124] UNCITRAL Legislative Guide, Part Two, Chap V, paras. 67-71

believed that such claims operate against the principle of *pari passu* distribution[125] and, consequently, they could reduce the value of assets available for distribution to other ordinary unsecured claims.[126] Where such privileges are to be incorporated into the insolvency law, it is recommended by the UNCITRAL Legislative Guide that such privileges are minimised.[127]

Strikingly odd, the privileged claims in Libya enjoy a priority order above not only the claims of unsecured creditors, but also over secured creditors. This contradicts with maximisation of the value of the assets and equitable distribution of the creditors and is detrimental to the any insolvency procedures.[128] It also undermines the pre-insolvency rights of the secured creditors which must be protected to ensure certainty of the insolvency procedures which is crucial to enhance the affordability and availability of credit in the market.

3.4.5. Obj.5. Provision for Timely, Efficient and Impartial Resolution of Insolvency

Effective insolvency and rescue procedures require the court and the insolvency practitioners to take rapid decisions and quick actions to address insolvency cases because if the procedures take longer than necessary they otherwise will result in inefficiency as well as maximising the distress of creditors because of the losses they suffer.[129] The delay of the procedures is detrimental to the whole rescue process by

[125] Preferential creditors in the UK, for example the employees, are prioritised ahead of a floating charge holder and other unsecured creditors. IA 1986, Sec 175(1) and 175(2)(b)
[126] Christopher Symes, *Statutory Priorities in Corporate Insolvency Law: An Analysis of Preferred Creditor Status* (Routledge 2016) 1
[127] UNCITRAL Legislative Guide, Rec 187
[128] A detailed discussion on the privileged creditors will be furthered in Chapter Five in Sec 5.3.7
[129] John Armour, 'The Law and Economics of Corporate Insolvency: A Review' (2001) ESRC Centre for Business Research, University of Cambridge Working Paper No 197, 20 <www.cbr.cam.ac.uk/fileadmin/user_upload/centre-for-business-research/downloads/working-papers/wp197.pdf> accessed 8 Nov 2019; Soogeun Oh and Terence Halliday, 'Rehabilitating Korea's

minimising the likelihood of successful rescue efforts. The delay leads to reducing the value of the debtor's assets and maximising loss by creditors even where the process has potential for a successful rescue.[130] The UNCITRAL Legislative Guide Objective Five insists that "Achieving timely and efficient administration will support the objective of maximizing asset value …".[131] Insolvency laws, accordingly, have to ensure flexibility in the procedures; in that nonviable and inefficient businesses can be liquidated in time while efficient and potentially viable businesses can be rescued.[132]

In order to apply rapid decisions, courts have to put a time limit to certain procedures and commence the rescue procedures within a short time from the date of application. In this short period, courts will not need to undertake substantive tests regarding the eligibility of the insolvent business for the rescue procedures. Thus, the court's examination authority for the commencement of a procedure should be limited to procedural formalities like whether the debtor has used the proper forms and the fees of application.[133] Delays in courts' decisions, as the IMF acknowledges in its 1999 document regarding to *Orderly & Effective Insolvency Procedures*, can adversely affect the value of the debtor's assets or the viability of the business.[134] Therefore, courts have to ensure that their decisions are made in a quick and orderly manner. And when appeals are available, they have to be expeditious ensuring that the lower court's decisions continue to be binding pending the outcome of appeal.[135]

Corporate Insolvency Regime, 1992–2007' in John Gillespie and Randall Peerenboom (eds), *Regulation in Asia: Pushing Back on Globalization* (Routledge 2009) 244-45

[130] Janis Sarra, *Creditor Rights and the Public Interest: Restructuring Insolvent Corporations* (UTP 2003) 59

[131] UNCITRAL Legislative Guide, Part One, Chap I, para 8

[132] Ibid, Part One, Chap I, para 8

[133] Oh and Halliday (n 129) 244-45

[134] International Monetary Fund (IMF), *Orderly & Effective Insolvency Procedures: Key Issues* (1999) <www.imf.org/external/pubs/ft/orderly/> accessed 24 Oct 2018

[135] Ibid

Furthermore, striking a balance between liquidation and rescue requires the insolvency law to facilitate easy conversions from failed rescue to liquidation. In the absence of such a mechanism, the rescue process would be at the expense of the creditors who may decide not to support it as a consequence.[136] And, the court and the insolvency practitioners should be independent and not try to waste their efforts by trying to bring pulses to a dead body because this will result in wasting creditors' interests by decreasing the estate value through needless incurring of costs.

In general terms, efficiency is described as the relationship between the aggregate benefits and the aggregate costs of a situation or a legal rule.[137] Efficiency of insolvency laws seems to relate to, as Ringe acknowledges, the speedy process in which the available resources are allocated to their best use in the insolvency procedures, either through traditional liquidation or rescue processes. The efficiency of the insolvency law is achieved by expeditious process since this would result in lower costs and higher efficiency of the process.[138]

The UNCITRAL Legislative Guide in Objective Five provides examples on how to achieve quick and orderly resolution of the debtor's financial trouble by introducing an insolvency law that provides: (a) easy access to the insolvency procedures either in liquidation or reorganisation, (b) a convenient means of identifying, collecting, preserving and recovering assets and rights that should be applied towards the debtor's payment of debts and liabilities, (c) participation of the debtor and the creditors with the least possible delay and costs, (d) a proper structure of the supervision and

[136] Carruthers and Halliday, 'Institutionalizing Creative Destruction' (n 96) 252
[137] A Polinsky, *An Introduction to Law and Economics* (5th edn, Wolters Kluwer 2018)
[138] Wolf-Georg Ringe, 'Strategic Insolvency Migration and Community Law' in Wolf-Georg Ringe, Louise Gullifer and Philippe Théry (eds), *Current Issues in European Financial and Insolvency Law: Perspectives from France and the UK* (Hart Publishing 2009) 91

administration of the procedures either through professionals or court processes, (e) effective resolution of the debtor's financial burdens.[139]

Further, to achieve the goal of equitable treatment, the insolvency law has to be applied impartially.[140] Impartiality of insolvency law relies on certain characteristics of the persons who are in charge of administrating the insolvency procedures. To ensure that, the UNCITRAL Legislative Guide indicates that "the insolvency law should specify the qualifications and qualities required for appointment as an insolvency representative", as well as "grounds upon which a proposed insolvency representative may be disqualified from appointment".[141] The insolvency practitioner should attain qualifications and personal qualities as prerequisite for appointment. Qualities of the practitioner may include "integrity, independence, impartiality, requisite knowledge of relevant commercial law and experience in commercial and business matters".[142]

The UNCITRAL Legislative Guide explains in the commentary the focus on the qualifications and qualities prerequisite for the appointment of insolvency representatives by the central role that the representatives play to ensure effective and efficient implementation of the insolvency law. They are authorised to exercise certain powers over distressed businesses and they have a duty to protect the value of those businesses. They are also empowered to protect the interests of other stakeholders such as the creditors and the employees.[143]

In Libya, there are concerns regarding the duration of the procedures and the issue of insolvency qualifications. The insolvency law of Libya does not provide a timeline for

[139] UNCITRAL Legislative Guide, Part One, Chap I, para 9
[140] Ibid, Part One, Chap I, para 8
[141] Ibid, Rec 115
[142] Ibid
[143] Ibid, Part Two, Chap III, para 35

the procedures as the court has wide discretion to determine the time of the procedures, not to mention the cumbersome and time-consuming nature that have tended to characterise the court procedures. They are subject to multi appeal processes triggered by dissenting parties which results in delays in procedure conclusion.[144]

And the insolvency representatives in the country, namely the court appointed judge and the trustee/ practitioner, are neither required to obtain insolvency or business-related qualifications or experience nor do they receive training to deal with insolvency cases. Regarding the insolvency trustees/ practitioners, Article 1032 of the CCA 2010, entitled 'Roster of Judicial Administrators', provides that District Courts shall keep a roster of judicial experts among whom the insolvency trustee is selected but no specific knowledge is required. The Judicial Expertise Act 2003[145] in Article 5(3) and its Executive By-law[146] in Article 2(z) require for judicial experts to obtain only graduation qualifications with practical experience defined by the Expertise Committee. However, what constitutes a practical experience does not necessarily relate to insolvency or business matters. In fact, insolvency and liquidation matters have been dealt with either by lawyers or accountants who have no specific knowledge about the insolvency and rescue cases.[147]

It is vitally important for the insolvency and rescue procedures to proceed in a timely manner because this would increase the confidence of the creditors in the procedures and would in turn increase credit availability and affordability. Therefore, insolvency law and procedures have to include sufficient mechanisms that help the court and the practitioners to ensure that procedures are concluded quickly and efficiently. In

[144] Uttamchandani, 'No Way Out' (n 75) 10
[145] The Judicial Expertise Act no 1 of 2003 (published in the Official Gazette in 13 Jun 2003)
[146] The Executive by-law no 305 of 2009 of the Judicial Expertise Act 2003, (promulgated in the Official Gazette in 27 Jun 2009). Also see: Uttamchandani, 'No Way Out' (n 75) 26-27
[147] Uttamchandani, 'No Way Out' (n 75) 16

addition, the matter of the insolvency representative is very essential in achieving decent outcomes from the procedures and, therefore, the introduction of training and certification at the same time as the legal framework would clearly be useful in the country. This is very crucial for an effective insolvency law that is anchored on principles such as the maximisation of the insolvency estate value, saving viable businesses from liquidation and applying a timely resolution of insolvency. Such principles cannot be achieved without professional and competent practitioners that capable of realising such principles.[148]

Evidence from international practice has shown that countries that pay particular attention to the minimum qualifications and insolvency-specific training and knowledge for insolvency practitioners succeeded in increasing the recovery rates in the insolvency proceedings.[149] For example, the UK IA 1986, influenced by the Cork report, adopted the compulsory professional licensing "for most insolvency procedures" as a response to a number of high-profile scandals caused by misconduct of unqualified liquidators. The insolvency practitioners these days in the UK are professionally qualified and members of recognised professional bodies. The introduction of this system in the UK has been praised for its benefit to the insolvency profession as it has led to improved standards of supervision and management of insolvent companies.[150]

[148] Halliday, 'Lawmaking and Institution Building' (n 21) 8-13
[149] World Bank, *Doing Business 2009* (World Bank 2008) 55, Figure 11.3
[150] David Milman, *Governance of Distressed Firms* (Edward Elgar 2013) 83-86

3.4.6. Obj.6. Preservation of the Insolvency Estate to Allow Equitable Distribution to Creditors

Preservation of the value of the insolvency estate is a fundamental objective to collective insolvency procedures as it may ensure that the insolvency estate has sufficient value for distribution among creditors by keeping the assets in the estate together.[151] It also increases the likelihood of a successful rescue or the sale of the business as a going concern in liquidations by maintaining sufficient assets available for the process.[152] Preservation of the insolvency estate is usually achieved by preventing the insolvent debtor from making unfair disposition of its assets at the expense of creditors.

In insolvency, the property of the distressed company is supposed to be available for distribution to the creditors. But the insolvency estate could potentially be depleted when an insolvent company disposes of its property for less than full value to the extent that would affect the distribution for creditors, either in the value of the estate available or in the entitlements of creditors. The legal response to this problem is to employ provisions enabling the avoidance of such abusive transactions to maintain the scheme of distribution.[153] These provisions are known as the transaction avoidance laws. Provisions governing transaction avoidance are considered key features of any effective insolvency law because of their contribution to maintaining and enforcing the schemes stated in the insolvency laws for the distribution of the insolvency estate. Without such provisions, the insolvency estate can be depleted before or after the opening of the

[151] Adrian Walters, 'Preferences' in John Armour and Howard Bennett (eds), *Vulnerable Transactions in Corporate Insolvency* (Hart Publishing 2003) 131; Rizwaan Mokal, 'What Liquidation Does For Secured Creditors, And What It Does For You' (2008) 71 Mod L Rev 699

[152] UNCITRAL Legislative Guide, Part One, Chap I, para 10

[153] Rebecca Parry, James Ayliffe and Sharif Shivji, *Transaction Avoidance in Insolvencies* (2nd edn, OUP 2011) 4

insolvency case which may lead to creditors being left with little, if anything, for distribution.[154]

To avoid this risk, therefore, the transactions avoidance laws are designed to enable the insolvency practitioner to restore the estate to a value equivalent to what would have been if the transaction had not taken place.[155] This is the rule. The UNCITRAL Legislative Guide recommends that the insolvency law "… should include provisions that apply retroactively and are designed to overturn transactions, involving the debtor or assets of the estate, and that have the effect of either reducing the value of the estate or upsetting the principle of equitable treatment of creditors".[156]

According to the Legislative Guide, there are three types of avoidable transactions that can be found in most legal systems: (a) transactions intended to defeat, hinder or delay creditors from collecting their claims, (b) transactions at undervalue, (c) transactions that could be regarded as preferential treatment to certain creditors.[157] Any transactions that are considered by the insolvency practitioner or the court to fall into one of these categories should be potentially voidable. To trigger the transaction avoidance system, transactions typically have to occur within a certain period of time; called the suspect period.[158]

The date of a transaction is of a vital aspect in the avoidance provisions. Most insolvency laws in the world explicitly specify the time period within which a transaction must have occurred if it is to be voidable as well as indicating the date from

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[154] Walters (n 151) 133-34

[155] Rebecca Parry, 'Transaction Avoidance' in Rebecca Parry, Yongqian Xu and Haizheng Zhang (eds), *China's New Enterprise Bankruptcy Law: Context, Interpretation and Application* (Ashgate 2013) 149

[156] UNCITRAL Legislative Guide, Rec 87

[157] Ibid, Part Two, Chap II, para 170

[158] The mechanism of suspect period is important to protect commercial expectations by not interfering with settled transactions. See: Walters (n 151) 133-35

which the period is calculated retroactively. The suspect period could be several days or months prior to a particular event or time. For example, the date of application for commencement of procedures or the effective date of commencement of the procedures, or it could be the date decided by the court as being the date of cessation of payments.[159]

Voidable transactions provisions should be properly balanced with the competing social benefits. The UNCITRAL Legislative Guide proposes that insolvency laws, relating to actions to restore assets to the insolvency estate, should take into account whether the avoidance of a transaction will be beneficial to the insolvency estate and whether the avoidance of a transaction may disturb the rescue plan and the possible cost of avoidance proceedings should also be considered. Transaction avoidance should be subject to the discretion of the court when exercising its obligation of maximising the assets value.[160]

In addition, the avoidance provisions are not only shaped by the need to maintain and enforce the scheme of asset distribution for the benefit of creditors, but there is also a need to achieve a balance between the need to protect the creditors' interests with the need to ensure contractual certainty.[161] Therefore, it should be taken into account that in some situations parties may have acted in good faith believing that the transaction is valid. There is an undesirable consequence then to affect transactions which will undermine certainty in contractual dealings. It has been pointed out that, while the

[159] UNCITRAL Legislative Guide, Part Two, Chap II, para 188
[160] Ibid, Part Two, Chap II, para 187
[161] Walters (n 151) 135

former concern leads to the implementation of transaction avoidance, the latter concern limits the scope of the transaction avoidance.[162]

In Libya, avoidable transactions are regulated in the insolvency law which provides a wide range of transactions that are subject to avoidance if they occurred within a certain fixed period of time (one year or two years prior to the insolvency declaration) and specified that such transactions will be, accordingly, void. The CCA 2010 in Article 1069, entitled 'Transactions Free of Charge', provides that: "It shall be void, any transactions free of charge occurring within two years prior to the insolvency declaration…".[163] Article 1070, entitled 'Repayments', states that: "It shall be void, the repayments of debts that have fallen due in or after the day the insolvency status was declared if such transactions occurred within two years prior to the insolvency declaration".[164] Article 1072 covers a wide range of transactions stating that: "(1) Unless otherwise proven that the beneficiary (the counterparty) acted in a good faith,[165] the following transactions shall not be effective against the creditors: (a) the transactions or the obligations occurring within two years prior to the insolvency at an unreasonable undervalue, (b) the repayments of monetary debts that have fallen due if they are not paid by monetary means as long as they are paid two years prior to the insolvency declaration, (c) securing debts that have not fallen due and were not previously secured if they occurred within two years prior to the insolvency declaration, (2) Provided that the insolvency practitioner/ trustee proves that the beneficiary (the counterparty) was acting in bad faith,[166] it shall not be effective against

[162] Parry, Ayliffe and Shivji (n 153) 15
[163] CCA 2010, Art 1069. This Article however made some exemptions from avoidable transactions. These include conventional gifts of a minor value, transactions made as fulfilment of a moral duty or for achieving public benefit as long as they are at minor value.
[164] Ibid, Art 1070
[165] That the beneficiary does not know about the debtor's inability to pay debts.
[166] That the beneficiary knows about the debtor's inability to pay debts.

the creditors also the fulfilment of debts that have already fallen due, and any transactions (even) at reasonable prices and the transactions that immediately grant security or preference on a debt if these transactions occurred within one year prior to the insolvency declaration".[167]

A critical review of these provisions leads to two main conclusions. On the one hand, the Libyan law does not cover all types of avoidable transactions as anticipated in the Legislative Guide. The avoidance provisions in Libya do not cover transactions intended to defeat, hinder or delay creditors from collecting their claims. On the other hand, the duration of the suspect period, which is generally two years or one year when it is proved that the counterparty was acting in bad faith, calculated retroactively from the date of the insolvency declaration can be criticised on the ground that specifying the date of insolvency declaration as the date from which the suspect period is calculated can undermine certainty regarding the transaction's validity. This is because the date of the insolvency declaration is not certain as there is a potential for a delay of several months after the petition or the commencement of proceedings, then several months of that fixed period will be taken up by the period of the delay between the application and the insolvency declaration. Such a potential delay can also occur during the composition system between the date of the composition application and the insolvency declaration. In the meanwhile, debtors may take advantage of the composition to get away with transactions during the suspect period, especially when there is no potential for the composition, as there is no time limit within which the composition proceedings should conclude. Accordingly, some voidable transactions may not be subject to the avoidance provisions only because they occurred within a period of more than two years, or one year as the case maybe, from the date of the insolvency declaration.

[167] CCA 2010, Art 1072

Undoubtedly, this will in turn limit the potential effectiveness of the avoidance powers and will in turn prejudice the objective of maximisation of the assets value and also the equitable distributions to creditors. The UNCITRAL Legislative Guide discussed the situation when such a potential delay could happen and recommends that the insolvency law should precisely specify the date from which the suspect period is calculated. The date may be "… either the date of application for, or commencement of, the insolvency proceedings".[168]

3.4.7. Obj.7. Ensuring a Transparent and Predictable Insolvency Law that Contains Incentives for Gathering and Dispensing Information

It is believed that transparency and predictability are very significant in any legal system. Transparent and predictable insolvency laws play a fundamental role in dealing with distressed companies and in preventing and resolving financial crises.[169] Transparency implies that the insolvency law aims to facilitate accessible corporate information. This is important to assess whether a process is reliable and whether the procedures are adequate to afford a level of protection to the affected parties. The purpose of enhancing transparency in the insolvency procedures is to determine whether a decision made by the court or the insolvency practitioner was based on sensible justifications. This is essential to ensure that the decision made in the process is not benefiting one party over another.[170]

Enhanced transparency of insolvency procedures can encourage the creditors to play an active role in the decision making. This is because, as the WB acknowledges,

[168] UNCITRAL Legislative Guide, Rec 89. The Legislative Guide in this recommendation allows insolvency laws to specify different suspect periods for different types of transactions. For details see: Ibid, Part Two, Chap II, para 188

[169] Halliday, 'Architects of the State' (n 83) 273

[170] John Wood, 'Corporate Rescue: A Critical Analysis of its Fundamentals and Existence' (PhD thesis, University of Leeds 2013) 155-56

enhancing transparent legal systems through more stringent disclosure requirements is an essential requirement to strengthen investors' protection and increase their confidence.[171] And transparent insolvency procedures are vital to enable the creditors to assess the value of their rights and interests over the assets and liabilities encumbering them with a high degree of accuracy.[172] Creditors should be provided with relevant and accurate information about the financial affairs of the debtor's business and should be provided also with notice of issues that may affect their interests and on which they may be required to decide or advice.[173]

Predictable insolvency law is beneficial to debtors and creditors as it provides them with a high degree of assurance by which they can predict the outcomes of the procedures. For example, they can predict what rights and interests they have over assets, what liabilities the assets are encumbered with and how their rights and liabilities will be enforced in courts.[174] Predictability as such is linked closely to legal certainty; in essence the law is structurally clear and known in advance as discussed above,[175] because when the law is associated with legal uncertainty, the outcomes of the process would become very unpredictable. Equally important, the insolvency law should not only be clear to achieve predictability, but it should also be effectively enforceable with less discretion vested in the court or the trustee. It is acknowledged that predictable insolvency systems and sound systems for the collective debt resolution can have a significant influence on the investment decisions of investors.[176]

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[171] World Bank, *East Asia: Recovery and Beyond* (World Bank 2000) 83
[172] Lawrence Summers, 'International Financial Crises: Causes, Prevention, and Cures' (2000) 90 Am Econ Rev 1, 11; Carruthers and Halliday, 'Institutionalizing Creative Destruction' (n 96) 263
[173] UNCITRAL Legislative Guide, Part Two, Chap III, para 86
[174] Carruthers and Halliday, 'Institutionalizing Creative Destruction' (n 96) 263
[175] See above Sec 3.4.1
[176] Frouté (n 68) 204

The law in Libya insists on the final reports provided by the insolvency practitioners in both rescue and liquidation procedures. Such reports are sources for the court and its judge to gather relevant information regarding the situation of a distressed business. For example, in the composition procedures, the trustee is committed to do a preliminary assessment of the company's insolvency, the debtor's composition proposals and the guarantees offered to the creditors and submit an assessment report to the court at least three days prior to the creditors' meeting.[177] The trustee has to inform the judge delegate immediately about any activities that may prove the debtor's dishonesty or unworthiness or any unauthorised activities that may prejudice the creditors' interests during the procedures.[178] Such reports are useful to determine the viability of the business before the approval of the debtor's proposals. During the implementation of the composition, furthermore, the trustee has to report to the judge about whatever may affect the creditors' interests.[179]

In the insolvent liquidation procedures, the trustee has a duty to submit to the judge a detailed report within one month of the insolvency declaration articulating all relevant information and documents that demonstrate the responsibility of the management, the supervisory board, external accounts auditors and shareholders. The trustee is expected to provide a monthly statement to the judge articulating his/ her management of the insolvent company's business and assets.[180]

Due to the lack of an insolvency profession in Libya, it may be useful to resort to related professional bodies to assist the court and its representatives in carrying out the rescue and insolvency procedures. In some cases, the law refers to the options where

[177] CCA 2010, Art 997(1)(2)
[178] Ibid, Art 998
[179] Ibid, Art 1010
[180] Ibid, Art 1038

the judge may appoint an assistant expert to assist the practitioner in carrying out the procedures. For instance, in Article 997(2) of the CCA 2010, the judge is authorised to appoint an external expert to help in assessing the valuation of the business.[181] One of the professional bodies that the court may resort to is the Libyan Auditors and Accountants Association. The CCA 2010 refers to this body and obliges companies to appoint at least one external accounts auditor. The law considers the reports issued by the auditor valid and effective unless otherwise proven.[182]

Further, the law vests in the external accounts auditor an important duty to examine the company's financial situation and submit a report in this regard to the company's general assembly within a period not exceeding forty five days from the date he or she received the company's financial data. The law requires the company's management to coordinate with the auditor and provide all financial statement and documents.[183] A copy of each of the auditor's report, the general assembly minutes, the reports of board of directors and the supervisory board must be approved by the general assembly and must all be submitted to commercial registry within ten days of the general assembly's approval.[184] In the insolvency context, it is important that the insolvency practitioners to cooperate with auditors' reports as they could foster transparency and predictability of the procedures and this would advantage not only the interests of the creditors but might also ensure local and foreign investors' confidence as to what to anticipate if they need to resort to the procedures. This, therefore, should be the norm and the insolvency practitioners in fact should be under a duty, where they lack the necessary experience, to seek advice and assistance from such professionals.

[181] Ibid, Art 997(2)
[182] Ibid, Art 18
[183] Ibid, Art 209 and 210
[184] Ibid, Art 211

When businesses become insolvent, creditors should be allowed by the insolvency law to exercise their rights and interests in a predictable manner with the facilitation of the possible alternatives, whether liquidation or rescue, that maximise the economic values of the insolvency estate.[185] In Libya, creditors, mainly banks, are frustrated from enforcing their interests in the event of insolvency and the tendency among creditors is to overlook loan delinquency and roll over the debts hoping for turnaround. In the meanwhile, they tend to declare the non-performing status of loans. Actually, this is attributable to inefficiency of courts for debt recovery combined with the inefficiency of the current structure of the insolvency law which has been associated with unpredictability in terms of enforcement since creditors may wait years before they can see any returns, if ever.[186]

For example, time limitation on the formulation of insolvent liquidation or the composition strategy within which procedures are conducted is lacking while the court is vested with great discretion over this matter. Article 988 of the CCA 2010, for instance, states that "Should the court deem the proposal to be admissible, it shall declare the commencement of the composition procedure by an order that includes the following: (1) to delegate a judge to carry out the procedures; (2) to call for the creditors to convene within thirty days from the date of the commencement order; (3) to appoint the judicial supervisor selected from the judicial supervisors list; (4) to specify a time limit not exceeding eight days within which the party who applied for the composition has to pay the expenses necessary to carry out the procedures; …". As it appears from this Article, there is no clear timeline within which the court has to commence or conclude the procedures and as such it may take the court a longer time than necessary to deem the admissibility of the proposal. This would undoubtedly raise

[185] Carruthers and Halliday, 'Institutionalizing Creative Destruction' (n 96) 247
[186] Gabgub (n 76) 192-224

concerns as to whether the proceedings provide an acceptable level of predictability and accountability to all interested parties.

In the insolvent liquidation, further, the insolvency trustee and the judge are the parties who carry out the management of the distressed business.[187] The law, however, does not define the limitation of the management by the insolvency representatives and as such they can exercise a great deal of discretion regarding the administration of the business. This opens the door for corruption and gives the insolvency representatives incentives to prolong the procedures. As a result, distressed businesses will likely be exposed to increased costs of the procedures including fees required by accountants, lawyers, auditors as well as costs caused by the delayed procedures.[188] The insolvency practitioners may get advantaged by the great discretion given to the court regarding their remunerations.[189] Arguably, such undefined discretion is undesirable as it should be limited to ensure transparency and predictability.[190] This otherwise would heighten the level of unpredictability to the creditors and would minimise returns to the creditors. Therefore, a clearly defined time limit that encourages expeditious handling for the procedures is necessary.

Transparency and predictability can be achieved when the creditors are enabled to clarify their priorities and when they are enabled to assess rights and risks.[191] Practically, this can be achieved by the establishment of an effective security

[187] CCA 2010, Art 1036(1)
[188] Stephen Ferris and Robert Lawless, 'The Expenses of Financial Distress: The Direct Costs of Chapter 11' (2000) 61 UPittL Rev 629. Also see: James Ang, Jess Chua and John McConnell, 'The Administrative Costs of Corporate Bankruptcy: A Note' (1982) 37 J Fin 219
[189] CCA 2010, Art 1044(1) states that "Remunerations of the trustee are determined by an unchallengeable order issued by the Court of Instance upon a request of the trustee, in accordance with the delegate judge's report and with the scheme of the experts' roster".
[190] UNCITRAL Legislative Guide, Part One, Chap I, para 11
[191] Ibid, Part One, Chap I, para 11

registration system.[192] This is because registration systems function to inform parties about the existence of secured assets and to establish the effectiveness and priority of secured creditors against third party claimants. By this, the problem of false wealth can be avoided and the certainty regarding continued rights of secured interests can be enhanced.[193]

The availability of credit assessment information provided by registration systems can contribute to enhance the certainty and predictability in the application of rescue procedures. First, with an effective registration system, insolvent businesses that are hopelessly burdened by debt and therefore nonviable may be identified as unsuitable to enter the procedures at an early stage. This would result in better candidates for possible rescue and would lead to the maximisation of the business value for the benefit of creditors. Second, as registration systems establish the validation and effectiveness of security interests, more certainty regarding secured property interests can be achieved. In the context of insolvency, this means that secured interests that are unperfected will be invalid against the insolvency estate and other secured property and they will be dealt with free from claims of such interests.[194] In addition, the determination of the priority between secured creditors in a certain manner can advantage the administration of the rescue procedures because any disputes regarding the priority of secured interests over the encumbered assets can be dealt with by the

[192] This will be discussed in more detail below in Sec 5.5

[193] Alejandro De la Campa, 'Increasing Access to Credit through Reforming Secured Transactions in the MENA Region' [2016] World Bank Policy Research Working Paper No 5613, at 35 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1794918> accessed 6 Mar 2019

[194] Ronald Harmer, 'Insolvency Law Reforms in the Asian and Pacific Region: Law and Policy Reform at the Asian Development Bank' (2000) 1 International Insolvency Institute Report No TA 5795-REG, at 91 <www.iiiglobal.org/node/1815> accessed 13 Apr 2018

insolvency representatives.[195] This would result in smooth and streamlined processes.[196]

3.4.8. Obj.8. Recognition of Existing Creditor Rights and Establishment of Clear Rules for Ranking of Priority Claims

In business failure, the interests of creditors are affected. Therefore, it is important that the law protects those interests against the insolvency of the debtor in accordance with national priorities. The UNCITRAL Legislative Guide sets out clearly that an insolvency law should clearly recognise the rights and priorities of creditors in insolvency. Creditors are passionate about having their interests protected in such situations and the law should provide assurance that the rights and priorities of the different creditors are recognised. This is an essential objective of the law because it "will create certainty in the market and facilitate the provision of credit".[197] Given the importance of this Objective, it will be discussed in more detail in Chapter Five which will analyse secured transactions law of Libya.[198]

3.5. Conclusion

Libyan policymakers are encouraged to use those international benchmarks and key objectives to bring its insolvency laws and practices in line with international best practices. The rationale for using the UNCITRAL Legislative Guide to evaluate the Libyan insolvency system is that its principles and recommendations reflect the best practices of developed economies where the insolvency field has witnessed a notable degree of success in enhancing national economies by increasing flows of capital and

[195] Ibid 92
[196] For details about the discussion on the registration system in Libya, see below Sec 5.5
[197] UNCITRAL Legislative Guide (Objective Eight), Part One, Chap I, Para 13
[198] See Sec 5.2

attracting investors both locally and internationally.[199] Also, the benchmarks of the Legislative Guide recognise the divergence between countries by offering a flexible approach built on a wide range of alternatives and options to allow national States to accommodate what best suits their domestic contexts.[200] Besides, the adaptability of such international benchmarks is further promoted by offering the opportunity to cooperate more closely with their technical assistance resource to help national policymakers to introduce adequate implementation of the insolvency reform.[201]

Such benchmarks provide decent proposals to Libya's policy designers to consider when reforming the insolvency law. Since the introduction of the economic reform and privatisation programme, Libya gave a great interest to the establishment of an attractive economic environment for investors, especially foreigners. However, insolvency law remained static. As has been discussed in this Chapter, reforming the insolvency law in Libya has now become important due to its associated weaknesses. It carries outdated features which can be traced back to insolvency systems that were widely prevalent in the 19th century. Since 1953 when Libya had adopted its first insolvency system, economies around the world have changed significantly in a way that leaves no doubt that the current insolvency law has no prospect of making any sense to the national economy.

By measuring against the UNCITRAL Legislative Guide benchmarks, the analysis in this Chapter showed that Libyan insolvency law is associated with profound shortcomings. The current insolvency procedures in Libya are characterised by high cost and time consumption. The delay in resolving an insolvency case has been a major challenge for many reasons. Those include the cumbersome procedures and

[199] Halliday, 'Lawmaking and Institution Building' (n 21) 33
[200] McCormack, 'Criticising the Quest for Global Insolvency Standards' (n 4) 1-2
[201] See above Sec 3.2

inefficiency of the court systems which are too formalistic and bureaucratic. The recovery rate for the creditors is very low in liquidation cases and the attempts on rescue are infrequent.[202] As has been mentioned,[203] Libya's insolvency law is ranked by the WB *Doing Business* report at 168th out of 190. Its practical scarcity in court cases can also evidence this claim.[204]

In addition to the above, the widespread intervention by the government to subsidise its insolvent SOEs adds to the situation and threatens an effective application of insolvency law. What matters to the government is the political and social values associated with the existence of those enterprises; i.e. to maintain social and economic stability. This agenda, however, can negatively affect the economic reform process and the rule of law in Libya. The assets of nonviable SOEs should be allocated at their best use by facilitating liquidation of nonviable businesses. Consideration of political and social values is legitimate but this should have limits as this should not be at the expense of private competitors in the market. In regard to social and political objectives, these can be achieved instead by promoting an effective business rescue system, where employees maintain their jobs, and where liquidation is necessary, social instability can be mitigated by promoting social safety net systems in the country.[205]

Equally important, since the insolvency framework of Libya is heavily led by courts, and in order to gain any possible achievements, any reform process cannot overlook reconsidering the inefficiency of the judicial system.[206] Training and educational

[202] Uttamchandani, 'No Way Out' (n 75) 30
[203] See above Sec 1.2.3
[204] See above Sec 1.2.1
[205] This will be discussed in Sec 6.6.1
[206] There was an attempt in Libya with the cooperation of the United Nations Development Programme (UNDP) to reform the judicial system in the period between 2006 and 2009 under the project of the Modernisation of the Justice Sector in Libya. Unfortunately, the reform was unsuccessful. See: 'Assessment of Development Results: Libya' [2010] UNDP, at 25 <https://erc.undp.org/evaluation/evaluations/detail/6011> accessed 5 Apr 2018

programmes can be considered in parallel with reforming the contextual legal framework. This would contribute to the development of proficiency in this field of law as well as to foster more sympathetic approaches to insolvency among judges and practitioners as well as the public. As this is the case, Libya is burdened with a challenge of how to reform its insolvency system and bring it on track. The challenge becomes greater if we consider the fact there has been no real practice in this field of law in Libya since the birth of the insolvency law in 1953. This means also that there is a lack of an insolvency profession and experts necessary to properly implement the reform (this challenge will be discussed further particularly in Chapter Six). Having considered most of the Legislative Guide's benchmarks, attention now turns to two matters that require particularly detailed considerations namely business rescue and secured transactions and these will be the subject of the next two Chapters. Chapter Four will address Objective Three while the latter Chapter will examine Objective Eight.

Chapter 4 The Application of UNCITRAL Principles with Particular Reference to Business Rescue in the Libyan Context

4.1. Introduction

Traditionally, insolvency law's primary function used to focus on liquidation,[1] as well as receivership where secured creditors were able to enforce their security outside of the insolvency procedures.[2] Such an approach had no regard to the wide impact of business failure on various stakeholders including unsecured creditors, employees as well as the society. The UNCITRAL Legislative Guide signalled a global movement of law reform that is based on saving distressed yet viable businesses.[3]

It has been widely recognised in many jurisdictions that it is important to provide alternatives to liquidation by encouraging business rescue as one of the key objectives of the insolvency system.[4] This is because rescue on a going concern basis would benefit, directly or indirectly, all stakeholders and would protect them from business failure and liquidation. For instance, the employees keep their jobs, the community benefits from the business operations due to considerable contributions to the economic life of the society, the creditors' wealth can be maximised through maintaining the going concern value of the distressed business, the debtor will be offered a second

[1] Bo Xie, *Comparative Insolvency Law: The Pre-pack Approach in Corporate Rescue* (Edward Elgar 2016) 18

[2] Ian Fletcher, 'UK Corporate Rescue: Recent Developments–Changes to Administrative Receivership, Administration, and Company Voluntary Arrangements–The Insolvency Act 2000, the White Paper 2001, and the Enterprise Act 2002' (2004) 5 Eur Bus Org Law Rev 119, 122-25

[3] Terence Halliday, 'Lawmaking and Institution Building in Asian Insolvency Reforms: Between Global Norms and National Circumstances' (5th Forum for Asian Insolvency Reform, Apr 2006) at 6 <http://siteresources.worldbank.org/GILD/Resources/Halliday5.pdf> accessed 02 Aug 2018

[4] Janis Sarra, *Creditor Rights and the Public Interest: Restructuring Insolvent Corporations* (UTP 2003) 32

chance to survive etc.[5] Business rescue as seen by theory is a necessary mechanism to provide fair treatment for important stakeholders who deserve protection, which will in turn contribute to economic and social stability in the society.[6]

The Libyan insolvency law implements one route for rescue through the composition system since its first introduction by the Commercial Code 1953. Since then, this rescue regime has seen no reform. Not only that, but it remained inactive due to the introduction of the socialist regime in the country since early 1970s until the present as the country has still been under significant influence of the socialism despite the reform process.[7] This Chapter will examine the procedures of the composition scheme to identify whether it has features capable of delivering efficient rescue outcomes. It will also explore whether the composition system can provide sufficient incentives for the interested stakeholders to involve in this kind of procedure. As this Chapter focuses on examining business rescue in Libya, the Chapter will be dealing with Objective Three of the UNCITRAL Legislative Guide (Striking a Balance between Liquidation and Reorganisation) in more detail separately from the other Objectives which were previously examined in Chapter Three. This Chapter will draw upon the insolvency benchmarks as set out in the Legislative Guide in general as well as the theoretical discussion of Chapter Two.

[5] Rebecca Parry and Yingxiang Long, 'China's Enterprise Bankruptcy Law, Building an Infrastructure towards a Market-based Approach' (2020) 20 J Corp Law Stud 157, 160
[6] On the account of the traditionalist approaches see above Sec 2.2.2
[7] See above Sec 1.2.2 and 1.2.3

4.2. Preface to the UNCITRAL View of Business Rescue (Legislative Guide Objective Three)

As has been discussed previously,[8] the UNCITRAL Legislative Guide encourages rescue as an alternative to liquidation. The choice between rescue and liquidation lies at the heart of most disputes relating to the valuation of the business's assets. Creditors may support rescue procedures if they are assured that the going concern value of the business exceeds the liquidation value (piece meal value of business's assets), otherwise immediate liquidation may be the best option.[9] The thing with business failure is how to deal with the associated risk. Insolvency laws in general can reallocate the risk of failure and the chances of recovery for the creditors by, for example, the priority given to privileged or preferential claimants or by the imposition of the moratorium which affects the way in which creditors can recover their debts. But business rescue can introduce another layer of reallocation of impact on risk and recovery by prolonging the life of insolvent businesses which can lead to diminishing the asset value recovered by creditors. The outcomes of business rescue, as such, are more difficult to predict than the outcomes in liquidation and business rescue is therefore difficult to plan around. This is the scenario each party in insolvency does not really expect or desire.

A rescue system, therefore, should be rational[10] by not making the situation more uncertain. It should accordingly be implemented in a way that strikes the right balance between all competing interests by not reallocating the risk and burden of insolvency to

[8] See above Sec 3.4.3 (Key Objective Three of the UNCITRAL Legislative Guide)
[9] Chaim Fortgang and Thomas Mayer, 'Valuation in Bankruptcy' (1985) 32 UCLA L Rev 1061, 1063
[10] In circumstances where an insolvency law sounds irrational to some stakeholders, they would not lack the incentives to play strategically around the process in order to avoid the risk distribution and achieve their own certainty rather than to endure the risk they are not responsible for in the first place. Thomas Jackson and Robert Scott, 'On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors' Bargain' (1989) 75 Va L Rev 155, 164

be borne by stakeholders whose interests enjoy more protection under a non-insolvency system and who are less beneficial to the process; secured creditors.[11] This issue has been the subject of debate between theorists and lawmakers around the world. What proceduralists are concerned about in business rescue is the reallocation of risk produced by the procedures.[12] On the contrary, traditionalist approaches being more-friendly to business rescue than the proceduralist accept the reallocations of risk of business rescue.[13]

Because rescue procedures can add more risk to the process on the economic rights and interests of various stakeholders, the UNCITRAL Legislative Guide's principles are built on providing mechanisms as to how to make an appropriate balance between rescue and liquidation.[14] Therefore, the objective of business rescue does not really dominate above all other objectives and the UNCITRAL Legislative Guide still places a great emphasis on protecting the commercial bargaining of secured creditors and maintains their non-insolvency entitlements.[15] Rescue procedures should be facilitated only when distressed businesses are considered viable. This is because rescue is not supposed to establish a safe haven for nonviable businesses which should be dealt with under the process of liquidation in a quick and efficient manner.[16]

The insolvency law of Libya must provide the necessary mechanisms to put those principles in practical contexts. In doing so, the balance between liquidation and rescue needs to have a mechanism in place which can differentiate between viable businesses (that should be allowed to continue and then rescued), and nonviable businesses (that

[11] See above Sec 3.4.1 (Objective One of the UNCITRAL Legislative Guide)
[12] See above Sec 2.2.1
[13] See above Sec 2.2.2
[14] UNCITRAL Legislative Guide, Rec 1(C). See also: Gerard McCormack, *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (Edward Elgar 2011) 154-55
[15] For more details see above Sec 2.3
[16] UNCITRAL Legislative Guide, Part One, Chap I, para 18

should otherwise be liquidated). In the context of business rescue, the valuation of the business assets, especially the encumbered assets, is vital for the interested parties to calculate the risk. At the valuation stage, creditors would require sufficient information to allow them to make informed decisions on continuing to supply goods or extending the necessary credit to their debtors. The valuation of the assets, as such, determines whether secured interests are protected, sacrificed or risked during the rescue plan.[17]

It is essential to the rescue procedures that the confidence of secured creditors is enhanced in the procedures through the acknowledgement of the extent of the business's financial difficulty. This is arguably because interested stakeholders, with particular reference to secured creditors, have to be persuaded that there is a sensible reason to increase their financial risk in the rescue process.[18] A rescue system should be designed to provide creditors with better returns than they would receive if the business was first placed into liquidation. This should be carried out in a way that reassures that assets value of the estate are not diminished, the process is not expensive and the procedures do not delay the ability of creditors to recover their interests to unreasonable extent.

Encouraging business rescue in the society resonates well with the goals of enhancing the domestic economy and maintaining social stability by preserving for the employees their jobs and social security advantages and therefore it should be recognised as one of the key objectives of the law in a developing country like Libya. The emphasis of a theory like the TPT, as a chosen model for reform, that the team members of the business has to continue during the insolvency process allows for business rescue to take place and it particularly supports the retention of the employees in their jobs when

[17] Sarra (n 4) 54; Raymond Nimmer, 'Negotiated Bankruptcy Reorganization Plans: Absolute Priority and New Value Contributions' (1987) 36 Emory LJ 1009, 1043-45
[18] Sarra (n 4) 54

the business is sold to a new owner. Business rescue is also beneficial to the business environment because it allows businesses which face financial distress to emerge from their distress instead of being liquidated and thus continue to contribute to the economic life of the society. This view is desirable in the situation of Libya and should be reflected in the reform.

The perspectives of the UNCITRAL Legislative Guide in relation to business rescue reflect well with the view made by the TPT in this regard by encouraging business rescue to benefit wider interests. The idea of this model offers fair treatment to all affected stakeholders in that all team members who have firm-specific investment in the business should have equal weight of consideration in the insolvency settings by providing mechanisms whereby such investment, whether in the form of capital or human investment, is protected in the decision making process that may affect the future of the business entity they have made the investment in. By this account, the TPT provides an elegant approach of addressing the issue of business failure by making a right balance between the various interests without resulting in one party being privileged over the other. For example, the rescue of the distressed business is encouraged only if doing so would lead to save the employees their jobs and would not prejudice the interests of creditors too.[19] This is similar to the account of the UNCITRAL Legislative Guide by protecting the estate value in the rescue process.[20]

Unlike the narrow view of the CBT which focuses on the interests of secured creditors, the TPT provides the employees with special treatment which is desirable to maintain social stability in the country. An insolvency system influenced by the TPT perspectives would favourably take into account not only the traditional entitlements of

[19] Samuel Etukakpan, 'Transfer of Undertakings: The Tension between Business Rescue and Employment Protection in Corporate Insolvency' (PhD thesis, Nottingham Trent University 2012) 105
[20] See above Sec 2.3

the employees as creditors, but also their, more important, non-contractual interests and expectations in the future of their employer by preserving the going concern of the business which would lead to preserving some jobs for the employees.[21]

4.3. Preventive Composition System and Procedures

4.3.1. Historical Overview

Since the features of the current preventive composition of Libya are a legacy of the colonial period in the country,[22] it may be suitable to have a brief account of the history of this system before exploring it in detail. Historically, the preventive composition was first introduced in Italy by the enactment of the law no 197 of 24 May 1903[23] with the aim of promoting rescue procedures. Encouraged by recommendations of a royal commission in Italy, the Italian policymakers reviewed the insolvency law modelled on the English Victorian legislation of the Joint Stock Companies Act 1870 (by means of schemes of arrangement) and the Belgian Insolvency Law of 29 June 1887[24] in order to draw lessons regarding the composition procedures (the debtor-creditors arrangement procedures).[25] This model of the preventive composition, known as the Anglo-Belgian model, innovated a shift from the liquidation focused insolvency system towards more reorganisational regimes.[26]

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[21] Samuel Etukakpan, 'The Lost Voice in Insolvency: Theories of Insolvency Law and their Implications for the Employees' (2014) 23 Nottingham LJ 34, 60

[22] See above Sec 1.2.1

[23] Stefan Riesenfeld, 'The Evolution of Modern Bankruptcy Law: A Comparison of the Recent Bankruptcy Acts of Italy and the United States' (1947) 31 Minn L Rev 401, 450-51

[24] Jan Dalhuisen, *Compositions in Bankruptcy: A Comparative Study of the Laws of the EEC Countries, England and the USA* (A W Sitthoff 1968) 50

[25] Jan Dalhuisen, *Dalhuisen on International Insolvency and Bankruptcy* (Matthew Bender 1986) 1.77-78. Also see: Riesenfeld (n 23) 450, f.n. 386

[26] Haizheng Zhang, 'Making an Efficient and Well Functioning Corporate Rescue System in Chinese Bankruptcy Laws: From the Perspective of a Comparative Study between England and China' (PhD thesis, University of Leicester 2008) 50

The Anglo-Belgian 19th century creditors-debtor arrangements introduced one of the oldest rescue-oriented procedures in the world.[27] This new innovation promoted self-restructuring mechanisms for distressed companies away from the traditional liquidation procedures with an aim of enabling debtor businesses to make a debt-arrangement with creditors with a chance not to be forced into insolvency.[28] By this mechanism, troubled companies were enabled to keep some control over their assets though under judicial control and oversight. This model of arrangements was subject to gaining support of the creditors' majority of 51% by number representing two thirds of the debt value, without which the debtor would be forced into liquidation.[29]

The preventive composition was devised as a tool for *bona fide* debtors who were honest but unlucky in order to enable them to initiate rescue procedures and save their businesses under court control and supervision.[30] Despite the fact that this composition was designed to be less socially repressive, some drawbacks were witnessed. First, the law required the involvement of the Public Prosecutor in the procedures in order to examine whether the insolvency situation carries any criminal characters.[31] This is because the insolvency system was excessively punitive influenced by the assumption that the insolvency occurs due to the inappropriate attitude of the debtor which therefore is deserving of punishment.[32] Further, the protection of the creditors' private rights and interests was still central to this procedure at the expense of other

[27] Rebecca Parry, *Corporate Rescue* (Sweet & Maxwell 2008) 234
[28] Zhang (n 26) 46-50
[29] Jérôme Sgard, 'Bankruptcy Law, Creditors' Rights and Contractual Exchange in Europe, 1808 – 1914' (2006) Oesterreichische National Bank (OeNB) Working Paper No 109, at 11 <www.oenb.at/dam/jcr:40a4d296-d664-46d6-aefe-2c02f7a007ba/wp109_tcm16-38078.pdf> accessed 18 Dec 2017
[30] Riesenfeld (n 23) 450, f.n. 387
[31] Dalhuisen, *Compositions* (n 24) 51, f.n. 129
[32] Roberto Cercone, 'Italian Crisis Procedures for Enterprises: An Overview' (Bankruptcy Legislation in Belgium, Italy and the Netherlands conference, Brussels Jul 2000) at 43 <www.bancaditalia.it/pubblicazioni/quaderni-giuridici/2001-0052/quaderno_52.pdf?language_id=1> accessed 5 Jul 2017

stakeholders.[33] For instance, secured creditors were not affected by the procedures as it affected only unsecured creditors who were not allowed to pursue or initiate any execution against the debtor during the composition proceedings.[34] Secured creditors were not bound by the procedures unless they wished to be so, by surrendering their security fully or partially by at least one-third of their total claims.[35]

In addition, courts were excessively empowered over the procedures. They had to consider various conditions the absence of which would lead to the refusal of the proposal. These conditions included the plan feasibility test and the good faith status of the debtor.[36] In order to protect the creditors' interests, the court in this system was given great *ex officio* powers to refuse the composition and declare the insolvency status of the debtor irrespective of the decision of the creditors on this regard. The courts exercised this power when they think that the composition failed the feasibility test or when it would prejudice the interests of the creditors.[37] The debtor company was required to have a worthy offer for the creditors in order to obtain the court's confirmation. They must provide a credible guarantee of at least 40% payment of all unsecured claims which must be payable within six months after the composition sanction.[38]

While the debtor company retains possession of its business during the composition procedures, the court would still scrutinise the whole daily business activities of the

[33] Wouter Bossu, 'Introduction to the Belgian Bankruptcy Law Reform' (Bankruptcy Legislation in Belgium, Italy and the Netherlands conference, Brussels, Jul 2000) at 21-22 <www.bancaditalia.it/pubblicazioni/quaderni-giuridici/2001-0052/quaderno_52.pdf?language_id=1> accessed 4 Jul 2017
[34] Dalhuisen, *Compositions* (n 24) 77
[35] Sgard (n 29) 11
[36] Riesenfeld (n 23) 451
[37] Dalhuisen, *Compositions* (n 24) 52-53
[38] Ibid, f.n. 313

debtor company.[39] During the plan implementation, the debtor would be limited to transactions that fall into the normal deeds of administration, whereas transactions made beyond this limit would be invalid, unless a prior official permission of the delegated judge was granted.[40]

Under this procedure, the court and the insolvency trustee were given a heavy role in the procedures lowering the influence of the creditors' role. The court was required to take control of the whole procedures and to make all key administration decisions while creditors were allowed a very limited role and only in few cases were they entitled an advisory function in the process.[41] The creditors' committee enjoyed no directive functions in the procedures but rather with consultative functions but neither the court nor its insolvency representatives would be bound to follow the decision the creditors would take or the advice they would give. An insolvency trustee was appointed along with the judge delegate by the court not by the creditors nor could they interfere with the court's decision in this regard.[42]

Finally, the composition was much worsened and deteriorated by introducing the procedures of 'assignment for the benefit of creditors'. This is because this assignment was designed to serve as liquidation rather than as a rescue, and once the assignment was approved, the court was authorised to appoint a liquidator to take over the process and to carry out procedures of the asset distribution.[43] By virtue of this mechanism, the debtor's proposal had to include all assets for the benefit of creditors, as long as the

[39] Riesenfeld (n 23) 404-05
[40] Cercone (n 32) 42
[41] Riesenfeld (n 23) 404, f.n. 16
[42] Paolo Manganelli, 'The Evolution of the Italian and US Bankruptcy Systems: A Comparative Analysis' (2010) 5 J Bus & Tech L 237, 249
[43] The origins of the assignment of assets generated back since the time of the Roman law by which the debtors were able to avoid personal execution and imprisonment for debt. See: Kurt Nadelmann, 'Compositions - Reorganizations and Arrangements -In the Conflict of Laws' (1948) 61 Harv L Rev 804, 816

assets value was equivalent to at least 40% of the total claims of unsecured debts and 100% of the secured ones, otherwise the proposal would not succeed and the debtor would be forced into insolvent liquidation.[44] Such a mechanism was devised for insolvent debtors to avoid the insolvency stigma, however, as commentators argued, this procedure blew away any chance for rescue and in practice the composition system lost its original objective of rescue.[45]

4.3.2. Access to the Procedures

The composition procedures are available only when the insolvency situation arises.[46] Insolvency is defined by the UNCITRAL Legislative Guide as when: "a debtor is generally unable to pay its debts as they mature or when its liabilities exceed the value of its assets".[47] These are the available tests to examine a company's inability to pay debts. The former concept of "the inability to pay debts as they mature or as they fall due" is known as the cash flow test, which is easy to prove and if satisfied, a company is deemed insolvent if it failed to pay the due debts even though there is other evidence that shows that the company's assets, if realised, would enable it to fully meet its liabilities.[48] While the latter test, "the liabilities exceed the value of assets", is known as the balance sheet test by which a company is deemed insolvent when its assets are insufficient to discharge its total liabilities.[49]

The CCA 2010 determines when a debtor company is qualified to apply for the composition by stating that: "Any person liable to be declared insolvent and who finds

[44] Monica Marcucci, 'The Inefficiency of Current Italian Insolvency Legislation and the Prospects of a Reform' (Bankruptcy Legislation in Belgium, Italy and the Netherlands conference, Brussels, Jul 2000) at 48 <www.bancaditalia.it/pubblicazioni/quaderni-giuridici/2001-0052/quaderno_52.pdf?language_id=1> accessed 5 Jul 2017
[45] Riesenfeld (n 23) 452-54
[46] For this purpose, insolvency arises when the debts are not paid when they fall due. CCA 2010, Art 984
[47] UNCITRAL Legislative Guide, Introduction, para 12(s)
[48] See: *Cornhill Insurance plc v Improvement Services Ltd* [1986] 1 WLR 114
[49] Roy Goode, *Principles of Corporate Insolvency Law* (4th edn, Sweet & Maxwell 2011) 111-15

himself/ itself unable to pay debts can propose a preventive composition with the creditors…".[50] Accordingly, the debtor must be unable to pay its due debts. The inability to pay debts as they fall due is considered as the fundamental concept on which the insolvency law is grounded[51] and which simply indicates the insolvency situation of a company.[52] Under the Libyan insolvency regime, the definition of the "inability to pay the debts", unlike in some other jurisdictions,[53] is absent. For instance, the preventive composition is based on the fact that the debtor is "unable to pay debts" as they fall due.[54] Also, the insolvency declaration is based on the same fact.[55] The law in these two cases does not provide any clarification of when a company is deemed "unable to pay debts" whilst it is important for the determination of the company's insolvency. There is a reference to the predictable failure to pay.[56] Here the law implicitly refers to the balance sheet test "external factors", but this is still not enough in determining the concept of "inability to pay" in a clear way.

It has long been acknowledged that the concept of "inability to pay debts" is referenced to its explicit meaning "the cessation to pay due debts" regardless of the actual solvency of the debtor. That is to say, a company is deemed unable to pay debts when it fails to pay its debts as they fall due even though the value of its assets, if realised, exceeds the value of its liabilities. Also, it is not required for a company to be considered insolvent for it to cease to pay all or a great majority of its due debts, as the

[50] CCA 2010, Art 984
[51] Goode (n 49) 110
[52] The phrase "unable to pay its debts" is what some jurisdictions use when referring to the insolvency situation of a company. For example, the UK IA 1986 uses the phrase "unable to pay its debts" in Section 123 and Sections 222-224
[53] The UK law, for instance, in Sec 123(1) and (2) of the IA 1986
[54] CCA 2010, Art 984
[55] Ibid, Art 1012(1), entitled 'Insolvency Declaration', states that: "… the insolvency of a trader, whether a natural person or a legal entity, must be declared … if they cease to pay their debts".
[56] Ibid, Art 1012(2) which states that: "The cessation of debts payment may be demonstrated when the debtor becomes unable to fulfil them, or when other external factors demonstrate the debtor's inability to fulfil its obligations on a regular basis".

cessation of paying an individual debt[57] is enough to determine its insolvency situation.[58]

Accordingly, in a legal sense, a company might be in an actual insolvency situation but would not be subject to the insolvency procedures simply because it has not ceased to pay its due debts (the cash flow test) even though its liabilities exceed the value of its assets (the balance sheet test). The balance sheet test, "the company's liabilities in relation to the value of its assets", is implicitly recognised in the Libyan law within the context of company provisions in Article 47(2) of the CCA 2010 which states that: "If it has become clear to the liquidator that the company's assets are insufficient to pay off its due debts, he or she must summon the shareholders' meeting to take the necessary decisions in the matter, including, *inter alia*, the initiation of a preventive composition with the creditors or filing for insolvency". However, debtor companies should be able to enter the procedure not necessarily only when they are all insolvent on the ground of either the cash flow test or the balance sheet test. Rather, they should be permitted to access the composition process even though they are only struggling but not technically insolvent because that would be a situation where business rescue can anticipate insolvency and restructure the company in such a way that insolvency is avoided.

Following from the above, the requirement of inability to pay debts prevents companies from filing for the composition at an early stage. The Libyan law does not define how early a distressed company can file for a composition. It only allows a distressed company to file for a composition with creditors not after the insolvency

[57] The Libyan law does not set a minimum amount of the debt that a company is deemed insolvent if it was unable to pay. Some jurisdictions, such as the UK IA 1986 in the Art 123(1)(a) defines the company's inability to pay debts that is when the company has for three weeks, after a written demand from the creditor requiring it to pay the due sum of debt exceeding £750, neglected to pay the sum or to secure or compound for it to the reasonable satisfaction of the creditor. See: Goode (n 49) 128

[58] See: Ali Younis, *The Bankruptcy* (Arabic Book Library) 41-44

declaration.[59] Accordingly, a company may be illegible to file only when it becomes unable to pay debts as they fall due and filing before this situation happens is impossible in Libya due to the statutory requirements for which the court has the right to strike down the application even though the company is in financial difficulty as long as it is still able to pay debts. This is detrimental to business rescue which requires access to the procedures at a sufficiently early time. This is because encouraging early access would help to maximise the value of the insolvency estate which can result in positive outcomes in business rescue and contribute to the avoidance of piecemeal liquidation.[60]

Therefore, businesses should be encouraged to file for the proceedings before they become insolvent. This feature can be seen in the US Chapter 11 reorganisation where there is no formal requirement for insolvency or inability to pay debts as they fall due as long as the debtor acts in good faith.[61] Also, the EU Directive on restructuring frameworks requires member states to enact legislation that will allow a debtor to access the restructuring before it becomes insolvent as this will encourage early access to the process which will in turn enable debtors to address their distress at an early stage.[62]

[59] CCA 2010, Art 985(1)
[60] Parry (n 27) 13
[61] See: *In re Johns-Manville Corp*, (1984) 36 BR 727, 732. Also see: Stephan Madaus, 'Leaving the Shadows of US Bankruptcy Law: A Proposal to Divide the Realms of Insolvency and Restructuring Law' (2018) 19 Eur Bus Org Law Rev 615, 617
[62] Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 Jun 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency) [2019] Official Journal of the European Union, L 172/18, Art 24

4.3.3. Governance of the Procedures

The composition scheme is a court-sanctioned arrangement between the company and its creditors. The composition is not offered to the secured creditors as their securities will not be affected by the composition. Thus, they are not meant to participate in the composition unless they relinquish all of their securities or part of them up to at least the third of their security.[63] To obtain the court sanction, the composition proposal must be accepted by the statutory majority of unsecured creditors who participate in the voting process. The statutory majority is 51% of the creditors in number representing two-thirds of the total claims held by creditors participating in the vote.[64] It should be noted in this regard that the Libyan insolvency law does not categorise creditors into different classes for the purpose of the voting process. As it appears from the above, the class of creditors who participate in the process is the unsecured creditors while the secured creditors are not required to participate as the composition does not affect their claims. And when they wish to participate in the process, they will be counted as unsecured creditors and will participate in the process with this status.

The success of the composition proposal will result in minority dissentient creditors being bound to the procedures (cram down). The aim of the cram down is to facilitate an agreement between the parties if they are unable to reach it between themselves. This is because in the absence of such a mechanism, the arrangement with creditors can only be concluded through unanimous consent, which may be difficult and costly to

[63] CCA 2010, Art 1002(2)(3)
[64] Ibid, Art 1002(1)

achieve and it could also be impractical when distressed companies encounter acute liquidity disasters.[65]

The composition procedures consist of two stages for a composition plan to proceed through. In the first stage, termed as the composition initial approval, the petition must meet the statutory formalities and conditions. If these formalities are met, the court will approve to proceed the composition proposal to be discussed with the creditors. The court at this stage has no concern with the merits or fairness of the composition plan as it has no discretion to exercise. The court will confirm the composition if it finds that all required formalities are complied with. These formalities as stipulated are: 1. the petition is submitted before the insolvency declaration, 2. the debtor company has been registered in the commercial registry for at least the past two years or has been engaged in doing businesses for the same period, 3. the debtor's accounts and its commercial books must be extant for the same period, 4. the debtor company was not previously declared insolvent in the five years prior to the composition application nor was involved in a preventive composition in the same period, 6. the debtor has offered the creditors either one of two options; (a) to provide affirmed guarantees, whether personal or in rem, that can cover payment of up to 40% of the total unsecured claims payable within six months from the composition approval; (b) to provide an offer worth up to 40% of the total unsecured claims.[66]

The law emphases that the debtor company must have a worthy offer for the creditors providing a sufficient guarantee to pay at least 40% of all unsecured claims payable within six months after the composition sanction. The debtor could alternatively base its composition proposal on the assets assignment for the benefit of

[65] Jennifer Payne, 'The Role of the Court in Debt Restructuring' (2018) 77 CLJ 124, 128
[66] CCA 2010, Art 985(1-6)

creditors (the assignment of all assets for the benefit of creditors). For the assignment proposal to proceed, the valuation of the assets and property must be sufficient to meet the creditors' rights to the minimum percentage of 40% of the total claims of the unsecured creditors.[67] In this kind of assignment, the court shall appoint a liquidator and a committee constitutes three or five of the creditors to assist the liquidator in carrying out the final stage of a company's life; i.e. the liquidation process.[68]

After hearing the debtor in the hearing session, the court can refuse the composition *ex officio* if such formalities are not met. In this case, the court has to declare the insolvency status of the debtor company and commence the insolvent liquidation process.[69] If the court granted its initial approval on the composition proposal, it shall announce the commencement of preventive composition procedures by an order including the following; 1- delegate a judge to carry out the procedure; 2- order a meeting of the creditors to be summoned within 30 days from the court's order; 3- appoint the judicial supervisor/ administrator (the insolvency practitioner/ syndic) who is selected by the court from its roster of qualified administrators; 4- assign a period not exceeding 8 days within which the petitioner has to deposit in the court's account a sum of money that is necessary to carry out the procedure. In the event that the company failed to pay the expenses of the procedures, the court shall *ex officio* declare insolvency status and start the insolvent liquidation.[70] Although the court has no discretion to exercise in this stage, its role can be valuable in ensuring that the creditors have adequate information in the meetings so that abuse can be avoided.[71]

[67] Ibid, Art 985(6)(a)(b)
[68] Ibid, Art 1007
[69] Ibid, Art 987
[70] Ibid, Art 988
[71] Payne, 'The Role of the Court' (n 65) 134-35

After the court's confirmation of the composition plan, the procedures will extend to the second stage, which can be termed as the feasibility test. In this stage, the majority creditors' are required to vote on the proposed plan to proceed. The majority creditors' vote in favour of the composition proposal will not, however, guarantee the court's sanction of the composition as the court still needs to examine the proposal's feasibility in order to maintain the creditors' interests. In doing so, the court considers the merit and worthiness of the debtor company for the composition. In doing so, the court takes into account the reasons behind the insolvency and the general activities of the insolvent company.[72] In this stage, the court is granted broad discretionary powers to approve the composition or refuse it regardless of the creditors' decision. So if the court thinks that the proposal has no potential to protect the creditors' interests,[73] it has to act on behalf of them and declare the insolvency status *ex officio*.[74]

Although the discretionary power granted to the court in this stage test may seem attractive in the first instant because it has a focus on protecting the creditors' interests, some concerns may be raised. The power and discretion vested in the court should be limited to reassurance that the statutory provisions and conditions are met by the composition proposal (for instance, the attainment of the majority vote or the absence of fraud in the approval process) and not beyond that. In examining the feasibility of the composition, the court should not be granted such unfettered discretion.[75] As long as the proposal is fair and equitable to the creditors as a whole and the requisite

[72] CCA 2010, Art 1006(1)(d)

[73] The legal test is that if the court thinks that the composition proposal would not achieve the economic interests of the creditors (taking into account the existing assets, worthiness of the debtor and its activity), it shall declare the status of insolvency. Ibid, Art 1006(1)(a)(b)

[74] Ibid, Art 1006(2)

[75] The court enjoys such unlimited discretion because the court can still have veto against the composition even though the majority of creditors have approved it and also because there is no structured guidance in the legislation as to how to exercise this discretion to refuse or accept the composition. Such kind of discretion would definitely create a degree of uncertainty among creditors who were pleased to accept the proposal.

majority have voted in favour of the plan, the court should not judge the proposals' commercial merits because courts should arguably be very reluctant to interfere with the creditors' decision of what they believe to be in their best interests.[76] Otherwise the court will unnecessarily add more time and complexity to the procedures and would constrain the discretion of the creditors since their opinion will not matter when they favour the rescue proposal.[77]

Besides, the implementation of the court's decision on the feasibility test supposedly requires more relevant knowledge and experience among judges because courts need to compare the liquidation value and the going concern value of the business's assets before taking any decisions in this regard. Courts will also be required to ensure that some insolvency standards and conditions can be achieved. These may include: that classes of dissenting creditors will share the economic benefits of the plan and they will receive as much of a return under the plan as they would receive in liquidation; that no creditor will have returns more than the full value of its claim; and that similarly situated creditors are treated equally.[78] This is a challenge in Libya since judges and the insolvency practitioners lack any relevant knowledge and expertise on business and insolvency cases. As such, courts' decision on the feasibility test could be problematic. The UNCITRAL Legislative Guide states that courts should not be tasked to review the economic feasibility of the plan unless the law narrowly defines the circumstances in

[76] On the court's discretion in sanctioning debt restructuring compositions see: Jennifer Payne, *Schemes of Arrangement: Theory, Structure and Operation* (CUP 2014) 77-78. Also see: *Re British Aviation Insurance Co. Ltd.* [2005] EWHC 1621 (Ch); "if the creditors are acting on sufficient information and with time to consider what they are about, and have acted honestly, they are, … much better judges of what is to their commercial advantage than the Court can be". Also see: Sarah Paterson, 'Reflections on English Law Schemes of Arrangement in Distress and Proposals for Reform' (2018) 15 ECFR 472, 476

[77] However, the dissenting minority (49% of the total participating creditors in number with a third of the total claims) may have a good reason to reject the proposal. Therefore, the court may also consider their interests especially where there is a possibility of abuse or misuse of the process by the majority creditors. See: Charles Qu, 'Sanctioning Schemes of Arrangement: The Need for Granting the Court a Curative Power' (2016) JBL 13, 15. Also see: Payne, 'The Role of the Court' (n 65) 132-33

[78] UNCITRAL Legislative Guide, Part Two, Chap IV, para 61

which this discretion can be exercised or the courts have sufficient competence and experience to exercise such discretion.[79]

If the composition plan succeeded to convince the majority of creditors and the court's final approval is granted, the court shall announce the commencement of the procedures. By this, the insolvent company will be allowed to continue its daily business activities guided by the judge delegate and the supervision of the insolvency practitioner. The company's capability of business participation, however, will be limited only to transactions that fall within the ordinary course of business, whereas transactions beyond this limit would be void against the creditors, unless a prior official permission from the judge delegate is granted.[80] Moreover, the presence of the petition to the court will have an effect on the creditors' claims. All creditors will not be able to enforce their interests immediately after the submission of the scheme to the court by means of the moratorium, but secured creditors are allowed to enforce their claims during the composition procedures which start only after the court's final approval of the composition.[81]

4.3.4. Debtor in Possession

The DIP[82] regime operates by keeping the existing management of the company in control of its business affairs.[83] The DIP system is praised for its flexibility with the debtor company since it places the rescue plan in the hands of its previous directors who have the best knowledge of the business and may be expected to have good

[79] UNCITRAL Legislative Guide, Part Two, Chap IV, para 63
[80] CCA 2010, Art 992(1)(2). This will be discussed later in Sec 4.3.4 (Debtor in Possession)
[81] Ibid, Art 993(1). See below Sec 4.3.5 (Moratorium)
[82] As will be seen, this system as so recognised in Libya is not unrestricted DIP because of both the involvement of the judge delegate and the insolvency practitioners and the transaction limit.
[83] Vanessa Finch, 'Control and Co-ordination in Corporate Rescue' (2005) 25 Legal Studies 374, 375

relationships with the company's creditors which will be useful in the negotiations.[84] Moreover, the DIP regime is designed to encourage the managers and directors to file at an early stage for the insolvency procedures before the financial situation of their company is worsened. The managers would be motivated to do so if they realise that their position would not be affected by the insolvency application.[85]

However, the DIP system is criticised on the ground that it can bring the risk of manipulation and would expose the creditors' interests to the influence and exploitation of the shareholders and managers. Contrary to that, practitioner in possession system (PIP) is considered advantageous because it brings great resistance to the pressure made by shareholders.[86]

In Libya, the preventive composition[87] enables the company's management to remain in possession after the court's approval of the proposal.[88] When the court approves the composition proposal, it has to delegate a judge (judge delegate) and appoint the judicial supervisor/ administrator chosen from the judicial administrators list of the court to carry out the composition procedure and supervise the debtor management during the process.[89] The company is not allowed to carry out transactions which fall outside the ordinary course of business,[90] without the prior officially written consent

[84] Payne, 'The Role of the Court' (n 65) 132
[85] David Hahn, 'Concentrated Ownership and Control of Corporate Reorganisations' (2004) 4 J Corp Law Stud 117, 141
[86] Finch (n 83) 389
[87] In the insolvent liquidation procedures, the management will be displaced by the judge delegate and the insolvency practitioner or the syndic. See: CCA 2010, Art 1036(1) and 1047(1)
[88] Ibid, Art 992(1) states that: "During the consummation of the composition procedures, the debtor shall still be able to manage its assets and take the helm of its business affairs under both the supervision of the judicial supervisor/ practitioner and the guidance of the judge delegate".
[89] Ibid, Art 988
[90] Ibid, Art 992(2) gives samples of type of transactions that fall outside of the ordinary course of business; any settlement with any of the creditors, any payment of any pre-petition claims, granting securities, disposing of any of the immovable properties and assets or mortgage them, making a pledge on the movable assets, writing off mortgages or accepting conditional wills, etc, and any of transactions that the court thinks they fall outside of the ordinary course of business with which the going concern value of the business is affected.

issued by the judge delegate. If such transactions are made in non-compliance with such provisions, they will not be effective against the pre-existing creditors. The court is authorised to put an end to the whole process and declare the insolvency status if the company was engaged in transactions that fall outside the ordinary course of business without obtaining a prior consent of the judge delegate.[91]

It should be noted that the successful application of DIP, as acknowledged by the UNCITRAL Legislative Guide, depends on variant factors including, *inter alia*, the effectiveness of the corporate governance regime and the insolvency institutions, corporate culture, the role of secured creditors, the effectiveness of the court system and the level of supervision provided by courts.[92]

According to the above statement, one can argue that the application of the DIP system in Libya can result in adversity for a couple of reasons. First is attributable to the inefficiency of judicial institutions. As the composition procedures in Libya are associated with a high level of court involvement, the process can be very expensive and potentially time-consuming. Moreover, the bureaucracy associated with the judicial system in the country[93] can make the process unreasonably delayed. Therefore, such a level of judicial involvement would disable the composition process and would make the process inadequate leading to minimising the value of the creditors' interests.

Second is because of the weaknesses and shortcomings associated with the corporate governance system in Libya especially with regard to SOEs as creditors' interests are

[91] Ibid, Art 998(2)
[92] UNCITRAL Legislative Guide, Part Two, Chap III, para 4
[93] Faraj Ma'rouf, 'Specialised Courts as a Mechanism to Improve Justice in Libya' (The Supreme Courts in Arab Countries conference, Doha, Sep 2013) at 08 <https://carjj.org/sites/default/files/wrq_ml_lyby-_lmhwr_lthlth.docx> accessed 9 Sep 2017

not well protected in the law and practice.[94] With the current corporate governance system in place, creditors' interests will be prejudiced by fraudulent activities and misbehaviour of the management.[95] In South Korea after reforms following the Asian Financial Crisis of 1997, for example, the DIP proposal received an unwelcome response by financial creditors until the corporate governance system improved to become more transparent.[96]

Although the DIP regime in Libya is a restricted version of the DIP as it operates under the supervision of the court, abuse can still happen due to the above reasons. Therefore, applying the DIP in such a situation in Libya would bring more harm than it would be possible to resolve and therefore inclining towards a system that relies on external expertise associated with more creditors' role in the procedures would be desirable to avoid any possible abuse of the process. It should be noted that the DIP system is not common worldwide because of its associated risk. An insolvency system like in the UK has not favoured the DIP system.[97] This is because the attitude towards business failure in the UK historically has been based on the assumption that failure is caused by the management of the company. Therefore, the law in the UK administration procedures favours the replacement of the management with an external

[94] Abdu-assalam Hussein, 'Corporate Governance in Code of Commercial Activity in Libya: A study in Line with Principles of Corporate Governance of the Organization for Economic Cooperation and Development' (2019) 23 UBJLS 219, 247

[95] Chuyi Wei and Yongwei Chen, 'The Predicament of Bank Creditors in Chinese Bankruptcy and the Way Out' (2018) 27 Int'l Ins Rev 110, 128-29

[96] Soogeun Oh and Terence Halliday, 'Rehabilitating Korea's Corporate Insolvency Regime, 1992–2007' in John Gillespie and Randall Peerenboom (eds), *Regulation in Asia: Pushing Back on Globalization* (Routledge 2009) 248-50

[97] It should be noted, however, that the Company Voluntary Arrangement (CVA) procedure in the UK Insolvency Act 1986 Sch A1, as amended by the Insolvency Act 2000, is DIP with a moratorium. Also, the UK Government is proposing, for the first time within the UK, to introduce greater DIP possibilities throughout the tenure of the restructuring plan. See: Department for Business, Energy and Industrial Energy, 'Insolvency and Corporate Governance: Government Response' (26 Aug 2018) para 5.131 <www.gov.uk/government/consultations/insolvency-and-corporate-governance> accessed 17 Mar 2019. See also: Rebecca Parry and Stephen Gwaza, 'Is the Balance of Power in UK Insolvencies Shifting?' (2019) 7 NIBLeJ 2 <https://www.ntu.ac.uk/__data/assets/pdf_file/0026/941417/2.pdf> accessed 31 Mar 2020

professional to carry out the rescue procedures which has been received as welcome by the lending market in the UK.[98]

4.3.5. Moratorium

The moratorium is an important device to help the company maximise its assets value for the purpose of rescue by prohibiting individual creditors from dismantling the going concern value of the business.[99] Allowing the creditors to enforce their claims during rescue procedures would, as Professor McCormack points out, frustrate the overall necessary purposes of corporate or business rescue.[100] This also can discourage insolvent companies from filing for rescue at an early stage since companies may rather hide the fact of their insolvency situation because of the low prospect for survival caused by the creditors' enforcement.[101] The UK Review of the Corporate Insolvency Framework 2016 in its proposals for reform recognised that the moratorium is a vital tool to encourage a company's directors to act early before the situation becomes irreversible, which is fundamental in establishing the rescue foundation to address the company's distress.[102]

The whole purpose of rescue would be frustrated if the moratorium only began as soon as the composition came into effect because if the debtor company has to wait until the composition proposal is approved, its assets would be dismantled by creditors

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[98] Hamiisi Nsubuga, *Employee Rights in Corporate Insolvency: A UK and US Perspective* (Routledge 2019) 151

[99] Susan Block-Lieb and Terence Halliday, 'Legitimation and Global Lawmaking' [2006] Fordham Law Legal Studies Research Paper No 952492, 66-67 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=952492> accessed 28 Jul 2018

[100] Gerard McCormack, *Corporate Rescue Law--an Anglo-American Perspective* (Edward Elgar 2008) 174

[101] Régis Blazy, Bertrand Chopard and Agnès Fimayer, 'Bankruptcy Law: A Mechanism of Governance for Financially Distressed Firms' (2008) 25 Eur J Law Econ 253, 256

[102] Insolvency Service, 'A Review of the Corporate Insolvency Framework: A Consultation on Options for Reform' (2016) para 7.6 <www.advocates.org.uk/media/2191/a_review_of_the_corporate_insolvency_framework.pdf> accessed 17 Sep 2017

and this would lead to weakening the prospects for rescue. Therefore, the automatic moratorium will be significant for rescue procedures because it leads to the effective maximisation of the business value by keeping all the assets together.[103]

The moratorium in the Libyan insolvency law is effective against all creditors' claims, including the secured, during the period between the composition petition submission date and the date of the court's approval and confirmation of the plan.[104] The moratorium comes into effect upon the filing for the composition and no court order is required to trigger it. During this period the creditors are prohibited from pursuing any legal actions against their debtor's business.

The moratorium in Libya, however, raises some concerns. It is only effective for a specific period of time which terminates at the moment when the composition proposal comes into force by court's approval on the feasibility test and the commencement of the composition procedures. Two issues may be raised about this structure. First, the moratorium can be effective for uncertain period of time as it can take a long time since the law does not define a limit within which the court has to approve the proposal's feasibility test. This is a case where an abuse can be caused by prolonging unnecessary procedures at the expense of creditors and all other stakeholders. In this regard, the UNCITRAL Legislative Guide emphasises that the moratorium should not diminish the certainty of the secured creditor's ability to recover debt or undermine the value of the

[103] Oh and Halliday (n 96) 247

[104] CCA 2010, Art 993 states that: "As of the date of the petition till the court's sanction on the composition comes into effect, the pre-petition creditors shall not institute or continue any debt-execution actions against the debtor's assets and properties, otherwise they will be subject to invalidity".

security interests because this may undermine the commercial expectations of the creditors and would also affect the availability of affordable credit.[105]

Second, the moratorium will not cover the period when the composition plan is being performed as secured creditors[106] will not be bound by the moratorium during the implementation of the composition plan. This is because their interests are not affected without their willingness.[107] Consequently, they will be free to enforce their claims unless they choose to participate in the composition and to do so they must relinquish their security and then they will be treated as unsecured creditors.[108] This approach is detrimental because it would lead to the company's assets being vulnerable to individual enforcement of secured creditors which would frustrate the rescue endeavours.

In addition, the moratorium in Libya arises automatically upon the debtor applying for composition procedures. Because of this, parties could possibly resort to the composition procedures for strategic purposes. Professor Delaney calls this "strategic bankruptcy" as a proactive attempt by which the process is used to achieve objectives that are not predicted by the doctrinal concept of the law to deal with threats posed by an interested stakeholder group. For example, management of the debtor company may apply for insolvency procedures to evade employees' entitlements or to avoid product liability claims of victims of defective products.[109] The moratorium as such could also be operated abusively to the creditors where the directors of the nonviable company

[105] "… as the protection provided by security interests declines, the price of credit may need to increase to offset the greater risk". UNCITRAL Legislative Guide, Part Two, Chap II, para 37
[106] Unsecured creditors will still be bound by the composition plan according to Articles 1002 and 1009 of the CCA 2010.
[107] Ibid, Art 1002(2)
[108] Unless they relinquish their security and accept to participate in the composition. In their participation in the composition they would be treated as unsecured creditors. Younis (n 58) 440
[109] Kevin Delaney, *Strategic Bankruptcy: How Corporations and Creditors Use Chapter 11 to Their Advantage* (UCP 1992)

could possibly use the moratorium only to take advantages of its breathing space. This will be to the detriment of the creditors as the value of the company's assets will be reduced during the operation of the moratorium.

As has been mentioned, the moratorium should not be intended to allow nonviable businesses to take advantage of the mechanism to prejudice creditors' interests.[110] Therefore, the moratorium, as the UK Insolvency Service on its consultation reform proposals 2016 recommended, should not be intended to allow nonviable businesses to take advantage of it by buying time with creditors because they have no practical prospect of a successful rescue.[111] In order to avoid any possible abuse by the automatic imposition of the moratorium under the UK's proposed framework,[112] distressed companies must first meet a number of qualifying conditions[113] for the moratorium. They have to demonstrate to the court their business viability and they have to offer a proposal with reasonable prospects for the consideration of the creditors.[114]

Accordingly, a careful balance between the need for the business continuation with the need to protect the economic value of the creditors' interests during the rescue process should be made. Protecting the economic value of the creditors' interests is considered as an immutable issue that should be prioritised. Although the UNCITRAL Legislative Guide provides for the actions against the debtor's assets that should be stayed, it recognises that the rescue procedures should not be carried out at the undue expense of secured creditors who should therefore be well protected. The moratorium

[110] For details see above Sec 3.4.2 (Objective Two of the UNCITRAL Legislative Guide)
[111] Insolvency Service, 'A Review of the Corporate Insolvency Framework' (n 102) para 7.16
[112] The Government in the UK has accepted this proposal in Aug 2018. See: Department for Business, Energy and Industrial Energy, 'Government Response' (n 97)
[113] In its response to insolvency and corporate governance reform, the UK Government has adopted the proposal regarding the qualifying conditions of the moratorium because they are necessary to be met to protect the interests of the creditors. For details see: ibid, paras. 5.6- 5.25
[114] For this recommendation see: Insolvency Service, 'A Review of the Corporate Insolvency Framework' (n 102) para 7.23 and for more details on the qualifying conditions see paras. 7.21-24

should not affect the right of creditors to take the necessary actions or proceedings to preserve their interests.[115] Further, the length of such restraint should be determined by the court or the practitioner who should examine whether the form of procedures will result in liquidation or a possible rescue. If there is a viable opportunity for a successful rescue, the restraint on the individual secured claims should be imposed, but for a limited and certain period of time.[116] In the meanwhile, secured creditors should be entitled to apply to the court to have the moratorium lifted on the ground that such a moratorium is no longer necessary or may possibly cause irreversible damage to their interests. In contrast, if rescue becomes unfeasible and the procedures will likely result in liquidation, it is suggested that, there would be no justification to prevent secured creditors from enforcing their interests against the debtor's property.[117] This is advantageous because it would promote market certainty to the creditors and it would support the availability of affordable credit.[118]

This approach can be seen in the UK administration regime of the IA 1986 which enables a creditor to have the effect of the moratorium lifted by either the consent of the administrator or the permission of the court.[119] By this, creditors can enforce their rights in the secured assets against the insolvency estate. Although the IA 1986 does not establish the conditions under which the court may exercise its discretion to lift the effect of the moratorium, the case law suggests that a set of conditions has been developed to be used as guidelines to make the balance between the need for the business continuation with the need to protect the interests of secured creditors during

[115] UNCITRAL Legislative Guide, Rec 47
[116] Ibid, Part Two, Chap II, para 56 and 58
[117] Ronald Harmer, 'Insolvency Law Reforms in the Asian and Pacific Region: Law and Policy Reform at the Asian Development Bank' (2000) 1 International Insolvency Institute Report No TA 5795-REG, at 96-97 <www.iiiglobal.org/node/1815> accessed 13 Apr 2018
[118] UNCITRAL Legislative Guide, Part Two, Chap II, para 37
[119] IA 1986, Sch B1, Para 43(2)

the administration process. The Court of Appeal in *Re Atlantic Computer Systems plc*[120] established that the moratorium is "intended to assist the company, under the management of the administrator, to achieve the purpose for which the administration order was made" and therefore the court held that the leave should normally be granted where the creditor seeking to exercise his proprietary rights,[121] and the creditor's action "is unlikely to impede the achievement of that purpose".[122]

It is argued that, the moratorium should be left to the court's discretion in order to ensure that such a strategic behaviour is avoided. Practically, for the rescue purposes, the moratorium can be established automatically subject to challenge by creditors and then the court can exercise its discretion in suitable cases upon request. This can ensure that the moratorium is stopped being unnecessarily extended if used strategically in the first place. In addition, to avoid any unnecessary delay and costs by courts, an independent expert can be referred to in order to assess whether the moratorium should still continue in effect or should otherwise be lifted if the debtor business has no viable potential. And the court will then act accordingly.[123] This is because it is not fair to impose a moratorium on rights and securities in respect of assets that are not necessary for the rescue process or when such rights are in unprotected situations.[124]

The UNCITRAL Legislative Guide insists that secured creditors should be enabled to seek protection where the moratorium is not necessary for the procedures and when the

[120] *Re Atlantic Computer Systems plc* [1992] Ch 505

[121] In carrying out a balancing exercise between the legitimate interests of the secured creditors and the legitimate interests of the other creditors of the company, the court stated that "great importance, or weight, is normally to be given to the proprietary interests". Ibid 542

[122] Ibid 542

[123] Such a response was adopted by the UK Government. See: Department for Business, Energy and Industrial Energy, 'Government Response' (n 97) para 5.19

[124] Payne, 'The Role of the Court' (n 65) 142-43. Jurisdictions like the UK IA 1986 and the US Chapter 11 entitle the creditors to apply to the court in some circumstances to have the moratorium lifted. For more details see: McCormack, *Corporate Rescue* (n 100) 162-67

secured interests seem to be not well protected.[125] In this regard, the WB in its *Principles for Effective Insolvency and Creditor/Debtor Regimes* recommends that "The stay (moratorium) should be of limited, specified duration, strike a proper balance between creditor protection and insolvency proceeding objectives, and provide for relief from the stay by application to the court based on clearly established grounds when the insolvency proceeding objectives or the protection of the secured creditor's interests in its collateral are not achieved".[126]

4.4. Post-commencement Funding: Its Importance and Problems

When a company is insolvent, by definition, it is short of cash.[127] For the debtor to keep its business going and to preserve the going concern value, obtaining additional finance[128] (post-commencement finance) to continue its operations and to emerge from the financial distress is considered very crucial to the rescue process. Such a fund will help debtor companies in their attempts to reorder their affairs until a satisfactory composition or arrangement with creditors can be reached.[129] Unless such finance is obtained, it is likely that any rescue attempt will fail and the probability of liquidation will increase.[130]

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[125] UNCITRAL Legislative Guide, Part Two, Chap II, para 60

[126] World Bank, *Principles for Effective Insolvency and Creditor/Debtor Regimes* (World Bank 2016) (hereinafter World Bank Principles) Principle C5.3

[127] Susan Block-Lieb and Terence Halliday, *Global Lawmakers: International Organizations in the Crafting of World Markets* (CUP 2017) 295

[128] It should be noted that the moratorium in effect is a source of credit to insolvent businesses by extending time within which existing creditors must be paid, since their enforcement efforts are suspended by the application of the moratorium. Accordingly, insolvent businesses may not need to obtain new finance if the extended credit obtained as a result of the moratorium is enough for businesses to restructure their affairs for rescue.

[129] Mahesh Uttamchandani, 'The Case for DIP Financing in Early Transition Countries: Taking a DIP in the Distressed Debt Pool' [2004] LiT, at 07 <www.ebrd.com/downloads/research/law/lit042.pdf> accessed 01 Dec 2017

[130] Fayez Elayan and Thomas Meyer, 'The Impact of Receiving Debtor-in-Possession Financing on the Probability of Successful Emergence and Time Spent Under Chapter 11 Bankruptcy' (2001) 28 Journal of Business Finance & Accounting 905, 910-11

The increased recognition of rescue justifies the encouragement of post-commencement finance because such finance would help a company to preserve the going concern value of its business by avoiding liquidation.[131] Given its importance to the rescue procedures, the provision of new funding has increasingly been part of the global consensus on insolvency law reforms.[132] For example, the UNCITRAL Legislative Guide confirms that keeping the debtor's business in operation after the commencement of the procedures is significant to rescue procedures and the company must have access to additional funds by means of post-petition new funding to achieve this goal. And insolvency laws that promote the continued operation of the debtor's business should facilitate new funding.[133]

However, access to finance during business distress can be rather difficult. This is because creditors and lenders lack the incentives to extend or provide new funds for the troubled companies because of the fear of further risk. Besides, business assets of a troubled company may be fully secured which limits the potential for the company to provide any further security to the creditors or it will be able only to borrow on a non-secured basis. This would be counterproductive to creditors because debt repayment will depend on the outcomes of rescue and thus may not be repaid in full in a case where restructuring fails because of a lack of finance.[134]

In response to this issue, some countries have used a super-priority regime to encourage existing or potential lenders to make fresh cash available to the debtor. This additional fund will be given a priority over the existing creditors. This is known as the super-priority system. The advantage of the super-priority system is that it reassures

[131] McCormack, *Corporate Rescue* (n 100) 177
[132] Uttamchandani, 'The Case for DIP Financing' (n 129) 9
[133] UNCITRAL Legislative Guide, Part Two, Chap II, para 94
[134] Gerard McCormack, 'Super-priority New Financing and Corporate Rescue' [2007] JBL 701, 702

post-commencement lenders that their security would not be wasted but will be prioritised over all existing creditors.[135] One of the ways in which Chapter 11 of the US Bankruptcy Code 1978 provides post-commencement creditors with incentives is through a priming lien as a super-priority system under section 364(d) when it seems there are no unencumbered assets available.[136]

Super-priority, nonetheless, is very controversial. This is because the application of such a system would interfere with the interests of pre-existing creditors and it would undermine creditors' predictability and certainty which in turn would cause a serious damage to secured transactions systems.[137] Unless the super-priority security is imposed only on assets newly brought into the pool of assets by transactions such as purchase money security,[138] it will likely disadvantage existing creditors[139] as it is spread across all secured creditors because it undermines the available security or it will spread the burden to sub-class of creditors such as unsecured creditors who would lose far worse because what hope they had of anything will be taken out by super-priority. As a consequence, super-priority will create a distributional problem in insolvency because it will interfere with the rights and interests of pre-existing creditors and should the company fail, post-petition funding would operate at the expense of pre-existing creditors.[140]

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[135] George Triantis, 'A Theory of the Regulation of Debtor-in-Possession Financing' (1993) 46 Vand L Rev 901, 902

[136] Darla Moore, 'How to Finance a Debtor in Possession' (1990) 6 Com Lending Rev 3, 4-7

[137] Harmer (n 117) 99

[138] This is one way to reassure that economic interests of the existing creditors are protected against the super-priority financing. See: UNCITRAL Legislative Guide, Part Two, Chap II, para 104 stating that: "As a general rule, the economic value of the rights of pre-existing secured creditors should be protected so that they will not be harmed. If necessary, this can be achieved … by making periodic payments or providing security rights in additional assets …"

[139] When the assets of the debtor are already encumbered, the US Bankruptcy Code 1978 under section 364(d) requires the debtor to demonstrate that the interests of existing lien holders (secured creditors) are adequately protected before the court approves a priming lien to secure post-commencement funding. See: Triantis (n 135) 907-08

[140] McCormack, 'Super-priority' (n 134) 706

Because of that, many developed rescue systems in the world reject the post-commencement finance.[141] In the UNCITRAL Insolvency Working Group on Insolvency Law, delegates from other developed countries, namely France, Germany and the UK, were sceptical about the issue on the basis that the incentives for post-commencement finance might take the law too far against the interests of secured creditors and away from the interests of unsecured creditors.[142] Lately, in its response to insolvency and corporate governance reform, the UK Government has again rejected the introduction of the rescue finance proposal on the ground that such finance was not necessary since the market already offers sufficient post-commencement finance to viable but struggling companies and, further, the introduction of the rescue finance that leads to change the order of priority would result in potential serious and negative consequences for the general lending market by increasing the cost of borrowing.[143]

Where post-commencement finance is to be adopted, lawmakers have to be aware to provide the existing secured creditors with reassurance that the economic value of their securities will be protected. In this respect, the UNCITRAL Legislative Guide emphasises that the provision of the post-commencement finance should not be provided unless it is balanced against the pre-existing rights and priorities of creditors.[144] As Finch and Milman argue that, post-commencement finance should not be provided unless it is genuinely value enhancing for all stakeholders.[145] Accordingly, super-priority funding should be provided only when there is a possibility for rescue.

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[141] The super-priority granted to post-commencement finance is a unique feature of the US Chapter 11 of Bankruptcy Law and not adopted in any country other than the United States and Canada. Terence Halliday, Susan Block-Lieb and Bruce Carruthers, 'Missing Debtors: National Lawmaking and Global Norm-Making of Corporate Bankruptcy Regimes' in Ralph Brubaker, Robert Lawless and Charles Tabb (eds), *A Debtor World: Interdisciplinary Perspectives on Debt* (OUP 2012) 266

[142] Block-Lieb and Halliday, *Global Lawmakers* (n 127) 296

[143] Department for Business, Energy and Industrial Energy, 'Government Response' (n 97) paras. 5.185-86

[144] UNCITRAL Legislative Guide, Part Two, Chap II, para 104

[145] Vanessa Finch and David Milman, *Corporate Insolvency Law: Perspectives and Principles* (3rd edn, CUP 2017) 335

This is because business rescue is not an inevitable solution that must be sought in every case because rescue procedures are a multiple-interested party game in which all concerned interests should be equally respected. When the company is economically onerous, it is not the creditors who should bear the burden of its insolvency whereas the liquidation should be the better option to protect their interests.[146]

In addition, a system of super-priority might be made less offensive to pre-existing secured creditors if such a priority is created by consensual agreement with existing creditors or by a court order after taking careful consideration of the existing secured interests.[147] It is recommended by the UNCITRAL Legislative Guide that in case no agreement was reached with existing secured creditors whereas the court sees that the new funding is value enhancing for the business, the court may be authorised to create super-priority on conditions that the existing creditors were given a notice or given the opportunity to be heard by the court, the debtor proves that finance is not available in any other way and the court sees that the interests of the existing secured creditors will be well protected.[148]

Obviously, the super-priority is not a straightforward mechanism that can be introduced in a country without careful considerations of the impact that it may have on the existing creditors. Implementing super-priority supposes that a jurisdiction has courts that are competent and staffed with qualified judges and experts in order to be able to examine the value enhancing element of the post-commencement financing and are able to determine that the economic interests of pre-existing secured creditors are well-protected before granting post-commencement creditors any priorities. This is

[146] Elayan and Meyer (n 130) 911. Also see: Michelle White, 'Does Chapter 11 Save Economically Inefficient Firms?' (1994) 72 Wash ULQ 1319, 1319
[147] Harmer (n 117) 99
[148] UNCITRAL Legislative Guide, Rec 67. This is the approach adopted by the US Bankruptcy Code 1978 in section 364(d)

because super-priority, as previously mentioned, could be counterproductive creating much uncertainty and undermining predictability in the market if it is not properly installed. As it was acknowledged by Professors Finch and Milman, it would not be possible to effectuate super-priority without establishing courts that incorporate appropriate training for judges and experts to be competent enough to deal with such insolvency cases.[149] A jurisdiction like the Libyan system needs, therefore, to enhance the judicial institutions to be able to provide confidence for existing creditors that their rights will be protected before incorporating incentives for post-commencement finance into the insolvency legal system and making the situation much worse.

Furthermore, adopting a super-priority system supposes that the secured creditors are well protected through a predictable and well defined ranking system. In Libya, contractual security interests are prejudiced by the priority given to privileged claims unless post-commencement finance is provided by the purchase money security transaction.[150] If this situation continues, super-priority of the post-commencement finance will likely be disturbed by the prevalence of the priority statutorily prescribed to some privileged claims. As such, creditors with such a structure would be very discouraged to provide any additional finance and the interests of the existing creditors will be prejudiced if a court decided to approve a post-commencement finance.

4.5. Role of the Court in the Procedures

Under the Libyan insolvency system, courts are given a great role to play in the procedures. In the composition procedures, the court will be in charge of the whole process from the day of the proposal submission. The first meeting of the creditors is convened by the court upon the commencement of the procedures and the meeting date

[149] Finch and Milman (n 145) 336
[150] This type of transactions is recognised under FLA 2010. See below Sec 5.3.6 and Sec 5.6.2.2

is defined by the court's order.[151] In the negotiations of the proposed scheme, the creditors will either accept, refuse or suggest modifications to the proposal but they are not entitled to initiate a proposal of their own.[152] The court is given the power to scrutinise and supervise the day to day business of the company.[153] The principal officer who will supervise the performance of the composition plan is the judge delegate whose actions must be conducted in compliance with the way detailed by the court.[154] For the benefit of the whole creditors, the court is granted wide discretion regarding the composition proposal. It can refuse the debtor's proposal even though the creditors have already accepted it.[155]

The insolvency practitioner is appointed along with the judge delegate, by the court not by the creditors nor can they interfere with the court's decision.[156] The insolvency practitioner in Libya is a civil servant and represents the insolvency estate with a duty to protect the creditors' interests.[157] The creditors have no right to interfere with the role of the practitioner, but if they are not satisfied with his performance they can appeal his actions to the judge delegate and the court,[158] and request the court to dismiss the practitioner and replace him with another.[159] Also, the creditors' meetings will be led and instructed by the judge delegate whose decisions really matter.[160]

[151] CCA 2010, Art 988(2)
[152] Ibid, Art 1000 and 1002
[153] Ibid, Art 992
[154] Ibid, Art 1010
[155] Ibid, Art 1006
[156] Ibid, Art 988 in the composition procedures and Art 1021 regarding the insolvent liquidation procedures.
[157] See: Ibid, Art 990
[158] Ibid, Art 1041
[159] Ibid, Art 1042
[160] Ibid, Art 999

As far as insolvent liquidation is concerned, the whole procedures are resided with the court.[161] The judge delegate is appointed to manage the entire process and he/ she is the person who orders for the creditors' committee to be convened when he thinks appropriate. The judge delegate is empowered to grant permission to the practitioner to carry out the debtor's business activities that fall outside of the ordinary course of business, if necessary, without the need to refer to the creditors' opinion in the matter.[162] Also, after the insolvency adjudication, the court can order the continuation of the ordinary business of the debtor temporarily if it thinks that the sudden cessation of the business would result in an irreversible damage to the debtor's business value. That can be done by a court order without the need to consult the creditors' committee unless the list of the creditors with details of their debts is concluded and brought into effect by the judge delegate. Only in the latter case does the creditors' committee have the final word regarding the continuation of the business of their debtor.[163] Finally, the creditors' committee is formulated by an order issued by the judge delegate consisting of three or five members selected among the creditors and the committee will be chaired by the judge delegate.[164] The creditors' committee is permitted merely consultative functions and only whenever the court or the judge thinks appropriate to get the creditors' consultation taken through a meeting or meetings convened by the judge delegate.[165] The creditors' committee is entitled no right to claim for remunerations for carrying out its duties, but it has the right to have the expenses necessary of its duty reclaimed.[166]

[161] Ibid, Art 1028 states that "The tribunal which has rendered the adjudication shall be in charge of the whole insolvency procedures…".
[162] Ibid, Art 1030(6)
[163] Ibid, Art 1099 entitled 'The Temporarily Extension of Business Activities'.
[164] Ibid, Art 1045
[165] Ibid, Art 1046(1)(2)
[166] Ibid, Art 1046(4)

Having the above in mind, it is plain that the court and its appointed officers are given control of the procedures of both the composition and the insolvent liquidation with the creditors having only a very limited role in the processes. Such excessive involvement of the court in the processes is undesirable. It can add to inefficiency of a rescue system due to some reasons. First, the costs of the procedures will increase. These include the direct cost, such as fees required by accountants, lawyers, auditors etc. and costs caused by the delayed procedures. The troubled companies can also be exposed to indirect costs, which include the loss of investment opportunities[167] due to the lack of business knowledge among the courts and judges in Libya.

In addition, the excessive court involvement in the composition procedures can limit the freedom of the debtor company in managing its business through the DIP system which may restrict the company's business choices and options. It would also add potentially significant delay and costs to the restructuring. Also, it is said that the court's *ex officio* power may encourage courts to go beyond supervising the procedures to scrutinise the pre-petition behaviour of the company's management and attempt to prosecute illegal transactions and insolvency-related crimes which, as a consequence, deters debtors from filing for insolvency.[168] In sum, the excessive involvement of the court and its representatives in the overall insolvency procedures limits in turn the right of the creditors to effectively participate in the procedures. This will be discussed below.

[167] Stephen Ferris and Robert Lawless, 'The Expenses of Financial Distress: The Direct Costs of Chapter 11' (2000) 61 UPittL Rev 629. Also see: James Ang, Jess Chua and John McConnell, 'The Administrative Costs of Corporate Bankruptcy: A Note' (1982) 37 J Fin 219

[168] Manganelli (n 42) 259

4.6. Role of Creditors in the Procedures

Creditors' participation in insolvency procedures is considered important in shaping any well-balanced insolvency and rescue regimes.[169] The justifications for strengthening the creditors' role in the insolvency procedures and in decision making are based on the fact that the insolvency increases the interest of the creditors in the business of the debtor and their financial interest will often be greater than that of other stakeholders.[170] This is because the common pool of assets, to which the creditors will have recourse in an insolvency scenario, will be affected and its value may be devaluated. For that reason, it is rational that the decision of the creditors in any proceedings should be taken into account.[171]

Strengthening creditors' participation is advantageous to the creditor group as a whole[172] as this would ensure that possible abuse of the insolvency procedures is avoided, excessive administrative costs are checked and information regarding the procedures is processed which will in turn contribute positively to the value of the insolvency estate. Also, they are often in a good position to provide advice and assistance regarding the debtor's business and to monitor the actions taken by the insolvency practitioner.[173]

The importance of promoting the creditors' role in the insolvency procedures is emphasised in the international benchmarks. For example, the UNCITRAL Legislative

[169] Adam Al-Sarraf, 'Bankruptcy Reform in the Middle East and North Africa: Analyzing the New Bankruptcy Laws in the UAE, Saudi Arabia, Morocco, Egypt, and Bahrain' [2020] Int'l Ins Rev 1, 9
[170] UNCITRAL Legislative Guide, Part Two, Chap III, para75
[171] Roman Tomasic, 'Creditor Participation in Insolvency Proceedings - Towards the Adoption of International Standards' (2006) 14 Insolv LJ, at 09 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1443762> accessed 26 Sep 2017
[172] As will be discussed later at the end of this section, two issues should be stressed about strengthening the role of creditors in insolvency. First, not all creditors will have sufficient incentives to take up an active role. Second, participation in real life may be dominated by secured creditors.
[173] UNCITRAL Legislative Guide, Part Two, Chap III, para75

Guide insists on increasing the creditors' participation "… especially as a counter-balance to the roles assigned to other participants under the law and as an important means of safeguarding creditor interests".[174] Also, the WB Principles assure that enabling creditors to effectively monitor and participate in insolvency proceedings would ensure that their interests are safeguarded which would in turn "ensure fairness and integrity …".[175] The UNCITRAL Legislative Guide recommends that it is desirable that the insolvency law should clearly specify the rights and functions resided to the creditors' committee in the procedures that may include:

"(a) Providing advice and assistance to the insolvency representative or the debtor-in-possession;

(b) Participating in development of the reorganization plan;

(c) Receiving notice of and being consulted on matters in which their class has an interest, including the sale of assets outside the ordinary course of business;[176]

(d) The right to hear the insolvency representative at any time;[177] and

(e) The right to be heard in the proceedings".[178]

As has been discussed,[179] the Libyan regime of insolvency relies heavily in its operation on the court and its representatives (the judge delegate and the syndic) as they are the parties in charge of making all key decisions on the procedures. However,

[174] Ibid, Part Two, Chap III, para 77

[175] World Bank Principles, Principle C7.1

[176] Receiving notice and being consulted would, in a practical sense, result in a slow and expensive process. Therefore, it is more efficient that, as the UNCITRAL Legislative Guide suggests, the creditors participate through a creditors' committee so that creditors can meet and be consulted in one place to save time and minimise costs. See: UNCITRAL Legislative Guide, Part Two, Chap III, para 110

[177] The phrase 'the right to hear the insolvency representative' appears to mean the right to request representations on matters relating to the functions of the creditors' committee (which include consulting with the insolvency representative and participating in the development of the rescue plan) and the rights of the committee to access up-to-date information on the financial affairs of the debtor. See: Ibid, Part Two, Chap III, paras. 111 and 112

[178] Ibid, Rec 133

[179] See above Sec 4.3.3

creditors participate at a very low level and have little influence. The main role that creditors can play in the procedures is the requirement of the majority of creditors to vote on the composition plan. This situation is undoubtedly unattractive to investors, both local and foreign, who prefer to play an active role in the decision making in the procedures to ensure that their rights and interests are respected.

The insolvency regime of Libya regulates the formation of the creditors' committee as a representative of their interests in Articles 1045 and 1046 of the CCA 2010. Article 1046(3) regulates the role of the creditors' committee stating that: "the creditors' committee, and every member of the creditors' committee, shall be entitled to receive monetary statements and documents on the conduct of the insolvency estate and shall be enabled to request information and clarifications from the syndic and the insolvent debtor". As noted above, this is important in providing the creditors' committee with the mechanism necessary for facilitating transparency and promoting creditors' confidence in the insolvent liquidation procedures.

However, as previously discussed, the creditors' committee under the Libyan law has only advisory functions and their decisions will not bind the court.[180] This is inadequate to boost the participation of creditors who should be afforded a more effective and adequate role to play in the procedures because they are more vigilant than any other party to protect their rights and to monitor the actions taken by the insolvency practitioner. Besides, they are often in a much better position to provide advice and assistance regarding the debtor's business.

Moreover, the possibility of establishing a creditors' committee in the composition procedures is not legislatively clear in Libya. To detail, the creditors' committee can be

[180] See above Sec 4.5

established only after the debt list is given an executive effect which can be made only in the insolvent liquidation process. The CCA 2010 states that "The creditors' committee must be established within ten days from the issuance date of the order stipulated in Article 1106. Nevertheless, it may be permitted to establish a provisional creditors' committee prior to the mentioned date as the judge thinks fit".[181] Article 1106 of the CCA 2010 regulates when the debt list is given an executive effect.[182]

It could be argued that even though the creditors' committee may not be allowed to be established during the composition procedures, this does not mean that the creditors cannot participate in the procedures individually or under any other form of participation. Arguably, however, participating through the creditors' committee is the preferred[183] form of participation by creditors because it ensures that their voice is heard in an efficient manner.[184] Where a creditors' committee is formed, creditors can select the most expert creditors to represent them in the procedures. Also, the costs of the procedures can be lower than if each creditor participates individually. Additionally, participation through a creditors' committee can help to concentrate the information on the debtor's business in one place so that creditors are able refer to them whenever is needed maybe with no costs. This would contribute to maintain and maximise the overall value of the debtors' business.

Furthermore, the approach adopted by the Libyan law regarding the vote on the composition plan raises some concerns. As has been discussed, secured creditors in

[181] CCA 2010, Art 1045(1)

[182] Ibid, Art 1106, entitled 'Executive Effect of the Debt List', states that "(1) The judge and the clerk shall sign the list of debts, and it shall be concluded by an order issued by the judge contending that its effectiveness will be from the date of the last creditors' meeting, or fifteen days after the date of the last creditors' meeting".

[183] This is preferable especially in cases where multiple creditors are involved. See: World Bank Principles, Principle C7.1

[184] Mahesh Uttamchandani, 'No Way Out: The Lack of Efficient Insolvency Regimes in the MENA Region' (2011) 1 World Bank Policy Research Working Paper No 5609, at 18 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1794914> accessed 4 Jan 2019

Libya are not required to take a role in the composition procedures and therefore they are not bound by the composition plan and procedures because the law reassures them the right to protection through court process.[185] However, as far as the rescue procedures and culture are concerned, such an approach is detrimental to a business rescue system and may make rescue impossible to implement especially where the encumbered assets are essential to the success of the plan. Particularly where courts, judges and practitioners lack capacity and expertise in insolvency laws, it should be acknowledged that the need for ensuring the creditor participation is more desirable in rescue procedures.[186]

In order to increase the success of rescue, secured creditors should participate in the procedures. Participation of secured creditors should be separated from that of unsecured creditors so that each would vote on the composition plan as divided classes; i.e. secured creditors are represented as a class, the general creditors are represented as class and the privileged creditors are represented as a class. The composition plan is then required to be supported by a majority of creditors of each class while the dissenting minority classes will be bound by the plan.[187] By doing so, the likelihood of successful rescue procedures is increased as secured creditors' interests are now dealt with along with other creditor interests in the composition meeting as they are now required to participate.

[185] This is because the debtor's proposal for the composition must have a worthy offer for secured creditors. Otherwise, the court will not approve their composition proposal in the first place pursuant to Article 985(6)(a) of CCA 2010

[186] However, the creditors' participation in the liquidation procedures can be informative to the court and the practitioner as they can provide a valuable source of advice and information regarding the debtor's business especially where the outcome of liquidation will be a sale of the business on a going concern basis. UNCITRAL Legislative Guide, Part Two, Chap III, para84

[187] There are different approaches that can be adopted in this matter. The requisite majority of creditors may be based on percentage of the total value of claims or a number of creditors, or may be a combination of both. For details see: ibid, Part Two, Chap IV, paras. 50-51

Although there are good theoretical reasons for strengthening creditors' participation in insolvency or business rescue procedures, some points must be acknowledged. Giving creditors the power to participate in the process may end up with two unpredictable possibilities. First, general creditors, especially those who are owed small amounts of debts, may not be enthusiastic to take up an active role. In practice, it is common that creditors do not participate in the process especially where it seems it is not economically rational for them to participate due to both possible further costs incurred by their participation and possible insignificant returns.[188]

Second, giving creditors control in insolvency or business rescue leads to a collective action problem for the dispersed creditor group and therefore it tends to lead to secured creditors taking control over the process.[189] This is because secured creditors, unlike general small creditors, are more economically incentivised and also because they have more expertise in dealing with insolvency matters. This is likely lead to secured creditors abusing the process to their own advantage especially when they are fully secured.[190]

The historical development of the UK insolvency law can be given as an example. The UK insolvency law pre-2002 reform placed control in insolvency procedures in the hands of secured creditors (floating charge holders) through the right to appoint an administrative receiver whose duty is to satisfy his appointer only.[191] This created conflicts of interest between the receiver (representing the secured creditor) and the

[188] Tomasic (n 171) 15-16. See also: UNCITRAL Legislative Guide, Part Two, Chap III, para 85

[189] Although the dominance of secured creditors in controlling the process may be problematic because of the possible conflict with the interests of junior creditors, considering the Libyan situation this approach still seems a realistic solution to make a balance with other objectives of business rescue.

[190] UNCITRAL Legislative Guide, Part, Two, Chap III, para 87. Also see: John Armour, Audrey Hsu and Adrian Walters, 'The Costs and Benefits of Secured Creditor Control in Bankruptcy: Evidence from the UK' (2012) 8 RLE 101; Parry and Gwaza (n 97)

[191] This was seen as an incompatible feature with the collective nature of a sound insolvency system. See: Kayode Akintola and David Milman, 'The Rise, Fall and Potential for a Rebirth of Receivership in UK Corporate Law' (2019) 20 J Corp Law Stud 99, 100

junior creditors since secured creditors took this procedure to their own advantage.[192] In response to this problem, the development of insolvency law by the EA 2002 in the UK shifted control from secured creditors to unsecured creditors (through the administration) to make sure that interests of unsecured creditors are also considered. This goal was boosted by the mechanism of voting on the administration proposal and the administrator's accountability to the creditors as a whole.[193]

However, the emphasis on secured creditors in the UK is still recognised to a great extent. For example, the pre-packs under the administration procedure are in practice influenced to a great extent by the floating charge holder.[194] Nonetheless, the secured creditors' control[195] in the insolvency procedures can yet produce efficient outcomes to the benefit of the general body of creditors. This can be manifested by the maximisation of returns through the sale of the business as a going concern and the reduced costs of pre-packs in comparison with the administration procedures.[196] This is to suggest that the predominance of the secured creditors in the process may not be perceived as a deficient feature of an insolvency law as long as this would lead to better

[192] Especially where the assets of the business were worth more than what the secured creditor was owed. See: John Armour and Rizwaan Mokal, 'Reforming the Governance of Corporate Rescue: The Enterprise Act 2002' (2004) ESRC Centre for Business Research Working Paper No 288, at 3 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=567306> accessed 22 Mar 2020

[193] For details see: Armour, Hsu and Walters (n 190) 102-07; Akintola and Milman (n 191) 110

[194] This is manifested by the ability of the administrator to sell the distressed business outside the collective insolvency procedures, the absence of the consent by the general body of creditors to such a sale which is rather marshalled by the floating charge holder who is usually the beneficiary of the sale. It is suggested therefore that pre-packed administrations achieve objectives similarly to those under the administrative receivership. Akintola and Milman, ibid 108

[195] It should be noted that the theory of Creditors' Bargain is less likely to be concerned with the rescue process when secured creditors having an active role in the process because the rights of secured creditors will be well-protected.

[196] See generally: Armour, Hsu and Walters (n 190)

outcomes for the benefit of the various stakeholders and it may thus be a better option[197] where there are insufficient institutions.

4.7. Position of the Employees

The employees always enjoy special regard by the lawmakers in Libya as an application of the theory of 'social justice' in the society. An example is that the employees enjoy a special hierarchy position in the liquidation. The CC 1953 treats the employees' entitlements (salaries and wages due to employees and public servants for the last six months) against their insolvent employer as privileged claims which must be paid in full before any secured creditor is paid anything.[198]

In business rescue, the sale of the business as a going concern is the strategy that should be adopted where this is the better option to maintain the creditors' interests. Under this form of rescue, the business may continue to operate under a new ownership as a going concern.[199] The Code of Employment Relationships (CERs 2010) safeguards employment for the employees when the business is transferred to a new buyer in business rescue. Article 49(1) of the CERs 2010 sets a general rule and prohibits the employer from terminating the employment contracts when the business is transferred to a new buyer for any reason.[200] This is a rigid response to the employment issue in

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[197] Scholars in the UK commenting on the historical development of the UK insolvency regime regarding the shift of control of creditors conclude that no one approach of creditor governance is superior over the other. Ibid 103; Akintola and Milman (n 191) 119

[198] CC 1953, Art 1145(1)(a)

[199] Sandra Frisby, 'In Search of a Rescue Regime: the Enterprise Act 2002' (2004) 67 Mod L Rev 247, 262; Rizwaan Mokal, 'Administration and Administrative Receivership-An Analysis' (2004) 57 CLP 1, 7 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=466701> accessed 23 Jul 2019

[200] CERs 2010, Art 49 states that: '(1) The fulfilment of obligations provided by means of this law shall not be discharged by the … transfer of ownership under any kind of transactions … (2) With regard to cases other than liquidation or insolvency or the final closure, employment contracts shall remain effective for the term period as set out in the employment contracts and the former employer shall be jointly responsible for a period of one year with the successor for fulfilling all pre obligations as set out in the employment contracts'.

Libya to prevent the employer and the new owner from making unfair dismissals of the employees.

Although employees may benefit from business rescue, as opposed to corporate rescue, because this may secure their jobs by avoiding liquidation, the effectiveness of business rescue may require some job reductions. This strategy is necessary to enhance the rescue process by providing the new buyers with incentives to buy the business with higher going concern value and fewer liabilities owed by the insolvent transferor.[201] The CERs 2010 provides the employer with an opportunity to make business decisions in order to address their business needs as a going concern by which the liability for the employment contracts can be discharged provided that the dismissals are not connected to the sale or the transfer of business as set out in the Article 49(1) of the CERs 2010.

The law allows the dismissal of the contracts if it was based on restructuring purposes or on economic reasons. Article 77(2) of the CERs 2010 states that: "… the employer is prohibited from terminating an employment contract unless it is based on the inability of the employee to perform its job … or the work necessities (entailing changes in the workforce), including the restructuring purposes or for economic reasons …". This Article affords the employers flexibility to make business decisions to address their business desires and needs as a going concern which is relevant to business rescue as otherwise the rescue process could be restricted. It is argued that the statutory provisions that require preserving employment contracts would in some instances

[201] This appears to align with the approach offered by the TPT which insists on striking a balance between the employees in ensuring their employment and those of the creditors (by ensuring that the value of the business is not undermined in the rescue process). See above Sec 4.2 (Objective Three of the UNCITRAL Legislative Guide) and 2.2.2.3

potentially undermine the rescue procedure.[202] To ensure accountability to the employees, the law requires the employer to send notice to the Labour Union to which the employees belong and to the concerned Job Office (Job Centre)[203] explaining the reasons for employment dismissals at least one month prior to the dismissal. This is to examine the worthiness of reasons for dismissal in order to avoid any possibility of unfair dismissals of the employment contracts.[204]

However, unfair dismissal could still happen, given the fact that the law provides no definition for the terms 'economic or restructuring' reasons.[205] As such, the balance between the interests of the employees and employers would possibly not be achieved in practice. Although the dismissal of the employees is prohibited by the law if the dismissal was based solely on the transfer or the sale of the business, the employers could possibly prejudice the employees' interests by resorting to Article 77(2) to validate dismissals. Therefore, the law should ensure in the insolvency or business rescue situation that adequate protection of employees' rights is granted.

4.8. Conclusion

As demonstrated in this Chapter, the current insolvency law is not adequate to achieve rescue objectives nor can it contribute to the enhancement of the rescue culture in the community. As has been mentioned,[206] the current insolvency and rescue framework in Libya is traced back to the 19th century Anglo-Belgian insolvency laws.

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[202] This illustrates the tension between the insolvency law and the employment law as each of these laws employs objectives that conflict with each other. The discussion of this point falls beyond the scope of the thesis. For details see: Etukakpan, 'Transfer of Undertakings' (n 19) 40-41; John McMullen, 'An Analysis of the Transfer of Undertakings (Protection of Employment) Regulations 2006' (2006) 35 Industrial Law Journal 113, 133

[203] The Job Office is a government employment agency overseen by the Ministry of Labour. Its purpose is to help citizens to find job vacancies. CERs 2010, Art 6

[204] Ibid, Art 77(2)

[205] For similar discussions in the UK law see: Nsubuga (n 98) 102-05

[206] See above Sec 4.3.1

During this time, economies have improved and legal systems have accordingly been reformed and different mechanisms to deal with the phenomena of business failure have been invented. Obviously, Libya has lagged behind. Reports of international institutions and the scarcity of insolvency cases in the country prove this claim.[207]

Because of the inadequacy of such an insolvency framework to achieve rescue objectives, countries which inherited similar legal systems have recently become aware of the necessity of reform. For example, Tunisia has abandoned its alike-structured insolvency regime and introduced a reform with the aim of promoting more rescue objectives. The Tunisian law abolished the provisions of the composition from its Commercial Code of 1959[208] and substituted it with the law of Rescuing the Economically Distressed Enterprises.[209] This reform adopted some features of modern insolvency laws. For example, it abandoned the punitive nature of the old regime and shifted its focus from liquidation for the benefit of creditors towards achieving more rescue objectives for the benefit of various stakeholders with the focus on maximising the value of the insolvent estate.[210] The new law insisted from the very outset that its primary aim is to help distressed yet viable businesses to continue their business activities, maintaining jobs and to help to fulfil a business's liabilities.[211] Furthermore, this reform adopted more streamlined and more expedited procedures with shorter timelines which is essential to maximise the insolvent estate value. Also, the

[207] See above Sec 1.2.1 and 1.2.3
[208] The Commercial Code of Tunisia no 129 of 1959 (promulgated in the National Gazette in 5 Oct 1959)
[209] Rescuing the Economically Distressed Enterprises Act 1995
[210] Régis Blazy and Aziza Letaief, 'When Secured and Unsecured Creditors Recover the Same: The Emblematic Case of the Tunisian Corporate Bankruptcies' (2017) 30 Emerg Mark Rev 19, 20. Also see: Monsif Al-kasho, *The Law of Rescuing Enterprising Experience Economical Distress* (Sojeek 2015) 20-21
[211] Rescuing the Economically Distressed Enterprises Act 1995, Art 1

moratorium against the creditors is applied only where the enforcement on the business's assets frustrates the rescue process.[212]

This new insolvency approach and practice adopted in Tunisia paved the way towards more effective and efficient insolvency practices in the country. According to the WB *Doing Business* 2019 report, the reformed system enabled the country to achieve the highest recovery rate in the MENA[213] region with just over 51% and lowest costs of only 7% of the insolvency estate.[214] And courts in Tunisia have perceived this reform differently from the old system of composition as a law with collective nature characterised with rescue orientations to shift the concerns from the focus on the liquidation and creditors' pay-off together with management restrictions and liability towards achieving more rescue objectives.[215]

Such an example is potentially inspiring and instructive for Libya. Taking into account all of the economic and social circumstances and situations that Libya has been through,[216] a sound insolvency law that aims to achieve more rescue goals has become very significant in the country as it can contribute to promoting the economic growth and to mitigating social instability. It is also vital to attract foreign direct investment and is a prerequisite for positive investment decisions in a transitional market like Libya. An emphasis should also be placed on institutional reform. A substantial investment should be made in legal training and education prior to the enactment of the reform in order to enhance familiarity of judges and professionals and adaptability of the new rules.

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[212] For details see: Sami bin Farhat, *Comments on the Law of Rescuing the Economically Distressed Enterprises* (El-Magharibia Publishing 2004) 11-17

[213] The term MENA refers to the Middle East and North African States.

[214] World Bank, 'Doing Business: Resolving Insolvency' (*World Bank Group* 2019) <www.doingbusiness.org/en/data/exploretopics/resolving-insolvency> accessed 29 May 2019

[215] Al-kasho (n 209) 34-35

[216] See above Sec 2.5

Chapter 5 The Application of UNCITRAL Principles with Reference to the Libyan Secured Transactions System

5.1. Introduction

The credit sector in Libya was a subject of recommendations for reform provided by the World Bank (WB) in its 2006 and 2008 reports. In the 2006 report, the WB insisted that in order to successfully proceed with the transition to a market economy, Libya needs to reform its existing financial system and the functioning of the credit market.[1] This was followed by a more detailed report conducted by the WB in 2008 which recommended that Libya ought to develop its existing legal system of secured transactions in line with international practices in secured transactions in order to enhance the credit market in the country. The main critical areas that need urgent reform, as advised by the World Bank, include the creation of secured transactions, publicity of the collateral through a modernised registration system and the improvement of the enforcement mechanisms through both judicial and non-judicial mechanisms.[2]

As has been mentioned, some legal reforms regarding secured transactions were introduced, influenced heavily by the views and recommendations of the above mentioned World Bank reports. For example, the Government reformed the secured transactions regime embodied in the Commercial Code of 1953 by introducing the Code of Commercial Activity 2010 (CCA 2010) and also by the introduction of the Financial Lease Act 2010 (FLA 2010). The reform of the secured transactions law was

[1] World Bank, Libya Economic Report 2006, 67

[2] World Bank, *Modernising the Legal Environment for Business Activities* (2008) 48-50. (This document is in Arabic - private communication and in file with the author). Hereinafter World Bank, *Modernising the Legal Environment* 2008

part of the country's initiatives to enhance the shift towards the market economy, thereby enhancing the role of the private sector and to promote economic growth by increasing the availability of credit.[3]

The fundamental aim of secured transactions laws is to provide creditors and loan providers with the power to enforce their claims against defaulting debtors for the unpaid debts.[4] As the risk of default is now expected to increase in Libya as a consequence of the secured transactions reform, it is important to ensure that the legislation provides creditors and lenders with the necessary mechanisms to protect and enforce their rights against their debtors when they become insolvent. Indeed, the legislature in the 2010 reform allows creditors, for the first time in the country, to enforce their security claims under expeditious kinds of court procedures instead of the full court procedures in order to streamline enforcement procedures to achieve swift and effective outcomes.[5] It should be acknowledged, however, that creditors' debt enforcement in the event of insolvency would potentially result in depletion of the value of debtor's assets by the dismemberment of its business if enforcement was allowed on an individual basis. The insolvency law therefore intervenes to prevent such an inefficient 'race to collect' to be replaced by a collective system of enforcement.[6] Obviously, these two aims interact with each other in the event of insolvency and a legal system therefore should be designed to regulate such interaction between these two statutory systems.

[3] For further details see above Sec 1.2.3

[4] John Armour, 'The Law and Economics of Corporate Insolvency: A Review' (2001) ESRC Centre for Business Research, University of Cambridge Working Paper No 197, 1 <www.cbr.cam.ac.uk/fileadmin/user_upload/centre-for-business-research/downloads/working-papers/wp197.pdf> accessed 8 Nov 2019

[5] This will be dealt with later in Sec 5.6.2.1 (regarding the enforcement of the going concern security) and Sec 5.6.2.2 (regarding the enforcement of the financial lease)

[6] Armour (n 4) 1

This Chapter will examine whether or not the secured transactions reform in Libya achieves harmonisation between the secured transactions law and the insolvency law. It aims to analyse the reform of the secured transactions law of Libya and assess whether it has the potential to provide any sound treatment of credit and of the creditors' interests in the context of insolvency. In so doing, the Chapter will examine the impact of the 'social justice' theory as adopted by the CC 1953 on the rights of creditors in insolvency, given its importance in Libya.

The Chapter will focus on discussing whether the current framework of the secured transactions system could implement features of effective secured transactions laws. A secured transactions law should include features that aim, for example, to achieve a simple creation of interests in movable assets,[7] a comprehensive and clear scheme of priority of the competing interests in the assets, a provision for publicity of the secured interests, and effective enforcement procedures. These features, as insisted by International Finance Corporation report on its secured transactions reform initiative 2010, are important for the development of any secured transactions system.[8] Because this Chapter will examine the secured transactions system in Libya, it will first give a brief account of the UNCITRAL Legislative Guide with particular reference to Objective Eight (Recognition of the Rights and Priority of the Existing Creditors) in more detail separately from the principles of the Legislative Guide that were subject of investigation in Chapter Three, since it has implications for the treatment of secured credit. The examination in this Chapter will also be carried out in light of the theoretical discussion undertaken in Chapter Two.

[7] In the Libyan context, however, movable assets are less important than immovable assets. Banks prefer to use immovable assets as security because they are fully effective and cheap security devices. See: Al-habeeb Ejboudah, 'The Pledge on Future Assets in the Libyan Law' (2014) 3 UTJLS 51

[8] World Bank, *Secured Transactions Systems and Collateral Registries* (IFC 2010) 39-41

5.2. Recognition of the Rights and Priority of the Existing Creditors (UNCITRAL Legislative Guide Objective Eight)

It is identified that the most important reason behind the taking of security is to prioritise the rights of secured creditors over other claimants in order to maximise returns to creditors in the event that the debtor faces financial or economic distress and cannot meet its obligations in full.[9] The position against which the creditors most want protection is when their priority and the value of their security rights are reduced due to the insolvency of their debtor.[10] Creditors typically suppose that the insolvency law preserves their legitimate expectations by upholding their pre-insolvency rights and priority with the secured interests being respected although through collective processes. This is vital to ensure in the insolvency law because subordinating the secured creditors' rights would otherwise introduce a level of uncertainty in daily commercial relationships.[11] It is important, therefore, that the law ensures certainty for creditors by clearly stating whether secured interests will be recognised upon the commencement of the insolvency procedures.[12]

But, insolvency, by a balance sheet definition, means that a distressed company is encumbered with liabilities which exceed the value of its assets which will result in some creditors not receiving full satisfaction. Therefore, the burden of distress is to be shared among creditors. This issue is regulated by insolvency laws by classifying creditors into different classes in an orderly ranking system by which higher priority creditors (secured or preferential creditors) must be repaid in full before lower priority

[9] Gerard McCormack, *Secured Credit under English and American Law* (CUP 2004) 5-7

[10] EBRD, Core Principles for a Secured Transactions Law (Jul 2010) <http://www.ebrd.com/documents/legal-reform/secured-transactions-coreprinciples-english.pdf> Principle 5, accessed 2 Mar 2018

[11] See above Sec 2.2.1. Also see: Thomas Jackson, *The Logic and Limits of Bankruptcy Law* (HUP 1986) 157

[12] UNCITRAL Legislative Guide, Rec 4; and UNCITRAL, *Model Law on Secured Transactions* (United Nations 2016) Art 94

creditors (ordinary unsecured creditors) may receive anything, under a rule of absolute priority.[13]

The UNCITRAL Legislative Guide expresses the importance of having the pre-existing rights of various creditors, especially with respect to the rights of secured creditors, recognised and effectively enforced.[14] It is important that those existing as well as post-commencement interests are set forth in a clear priority ranking as this will provide predictability to investors as to how to assess and manage the risk of insolvency.[15] Recognition of the existing creditor interests and priorities requires the law to minimise priorities of social and political considerations and instead limit the priority rules to those priorities of commercial bargaining. But if such socially or politically-based priorities were to be recognised by the law, it is fundamental to ensure that these priorities are clearly set forth and are predictable to the creditors and lenders and are also limited to as great an extent as possible.[16] Otherwise, the outcomes of the procedures may likely be distorted and the rule of absolute priority will be rarely applicable leaving secured creditors with little hope of recovering anything.[17]

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[13] Thomas Jackson and Anthony Kronman, 'Secured Financing and Priorities among Creditors' (1979) 88 Yale LJ 1143, 1161-62; Bruce Carruthers and Terence Halliday, 'Institutionalizing Creative Destruction: Predictable and Transparent Bankruptcy Law in the Wake of the East Asian Financial Crisis' in Meredith Woo (ed), *Neoliberalism and Institutional Reform in East Asia: A Comparative Study* (Palgrave Macmillan 2007) 242

[14] It is clear that the UNCITRAL Legislative Guide holds a position that protects the pre-existing rights of secured creditors that simulates the CBT's view about pre-insolvency entitlements of secured creditors. See above discussion Sec 2.2.1 and Sec 2.3

[15] UNCITRAL Legislative Guide, Part One, Chap I, para 13

[16] Jenny Clift, 'Choice of Law and the UNCITRAL Harmonization Process' (2014) 9 Brook J Corp Fin & Com L 29, 54

[17] McCormack, *Secured Credit under English and American Law* (n 9) 7; Mahesh Uttamchandani, 'No Way Out: The Lack of Efficient Insolvency Regimes in the MENA Region' (2011) 1 World Bank Policy Research Working Paper No 5609, at 7 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1794914> accessed 4 Jan 2019

5.3. Overview of Secured Transactions System in Libya

Historically in the Roman law, a security interest in either movable or immovable property could be obtained by a contract known as *fiducia* which was based on the essence that the debtor agrees to transfer ownership of his property and assets to the possession of the creditor who agrees to transfer the property back to the debtor when the debt was satisfied (sale-for-resale-form). By means of this kind of transaction, the creditor became the owner of the transferred property.[18] This kind of secured transaction was gradually replaced by secured transactions that corresponded more closely to the modern concept of pledge known as the *pignus*. Pignus was based on the essence that the debtor transfers only the possession of the property to the creditor while he remains the owner (possessory pledge) and was entitled to have the collateral returned to him.[19] During the time, pignus developed to take the form of *hypotheca* which allowed the debtor to grant a security interest in his property without losing its possession during the agreement period (non-possessory pledge).[20]

This classification survived the civil law systems, through the French Civil Code of 1804, with a differentiation between immovable property, which was governed by the mortgage system[21] where the debtor in most cases remains in possession, and the movable tangible property that was dealt with by the pledge which requires the debtor to transfer the possession of its pledged property to the creditor.[22] As a civil law

[18] Harry Sachse, 'Purchase Money Security Interests in Common Law and the French System of Civil Law' (1969) 15 McGill LJ 73, 74. In the common law, this type of security (*fiducia)* is known as a mortgage. See: McCormack, *Secured Credit under English and American Law* (n 9) 40

[19] In common law systems, this security is known as pledge too. See: McCormack, ibid 41

[20] Sachse (n 18) 74. This device is similar to the common law charges. See: McCormack, ibid 40

[21] The mortgage device functions like the charge in the common law systems where the borrower retains ownership but the lender is given a right to seize the property if the debt is not paid. See: McCormack, ibid 40

[22] Abdulrazzaq al-Sanhuri, *General Commentary on the Civil Law: in personam Security and in rem Security*, Vol 10 (2ed edn, Arab Heritage 1967) 262-63. (Hereinafter *in personam Security and in rem Security*)

system, the Libyan law recognises this dichotomy between movable and immovable property.[23] Accordingly, the CC 1953 distinguishes between immovable and movable property. Property that is fixed in a place and cannot be removed undamaged shall be considered immovable and any property that falls outside this definition shall be considered movables.[24] However, a movable property that is assigned by the owner to exploit the immovable shall be deemed immovable for that purpose (designed immovable).[25] Moreover, the law extends the term immovable property to every right over immovable property including the ownership of property as well as every legal action related to rights *in rem* on immovables. And any rights that fall outside this restriction shall be considered movable property.[26] Accordingly, the leasing rights on immovable property are not considered immovable property because they fall outside the definition of the *in rem* immovable right in the Libyan law.

Beside this classification of the security devices (known as real security), there are other devices that originally are not security devices as such but they have equivalent functions (known as quasi-security). This classification includes the conditional sale[27] and the financial lease agreements.[28] Furthermore, the law assigns some claims a security right by the operation of the privilege system.[29] These claims originally are unsecured but they are preferential by the law for social and political considerations.

[23] CC 1953, Book IV entitled 'Accessory Rights in *Rem*', Title II 'Authentic Mortgages', and Title IV 'Possessory Pledges'.
[24] Ibid, Art 82(1)
[25] Ibid, Art 82(2)
[26] Ibid, Art 83
[27] CCA 2010, Art 519 and CC 1953, Art 419
[28] Introduced by FLA 2010
[29] CC 1953, Art 1134

5.3.1. Mortgage (Charges)

The mortgage (similar to the charge as known in common law systems)[30] is a security device over immovable property by which the creditors obtain priority over ordinary creditors and secured creditors following in ranking for the payment of their claims over the sale price of the immovable.[31] The Libyan law distinguishes between consensual mortgage, mortgage by law and judicial mortgage. The mortgage by law arises by the operation of law to secure claims like those of the building constructor over obligations related to the construction of buildings of reconstruction and to secure claims of the State over the property of criminally accused people with civil responsibility according to the criminal law and criminal procedural law.[32] The judicial mortgage is granted to any creditor holding an enforceable court judgment against a debtor to secure the creditor's claims.[33] The consensual mortgage is created by a mutual agreement and can only be created by an authentic document,[34] and will not be effective against third parties unless the mortgage deed of agreement is registered in the land registry.[35] The priority of the mortgage is determined by the date of inscription (the date and time of registry).[36]

It should be noted that all these types of mortgages are non-possessory in type and are imposed on immovable property only. However, the most common type in practice is the consensual mortgage and the term mortgage applies to the consensual mortgage.[37] This type of mortgage is traditionally preferred by banks in Libya as ideal security for

[30] However, the charge in the common law can be over both types of property, movables and immovables.
[31] Farhat Ziadeh, *Property Law in the Arab World: Real Rights in Egypt, Iraq, Jordan, Lebanon, Libya, Syria, Saudi Arabia and the Gulf States* (Graham & Trotman 1979) 75
[32] CC 1953, Art 1033
[33] Ibid, Art 1089
[34] Ibid, Articles 1034-1088
[35] Ibid, Art 1057 and 1058
[36] Ibid, Art 1061
[37] Ziadeh (n 31) 75

lending because it does not usually depreciate in value and it cannot be hidden away from the creditor.[38] The creditor secured by consensual mortgage enjoys priority over the ordinary unsecured creditors and secured creditors following in rank whether they are other mortgagees or holders of a judicial mortgage.[39] However, security over land by mortgage does not always enjoy a priority. Secured creditors over land are ranked lower than general privileges (which are not even required for registration to be effective) and they could be ranked lower than holders of special privilege over immovables if they registered their security in the land registry later than the privileged creditors.[40]

5.3.2. Pledge

The pledge in Libya is a possessory security device which can be used for security over both movable property (similar to pledge in the common law), especially tangibles, and immovable property.[41] Both of the pledge of immovable and pledge of movable property become valid as against third parties by the physical delivery of the property to the creditor pledgee or to a third party selected by them.[42] Under the CCA 2010, the possessory pledge, termed as the commercial pledge,[43] can be used to secure tangible movables only and its effectiveness against third parties is subject to transference of the physical possession of the secured property from the debtor to the creditor or to a third party selected by them.[44] However, a pledge of immovable property has to be registered in the land registry in addition to the physical delivery.

[38] Ejboudah (n 7) 64
[39] Ziadeh (n 31) 75
[40] al-Sanhuri, *in personam Security and in rem Security* (n 22) 264-65. For details see below Sec 5.3.7
[41] CC 1953, Art 1101
[42] Ibid, Art 1103(1) and CCA 2010, Art 665
[43] The commercial pledge is the pledge that is granted to secure a commercial debt and is defined by Art 664 of CCA 2010 as: "the pledge over movable property granted to secure a debt that is considered commercial for the debtor".
[44] Ibid, Art 665

The ranking of the creditors' priority is determined by the date of registry in the land registry regarding the immovable property and by the date of the written contract regarding the movable property.[45] The possessory pledge is the only security in the Libyan law for tangible movables in contrast to the immovable which can be secured by the mortgage device in addition to the pledge.[46]

Additionally, Article 1101 of the CC 1953, entitled 'Assets Subject to Possessory Pledge', stipulates that only the movable or immovable property that can be sold independently by public auction can be used as the subject of a possessory pledge. Accordingly, only tangible property can be used as security whereas intangibles, such as intellectual properties, bank accounts, insurance policies etc. are not capable of being used as secured assets[47] in Libya.[48] Further, the creation of a security under the Libyan law requires the existence of the secured property as the law requires the security agreement to contain a sufficiently detailed description of the pledged properties.[49] Therefore, the creation of security for after acquired assets is not recognised in Libya.[50]

Having the above discussion, some points can be raised. First, the requirement of the possessory pledge to transfer the physical possession to the creditor can make a pledge of tangible movables less effective in practice because it deprives the debtor of taking any advantages of their property and in return it would restrict the ability of the borrower to raise capital. In contrast, non-possessory security allows debtors to continue using their secured property during the period of the loan and it, therefore,

[45] Ziadeh (n 31) 79
[46] Except the pledge of a going concern. See below Sec 5.3.4
[47] Except for the pledge of a going concern which can capture intangible property. See below Sec 5.3.4
[48] See: World Bank, *Modernising the Legal Environment* 2008, 46
[49] CC 1953, Art 1121 on the pledge of movable property.
[50] The pledge of a going concern, however, can include future assets. See below Sec 5.3.4

plays a significant role in promoting business lending.[51] Given its important role in promoting lending in the market, the non-possessory security should be facilitated in Libya. Second, the limitation of the pledge on tangible movables is criticised because, as it is insisted that, in modern security transactions systems, the scope of the assets that can be used as collateral should be broad to include all types of assets, with the exception of those specifically excluded.[52] In addition, the requirement of sufficiently detailed description is also disadvantageous as it results in future and after acquired property being excluded from being used as security and this will lead to a "lack of flexibility to address important financing transactions involving changing amounts of secured obligations and changing pools of encumbered assets, including future assets …".[53] A good practice of secured transactions is to allow a general description of the assets subject to security that is enough to allow the identification of the collateral. The advantage is to permit a wide range of assets to serve as collateral over all types of obligations, including present and future as well as products and proceeds.[54]

5.3.3. Pledge of Debts (Receivables)

The CC 1953 provides for the pledge of debts, which is an application of the assignments of rights to payment. By this pledge, any right to receive payments may be assigned as security in the receivable to the assignee creditor for advances made or credit extended to the assignor debtor.[55] This is a type of security over intangible

[51] Richard Calnan, *Taking Security* (3rd edn, Jordans Publishing Ltd 2013) 37. See also: Spiros Bazinas, 'Key Objectives and Fundamental Principles of the UNCITRAL Legislative Guide on Secured Transactions' in John de Lacy (ed), *The Reform of UK Personal Property Security Law: Comparative Perspectives* (Routledge Cavendish 2010) 465
[52] UNCITRAL ST Guide, Chap I, para 5
[53] Ibid, Chap II, para 27.
[54] World Bank, *Doing Business 2017: Equal Opportunity for All* (World Bank 2017) 53
[55] Ronald Cuming, 'Secured Transactions Law Reform: Description and Assessment of Current Iraqi Secured Transactions Law and Approach to Reform' [2005] USAID, at 6 <http://pdf.usaid.gov/pdf_docs/Pnadq152.pdf> accessed 12 Feb 2018

movables which is equivalent to the UK fixed charge over book debts.[56] The pledge of debts involves three parts; the pledger (debtor), the pledgee (creditor) and the receivable debtor. The latter is liable to the pledgee creditor for payments made to the pledger after the receivable debtor has received sufficient notice of the assignment. If the receivable debtor continues to pay the pledger with no objection from the pledgee, the receivable debtor will not be bound by the assignment even if he was aware of the assignment. Therefore, the pledgee has to notify the receivable debtor in order to effectuate the assignment against him and the pledger's creditors (third parties).[57] As a possessory pledge,[58] this type of transaction will not become enforceable and effective against third parties unless the pledgee creditor holds the title document of the debt physically. The priority among successive pledgees of the same receivable will be accorded to the pledgee who first managed to deliver notice of the pledge to the account debtor.[59] In such a mechanism, failure to bring the notice to the attention of the receivable debtor would result in the creditor losing the security upon the assignor's insolvency.[60] In addition, the assignment cannot be used as security collateral in rights that are not presently enforceable.[61]

It was pointed out that, such a mechanism of the assignment of receivables is in most cases impracticable to be taken as security in jurisdictions where it is recognised. This is because the stringent requirements and limitations of the notice provided in favour of the receivable debtor can prevent the assignment from being a significant feature of a modernised secured transactions system. The efficacy of assignment, therefore, should not rely on a notice to the receivable debtor. Alternatively, the notice should be

[56] Roy Goode, 'Charges over Book Debts: A Missed Opportunity' (1994) 110 LQR 592, 594-95
[57] CC 1953, Art 1127(1) and 292
[58] Ibid, Articles 1127-1133
[59] Ibid, Art 1127(2) and 300
[60] Stephan Haimo, 'Practical Guide to Secured Transactions in France' (1983) 58 Tul L Rev 1163, 1184
[61] CC 1953, Art 291

provided to the receivable debtor only when the assignor fails to meet his obligations to the assignee.[62]

5.3.4. Pledge on a Going Concern (Floating Charges)

The going concern is a legal institution that is based on the notion that the collection of all property, immovable and movable (tangible and intangible), which is encompassed in and used to operate the business may altogether contribute to the value of the business which exceeds the value of individual assets themselves if dismantled.[63] The law defines the going concern as "… a set of assets that are used by a trader in connection with the operation of his going concern activity and the rights connected thereto in order to attract clientele. The going concern may include a set of tangible and intangible elements that (non-exclusively)[64] may comprise in particular the name, the trademark, leasehold rights,[65] licenses and patents, industrial drawings, designs, furniture and equipment and goods".[66]

The pledge on a going concern[67] is a non-possessory pledge type where the company has the freedom to deal with the encumbered assets in the ordinary course of business.[68] The Libyan law introduced the going concern security to facilitate a general security interest to be taken over the entirety of a business's property. This type of pledge can

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[62] Cuming (n 55) 6-7; Haimo (n 60) 1184

[63] Abdul-Monaem Al-shafah, *The Collateral of the Business Assets in the Libyan Law* (University of Tripoli 2016) 15-16

[64] The examples given in this Article are not exclusively mentioned. Mohamed Al-badawi, *The Law of Economic Activity: General Principles* (6th edn, 2013) 359

[65] It should be noted that, the leasehold rights in Libya are, like the most civil law systems, viewed as movable property not a property ownership. In Title One, Book Two, the Civil Code 1953 deals with the ownership contracts but not including the leasehold rights which are dealt with in Title Two in the exploiting contracts. In contrast, the leasehold in the UK is an ownership interest in land. See: Jane Ball, 'Renting Homes: Status and Security in the UK and France–A Comparison in the Light of the Law Commission's Proposals' (2003) 67 Conveyancer and Property Lawyer 38, 39

[66] CCA 2010, Art 468

[67] EBRD Model Law on Secured Transactions recognised this type of security and it is referred to as the enterprise charge. EBRD, Model Law on Secured Transactions, Art 5.6

[68] CCA 2010, Art 478. See also: Al-shafah (n 63) 12-13

be extended to all assets of the company, including, unless agreed otherwise, the tangible and intangible movables, receivables and immovable property and it can also secure all debts due by the company including future debts. All property and obligations including present, future and after-acquired assets, products and proceeds can now be used as security by this device.[69] Therefore, it has become possible now for creditors in Libya to use a floating security over the business that would not otherwise be allowable with other security devices.[70] It should be noted that, this security device is similar to the French '*nantissement de fonds de commerce*',[71] and to the general floating charge that is available in the UK legal system,[72] and it is the only floating security available under the Libyan law.[73]

Regarding the effectiveness of the going concern security, moreover, the agreement is required to be ascertained by a notarised document,[74] and, unlike the principles of the CC 1953, a generic description of the collateral is adequate to legally effectuate the agreement.[75] The pledge agreement should also be registered in the commercial registry.[76]

[69] Al-shafah (n 63) 38-39
[70] Ibid 39-40
[71] Haimo (n 60) 1180
[72] George Gretton, 'Reception without Integration-Floating Charges and Mixed Systems' (2003) 78 Tul L Rev 307, 313-14; McCormack, *Secured Credit under English and American Law* (n 9) 46
[73] The pledge on the going business is a common law feature, with reference to the English law, of the 'floating charge' in which the security interest covers almost all the assets of a company. But the floating charge introduced by means of the going concern security in civil legal traditions has no feature of appointing a security administrator as the situation in the English law. Jan-Hendrik Röver, *Secured Lending in Eastern Europe: Comparative Law of Secured Transactions and the EBRD Model Law* (OUP 2007) 72
[74] CCA 2010, Art 476(1)
[75] Ibid, Art 476(2) states that "If the lien agreement does not fully describe the assets subject to the security, it shall be assumed that it includes the name and designs, leasehold rights and trademark".
[76] Ibid, Art 477(1)

5.3.5. Conditional Sale

The law in Libya permits the contractual parties in deferred sale price contracts to add a conditional clause of retention of title by which the ownership of the property is retained to the seller until the purchase price is paid in full.[77] Conditional sale transactions, as quasi-security devices, are not generally recognised as security agreements in the legal sense simply because the buyer is not yet the owner of the sold property. However, they have an economic function equivalent to real security devices by using the ownership to secure the buyer's obligation under the contract.[78] Historically, this type of transactions as a security to the seller's interests was recognised due to the absence of non-possessory security over movable property.[79]

There are two assumptions that should be noted. First, the seller who has inserted such a retention of title clause has a security only for the price of the sold property. Therefore, the retention of title clause will not be extended to proceeds that resulted from a mixture of raw material bought under a contract containing a retention of title clause with the buyer's own goods. Accordingly, the buyer should be able to sell proceeds to a third party who will receive a good title.[80] Second, in the conditional sale retention of title in movables, the buyer can sell the property to a good faith third party who will receive perfectly good title to the property. According to Article 980(1) of the CC 1953, whomsoever possessed a movable, or an *in rem* right in a movable, based on

[77] Ibid, Art 519 and CC 1953, Art 419
[78] Hugh Beale and others, *The Law of Security and Title-Based Financing* (OUP 2012) 1.20
[79] Cuming (n 55) 9
[80] Annina Persson, 'Security Interest and Insolvency: A Comparative Analysis between Swedish, Estonian, Latvian and Lithuanian Law' in Karl Gratzer and Dieter Stiefel (eds), *History of Insolvency and Bankruptcy from an International Perspective* (Södertörns Högskola 2008) 313

a valid and legitimate cause shall be considered an owner, provided that the possession was carried out in good faith.[81] This is rational to protect market transactions.

5.3.6. Financial Lease

Financial lease agreements, as ownership-based transactions, are not classified in the true legal sense as security devices because they are not rights prescribed over the assets that are secured by the grantor.[82] However, they play an equivalent economic function and they are treated by law like a security device in order to incentivise creditors to provide funds.[83] In an economic sense, financial lease agreements are designed as an alternative to normal bank loan advancement financing for equipment purchase where the lessee uses the equipment purchased by the lessor during the period of the lease term.[84]

As the leasing has become so popular among small and medium sized enterprises (SMEs) in the industrialised countries, there is a high demand for leases of equipment in emerging countries expecting it will become the financing tool of choice for SMEs in such countries, due to some advantages. Instead of paying cash for equipment and asset acquisitions, leasing would allow businesses to use the leased equipment and use the financial benefits arising from using the equipment, such as increased returns, decreased cost or both, as a means to meet the lease payment instalments. In addition,

[81] Art 980(3) of the CC 1953 states that the possession itself is a proof of the legitimate cause and good faith, unless otherwise proven.

[82] Roy Goode, 'The Private Initiative and Security for Payment under English Law' (2002) 54 Rev Intl Droit Comp 41, 48. Also see: Ulrich Drobnig, 'Basic Issues of European Rules on Security in Movables' in John de Lacy (ed), *The Reform of UK Personal Property Security Law: Comparative Perspectives* (Routledge Cavendish 2010) 449

[83] UNCITRAL ST Guide, Introduction, para 22

[84] Olatunji Sule and Sarat Amuni, 'Equipment Leasing as a Source of Finance for Small and Medium Scale Entrepreneurs in Nigeria' (2014) 2 IJME 247, 249

by enabling businesses to conserve cash which can be used for other essentials, leasing would enable businesses to have a potential to achieve higher investment returns.[85]

The concept of financial lease in Libya was established by the FLA 2010. In order to achieve a variety of ways of obtaining finance to businesses, according to the Deputy Minister of Industry and Trade of Libya, the financial leasing is aimed at providing viable opportunity for businesses, especially SMEs, to access cheap and affordable credit in order to support long-term sustainability and to contribute to the socio-economic development in the country. The financial lease, he added, would have the potential to increase access to finance for businesses as an alternative method of financing to that traditionally advanced by bankers which has long been expensive and hard to obtain due to the inefficiency of the current secured transactions regime.[86]

Under the FLA 2010, financial leasing can take two different forms: 1- new assets are provided either by the lessor or a third party supplier to the lessee,[87] 2- assets are originally owned by the lessee who sells them and leases them back from the purchaser under a "sale and lease-back" arrangement.[88] In a financial lease contract, the debtor (lessee) receives the property from the creditor (lessor) who reserves ownership of the property. The lessee will be granted the right to hire and use the property for a set period of time in exchange for, at least in part, instalment fees payable to the lessor.[89] The property that can be subject to lease agreements in the Libyan law is tangible movable and immovable property and it does not cover intangible movables.[90] While

[85] International Finance Corporation, Global Leasing Toolkit: An Introduction (World Bank 2011) 5
[86] 'Financial Lease Act 2010 will Make a Shift in Small and Medium Sized Businesses' (*Libya2020*, 24 Jan 2011) <https://libya2020.wordpress.com/2011/01/24/> accessed 25 Jan 2018
[87] FLA 2010, Art 2(1)(2)
[88] Ibid, Art 2(3)
[89] Ibid, Art 2 and 8. Also see: Haimo (n 60) 1188
[90] FLA 2010, Art 2

using the leased assets, the lessee carries the risk of obsolescence and costs to maintain the assets in good condition upon the agreed terms.[91]

The leased equipment may be provided by the lessor or a third party supplier but the funds used to purchase the assets will always be provided by the lessor of the equipment.[92] In the sale and lease-back transactions, the borrower transfers ownership of the property to the lender who leases the property back to the borrower. These types of transactions facilitate the availability of credit to businesses while the assets remain in their possession with the right to use them to operate in their businesses in exchange for granting the creditor a security over the leased property by transferring the ownership.[93] The sale and lease-back mechanism is an attempt to improve the availability of non-possessory security on tangible movables in Libya. Lawmakers in the country were aware that there would be some cases where businesses could not legally use non-possessory security over their movable assets if the sale and leaseback mechanism was not recognised.[94]

In a financial lease, the lessee is granted an option, not an obligation, to acquire equipment at the end of the term while the ownership will be transferred to the lessee at the end of the lease term if he exercised his option to purchase.[95] Under the FLA 2010, the lessee is given either the option to purchase the leased goods on the date and at the price specified in the agreement or to renew the lease agreement at the end of the lease term.[96] This type of transaction is known as a hire-purchase transaction. Where the

[91] Ibid, Art 10 and 13
[92] Ibid, Art 1 defines the term 'lessor', 'lessee' and 'third party supplier'. The latter term is defined as the party from which the lessor or the lessee receives the assets subject of the lease agreement.
[93] UNCITRAL ST Guide, Introduction, paras. 41-42
[94] Sale and lease-back agreements are primary found in countries where non-possessory security is not generally recognised. See: Ibid, Introduction, para 41
[95] Ibid, Introduction, para 26
[96] FLA 2010, Art 8 states that that the lessee can choose to purchase the leased goods … and the paid rent instalments shall be counted in determining the sale price.

lessee acquires ownership at the end of the lease period, whether automatically or with an option to acquire ownership, the transaction is considered to be a hire-purchase transaction in substance. This is irrespective of the form that the lease agreement takes whether the arrangement involves each of the lessee, the lessor and the supplier or when the arrangement is commenced by the lessee who leases the assets directly from the lessor.[97]

It should be noted that the FLA 2010 recognises only financial leasing as opposed to operating leasing. Under the operating lease, the lessee is not granted the option to purchase the leased equipment at the end of the lease term while the lessor retains ownership of the leased assets at all times.[98] However, the operating lease was referred to in the Banking Law 2012. Article 100 bis (3) s.4 numerates the activities that can be carried out in compliance with Islamic Sharia'[99] including the operating lease. As the system of Islamic banking has not been completely implemented in Libya,[100] the operating lease is yet to practically take place in the domestic market.

5.3.7. Privileges

Privileges/ privileged rights are statutory (non-consensual) liens[101] for claims that originally are unsecured. Privileges are defined as a priority to payment of specific types of debts that are determined by, and only by, the operation of the law.[102] The

[97] UNCITRAL ST Guide, Chap IX, para 32
[98] Ibid, Introduction, para 26
[99] The Banking Law 2012 amended the Banking Law 2005 and inserted a chapter on Islamic banking.
[100] Central Bank of Libya, 'The Evaluation of the Shift towards Islamic Banking in the Banking sector in Libya' (*Central Bank of Libya*, 20 Oct 2016) <https://cbl.gov.ly/blog> accessed 19 Mar 2018
[101] The privileges are divided into three categories. First category is the general privileges which can be over any type of the debtor's assets. The second category is the privileges over the debtor's movable tangible property. The third is the privileges over immovable property of the debtor. They are also non-possessory and non-transactional security. The general and specific privileges over debtor's movable property are not required for registry to be effective but the specific privileges over debtor's immovable property are required for registry to be so.
[102] CC 1953, Art 1134

priority rank of a privileged right is usually set out by the law creating the privilege. Where the law does not determine its rank, the privilege will have a subordinated rank to the priority of other privileges stated by the law.[103]

Privileges under the CC 1953[104] are divided into; general privileges which affect all property of the debtor including movable or immovable, and special privileges which are limited only to specific property of the debtor (privileges over the debtor's specific movable property and privileges over the debtor's specific immovable property).[105] This classification of privileges has an effect on the priority of these claims. The priority that privileged claims enjoy varies depending on the type of the property whether movable or immovable property. Privileged claims over movable property always enjoy a priority over claims secured over movable property. Privileged claims against immovable property, the priority between secured and privileged creditors is determined by the date of the registry (the first in time first in priority).[106] The general privileges enjoy a priority ranking order over any type of security rights whether over movable or immovable property and irrespective of its date of registry. The striking feature of the general privileges is that they are not subject to publicity in that they are not required to be registered even if they extend to immovable property.[107] The privileges, however, are not effective against a possessor of movable property acting in good faith.[108]

The privileges over specific movable property can be divided into two subcategories; primary and secondary. Primary privileges on movable property include (a) Judicial

[103] Ibid, Art 1135(1)
[104] Art 1058(1) and Art 1120 of CCA 2010 refers to the priority hierarchy as specified in CC 1953
[105] CC 1953, Art 1136
[106] al-Sanhuri, *in personam Security and in rem Security* (n 22) 264-65
[107] CC 1953, Art 1138(2). Also see: al-Sanhuri, ibid 930
[108] Ibid, Art 1137(1)

expenditures spent for maintaining and sale of the debtor's property for the benefit of all creditors,[109] including the liquidation expenses,[110] (b) Sums due to the public treasury for taxes, fees and any other rights,[111] (c) Expenditures for maintaining the debtor's movables.[112] After these primary privileges comes in priority the general privileges which include salaries and wages due to employees and public servants[113] for the last six months.[114] After the general privileges, which would tend to be typical of insolvency systems, come the secondary privileges on movable property in lower priority.[115] These include some more unusual categories: (d) the privilege for agricultural businesses (such as sums of money paid for seeds, fertilisers, cultivation and harvesting and the price of agricultural machinery etc),[116] (e) the privilege of the lessor of land on unpaid rent over the debtor's movable property that exists in the land possession (privilege of the lessor of land),[117] (f) and the vendor's privilege for the purchase price of sold goods and assets as long as they remain in the possession of the vendee (vendor's privilege).[118]

The privileges over the debtor's specific immovable property include one type which is the sums of money due to contractors and architects for the erection, reconstruction, repair and maintenance of buildings or other constructions.[119] Because this privilege is over the debtor's immovable property, it must be inscribed and registered and its rank

[109] Ibid, Art 1142
[110] Ibid, Art 884(2)
[111] Ibid, Art 1143
[112] Ibid, Art 1144
[113] It should be mentioned that the privileges of judicial expenditures, the privileges of public treasury such as taxes and the privileges of the unpaid wages for the employees are standard in many insolvency systems because they are based to maintain some social or public interests (privileges of employees and tax authorities). However, the privileges over the judicial expenses spent for the benefit of all creditors should be limited to the expenses only spent for the benefit of secured creditors. See discussion above at Sec 3.4.4 (Objective Four of the UNCITRAL Legislative Guide)
[114] CC 1953, Art 1145(1)(a)
[115] al-Sanhuri, *in personam Security and in rem Security* (n 22) 925-28
[116] CC 1953, Art 1146
[117] Ibid, Art 1147
[118] Ibid, Art 1149
[119] Ibid, Art 1151(1)

will be fixed by the date of registry.[120] This privilege is treated the same way as the security over immovables (mortgage) and the priority between them are defined by the registry date (first in time first in priority).[121]

According to the above, the ranking order of privileges and security interests are as follows:

1- Primary specific privileges over movable property which include: a). Judicial expenditures spent for maintenance and sale of the debtor's property for the benefit of all creditors; b). Sums due to the public treasury for tax and other debts; c). Expenditures for maintaining the debtor's movables). These claims have a priority hierarchy among themselves in the order specified above;[122]
2- General privileged claims (unpaid wages for employees and public servants for the last six months);
3- Secondary specific privileges over movable property which include: a). Privilege for agricultural businesses; b). The lessor of land for unpaid rent; c). The vendor's privilege for the purchase price of sold goods. The priority between these claims is in the order specified above following in ranking after the general privileges;[123]
4- Privileges over specific immovable property (privilege to contractors and architects) and secured claims over immovable property (mortgagee creditor) (first registered, first in priority);
5- Secured claims over movable property (pledgee creditors);
6- Ordinary unsecured claims;
7- Deferred claims.

[120] Ibid, Art 1151(2)
[121] al-Sanhuri, *in personam Security and in rem Security* (n 22) 930
[122] CC 1953, Art 1142(2), Art 1143(2), Art 1144(2)
[123] Ibid, Art 1146(2), Art 1147(4), Art 1149(2)

The wide-ranging privilege system as such is very detrimental to secured creditors whose rights should be assigned priority over other claimants in the insolvency setting. As acknowledged by the UNCITRAL Legislative Guide, recognition of priorities and rights of secured creditors in insolvency should be one of the key objectives for an efficient and effective application of the insolvency law.[124] This is justified by the desirability to recognise and respect the contractual bargains and preserve commercial expectations because this would foster predictability in commercial debtor-creditor relationships.[125] Such treatment of the privileged rights in Libya is a clear application of the theory of 'social justice' upon which the CC 1953 has been based. Under such a theory, property in Libya is designed to play more social function, a result of which is the inadequate protection to the private rights of secured creditors due to the supremacy of privileged creditors as illustrated above. The effect of social justice theory will be discussed in the following section.

5.4. Theory of Social Justice under the CC 1953 and Its Effect on the Creditor-debtor Relationships

The Libyan legal system has been based on principles that promote social objectives in the community rather than individualistic and economic ones. Another aspect, which is the protection of individual interests, is not neglected but not as much emphasised. The CC 1953 abandons the individualistic and capital approach replacing it with an altruistic approach to property and contract laws.[126] This sociological philosophy adopted by the Libyan system was based on the notion of 'supporting the weak' or 'holding the hand of the weak' in order to strengthen the position of the weak in the

[124] See above Sec 5.2 (Objective Eight of the UNCITRAL Legislative Guide)
[125] UNCITRAL Legislative Guide, Part Two, Chap V, para 52
[126] Abdulrazzaq al-Sanhuri, *General Commentary on the Civil Law: Theory of Obligation in General*, Vol 1 (2ed edn, Arab Heritage 1967) 98 (hereinafter *Theory of Obligation*)

society by addressing the problem of inequalities of bargaining power.[127] This philosophy pushed the law and culture in Libya towards accepting the loss distribution among parties in the society.[128]

As far as the notion of the 'weaker party' is concerned, al-Sanhuri defined the weak in socioeconomic and legal terms. The weak in socioeconomic terms is defined as the individuals who find themselves in a situation of socioeconomic hardship. Examples for this may include an insolvent debtor unable to pay debts or loans, employees or customers. Under the legal terms, the weak party can be defined as the party who is in a position of contractual inferiority to the other party.[129] Under the latter definition, secured creditors are excluded from the term 'weak' although they may be affected by the hardship (because they are not paid by the debtor business) that characterises the weak party in socioeconomic terms simply because they enjoy a superiority position vis-à-vis debtors in the contractual agreements.[130] As Professor al-Sanhuri concluded, the central objective of the civil law is to provide particular emphasis on the interests of the debtor other than to those of the creditors because the debtor is the weak party.[131] The Supreme Court in Libya in a case related to enforcement of contractual security interests justified the statutory prohibition on enforcement of security interests privately out of court by the desire to protect the debtor being in an inferior position and exploited by the creditor.[132]

[127] Guy Bechor, 'To Hold the Hand of the Weak: The Emergence of Contractual Justice in the Egyptian Civil Law' (2001) 8 Islamic Law and Society 179, 197
[128] al-Sanhuri, *Theory of Obligation* (n 126) 650
[129] Guy Bechor, *The Sanhuri Code and the Emergence of Modern Arab Civil Law (1932 to 1949)* (Brill 2007) 151; Bechor, 'To Hold the Hand of the Weak' (n 127) 190
[130] al-Sanhuri, *Theory of Obligation* (n 126) 98
[131] ibid 98
[132] Supreme Court of Libya, Civil Cassation No 75/19J. Decision issued on 21 Apr 1974, [1974] 10 (4) Journal of Supreme Court, 55

The supremacy of the social consideration features in the Libyan legal system can be realised in the statutorily enacted priority of various privileged rights explored above.[133] This simulates the country's normative choice of social justice under which the institution of property no longer functions solely to serve individual property holders but has now a more 'social function' character under the property law, which is designed primary to achieve more social objectives in the community. Property rights under this approach, as influenced by Professor al-Sanhuri, are seen as to have limited and relative, no longer absolute and limitless, function. The owner or the holder of a property right, according to this approach, must consider the collective interests of the society.[134] This explains the impaired function of the property law in the country to provide adequate protections to the property rights of secured creditors which are subordinated to the dominance of the privileged creditors even when the law decides to prioritise the secured interests like in the insolvency law.[135] The theory of social justice in property law negates the objective emphasised by the UNCITRAL Legislative Guide to protect the rights and priorities of the existing creditors as one of the objectives of the insolvency law.[136]

In the context of contract law, the Libyan legal system implements a philosophy that is founded on the view that an unchecked principle of freedom of contract in contractual relationships is not appropriate for the society because it leads to social instability and societal calamities caused by potential social injustice.[137]

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[133] See Sec 5.3.7

[134] Abdulrazzaq al-Sanhuri, *General Commentary on the Civil Law: Property Right*, Vol 8 (2ed edn, Arab Heritage 1967) 553-57

[135] Obviously, the Libyan system in this field suffers from an issue of conflicting ideologies between different areas of law. This will be discussed later in Sec 6.2

[136] See above Sec 5.2 (Objective Eight of the UNCITRAL Legislative Guide)

[137] al-Sanhuri, *Theory of Obligation* (n 126) 98

The Civil Code 1953 of Libya was designed to achieve social justice by the application of the principles of equity and justice, including to address the problem of inequalities of bargaining power when the balance of contractual relationships is disrupted. By this, the law places the interests of the society at the centre and superior to any private and individual interests. To achieve that, the law gives the court the power to intervene in the freedom of the contractual parties and the content of contracts and, sometimes, does not allow parties to agree otherwise.[138] Courts in Libya are given discretion to adjust the contractual obligations to redress any economic imbalance to resolve the problem of inequalities of bargaining power[139] between the contractual parties by the operation of the unforeseen circumstances (Article 147(2) of the CC 1953). The theory of unforeseen circumstances or events is applied when the economic relationships between the contractual parties is imbalanced during the execution of the contract.[140]

The CC 1953 gives the court extensive discretionary powers to intervene in contracts when there is an economic imbalance between the contractual parties caused by general exceptional events (unforeseen circumstances) after the contract was entered into, stating in Article 147(2)[141] that: "… if, as the result of exceptional events of a general nature[142] that could not have been anticipated, the implementation of the contractual

[138] Bechor, 'To Hold the Hand of the Weak' (n 127) 197-99

[139] It may be useful here to refer to *Lloyds Bank Ltd v Bundy* [1975] QB 326 by Lord Denning MR. In this case, Denning adopted a doctrine of equitable intervention where one party enters into a contract upon terms which are very unfair due to the inequality of bargaining power between the parties. About the criticism of this judgement see: Paul Richards, *Law of Contract* (9th edn, Pearson Education 2009) 306

[140] The theory of unforeseen circumstances is based on the notion that the contract is based on an implicit condition that the economic circumstances during which the contract was entered into are the same or are not changed significantly during the execution of the contract. See: al-Sanhuri, *Theory of Obligation* (n 126) 633

[141] Section 1 of the Article states that "The contract makes the law of the parties and it is to be nullified or amended only by mutual consent of the parties …".

[142] The term "general" is a condition of the application of this provision requiring that the exceptional events must have an impact on a wide range of people not only on a particular debtor. For example, a big and unexpected flood or spread of a pandemic. al-Sanhuri, *Theory of Obligation* (n 126) 643

obligation, even if it is still possible to perform, becomes excessively onerous[143] for the debtor, threatening him with severe losses, the judge may, in the circumstances of the matter and having weighed the interests of the parties, reduce the burdensome obligation to reasonable limits. Any agreement negating such a possibility is void".[144]

An application of unforeseen circumstances was stated obviously in Article 333 of the CC 1953 which vests to the court, in exceptional cases, the power to intervene to allow for a reasonable payment delay for a distressed debtor to pay the due debts as long as this payment delay will cause no grave prejudice against creditors.[145] This Article does not define what constitutes an 'exceptional case' and 'a reasonable' delay and what 'severe prejudice' exactly means and therefore the court will have to exercise its discretion. In the absence of statutory guidelines, the court may drive a case to protect the debtor rather than the creditor as long as no severe damage is caused to the latter. As the law in Libya accepts loss distribution between parties and this Article (333 of the CC 1953) is an obvious application of the social justice theory,[146] the interests of creditors will likely be prejudiced obviously because the creditor is not a

[143] The term "excessively onerous" is a condition for the application of this provision. This condition gives to courts the power to intervene in the contract even if the implementation of the contract is still possible but onerous for the debtor. This is unlike the situation of the *force majeure* (Art 360 of the CC 1953) where the court interferes only when the implementation of the contract becomes impossible to perform. Also, in the application of the unforeseen circumstances/events, the court is not authorised to terminate the contract like in the event of *force majeure* but it only addresses the contractual imbalance by reducing the contractual obligations of the debtor to the reasonable limit so that the risk of loss is shared between the debtor and the creditor. al-Sanhuri, ibid 644-45

[144] See: Bechor, *The Sanhuri Code* (n 129) 178. It should be noted here that the doctrine of Art 147(2) of CC 1953 is equivalent to what is known in the UK as the law of frustration. What is noted is that the UK law of frustration applies a narrow doctrine in comparison to the CC 1953. Whereas Art 147(2) applies if the performance of the contract would be "excessively onerous" owing to the occurrence of unforeseen events even if it is still possible to do, in the UK, the law of frustration operates only when the performance of the contract becomes impossible. See: Ewan McKendrick, *Contract Law* (12th edn, Palgrave 2017) 276-77. It should be noted that the UK law of frustration of contracts was elaborated in a famous case that had its facts in WWII, *Fibrosa Spolka Akcyjna v Fairbairn Lawson Combe Barbour Ltd* [1943] AC 32, and it led to statutory intervention of the Law Reform (Frustrated Contracts) Act 1943. Richards (n 139) 378-79

[145] CC 1953, Art 333(2)

[146] al-Sanhuri, *Theory of Obligation* (n 126) 650

weak party as defined previously. In the context of insolvency, this will be detrimental to the creditors whose rights should be protected in the law not prejudiced.

To conclude, the legal approach of social justice adopted by the Libyan system was designed towards achieving and maintaining more moral-sociological considerations in the community. This, however, is at the expense of individual rights and considerations.[147] The theory of social justice of the CC 1953 implements an excessively social based approach that dramatically deviates from the discussed theories and the international benchmarks of the insolvency law. It fails to protect the important rights and priorities of creditors which are identified as one of the overriding objectives of the insolvency law. The objective of social justice of the CC 1953 needs to be reconsidered to reach a reasonable approach that can cater for all affected stakeholders.[148]

5.5. Publicity of Security Interests

The registration system is considered a key component in improving secured transactions laws as it promotes greater transparency and predictability of secured interests with respect to the debtor's assets and it provides for certainty of recognition and continued rights in relation to secured interests.[149] Security registration systems are designed to fulfil two essential functions: to inform parties about the existence of interests on secured assets and also to establish the effectiveness and priority of secured creditors against third party claimants.[150] This means that in the context of insolvency,

[147] Bechor, 'To Hold the Hand of the Weak' (n 127) 197-99
[148] This will be subject of discussion in Sec 6.2
[149] Persson (n 80) 318
[150] Alejandro De la Campa, 'Increasing Access to Credit through Reforming Secured Transactions in the MENA Region' [2016] World Bank Policy Research Working Paper No 5613, at 35 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1794918> 6 Mar 2019

unregistered security interests will be invalid against third parties and the insolvency trustee.[151]

In Libya, registration defines priority among security interests and non-registered security has no effect against a third party.[152] To detail, the priority of an interest over land and immovable property by means of the mortgage is defined by the time of registration,[153] and will not be enforceable against a third party unless it is registered.[154] The effectiveness of the financial lease against third parties is defined by the time of the registration.[155] Regarding the security on the going concern, the priority among secured creditors and the effectiveness of the security on the going concern is determined by the time of the registration.[156]

It should be noted that, the current registration method in Libya is carried out through transaction filing, as opposed to notice filing;[157] that is the secured creditor consigns a copy of the security transaction agreement to the registry. The secured creditors submit to the commercial registry all the particulars of registration in the documented format

[151] Ronald Harmer, 'Insolvency Law Reforms in the Asian and Pacific Region: Law and Policy Reform at the Asian Development Bank' (2000) 1 International Insolvency Institute Report No TA 5795-REG, at 91 <www.iiiglobal.org/node/1815> accessed 13 Apr 2018

[152] The possessory pledge on movables is not required for registry as its effectiveness is valid by the physical delivery to the creditor pledgee or to a third party. See above Sec 5.3.2

[153] CC 1953, Art 1061 and Art 1099 extends the same provision on the judicial mortgage. Also, Art 50 of the Real Estate Registry and State Owned Property Act 2010 (no 17 of 2010, promulgated in the National Gazette in 6 Jun 2010. Hereinafter Real Estate Registry Act 2010) states that any unregistered security interests on immovable property will not be enforceable against a third party.

[154] CC 1953, Art 1057

[155] FLA 2010, Art 26

[156] Al-shafah (n 63) 68-71

[157] For an explanation of the difference between the registration filing and the notice filing methods see: the Scottish Law Commission, Discussion Paper on Registration of Rights in Securities by Companies (Discussion Paper No 121, Oct 2002) at 8 <https://www.scotlawcom.gov.uk/files/6112/7892/7069/dp121_registration.pdf> accessed 15 Apr 2018. Also see: Gerard McCormack, 'American Private Law Writ Large? The UNCITRAL Secured Transactions Guide' (2011) 60 Int'l & Comp LQ 597

combined with the security instrument.[158] The law allows any interested party to request the information they need for the search of the security.[159]

In 2010, the law established the commercial registry[160] which is supervised by the Ministry of Economy.[161] The commercial registry is divided into four divisions for: individual traders, commercial companies, non-commercial companies and investment funds and any other legal entities that the law requires its registration.[162] Establishing the commercial registry aims at recording and gathering all the particulars and information regarding those who are required for registry as well as enabling any interested party to request such information. Besides, the registry aims at confirming the legal effect arising from the registration.[163] And to make the information that is registered in the commercial registry unified, the law requires each local commercial registry to submit a copy of the particulars and information registered to the general commercial registry office on a weekly basis.[164] Further, to achieve coherence between the existing registries in the country, the law states that the registry in any other registries does not exempt from the requirement of registration in the general commercial registry.[165] In the case of a pledge of a going concern (the floating charge),[166] for example, the registration of encumbered land in the land registry does not exempt the pledge from the requirement of registration in the general commercial registry.

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[158] CCA 2010, Art 486(1) and Art 11 of the Executive By-law (no 187 of 2012) of the Commercial Registry, promulgated in the National Gazette in 22 Apr 2012 (hereinafter the Executive By-law of the Commercial Registry 2012). For details see: Al-shafah (n 63) 67

[159] CCA 2010, Art 485(5)

[160] Which is regulated by the CCA 2010 and its Executive By-law of the Commercial Registry 2012

[161] Executive By-law of the Commercial Registry 2012, Art 3

[162] Ibid, Art 5

[163] Ibid

[164] CCA 2010, Art 485(3)

[165] Ibid, Art 485(4)

[166] Art 477 of CCA 2010 requires the going concern security to be recorded in the general commercial registry.

Beside the commercial registry, there is also a different registry institution established by the law regarding the land and immovable property security. This institution is now regulated by a different piece of legislation (the Real Estate Registry Act 2010). Three issues will arise. First, as the law in Libya is still largely dominated by the possessory pledge over movable tangibles, intangibles are therefore not recognised to be used as security, unless they are included in the going concern. Because of that, the law does not regulate the registry of the intangibles.[167] And the only instance where intangible movables are recognised to be used as an individual security is the pledge of debt receivables, however, this type of security is possessory in nature therefore there is no requirement for registry.[168]

Second, despite the statutory requirement of Article 485(3)(4) of the CCA 2010 for each local registry to submit a copy of the information registered regarding any securities to the general commercial registry office and the necessity for registration in the commercial registry as an attempt to unify the registration system in the country, the treatment regarding the different registry systems is yet incoherent as to how these different registries would interact with each other. For example, in the security on the going concern, as it involves different types of property ranging from movables tangible and intangible and immovable property, the law does not clearly define whether the registration of such security in the commercial registry will be legally effective in that no additional requirement to register each individual asset in the concerned registry is needed or there is a requirement for additional registry (the

[167] See above Sec 5.3.2
[168] See above Sec 5.3.3

registry of land and immovable property).[169] This will raise the issue of priority among creditors when encumbrances are found in different registries.

Furthermore, the available registries are still functionally disconnected from each other. Consequently, the data regarding security interests will be registered in different institutions with different locations depending on the type of assets on which a security is granted whether on a going concern or on land. This will make obtaining the information about the security interests costly and hardly accessible because prospective lenders and creditors will have to conduct several searches in different registries, which is undesirable to the creditors.[170]

It is argued therefore that the object of the reform should be to bring in all types of security interests under the umbrella of a single unified registry with the possibility to make all information about security interests accessible to the general public in real time and for a reasonable fee. This would ensure that the priority among secured claims is clearly determined.[171] International benchmarks, such as the UNCITRAL ST Guide and International Finance Corporation, insist that the efficiency of a security transactions system will be enhanced if all types of secured interests are brought in under one centralised general registry that has the function of recording information about the existence of security interests.[172]

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[169] Al-shafah (n 63) 68-70

[170] Inessa Love, María Pería and Sandeep Singh, 'Collateral Registries for Movable Assets: Does their Introduction Spur Firms' Access to Bank Financing?' (2016) 49 JFSR 1, 4

[171] Heywood Fleisig, Mehnaz Safavian and Nuria De la Peña, *Reforming Collateral Laws to Expand Access to Finance* (World Bank 2006) 37. Also see: De la Campa (n 150) 9

[172] UNCITRAL ST Guide, Introduction, para 66. Also see: World Bank, *Secured Transactions Systems* (n 8) 65-66

The third issue is regarding the land registry system.[173] Although land registry has been in practice for a long time, it has proved to be inefficient as it is associated with uncertainty and complexity that may affect proper implementation in case of insolvency and default.[174] For instance, commercial banks who wish to provide loans on immovable property always encounter the problem of information insufficiency about the collateral provided by customers. The latter tend to get advantages of the situation by providing the same encumbered property as collateral in multiple transactions with several banks.[175]

5.6. Enforcement of Security Interests

A sound legal system for enforcement where private transactions can safely be carried out has become more desirable for developing countries to attract investment and to promote the development of the private sector. The disadvantage of a lack of an effective and low-cost enforcement system is summarised by Douglass North as "…the most important source of both historical stagnation and contemporary underdevelopment in the Third World".[176] Enforcement of security interests is an area that is of vital importance to an effective secured transactions law. A law that provides a lender with certainty regarding the priority of their security interests and with enforcement mechanisms that are effectively functional in the event of insolvency or

[173] Registration of immovable property is now regulated by the Real Estate Registry Act 2010. Art 50 states that all securities over immovable properties must be registered or, otherwise, they shall be unenforceable.
[174] World Bank, *Modernising the Legal Environment* 2008, 43
[175] Aburawi Gabgub, 'Analysis of Non-performing Loans in the Libyan State-Owned Commercial Banks: Perception Analysis of the Reasons and Potential Methods for Treatment' (PhD thesis, Durham University 2009) 192
[176] Douglass North, *Institutions, Institutional Change and Economic Performance* (CUP 1990) 54

default will provide lower risk to the creditors. This provides incentives to creditors to provide finance.[177]

Implementing effective enforcement is essential not only for an effective secured transactions system, but it also has paramount importance to the insolvency and rescue regime. If creditors are constrained from exercising their powers of enforcement regarding the secured property due to inefficiency of the legal process, a number of undesirable consequences may arise. For example, debtors with an ineffective enforcement system will have no impetus to participate in rescue procedures at an early stage but rather it may encourage them to frustrate any enforcement procedures on its property as much as possible. This will leave creditors with no choice but to employ harsh remedies, such as filing for insolvency or liquidation procedures in order to enforce their securities.[178] In Libya, the traditional enforcement process is conducted under the full court procedures as regulated by the Code of Civil Procedures 1954 (CCPs 1954).[179] However, the legislature in the 2010 reform allows creditors in the going concern security and the financial lease to enforce their security under different procedures known as the 'Orders upon Petition'. These will be dealt with below.

5.6.1. Security Enforcement under Full Procedures of the CCPs 1954

The enforcement of secured transactions prior to the introduction of the 2010 reform was carried out under the regular court procedures of the CCPs 1954. These procedures were inadequate to realise any effective enforcement due to the high court involvement and time-consumption with the opportunity for the debtor to challenge not only court

[177] Sahar Nasr, 'Access to Finance and Economic Growth in Egypt' [2008] World Bank Research Working Paper No 31405, at 82 <http://siteresources.worldbank.org/INTEGYPT/Resources/Access_to_Finance.pdf> accessed 12 Feb 2018

[178] Harmer (n 151) 92-93

[179] Code of Civil Procedures 1954 (promulgated in the National Gazette in 1954)

decisions, such as those pertaining to sale procedures and distributions of sale proceedings, but also the creditors' claims themselves while the court must consider all those challenges.[180] There were several attempts in Libya to reform the judicial system with the cooperation of the United Nations Development Programme (UNDP) (under a project known as Modernisation of the Justice Sector in Libya). The project aimed at improving procedures within the court system as well as establishing fair and efficient administration of justice. Unfortunately, the project faltered and procedures remained as inefficient and ineffective as ever.[181] According to the Central Bank of Libya (CBL), banks operating in the country have long been affected by inefficiency of enforcement procedures and, as a result, the tendency among banks changed to invest in business fields other than providing credit.[182] Banks have always attributed the endemic issue of the credit write-off of non-performing loans to the inadequacy of the enforcement procedures.[183] This fact led the legislature to shift the security enforcement to be conducted under Orders upon Petition procedures to accelerate the enforcement process for some security devices (the going concern security and the financial lease).

5.6.2. Security Enforcement under Orders upon Petition

The unsatisfactory outcomes of the full court enforcement procedures forced the lawmakers in Libya to improve the procedures for enforcement of the going concern security and the financial lease. Such enforcement is now done under expeditious procedures of 'Orders upon Petition'. Theoretically, Orders upon Petition are expeditious and flexible procedures enabling speedy enforcement. Unlike the full court

[180] On enforcement procedures under civil law systems see: Fleisig, Safavian and De la Peña (n 171) 42-44

[181] 'Assessment of Development Results: Libya' [2010] UNDP, at 25 <https://erc.undp.org/evaluation/evaluations/detail/6011> accessed 5 Apr 2018

[182] Central Bank of Libya, Evolution of Financial Data Indexes of the Libyan Commercial Banks between 2008 and 2016 (*Central bank of Libya*) 12-20 <https://cbl.gov.ly/بحوث-و دراسات> accessed 09 Feb 2018

[183] Gabgub (n 175) 205

procedures, Orders upon Petition procedures are non-adversarial in nature; i.e. they are heard and seen by the court without the presence of the debtor, and the court order regarding creditors' petition must be issued not after the following day the petition was presented to the court.[184]

5.6.2.1. Enforcement of the Going Concern Security

The enforcement of going concern security through Orders upon Petition was intended to promote the effectiveness of the sale.[185] The holder of the going concern security has to first deliver an eight days' enforcement notice to the debtor before the sale is effectuated.[186] The law enables the holder of the going concern security to initiate sale proceedings through Orders upon Petition procedures when the debtor fails to fulfil the secured debt requirements by the due date. Sale enforcement under Orders upon Petition is an expedited type of court procedure for which creditors have to apply.[187] The sale order will be issued by the judge who is in charge to define the place and date and the way the sale auction is carried out. The judge is also authorised to appoint an insolvency practitioner to supervise the sale auction.[188] Moreover, Orders upon Petition are enforceable under expeditious execution procedures.[189] This implies that the order upon petition on the sale of the going concern security, once issued, is promptly enforceable against the debtor though it may still be challengeable.[190]

The going concern security has, in principle, a potential to represent the first mechanism under the Libyan legal system that paves the way towards business rescue.

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[184] CCPs 1954, Art 294
[185] Al-shafah (n 63) 106
[186] CCA 2010, Art 479
[187] CCPs 1954, Art 293
[188] CCA 2010, Art 479, entitled 'Permission for the Sale of the Going Concern in a Public Auction'. See also CCPs 1954, Art 627
[189] CCPs 1954, Art 379
[190] Al-shafah (n 63) 112

This is because the floating charge, as acknowledged internationally, is associated with a remedy of selling the business as a going concern rather than through a piecemeal sale which "may enable an enterprise in financial difficulties to be salvaged while increasing the recovery of the secured creditor".[191] This is true particularly where the sale on a going concern basis is in the interest of the pledge holder; i.e. where the value of the business' assets is greater than the amount of the debt owed. But where it is otherwise, the pledge holder, if granted strong control rights in the process, might prefer to liquidate the business as this is the easier and quicker way to get its debt recovery than going concern sale.[192]

Undoubtedly, the sale of the business as a going concern is justified for a number of reasons including maximising returns to creditors, preserving jobs for employees and the rescue of viable businesses. In practice, however, the sale as a going concern can possibly be associated with a risk of abuse leading to an inefficient sale (undervalued sale). Experience from the pre-pack administration as a method of selling the business as a going concern in the UK,[193] for example, shows that the sale through the pre-pack is fraught with a perception that the process, as practiced by the insolvency practitioners, does not always result in the best value for the business.[194] This is believed to be caused by the lack of transparency[195] and insufficient marketing which led to the lack of trust, most notably among general unsecured creditors.[196]

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[191] EBRD Model Law on Secured Transactions, Introduction, Principle 8

[192] This was the situation in the per-2002 UK insolvency law reform under the Administrative Receivership procedure. See: John Armour, Audrey Hsu and Adrian Walters, 'The Costs and Benefits of Secured Creditor Control in Bankruptcy: Evidence from the UK' (2012) 8 RLE 101, 105

[193] Sandra Frisby, 'The Second-chance Culture and Beyond: Some Observations on the Pre-pack Contribution' (2009) 3 Law and Financial Markets Review 242

[194] Sandra Frisby, 'Report to the Association of Business Recovery Professionals: A Preliminary Analysis of Pre-packaged Administrations' (Aug 2007) at 8-9 <www.iiiglobal.org/sites/default/files/sandrafrisbyprelim.pdf> accessed 17 Feb 2020

[195] The lack of transparency in the pre-packs attracted criticism by scholars in the UK as it makes the process function as administrative receiverships in effect but under another name in cases where the

Therefore, a good practice in respect of the sale as a going concern in Libya requires actions to be taken to promote institutional support for such sale methods. The focus will be placed on the people who are in charge of rescue procedures which are the judge and the trustee. Training programmes should be provided to those participants to improve the profession in this regard. Also, as previously mentioned, insolvency judges and trustees should have personal qualities such as integrity, impartiality and independence to ensure that the process is not used abusively.[197]

5.6.2.2. Enforcement of the Financial Lease

The lease agreement is required to be recorded at the respective registry in order to be effective and enforceable.[198] The enforcement of the lease agreement is accorded treatment distinct from the full court procedures. In order to protect the lessor's interests, Article 17 of the FLA 2010, entitled 'Termination of the Financial Lease Agreement', numerates three cases where the lease agreement will be terminated upon default or insolvency of the lessee, as the following:

"The agreement shall be terminated automatically with no notification requirement in the following events:

1- The lapse of a sixty-day period of time without paying the rent price by the lessee, unless otherwise agreed.

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interests of secured creditors are recovered. Kayode Akintola and David Milman, 'The Rise, Fall and Potential for a Rebirth of Receivership in UK Corporate Law' (2019) 20 J Corp Law Stud 99, 109

[196] For details see Teresa Graham CBE, 'Graham Review into Pre-pack Administration Report to the Rt Hon Vince Cable MP' (The Insolvency Service, 16 Jun 2014) paras 3.8-3.11 <www.gov.uk/government/publications/graham-review-into-pre-pack-administration> accessed 26 Mar 2020. This report was commissioned by the Secretary of State for Business, Innovation and Skills and was designed to promote transparency and trust in the use of the pre-packs. For that, the report made some recommendations, part of which require actions to be taken in relation to the insolvency profession. For details see: ibid, paras. 5.21-5.28. See also: Frisby, 'The Second-chance' (n 193)

[197] See above Sec 3.4.5 (Objective Five of the UNCITRAL Legislative Guide)

[198] According to Art 20 of FLA 2010, the registry for the authorised lessors (financial lessors registration) is separate from the registry for recording the financial lease agreements (financial lease agreement registration).

2- The institution of the liquidation procedures against the lessee, provided that the lessee is an artificial entity, whether the liquidation was voluntary or compulsory …

3- …

4- …

5- a) Insolvency declaration of the lessee.[199] In this case, the leased assets shall not fall within the insolvency estate nor the creditors' common pool.[200]

b) In the event that the insolvency trustee chooses to perform the lease agreement, she/ he must notify the lessor about her/ his intention within 30 days from the day of the insolvency declaration. In such cases the lease agreement shall stay effective, provided that the trustee makes the lease payments as they become due".

The consequences of terminating the lease agreement are defined in Article 18(2) as the following:

"When the lease agreement is terminated for any reason, the lessee or his successor, or the rest of joint partners, or the insolvency trustee, or the liquidator, as the case may be, must return the leased assets to the lessor in the condition agreed in the agreement. And in case no return has occurred after a repossession notice has been delivered, the lessor shall be entitled to file for Orders upon Petition, addressed to the expeditious matters judge in the competent court, to issue a repossession order in accordance with the procedures available in the Code of Civil Procedures".

As we have seen, upon the lessee's default, insolvency, liquidation and other contingencies, the financial lease agreement shall be terminated whereupon the lessor is entitled to have the leased property and equipment repossessed and they are not

[199] FLA 2010 does not distinguish between personal insolvency and corporate insolvency since the lessee can be an individual or a company. For example, Art 17(4) and Art 18(2) of FLA 2010 refer to the case where the lessee is a company.

[200] Privileged claims are security over a debtor's assets, therefore, they are excluded from financial leased assets because the assets are not owned by the lessee business.

included in the insolvency estate. This also means that the lessor has the right to dispose of the property and assets as they please without resorting to the court administrated sale. In a case where this obligation is breached, however, the lessor is entitled to apply for a court order through the expeditious court procedures of Orders upon Petition in order to instruct the police or other enforcement agents to forcibly repossess the collateral.

If properly installed and effectively enforced the way the law has structurally designed it, financial leasing can have the potential to play a part in business rescue in Libya. As has been mentioned, the FLA 2010 in Article 17(5)(b) enables the insolvency trustee to force a continued lease when she/ he thinks that would lead to protect the going concern value of the business. Also, in Article 17(2) and (5)(a), the law extracted the leased property from insolvency and liquidation procedures while Article 18(2) provides instruction for the liquidator or the insolvency trustee, as the case may be, to return to the lessor the leased property. This would, therefore, encourage the lessor to provide funding to the lessee through the hire-purchase transactions, if a post-insolvency lease has been agreed, without having to lose priority over the leased property. Such a way of treatment can encourage distressed businesses to use this instrument as a source of post-commencement funding during the rescue procedures.[201] In exchange, creditors (lessors) will be offered an exceptional superiority which functionally amounts to the super-priority system over the leased property and equipment ahead of pre-insolvency secured creditors. Not only that, but seemingly the

[201] However, the lessee will still need to obtain consent from the judge delegate because this transaction falls outside the ordinary course of business according to Art 992(2) of CCA 2010. See above Sec 4.3.4

lessor will also enjoy a priority even over the privileged claims such as those of the employees.[202]

In a case where the lease agreement is used to provide funding during the rescue procedures, the priority of the financial lessor will not violate the post-commencement financing conditions regarding the protection of pre-insolvency creditors' interests.[203] This is arguably because the security of the pre-insolvency creditors and the financial lessor as a post-commencement creditor do not overlap with one another because the lessor will enjoy a priority over new property that is not already encumbered by the pre-existing creditors. Of course, the arrangement would be a classic example of purchase money security and therefore not detrimental to existing priority rights. Further, a post-commencement financial lease agreement may be of benefit to the pre-existing creditors by increasing returns when the rescue succeeds. However, the financial lease agreement should be agreed by existing secured creditors before it is used as post-commencement financing.[204] This is because if the business was already economically distressed, the best solution would then be to liquidate the business instead of making the situation much worse for the pre-existing creditors.

5.6.2.3. Evaluating Enforcement Reliability of Orders upon Petition

As has been mentioned,[205] the enforcement through Orders upon Petition was designed to streamline enforcement procedures regarding the going concern security and the financial lease distinctively from the general rules of enforcement that are available in the CCPs 1954 and the CC 1953. However, the practice regarding Orders

[202] FLA 2010, Art 17(5)(a) which excluded the leased assets from the bankruptcy estate and the creditors' common pool.
[203] Bazinas (n 51) 468
[204] See above Sec 4.4 regarding the requirement of a consensual agreement with pre-existing creditors as a condition of super-priority financing.
[205] In Sec 5.6.2 above

upon Petition illustrates that the effective and swift enforcement may still be frustrated for a number of reasons.[206] For example, the discretionary power vested in the court under the current structure of Orders upon Petition may frustrate effective enforcement of the procedures. To detail, according to the general principles of the Orders upon Petition, the court is entitled full discretion either to approve or even decline to issue the sale order regarding the going concern security. Not only that, but the court, in a case where the sale order was already approved, also has the discretion to halt the sale enforcement process if it thinks that the sale would probably cause a gross harm to the defendant debtor.[207]

This would, undoubtedly, have a detrimental effect on the effective security enforcement. The practice of this way of enforcing against collateral, for example on a going concern basis, in countries with similar systems in the MENA region suggests that sale procedures have proved inefficient and have no practical potential.[208] For the effectiveness of the sale process, it is suggested that, the court must issue the order upon receiving enough evidence from the creditor showing that the security is valid and that the debt has been in default.[209]

Regarding the enforcement on a going concern security, further, secured creditors must first deliver an eight days' enforcement notice to the debtor before the sale is effectuated.[210] This is another unnecessary barrier put by law to effective enforcement because this notice would allow the debtor to hide or even transfer the secured assets out of the court's jurisdiction within the notice period.[211] To make it worse, creditors

[206] Al-shafah (n 63) 120-25
[207] CCPs 1954, Art 384
[208] See: De la Campa (n 150) 30
[209] Fleisig, Safavian and De la Peña (n 171) 19
[210] CCA 2010, Art 479
[211] Williams Iheme and Sanford Mba, 'Towards Reforming Nigeria's Secured Transactions Law: The Central Bank of Nigeria's Attempt through the Back Door' (2017) 61 J Afr L 131, 149-50

would be frustrated from tracking the collateral, especially movables, in the hands of a third party purchaser who acted in good faith.[212] To tackle such an issue, the EBRD Model Law on Secured Transactions provides a mechanism to protect the creditor's security from being prejudiced by the debtor after the delivery of the enforcement notice. Article 23 of the Model entitles secured creditors to possess the secured business as a protective measure necessary to immobilise the secured business so as to prevent the use or transfer of its ownership.[213] The Libyan regime should consider adopting this treatment to protect creditor's interests especially when the security involves movable property which is advantaged by the good faith principle of the CC 1953.[214] In the context of insolvency and business rescue, the insolvency trustee should be enabled to possess the business's assets soon after the enforcement notice is delivered. This would both protect the creditors' interests and maximise the likelihood of business rescue.

Furthermore, the current structure of the judicial enforcement through Orders upon Petition may also be to the detriment of business rescue as the procedures may result in a piecemeal sale[215] whereas a going concern sale at a better price for the business may still be achievable.[216] This is because the law does not provide the court with guidance on the appropriate sale enforcement, coupled with the lack of a rescue culture among judges and practitioners in the country, so the court will exercise its full discretionary power. Therefore, both options of the sale are equally possible. This being the case, and

[212] CC 1953, Art 980
[213] EBRD Model Law on Secured Transactions, Art 22.3, and for more details see Art 23.1-2 and Art 25.
[214] CC 1953, Art 980
[215] Art 479(1) of CCA 2010 explicitly refers to the possibility to sale the going concern security "wholly or partially".
[216] In Tunisia, enforcement of the pledge on the going concern can only be sought for the entirety of the business as a going concern while the piecemeal sale for individual components of the business, such as the equipment, is largely restricted unless this would generate higher returns to creditors. See: Art 248 of the Commercial Code of Tunisia (no 129 of 1959) promulgated in 7 Oct 1959. For more details see: EBRD, 'Commercial Laws of Tunisia: An Assessment by the EBRD' (EBRD, Mar 2013) at 48 <www.ebrd.com/downloads/sector/legal/tunisia.pdf> accessed 19 Apr 2018

with the absence of specialised training programmes for judges, courts may likely opt for the enforcement that leads to the dismemberment of the business by a piecemeal sale.

The regulatory structure of the enforcement of the going concern security also requires some attention. Lessons from similar jurisdictions illustrate that enforcement of the going concern security, as in the way currently structured in Libya, can be useless to say the least. In Egypt, as a jurisdiction similar to the Libyan system, the enforcement of such a security proved inefficient. This is attributable to the principles available in the Egyptian Code of Civil Procedures and the structure used in the law regulating the going concern security. In the Sale and Pledge on a Going Concern Act 1940,[217] the sale of the going concern security is carried out through Orders upon Petition procedures.[218] The principles of the Orders upon Petition entitle the courts discretion either to approve or refuse to issue the order.[219] This situation forced the law designers in Egypt to amend the structure of the enforcement of going concern security. Instead of resorting to the court for the sale order, the pledge on a going concern has now been dealt with as an executory document (a writ of execution)[220] with which the creditors are enabled to enforce the sale without recourse even to Orders upon Petition

[217] The Sale and Pledge on a Going Concern Act (no 11 of 1940) promulgated in 1940
[218] Ibid, Art 14
[219] The common tendency among courts in Egypt is to refuse the sale of the going concern security under the Orders upon Petition system. Al-shafah (n 63) 112
[220] The writ of execution is the final procedure in the judicial process without which debt enforcement cannot be carried out. Writs of execution include court decisions and judgments, court orders, official resolutions and contracts, bank drafts and any documents that are given executory character by the law. The execution officials are the parties with the duty of carrying out the writ of execution and if necessary they can seek assistance of the police or other public security agents. See: CCPs 1954, Art 369(1)(2) and Art 371

procedures.[221] Although this seems effective to protect the creditors' interests, it prejudices an efficient conduct of business rescue.

Regarding the enforcement of the financial lease under the FLA 2010 in Libya, the enforcement can still be hampered by the same unsupportive institutional environment available in the country. Although the FLA 2010 attempted to boost the lessors' position, in the scenario of default or dispute, by ensuring that the leased property is repossessed by the lessor,[222] the dispute may still arise should the property not be returned voluntarily. This situation will have to involve the court in order to issue a repossession order under the Orders upon Petition proceedings. As has been discussed in this section, the Orders upon Petition mechanism is not the optimal response to the issue of security enforcement. Accordingly, repossession may still be the main impediment facing the effectiveness of the financial leasing. In a similar situation in Egypt under the law of financial lease,[223] it has been pointed out that, despite the expeditious procedures undertaking under the Orders upon Petition procedures, the repossession order is associated with very high costs and a time consuming process.[224]

The problem is much deepened in Libya by a statutory approach and a legal culture that has long existed in practice which restrains the contractual parties from following enforcement remedies other than the formal remedies provided in the CC 1953 and the CCPs 1954. Enforcement of security interests through formal judicial intervention is a firm principle; in that any agreement entitling the creditor to privately enforce the

[221] Art 104 of the Egyptian Law of Central Bank and Banking System 2003 (no 88 of 2003) promulgated in the National Gazette in 15 Jun 2003

[222] FLA 2010, Art 18(2). For details see above Sec 5.6.2.2

[223] The Financial Lease Act of Egypt (no 95 of 1995) promulgated in the National Gazette in 01 Jun 1995. Articles 19 and 20 of the Egyptian Financial Lease Act 1995 have exactly the same structure of Articles 17 and 18 of FLA 2010

[224] Nasr (n 177) 75. Also see Art 20(2)(3) of the Financial Lease Act 1995 of Egypt which entitles the lessee the opportunity to appeal the repossession order within three working days of the repossession order and grants the court the discretionary power either to approve, amend or even repeal its repossession order.

collateral or to sell the secured property out of court will be void.[225] The Supreme Court of Libya has a culture that strongly affirms this attitude on the basis that enforcement without a court order will lead to the interests of debtors being in a position worse than those of creditors and then will be vulnerable to be prejudiced.[226] It is pointed out that the enforcement under such unreformed legal systems presents many barriers to achieve a speedy seizure and sale of the collateral. As a consequence, the collateral will be less attractive and much devalued because of the high enforcement cost and delay.[227] Thus, the need for an alternative method of enforcement may be necessary.

5.6.3. Self-help Remedies as an Alternative to Court Enforcement

Self-help enforcement is praised for its capability of providing effective remedies to a secured transactions system because it enables a speedy and satisfactory sale of the secured interests.[228] Because of the effectiveness that self-help enforcement has been able to manifest, many jurisdictions have largely recognised the importance of self-help as the most efficient remedy for enforcement of secured transactions.[229] According to the WB *Doing Business* report, there are more than 130 jurisdictions today that equip their security transactions systems with the mechanism of out of court enforcement by which secured creditors are allowed, for example, to sell the collateral through public auction.[230]

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[225] CC 1953, Art 1056 and Art 1112. For more details see: Al-shafah (n 63) 106
[226] Supreme Court of Libya, Civil Cassation No 75/19J. Decision issued on 21 Apr 1974 (1974) 10 (4) Journal of Supreme Court, 55
[227] Fleisig, Safavian and De la Peña (n 171) 42
[228] Cuming (n 55) 20
[229] Yoram Keinan, 'The Evolution of Secured Transactions' (2001) 1 World Bank Working Paper No 27827, 23 <http://documents.worldbank.org/curated/en/564371468780338375/pdf/wdr27827.pdf> accessed 23 Jan 2018
[230] World Bank, 'Doing Business: Getting Credit' (*World Bank Group* 2019) at the Strength of Legal Rights Index <www.doingbusiness.org/en/data/exploretopics/getting-credit> accessed 11 Mar 2019

Out-of-court enforcement of security interests is praised by international bodies like the UNCITRAL in its ST Guide[231] for its capability to realise effective and efficient procedures that promote to the maximisation of the value of creditors' interests.[232] Also, the EBRD *Model Law on Secured Transactions*, in Part 4 Articles 22-32, provides considerable flexibility to the secured creditors to enforce their security immediately[233] after the payment failure of the secured debt without the need to rely on the court for enforcement.[234] What self-help enforcement is praised for is its capability to make the right balance between the protection of the interests of defaulting debtors, by ensuring that the seller carries out the sale in a good faith and in an efficient manner, and the interests of secured creditors, by promoting the speedy seizure of the collateral.[235]

However, self-enforcement remedies of the secured transactions regime should be carefully considered in the context of insolvency and rescue procedures. As the UNCITRAL ST Guide suggests, the secured transactions law should ensure a close coordination with the rules of insolvency law.[236] Therefore, self-enforcement should be relatively limited where rescue procedures are commenced. This is because self-enforcement mechanisms, although they are advantageous especially to secured creditors, can be very detrimental to the rescue procedures as they lead to breaking up the business assets leading to the decrease of the business value at the expense of the

[231] It should be noted that the UNCITRAL ST Guide employs policies that deviates from the UNITRAL Legislative Insolvency Guide. While the latter takes a view which tries to take into account all the interests involved in insolvency, which is one of its strengths, (see above Sec 2.3), the former appears in this section to be rather focused on the interests of secured creditors only. This is because the UNCITRAL ST Guide has been based on the perspectives of secured creditors. See: Gerard McCormack, *Secured Credit and the Harmonisation of Law: The UNCITRAL Experience* (Edward Elgar 2011) 183

[232] UNCITRAL ST Guide, Introduction, para 56

[233] After enforcement notice is delivered to the security grantor, Art 22.2. of EBRD Model Law on Secured Transactions 2004

[234] Röver (n 73) 79

[235] Cuming (n 55) 12

[236] UNCITRAL ST Guide, Introduction, para 56

other stakeholders. In the UK pre EA 2002, for example, the administrative receivership procedure allowed a receiver to be appointed under the terms of the debenture to take control of the business of the distressed company with a basic function to realise its assets for the benefit of the holder of a floating charge who made the appointment. The EA 2002 virtually abolished administrative receivership in most cases and promoted the administration procedure with wider duties to enable the administrator to achieve a more going concern based business rescue.[237]

Therefore, these mechanisms should be subject to any procedures that promote more efficient outcomes in business rescue, such as the moratorium. Then secured creditors can enforce their securities through this procedure subject to the court consent. By this, a disorderly dismemberment of the assets can be avoided. The involvement of the court in the sale enforcement will ensure "appropriate checks to prevent abuse".[238] The UNCITRAL ST Guide suggests that effective and efficient enforcement would not be achieved without self-help enforcement remedies being subject to court supervision or review by other official parties.[239]

5.7. Conclusion

A security transactions system is essential to the insolvency system that seeks to promote business rescue. What creditors and lenders are always passionate about is the extent to which their interests are adequately protected in and outside the insolvency of their debtor.[240] And for a successful reform and satisfactory outcomes, it should be

[237] McCormack, *Secured Credit under English and American Law* (n 9) 8
[238] EBRD Model Law on Secured Transactions, comments on Art 29
[239] UNCITRAL ST Guide, Introduction, para 56
[240] Marek Dubovec and Cyprian Kambili, 'Using the UNCITRAL Legislative Guide as a Tool for a Secured Transactions Reform in Sub-Saharan Africa: The Case of Malawi' (2013) 30 Ariz J Int'l & Comp L 163, 183

ensured that the law of secured transactions is implemented thoroughly and concordantly with the existing legal framework and domestic circumstances.[241]

The reform of 2010 in Libya regarding the secured transactions law was aimed at promoting the social and economic development in the country. However, since the enactment of the secured transactions reform in 2010, the credit market has witnessed no change in the attitude towards lending practices in the country due to some reasons. Empirical studies showed that both the pledge on a going concern and the financial leasing devices, which were introduced to expand access to credit in the market, are yet to be considered by financial institutions.[242] This is perhaps attributable to the stakeholders' distrust of the effectiveness of the security transactions regime and the traditional enforcement procedures which are excessively time-consuming and costly. Further, the 2010 reform gives no regard to the relationships between the systems of secured transactions and insolvency and achieved no harmony with the insolvency law. For instance, the outcomes of the current structure of the enforcement proceedings may highly likely result in a detrimental effect on business rescue practices. Court enforcement of the going concern security under the Orders upon Petition could lead to a piecemeal sale as long as secured creditors are satisfied with the sale outcomes irrespective of whether a going concern sale may still be possibly achieved.

According to an empirical study, the inadequacy of the legal and judicial enforcement procedures in Libya, moreover, has discouraged banks and other financial institutions from initiating insolvency and sale procedures against defaulters.[243] The CBL also admitted that the commercial banks' prolonged exposure to the problem of the high

[241] Iheme and Mba (n 211) 140
[242] Al-shafah (n 63) 8. Also see: Omar Assadi, 'The Potential for Financial Leasing among Banks in Libyan: A Case Study on the Development Bank' (2015) 10 Sirit Economic Sciences 48
[243] Gabgub (n 175) 205-24

percentage of non-recovered loans is significantly ascribable to the inefficiency of the secured transactions law in the country. As a result, commercial banks have been inclined to reduce the availability of loans and credit facilities to invest in other business fields instead.[244]

Because of all the above mentioned factors, the current structure of the security transactions system in Libya still requires some attention to improve the outcomes of the reform. As illustrated in the *Doing Business' Strength of Legal Rights Index* indicator[245] for Libya in 2017, the current structure of the security transactions system in the country is still significantly weak. For example, Libya gained 0 points out of a 12-point scale on the Legal Rights Index indicator. As a consequence, Libya shared an international low rank regarding access to credit and creditor protection. In its *Doing Business* report, the World Bank ranked Libya 185 out of 189 countries on both the ease of getting credit and on protection of investors.[246] This is attributable, as suggested by a World Bank survey conducted in 2015, to the weakness of both laws regarding secured transactions and insolvency.[247] Besides, as previously noted,[248] the political situation of Libya since the adoption of the socialist economy in the country added to the situation, since businesses were not allowed to fail which means that the insolvency law in practical sense was paused resulting in a gap in the institutional level. In addition, the current political governance situation in Libyan as seen since 2011 will have a negative impact on the function of the institutional structure in the country.

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[244] Central Bank of Libya (n 182) 12-20

[245] The Legal Rights Index indicator measures the extent to which collateral and insolvency laws protect the rights of borrowers and lenders and thus the effectiveness of collateral and insolvency laws in facilitating lending. See: World Bank, *Doing Business 2017* (n 54) 220

[246] Ibid 220

[247] Pietro Calice and others, 'Simplified Enterprise Survey and Private Sector Mapping: Libya 2015' (2015) 1 World Bank Policy Research Working Paper No 99458, at 14 <http://documents.worldbank.org/curated/en/910341468191332846/Simplified-enterprise-survey-and-private-sector-mapping-Libya-2015> accessed 30 Mar 2018

[248] See above Sec 1.2.2

It is pointed out that, improving the perception of any newly enacted system among credit participants in a country needs to organise well-designed training programmes in order to have proper and effective implementation of the desired legal reform.[249] Therefore, the reform should focus on the dissemination of knowledge through a communication strategy and building capacity among stakeholders, such as banks and other financial institutions as well as enterprises, in order to accelerate their acceptance of the new strategy. For the country to derive a proper application of the secured transactions reform, the conceptual foundations and objectives of the reform must first be sufficiently and properly understood and interpreted by various interested participants, such as business people, financial and banking institutions, trade financiers, credit bureaus, lawyers, judges etc.[250] Comprehensive training programmes could include: introduction to the secured transactions system to familiarise creditors with the new concepts and principles, the scope of types of all traditional and new forms of security, property and obligations and the priorities between conflicting claims against the same assets.[251]

[249] Sean Stacy, 'Follow the Leader: The Utility of UNCITRAL's Legislative Guide on Secured Transactions for Developing Countries (and Its Call for Harmonization)' (2014) 49 Tex Int'l LJ 35, 67; Mike Gedye, 'The Development of New Zealand's Secured Transactions Jurisprudence' (2011) 34 UNSW L J 696, 731-32

[250] UNCITRAL ST Guide, Introduction, para 75

[251] World Bank, *Secured Transactions Systems* (n 8) 91-94. Also see: Iyare Otabor-Olubor, 'Reforming the Law of Secured Transactions: Bridging the Gap between the Company Charge and CBN Regulations Security Interests' (2017) 17 J Corp Law Stud 39, 69

Chapter 6 Synthesis of Insolvency Theory and International Benchmarks and their Application to the Libyan Law with Reform Proposals

6.1. Introduction

It has been more than sixty years now since the introduction of the insolvency law in Libya in 1953. However, the law has remained unenforced due to inefficiency, which can be attributable mainly to both the lack of judicial practices and the attitude towards insolvency under the socialist perceptions. The Libyan community has changed dramatically since the introduction of the insolvency system in 1953 through different periods of time up to the present. Given the economic reform of the Libyan economy towards the market economy, the insolvency law in the country should not remain static. Promoting the economic transition, rather, requires reappraisal of the insolvency law at regular periods to keep up with the societal needs. Therefore, a reform to insolvency law has become imperative.[1]

In spite of the introduction of the economic reform in Libya, the culture of the socialist economy still influences the current economic practice in the country. The legacy of the socialist economy in Libya may be the reason for the lack of incentives for the insolvency reform through all past years which consequently caused a lack of insolvency practice and expertise. All of this would make the reform for the insolvency and rescue system a challenging task.

In previous chapters, the thesis has analysed the insolvency law of Libya in light of the insolvency law theories and international benchmarks and concluded that a reform

[1] World Bank, Libya Economic Report 2006, 32

has become essential to the achievement of the national economic and social objectives. This Chapter will explore the barriers that need to be dealt with to pave the way for an adequate application of a reform in light of the various domestic circumstances of the country and in light of the insolvency law theories that were discussed in Chapter Two and the internationally recognised insolvency and rescue benchmarks that were discussed in Chapters Three, Four and Five. This Chapter will discuss the alignment of the insolvency law of Libya with the insolvency theories and it will suggest reform proposals for the development of the composition scheme and the secured transactions regime in order to promote an effective application of the rescue regime and culture in the country. It is also of vital importance for the same end to investigate the issue of institutional reform.

6.2. Aligning the Libyan Insolvency Law with Theory

In Libya, there is a lack of theoretical discussion and framework of the corporate or business insolvency law. This is because of two main factors. First, it may be because the insolvency law had not had a chance to develop in the country. It was first transplanted from a foreign country with no consideration of the domestic circumstances and desires so it was a completely strange piece of law at the time.[2] Second, the insolvency law was put on hold for almost four decades as the country adopted the socialist economy under which insolvency laws and policies were redundant.[3]

However, it is not hard to illustrate the ethos underpinning business insolvency law in Libya. First, the insolvency law in Libya is one of the most liquidation-focused regimes in the world and has the focus on prioritising the interests of creditors since it was first

[2] See Sec 1.2.1
[3] See Sec 1.2.2

introduced in 1953 as borrowed from the Italian bankruptcy system of 1942.[4] Even under the composition procedures which are available as rescue procedures, the focus is always to maximise the creditors' returns in liquidation. Secured creditors in Libya are given strong protections in the insolvency and rescue process. For example, they are not bound to vote on the composition plan and they are not bound by the composition procedures even after the court approval on the plan is granted. Therefore, they can enforce their security during the procedures and the court has no power to force them to accept the composition plan.[5] It is clear that the Libyan composition process inclines towards protecting pre-insolvency rights of secured creditors from the risk of loss that may be associated with the rescue procedures under the composition scheme. More strikingly, the Libyan system goes even further than a creditor friendly theory like the CBT by sacrificing the orderly process to secured creditor interests. Secured creditors are given an absolute and strong right of veto that can be used stop the whole process of composition.

The Libyan law gives the secured creditors a right to protection in the process and it authorises the court to protect their interests. To do so, the law grants the court wide discretion to approve or refuse the composition regardless of the creditors' decision. In exercising its discretion during the feasibility test process of the composition scheme, the court has to examine the feasibility of the composition proposal in order to maintain the interests of the secured creditors despite the creditors' acceptance and vote in favour of the proposal.[6] So, if the court thinks that the proposal has no, or only a feeble,

[4] The prime function of the Italian Bankruptcy Law of 1942 (Royal Decree no 267/1942 promulgated in 16 Mar 1942) was liquidation for the benefit of creditors. See: Mirko Saggiorato, 'Distress Investing under the Italian Bankruptcy Law: A Comprehensive Case' (PhD thesis, University of Padua 2019) 44

[5] Unless they wish to participate in the composition procedures. For details see above Sec 4.3.5

[6] The discretion of courts in determining business viability should be conducted in a sensible way because there are competent stakeholder interests in insolvency that should be balanced fairly so that the risk of rescue is not shifted at an expense of some stakeholders such as secured creditors. The

potential to protect the creditors' interests, it has to act on behalf of them and declare the insolvency status *ex officio*.[7]

In addition, it is generally recognised that for rescue procedures to lead to any positive outcomes, the process should be taken at a sufficiently early time.[8] However, the insolvency law of Libya does not facilitate early access to the procedures because of the statutory requirement that the company must be insolvent and unable to pay its due debts.[9] The insolvency procedures are therefore only available for businesses who already insolvent and unable to pay due debts. This would decrease the likelihood for any business struggling to maintain solvency to implement a successful rescue. Rather, this would likely increase the probability of liquidation.

Such a structure of the existing insolvency law of Libya indicates the extent to which the law is designed primarily to collect debts by prioritising liquidation only for the purpose of enforcing the creditors' pre-insolvency rights. It is obvious that the Libyan system promotes maximisation of realised assets only for the benefit of the creditors. It therefore parallels the principles of the CBT's approach that the insolvency law exists only as a debt collection remedy for the creditors' benefit. Such an approach fails to consider the interests of stakeholders other than those of the creditors in the society by failing to promote rescue procedures for insolvent businesses. The insolvency law should ensure that there is an orderly process under which all affected stakeholders are protected including, not only, secured creditors.

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capability of courts in Libya of determining business viability will be discussed later. See below Sec 6.4.4

[7] For details, see above Sec 4.3.3

[8] Rebecca Parry, *Corporate Rescue* (Sweet & Maxwell 2008) 13

[9] CCA 2010, Art 984

Although the insolvency law in Libya is designed to provide strong protections to the secured creditors, it actually struggles to deliver this objective for two reasons. First, the insolvency procedures are very expensive because of the high level of court involvement with lengthy processes which would likely lead to depleting the value of the assets required for the creditors. Second, the interests of secured creditors in the general legal system in Libya occupy a weak priority position in comparison to that of the preferential creditors (privileged creditors) who enjoy priority over secured creditors. This is caused by the conflicting ideologies that underpin the different areas of law in Libya. As has been mentioned,[10] the Libyan legal system is based on the notion of social justice and equality under which the redistribution of risk or loss among participants is accepted. However, the philosophy of the insolvency law is completely different.

As such, there are inconsistent and conflicting ideologies[11] resulting in incoherence within the legal system of Libya. These underlying ideologies of the laws have to be reconciled because the existence of such a framework would cause confusion and create legal uncertainty in court cases as to which interests are to be served by the law. As has been discussed, overemphasising the social justice doctrine (or supporting the weak party as regulated by the Civil Code 1953) may, on the one hand, result in prejudicing the interests of creditors which must not be sacrificed for pure social considerations because this would in turn undermine the business environment in the country, through creating uncertainty and undermining equitable treatment of all participants. On the other hand, the emphasis on protecting the interests of creditors (as

[10] See above Sec 2.6 and 5.3.7

[11] This can be explained by the historical transplantation process of the legal Codes in Libya as each of the Civil Code and the Commercial Code were imported from different sources. Whereas the CC 1953 was influenced by the Egyptian Civil Code 1948, which adopted an approach of giving the social considerations primacy, the Commercial Code, and the insolvency regime, was influenced by the European model of the Italian insolvency law, which implemented a different ideology.

regulated by the insolvency law) would lead to unfair outcomes for the wider stakeholders in the business.

In order to resolve such an ideological conflict and achieve coherence within the legal system across different areas of the commercial law (insolvency, property and contract laws) in Libya, one might argue that the approach of the Team Production Theory (TPT) would be appropriate for this end. It is contended that the TPT[12] fits the concerns and the policy imperatives that are identified in the Libyan context about the impact of business failure upon social actors in the society such as the local community (represented by local suppliers) and the local workforce who have legitimate concerns that should be taken into account in insolvency settings clearly without a doubt. The TPT is also realistic regarding the interests of creditors because they also contributed to the firm-specific investment by their financial capital inputs in the business.

The application of the theory of Team Production would help achieve the two important goals as identified in Libya which are the protection of the special interests of the employees and the encouragement of private sector investment by protecting and strengthening the interests of creditors. What distinguishes the approach of the TPT is that it takes a further step that responds well to the insolvency situation by making a well balanced decision between all interested stakeholders so that no one team member is privileged over the other team members without a good reason. This approach can rectify the incoherence that is associated with the current Libyan regime under which the social justice (which is only geared to protect the weak party) is overemphasised at the expense of other important objectives of the insolvency law (the protection of the value of the insolvency estate). For example, the TPT encourages the protection of the interests of the employees provided that the interests of the creditors in the insolvency

[12] See discussion in Sec 2.6 above

estate are not prejudiced. But if the decision is dealt with in accordance with the Libyan law approach, the interests of the employees will be protected but the interests of the creditors will be dismissed which would constitute a striking contradiction to one of the objectives that the insolvency law should endorse. By applying the TPT, all the above concerns would be avoided. Not only that, but also the concerns of ensuring social justice would more likely be reassured given the fact that the TPT's approach gives special treatment to the employees that they lack under the Libyan regime by making sure that their future interests in the business will continue, which is likely the employees' most important concern, by encouraging business rescue to effectively take place as much as possible.

As far as social justice is concerned, furthermore, the issue of protecting the vulnerable people in the society would be responded to more satisfactorily under the TPT's perspectives. The approach of the TPT responds appropriately to the legitimate needs to protect vulnerable and weak parties who contribute to the success of the business by ensuring that the treatment of such parties is dealt with through structured substantive legal provisions instead of doing that through judicial discretion. This would increase the amount of certainty and predictability within the law by shifting the power of protection from the hands of judges to be dealt with in a structured response and by doing so without jeopardising the vital concerns of social justice. Such a response would enable the law to increase trust and confidence of stakeholders in the system, thereby motivating the willingness towards investment which in itself is an important economic objective of the law.[13]

[13] See discussion on predictability (Objective Seven of the UNCITRAL Legislative Guide in Sec 3.4.7)

6.3. General Evaluations of the Insolvency Law

Having carried out evaluations by reference to the UNCITRAL Legislative Guide's Key Objectives in previous chapters, it appeared that the Libyan insolvency law can be associated with some shortcomings that deviate from efficient and effective features of insolvency law. To reform the insolvency law of Libya, the legislature must ensure that those widely recognised objectives of the UNCITRAL Legislative Guide are effectively incorporated. First and foremost, the insolvency law in Libya has a criminal nature because of the stigma of insolvency as it is perceived as a vehicle for fraud or mismanagement.[14] This undoubtedly has an effect on the insolvency law framework one of which at least is the lack of mechanisms necessary to encourage business rescue to take place. This perception has to change because insolvency and failure have been recognised as a routine feature of any market economy that can happen not necessarily due to deficiency of management or fraud. Rather, it can happen by multiple other factors such as global financial crisis, change in the consumer attitudes, the rise of the price of raw materials, severe competition atmospheres. Where company failure is triggered by such factors, the law should be designed in a way that such undesirable failure and its impact are not exaggerated.[15] One of the important roles that the law should ensure in such events is to facilitate restructuring and preserve the going concerns of distressed businesses where appropriate to ease the effect of failure.[16]

In addition, the Libyan insolvency framework is liquidation-oriented to a large degree and the composition system struggles to deliver positive rescue outcomes. Although liquidation can provide more certainty to creditor stakeholders than in rescue processes,

[14] See Sec 3.3
[15] Vanessa Finch and David Milman, *Corporate Insolvency Law: Perspectives and Principles* (3rd edn, CUP 2017) 131-45
[16] Philippe Frouté, 'Theoretical Foundation for a Debtor Friendly Bankruptcy Law in Favour of Creditors' (2007) 24 Eur J Law Econ 201, 201-04

a couple of points can be made in this regard. The liquidation procedures in Libya are very complex and extremely time-consuming which undermines the certainty of investors in the procedures as to when their interests will be enforced.[17] The rights of creditors in liquidation in Libya are also in an under-protected position due to the operation of the system of privileged creditors.[18] Besides, the insolvency system should not focus only on liquidation but it should also be designed to allow business rescue to take place. This is because insolvency laws, as recognised by theory[19] and by international benchmarks,[20] should contribute to the economic development in the community by encouraging business rescue by which many other stakeholders such as the employees and the suppliers whose interests in the insolvent business will be preserved.[21] However, the attempt of business rescue can be associated with more uncertainty because creditors cannot predict what will happen to the value of their rights in the process and there would be a fear that they would be the risk bearers. It is acknowledged, therefore, that achieving a balance between all insolvency law objectives and maintaining certainty in the rescue process will not be a straightforward task without efficient institutions which is a major issue in Libya.[22]

One of the issues in the Libyan insolvency law that the objective of maximising the value of the assets can be prejudiced by exempting the secured assets from the insolvency procedures which can result in a decrease in the going concern value of the business necessary to encourage business rescue attempts and going concern sales in liquidations by allowing secured creditors to enforce their entitlements, resulting in the

[17] See above Sec 3.4.1 (Objective One of the UNCITRAL Legislative Guide)
[18] See above Sec 5.3.7
[19] See above Sec 2.5
[20] See above Sec 3.4.1 (Objective One of the UNCITRAL Legislative Guide)
[21] Proposals on how to develop the business rescue system in Libya will be detailed in the next section.
[22] This issue will be examined below in Sec 6.6.2

dismemberment of the going concern.[23] An insolvency law should also be based on objectives that ensure equitable treatment of similarly situated creditors (*pari passu*).[24] By this objective, the insolvency law will ensure equality among unsecured creditors and offer predictability to investors as to what to anticipate when the debtor becomes insolvent.[25] In Libya, the objective of *pari passu* distribution to similarly situated creditors is affected significantly by the dominance of the privileged creditors who are assigned priority over not only unsecured creditors but also, oddly enough, on secured creditors. The operation of this system can also affect maximisation of the asset value for the benefit of secured creditors.[26]

Furthermore, an effective and efficient insolvency regime requires taking rapid resolutions of insolvency and rescue because unnecessarily time-lengthy procedures result in more incurred costs, reducing the asset value for creditors and rescue efforts would be unlikely to be successful.[27] An insolvency process should result in impartial outcomes. This relies closely on qualifications and personal characteristics of the people who are in charge of the insolvency process; judges and practitioners.[28] Ensuring timely and impartial resolution of insolvency is an issue of concern in Libya. For example, there is a lack of time limitation for most of the insolvency and rescue procedures and the court enjoys wide discretion to decide when a procedure is to be concluded resulting in inefficient outcomes caused by increased costs of the prolonged process. There is also a lack of requirement for judges and practitioners in Libya to obtain specific qualifications or training nor they are ensured to have impartiality and

[23] Further discussion on this issue will be dealt with below in Sec 6.4.2
[24] See above Sec 3.4.4 (Objective Four of the UNCITRAL Legislative Guide)
[25] Andrew Keay and Peter Walton, *Insolvency Law: Corporate and Personal* (4th edn, LexisNexis 2017) 505
[26] See above Sec 3.4.4 (Objective Four of the UNCITRAL Legislative Guide)
[27] Wolf-Georg Ringe, 'Strategic Insolvency Migration and Community Law' in Wolf-Georg Ringe, Louise Gullifer and Philippe Théry (eds), *Current Issues in European Financial and Insolvency Law: Perspectives from France and the UK* (Hart Publishing 2009) 91
[28] UNCITRAL Legislative Guide, Rec 115

integrity to be qualified for administering insolvency cases.[29] This will lead to bias in the insolvency cases.[30]

The UNCITRAL Legislative Guide insists that there should be mechanisms in the insolvency law to preserve sufficient assets of the business to allow equitable distribution to creditors in rescue or in liquidation.[31] This objective is usually achieved by transaction avoidance mechanisms. The Libyan insolvency law includes such laws. However, a reform is needed in this area to ensure effective preservation of the assets. For instance, the law failed to include transactions that are intended to prevent creditors from collecting the whole or part of their claims in a timely manner. Besides, the Libyan transaction avoidance system allows validity of some abusive transactions by the requirement of the suspect period to be calculated from the date of insolvency declaration. Setting the date of the insolvency declaration is too late to prevent abusive transactions. As such, some transactions will be deemed valid only because they took place before that date bearing in mind that the date of the insolvency declaration is not certain and can take months after filing up until the court decision to declare insolvency. This can be more obvious in the case of the composition where the procedures can take a long time before the court decides that the composition proposal is nonviable only after which the court can declare insolvency status. But this can take an excessive time considering that there is no time limit within which the composition is to be concluded. As such, some transactions will be deemed valid only because they occurred in a period beyond the time recognised for the suspect period. This needs amendment if an effective application of the avoidance powers that seeks to maximise and preserve the estate value is to be achieved. For example, the suspect period should

[29] The issue of reforming the judiciary will be examined below in Sec 6.6.2
[30] See above Sec 3.4.5 (Objective Five of the UNCITRAL Legislative Guide)
[31] UNCITRAL Legislative Guide, Part One, Chap I, para 10

be calculated at an early time such as from the date of the insolvency petition or from the date the debtor ceased to pay its due debts.[32]

Effective and efficient insolvency laws should ensure transparency and predictability among stakeholders. This is important to encourage effective participation by creditors and to promote the confidence of investors that the process is not abusive. It is desired by investors that the insolvency law provides mechanisms for effective and predictable enforcement of their rights to enable them to make the right investment decisions. In Libya, investors suffer significantly from inefficient enforcement due to the inefficient institutions with unpredictable outcomes and creditors may wait for a long time to receive returns, if ever. This is also attributable to the absence of the timeline limit for the insolvency procedures either in the liquidation or in the composition which leads to excessive delay in the insolvency resolution.[33]

One of the important objectives of the insolvency law as identified by the UNCITRAL Legislative Guide is the recognition and protection of the existing creditors' rights and priorities in insolvency.[34] Creditors have an expectation that the insolvency law will protect their rights and priorities they have bargained for through the use of non-insolvency law (property law).[35] Typically, this objective is achieved by classifying creditors into classes where creditors with higher priority ranking are paid in full before lower junior creditors are paid anything.[36] Effectuating this objective in a market-based system requires the law to limit the priority rules to rights gained by commercial bargaining rather than political or social considerations. But if the latter

[32] For details see Sec 3.4.6 (Objective Six of the UNCITRAL Legislative Guide)
[33] See above Sec 3.4.7 (Objective Seven of the UNCITRAL Legislative Guide)
[34] UNCITRAL Legislative Guide, Objective 8. See discussion above at Sec 5.2
[35] Thomas Jackson, *The Logic and Limits of Bankruptcy Law* (HUP 1986) 157
[36] Thomas Jackson and Anthony Kronman, 'Secured Financing and Priorities among Creditors' (1979) 88 Yale LJ 1143, 1161-62

considerations are to be recognised by the law, it is important that these considerations are limited to as great an extent as possible and are clearly set forth by the law in a predictable manner. Otherwise, secured creditors' rights and priorities will be prejudiced which would result in inefficient outcomes.[37] Besides, this would reduce certainty for creditors and lenders which would lead in turn to reduced availability and affordability of credit in the market.[38] Unfortunately, property rights of secured creditors in Libya are not adequately protected due to the overemphasis on social justice of which obvious example is the priority given to the privileged creditors.[39]

6.4. Reforming the Composition System

The composition framework[40] in Libya proved inefficient to deliver positive rescue outcomes. This is attributable to the deficiency of some mechanisms and approaches related mainly to the lack of encouragement for voluntary access to the process by the requirement of insolvency status, inadequacy of the moratorium system, the high level of court involvement in the composition procedure at the expense of the creditors who are given a significantly reduced role to play and the absence of mechanisms for effective valuation of business viability. These issues should be attended for the composition procedure to improve.

6.4.1. Encouraging Early Access to the Process

Rescue procedures in the Libyan composition scheme are available only after the debtor becomes insolvent by the inability to pay due debts upon demand.[41] As such, companies that face some financial difficulties would be frustrated from accessing

[37] See above Sec 5.2 (Objective Eight of the UNCITRAL Legislative Guide)
[38] See above Sec 3.4.1 (Objective One of the UNCITRAL Legislative Guide)
[39] See above Sec 5.3.7 and Sec 5.4
[40] The composition system was subject of discussion in Chapter Four.
[41] CCA 2010, Art 984. Also see above Sec 4.3.2

rescue procedures unless they are strictly insolvent. This should be reconsidered if rescue is to be promoted. Eencouragement for an early filing is advantageous because it leads to maximising the value of the insolvency estate which increases the potential for business rescue on a going concern basis and decreases piecemeal liquidations.[42]

Following from the above, the requirement of inability to pay debts prevents debtors from filing for the composition at a sufficiently early stage. The Libyan law does not define how early a distressed company can file for a composition. It allows a distressed company to file for a composition with creditors only before the insolvency declaration.[43] Accordingly, a company may be eligible to file only when it becomes unable to pay debts as they fall due and filing before this situation happens is impossible in Libya due to the statutory requirements for which the court has the right to strike down the application even though the company is in a situation of financial difficulty as long as it is still able to pay debts. This is detrimental to business rescue which requires access to the procedures at a sufficiently early time. This is because encouraging early access would help to maximise the value of the insolvency estate which can result in positive outcomes in business rescue and enable the avoidance of piecemeal liquidation.[44] Therefore, businesses should be encouraged to file for the proceedings before they become insolvent to enable them to address their distress at an early stage.

6.4.2. Reconsidering the Moratorium Regime

The moratorium prevents individual enforcement on the debtor's assets by creditors and avoids a chaotic race to collect their entitlements. Because of this, the moratorium

[42] See above Sec 4.3.2
[43] CCA 2010, Art 985(1)
[44] Parry, *Corporate Rescue* (n 8) 13

is recognised as a substantial mechanism to achieve a number of goals; i.e. effectively maximising the going concern value of the assets and encouraging distressed companies to file for the process at an early stage both of which would increase potential rescue outcomes.[45] In Libya, the moratorium is set up inappropriately and it cannot cater for any rescue purposes.

First, the automatic imposition of the moratorium can be very abusive because of the lack of a mechanism for creditors to apply to the court to release the effect of the automatic moratorium. This would lead to the interests of secured creditors being prejudiced by prolonging the life of hopeless companies for an uncertain period of time leading to undermining creditors' certainty in the process. This is undesirable for the rescue process because creditors will be discouraged to engage in the process from the first place and they can act to strike down the proceedings by their power to not participate which would allow them to enforce their claims (after the court's approval of the composition plan).[46] The moratorium in such a scenario can lead to both undermining the assets value at the expense of secured creditors and decreasing the likelihood for a successful rescue. It is emphasised that the moratorium should be designed in a way that does not undermine the ability of creditors to recover their debts or decrease the value of their rights in the secured assets. This is very important in a country where the promotion of credit flows is particularly desired.[47] Furthermore, the moratorium in Libya can allow for dismantling the business assets by allowing secured creditors to enforce their claims after the court approves the composition plan and

[45] See above Sec 4.3.5
[46] CCA 2010, Art 993
[47] UNCITRAL Legislative Guide, Part Two, Chap II, para 37

during the performance of the composition process. As such, rescue can be very hard to achieve.[48]

Such features of the moratorium in Libya should be reformed in order to promote business rescue in the composition regime. Practically, a moratorium can operate automatically upon petition to the court in order to prevent dismemberment of the business assets. This should be applied also during the implementation process of the composition plan because the moratorium is most needed during this period to increase rescue outcomes. This is because if creditors are allowed to exercise this over-protective power, the business's assets will be broken up between the creditors leaving the business with a feeble chance for rescue. In the meanwhile, there should always be a focus on protecting the interests of secured creditors. The application of the moratorium should be restricted where the interests of creditors may be damaged. Therefore, the law should allow courts to release the effect of the moratorium upon request of the creditors. This can achieve the appropriate balance between the stakeholders in the insolvency (promoting rescue by which multiple stakeholders are advantaged and protecting the interests of secured creditors).

6.4.3. Increasing the Role of Creditors with a Reduced Role of Courts

In the composition system, only unsecured creditors are allowed to participate in the voting process as secured creditors have the power not to participate. However, if secured creditors wish to participate, they do so in the position of unsecured creditors.[49] The law excludes secured creditors from participating in the process in exchange for providing protection of their interests by empowering the court to take up an active role in the procedures. For that, the court is given broad discretionary powers in order to

[48] See above Sec 4.3.5
[49] See Sec 4.3.3

protect the economic interests of secured creditors. It can, for example, reject the composition proposal if the court thinks that the interests of secured creditors will be prejudiced even though the plan was approved by the majority of voting creditors.[50]

The concern is that such an excessive level of court involvement would lead to more costs incurred by the creditors leading to less going concern value. Most importantly, the lack of specialised and trained judges and professionals in insolvency will add to the costs. This is because it is undesirable to have a rescue system run by courts where courts and judges lack the knowledge and experience necessary to deal with insolvency and rescue matters. Rescue procedures require a balance between rescue and liquidation and between all different stakeholders to be made and this cannot be easily achieved without efficient institutions.

Alternatively, court involvement should be reduced allowing more power to the creditors to take an active role in the procedures. Secured creditors particularly should be encouraged to lead the process because this is the best response to protect the value of their interests.[51] This is also beneficial to the business rescue as a system. It has been illustrated that where secured creditors take an active role in the procedures, the rescue outcomes can benefit different stakeholders.[52] This also can be justified from a theoretical point of view in the Creditors' Bargain Theory (CBT) and the TPT. The former theory, obviously, places a pronounced emphasis on protecting the economic interests of secured creditors as the only role of the insolvency law. Under the TPT, this approach can also be encouraged. As previously discussed, the TPT encourages business rescue to take place to benefit a wide range of stakeholders provided that the

[50] See Sec 4.3.3
[51] Giving secured creditors an active role in the insolvency process is a primary reason behind taking of security. See: Gerard McCormack, *Secured Credit under English and American Law* (CUP 2004) 7
[52] See above Sec 4.6

secured creditors are well protected in the process.[53] In Libya where efficient institutions are considerably lacking, encouraging secured creditors to lead the procedures would be the best appropriate response to protect the secured interests in the process.[54]

6.4.4. Determining Business Viability in Business Rescue

The insolvency law in Libya vests in the court discretion to approve the composition proposal, considering the feasibility of the proposal to the creditors' economic interests by taking into account the available assets and the debtor's financial sufficiency.[55] If it appears to the court that the debtor's proposal is not viable, it has to declare the insolvency status and then start the insolvent liquidation procedures.[56] Determination of business viability lies at the heart of rescue systems. In this regard, there are various approaches. One approach is that valuation is determined through agreement by the parties (the debtor or the insolvency representative and the secured creditors). Another approach is a court based approach where the court specifies the mode of determining the value which can be conducted by appropriate experts or, alternatively, by the insolvency practitioner. Another possible approach is through a market valuation of the assets through sale.[57]

However, the Libyan insolvency law does not specify the mechanism for the valuation test. This may open the door for considering the available alternatives. Since Libya suffers from the problem of institutional capacity, requiring that the valuation

[53] See above discussion in Sec 4.2 and 6.2

[54] It has been previously acknowledged that the approach where secured creditors are dominantly allowed to have an active role in the rescue process can result in conflict with the interests of junior creditors especially where secured creditors are over secured. However, this approach seems to be the most suitable solution to make the necessary balance of the process taking into account the weak institutions in the country. See above Sec 4.6

[55] CCA 2010, Art 1006(1)(1)

[56] Ibid, Art 1006(2)

[57] For more details see: UNCITRAL Legislative Guide, Part Two, Chap II, para 67

should be carried out by the court or its insolvency practitioners would clearly be inappropriate. The suitable two alternatives available are either through agreement by the parties or through independent experts while the court may still be enabled to exercise its discretion to approve the valuation test.

This is arguably appropriate for the Libyan system and can be justified for a number of reasons. The practice in the country indicates that banks are required by the law[58] to have recourse to expert offices or professional bodies for valuation of assets provided as collateral for loans and other financial facilities. Further, a professional body that the law refers to and the court may resort to is the Libyan Auditors and Accountants Association. This association is recognised and established by the law which requires all practicing accounts auditors to be members of this body in order to be permitted to practice.[59] The duty of the external accounts auditor is to examine the financial statements of the company before they are submitted to the general assembly in its annual meeting.[60]

An empirical study shows that members of the Auditors and Accountants Association in Libya have practical experience in examining companies' viability and indicating financial failure in line with the auditing international guidelines. In doing so, they have to raise the red flag before the financial situation worsens in order to alert the company to take the necessary steps to avoid any further trouble.[61] Arguably, such professional

[58] See: Art 82 and 83(3) of the Banking Law 2012

[59] Bob Ritchie and Esamaddin Khorwatt, 'The Attitude of Libyan Auditors to Inherent Control Risk Assessment' (2007) 39 British Accounting Review 39, 41

[60] CCA 2010, Art 208

[61] For details see: Adel Efkirin and Mosbah al-Khidri, 'Classifiying the Assessment Indicators of the Company's Viability to Continue from the Auditors' Perspective in Libya' (2017) 2 Journal of Financial and Economic Research 43, 49-50. According to this study, the account auditors in Libya are committed to follow the international benchmarks regarding the company's valuation assessment. ibid 71

bodies can be involved for the same purpose to help the court and the other concerned parties in business valuation.

Business rescue, however, entails that some interests will be risk bearers if the process is unsuccessful.[62] These could be secured creditors because business rescue requires them to negotiate around the bargain they have made in their contracts.[63] But, secured creditors usually do not favour this kind of negotiations as they are unwilling to take the risk, rather they prefer to have their bargaining enforced. That is legitimate but this would also mean that the other stakeholders will be risk bearers which would in turn mean that the rescue process will be unlikely to have any potential. This is also a potentially unfair resolution because in the society there are stakeholders, other than secured creditors, who have investment in the business and their interests as team members are therefore legitimate to be considered in insolvency.[64] As such, achieving a balance between those interests is not an easy task considering the issue of institutional weakness in the country.

To support business rescue culture in the community for such reasons, the State, driven by objectives of social stability in the community, may step in to reallocate the risk. In a Libyan context, an oil-rich State concerned with social and economic stability, whilst seeking enhanced efficiency in the country, has potential choices that would offer an appropriate balance between the various interests. Secured creditors would have their interests guaranteed and the other stakeholder interests would also be maintained. In practical terms, the State guarantees the position of the secured creditors

[62] Bruce Carruthers and Terence Halliday, 'Institutionalizing Creative Destruction: Predictable and Transparent Bankruptcy Law in the Wake of the East Asian Financial Crisis' in Meredith Woo (ed), *Neoliberalism and Institutional Reform in East Asia: A Comparative Study* (Palgrave Macmillan 2007) 245

[63] This is what the CBT is based on (negotiating around the pre-insolvency entitlements). See above Sec 2.2.1

[64] See above discussion in Sec 2.6

during the procedures for a limited period of time, six months for example, and at the end of that period the business will be subject to scrutiny in terms of viability of debt payment based on an accountancy test to testify and identify viability. Secured interests during this period will be held by the operation of the moratorium. If it appears that the business is still unable to pay debts as they fall due and its financial situation is not improving or is even worsening, the business should be forced into liquidation. The court with the assistance of the independent experts identified by the law and practice in Libya can implement this task on behalf of the State. By doing so, the need to recognise business relationships and the importance of non-creditor stakeholder interests like those of the employees, suppliers and the community and the demands of social justice in the context of insolvency can all be achieved.[65] Besides, the pressure that can be caused by institutional weakness in the country that might otherwise prevent a fair balance between all various stakeholder interests can also be resolved.

6.5. Secured Transactions Law: The Weak Position of Secured Creditors and the Lack of Harmony with the Insolvency Law

It is acknowledged that the strength of any secured transactions law is assessed upon the debtors' insolvency when various claims of creditors have to compete against the debtors' estate for debt satisfaction.[66] As both systems of insolvency and secured transactions may seek to achieve different objectives and different approaches to debt in the event of insolvency, there is a potential for considerable tension and conflict

[65] See above discussion in Sec 2.5

[66] Ulrich Drobnig, 'Basic Issues of European Rules on Security in Movables' in John de Lacy (ed), *The Reform of UK Personal Property Security Law: Comparative Perspectives* (Routledge Cavendish 2010) 449

between these two areas of law if each system endeavours to achieve its aims without a consideration of the other's.[67]

Secured transactions law in principle is identified as the law of secured creditors because it protects their rights and priorities against the insolvency of their debtor in order to promote secured credit.[68] Secured transactions laws seek to ensure that secured creditors are protected in insolvency[69] by emphasising effective enforceability of the rights of individual creditors in order to enable the realisation of the economic value of the encumbered assets for the benefit of secured creditors.[70] This is also identified by the UNCITRAL Legislative Guide as one of the Key Objectives that the insolvency law should cater for.[71] However, such an objective may interact with other objectives that seek to preserve and maximise the going concern value of the insolvent estate to benefit not only secured creditors but also wider stakeholder interests. Accordingly, the commencement of the insolvency procedures may affect the interests of the secured creditors in ways different from objectives set forth in the secured transactions law.[72]

The key issue then is that the law should aim at achieving a degree of harmonisation between the secured transactions regime and all existing debtor-creditor related laws, particularly the insolvency law. This is because both secured transactions law and insolvency law are part of the same legal system concerning debtor-creditor

[67] Mahesh Uttamchandani, 'The Case for DIP Financing in Early Transition Countries: Taking a DIP in the Distressed Debt Pool' [2004] LiT, at 8 <www.ebrd.com/downloads/research/law/lit042.pdf> accessed 08 Apr 2018
[68] McCormack (n 51)
[69] As we have seen earlier in this thesis, the Creditors' Bargain Theory claims that the insolvency law should always have the aim of protecting and honouring the interests of the secured creditors because this is the bargain they have made *ex ante*.
[70] UNCITRAL ST Guide, Chap XII, para 2
[71] See above Sec 5.2 (Objective Eight of the UNCITRAL Legislative Guide)
[72] UNCITRAL ST Guide, Chap XII, para 3

relationships and any weakness in one area poses an unhealthy burden on the other.[73] The UNCITRAL ST Guide insists that without taking consideration of the relationship between secured transactions law and other laws in particular law of obligation, enforcement procedures law and insolvency law, an effective and efficient secured transactions law would be far beyond the possibility of achievement.[74]

The issue in Libya that should be reconsidered is that the property law is excessively biased towards achieving social justice under which property is designed to have 'social function' which starkly deviates the secured transactions regime from what secured creditors expect when taking security (protecting their rights and priorities). This can be demonstrated by the statutory dominance of privileged creditors whose claims are prioritised over secured creditors leading to inadequate protections.[75] Another issue is that the enforcement procedures of secured interests under the reform of 2010 may be carried out without giving regard to the objectives of an insolvency law that seeks to maximise the going concern of the insolvent estate. This indicates the lack of harmonisation that should be achieved between the law of secured transactions and insolvency. It is therefore obvious that the secured transactions law needs to be amended so that some degree of effectiveness, in relation to priority of security rights, and some degree of compatibility with the insolvency and rescue laws can be introduced. These two issues are discussed below.

[73] Ronald Harmer, 'Insolvency Law Reforms in the Asian and Pacific Region: Law and Policy Reform at the Asian Development Bank' (2000) 1 International Insolvency Institute Report No TA 5795-REG, at 100 <www.iiiglobal.org/node/1815> accessed 13 Apr 2018
[74] UNCITRAL ST Guide, Introduction, para 73
[75] See above Sec 5.3.7

6.5.1. Correcting the Position of Secured Creditors

As reflected the principle of 'social justice', property in Libya is designed to have a very strong 'social justice' role to play in the society resulting in an unfriendly ranking system for secured creditors. This is manifested clearly by the powerful treatment given to the broadly defined and wide ranging privileged rights that are, ironically, prioritised even ahead of the secured creditors. It is argued that, the privilege system as so recognised in Libya is dangerous and an elusive enemy of a well-functioning property law as well as insolvency and rescue law. As has previously been discussed,[76] the Libyan privileges system can operate against most of the key objectives of insolvency law as recognised by the UNCITRAL Legislative Guide. They can undermine the *pari passu* distribution to similarly situated creditors, the maximisation of the value of the assets, the creditors' predictability and certainty regarding their priorities in insolvency. The privilege system can also disincentivise secured creditors from involvement in any rescue attempts which will consequently lead to frustration of rescue procedures which will in turn be at the detriment of all stakeholders.

Therefore, it constitutes a really significant hurdle that is capable of blocking any purpose of law development in this field. It may not be far-fetched to conclude that if this privilege system, as so structured in Libya, is the only issue within the Libyan legal system, it would be a powerful deficiency that is capable by its own to destroy the insolvency and rescue system. Thus, without reconsidering this system in the legislation, any reform attempts will be useless to say the least. This is because property, especially secured property, is, or should be, designed to primarily protect the

[76] See above Sec 6.3

property holders (secured creditors)[77] in the event of debtor insolvency by prioritising secured creditors over other creditors.[78] Otherwise, the property/ security transactions law will be unable to deliver any useful purposes to the very stakeholders the law was supposed to protect the most and will be unable therefore to support the goal of enhancing private business investments in the country. Recognition of the proprietary rights and priorities of the creditors is acknowledged in the insolvency law theory and in the international benchmarks as the law should be primarily built on commercial bargaining rather than on social or political considerations. The rationale behind this is to increase the level of predictability and to encourage businesses and create an investment-friendly environment.

Social considerations and objectives are important as they are given an important position against business failure in insolvency laws and theory as well as in the international norms. However, the law should provide a fair balance between these social objectives and other objectives in the community by protecting the commercial bargaining of creditors. This is because overemphasising the social objectives will lead to prejudicing many important interests that are also important to maintain as one of the fundamental objectives of the law.

From a theoretical point of view, the CBT defends very strongly that the rights and priorities of existing creditors to be protected hence rejecting any special treatment for interests other than those of creditors. The problem of the privileged creditors is most understood from the CBT's point of view[79] because of their capability of undermining

[77] Secured creditors generally are given a non-protective position within the legal system and practice in Libya even in issues other than the priority ranking. See above Sec 5.4

[78] McCormack (n 51) 5

[79] Privileged or preferential claims are clearly not grounded in perspectives of the CBT. See: Christopher Symes, *Statutory Priorities in Corporate Insolvency Law: An Analysis of Preferred Creditor Status* (Routledge 2016) 61

the hypothetical bargain that creditors have made *ex ante*. The TPT may be a wider approach yet it rejects the dominance of one party over the other. Accordingly, it rejects the dominance of social objectives prejudicing the commercial bargains of creditors. The UNCITRAL Legislative Guide also agrees with this approach and insists on protecting the rights of the secured creditors whereas social or political objectives should be minimised to a great extent as possible. It suffices to say therefore that the privileged claims, in the way currently structured in Libya, starkly contradict the common norms identified in theory and international benchmarks on insolvency.

Therefore, this class of creditors must be urgently revisited if Libya is going to reform its insolvency system so as to encourage private provision of capital and efficient business rescue in insolvency. This can be achieved, for example, by minimizing the number of social interests in insolvency. Some privileged claims such as the administrative costs of insolvency, those of the employees for unpaid wages and tax claims are important to maintain. Such claims are traditionally recognised as important in various jurisdictions in the world.[80] But recognising claims beyond these claims in insolvency will lead to unfair outcomes from which important stakeholder interests, like the creditors, will be disadvantaged. Libya can be informed by the recommendations of the UNCITRAL Legislative Guide in this regard. It recommends that the ranking order should be as in the following;

(1) Secured Creditors

(2) Administrative costs and expenses;

(3) Priority or privileged claims (employee and tax claims);

(4) Ordinary unsecured claims;

[80] Ibid 1

(5) Deferred claims or claims subordinated under the law.[81]

Accordingly, the priority ranking in Libya should be in the following order;

(1) secured claims,

(2) administrative costs and expenses;[82]

(3) privileged claims which may include;

(a) employees' unpaid wages;

(b) tax claims due to the public treasury;

(4) the ordinary unsecured creditors;

(5) deferred claims or claims subordinated under the law.

6.5.2. Harmonisation between the Secured Transactions and the Insolvency Laws

The 2010 reform in Libya regarding the secured transactions system failed to achieve harmony with the insolvency and rescue regime leading to some weaknesses. A couple of examples can be given to illustrate this claim. First, the FLA 2010 entitles the lessor to enforce its rights over the leased assets when the insolvent company ceased to pay the rent.[83] As has been mentioned, the FLA 2010 excludes the leased assets from the insolvency estate and the creditors' common pool.[84] As such, the insolvency practitioner is required to return the leased assets to the lessor upon the latter's request irrespective of the moratorium process. This would undermine the rescue process by dismantling the assets of the distressed business and reducing the going concern value, possibly obliterating the estate. The leased assets should be included in the moratorium

[81] UNCITRAL Legislative Guide, Rec 188 and Rec 189. For more details see: ibid, Part Two, Chap V, B. (1)(C) ranking of claims, paras. 62-79

[82] However, judicial expenses and resources expended by the court or the insolvency representative in maintaining the value of the encumbered assets (Art 1142 of the CC 1953) may exceptionally be prioritised ahead of secured claims.

[83] FLA 2010, Art 17(5)(b) provides a potential solution to this problem by allowing the insolvent company (the lessee) or the insolvency trustee to pay the rent. See above Sec 5.6.2.2

[84] Ibid, Art 17(5)(a). See above Sec 5.6.2.2

process because this is important to maximise the going concern value and increase the chance for rescue. This would not change the position of the secured creditor (the lessor) which is protected by excluding the leased assets from the common pool of creditors. The lessor instead should be enabled to apply to the court to lift the moratorium where the assets are not necessary for the rescue or they are not well protected.

Second, the structure designed for enforcement of going concern security under Orders upon Petition procedures is not consistent with the principles of an effective insolvency regime. In such a system a sale as a going concern, where a higher price is achievable, is preferred to a piecemeal sale. Article 479(1) of the CCA 2010 makes it explicitly clear that creditors can apply either for the whole or part sale of the going concern security without defining whether the court has the power to decide which option can achieve better results. In this way, with the absence of both the legislative guidelines and business rescue practice and experience, court practice may sacrifice the going concern value of the business in favour of a piecemeal sale even though the sale as a going concern may result in better outcomes for all.[85]

As has previously been mentioned,[86] the sale as a going concern is not easy to conduct as the process may lead to an undervalued sale. Therefore, in support for such a method, there is a need for institutional support and sufficient marketing. The lack of sufficient marketing in Libya might be a barrier for the potential of this kind of sale. In supporting the going concern sales of the distressed businesses in the market, the Government can step in as a way to support the implementation of an insolvency reform, for example, by providing potential buyers with loans for the most or whole of

[85] For more details see above Sec 5.6.2.1
[86] See above Sec 5.6.2.1

the purchase price. This intervention by the Government may be justified by the need to support business rescue to maintain various associated goals such as social and economic stability in the community.[87] This is important in Libya where the community already faces difficult social issues such as workers resettlement under the re-employment scheme set up in the Liquidation of State-owned Companies Fund.[88]

6.6. Institutional reform

Insolvency laws work best through effective institutions to achieve their purposes. Insolvency laws that encourage wide spread liquidations of nonviable business in a country need to have social safety net systems to absorb any potential unemployment. Without this, governments will be under pressure to maintain social stability in the society which may lead to the frustration of an effective application of the insolvency law by keeping nonviable companies going through governmental subsidies. [89] Institutional reform requires attention regarding the judiciary system in the country. Where the country still suffers from institutional inefficiency and to fill the gap caused by this, it suffices to argue that alternatives to the formal insolvency procedures should be encouraged.

[87] It should be acknowledged, however, that such a governmental intervention must be considered carefully. This should be limited to cases where the going concern of the business is economically viable and where the business is socially too-important-to-fail because the failure of such businesses may present a considerable risk to social stability. Government intervention beyond such cases can be problematic as it would create a problem of artificially prolonging the lives of economically inefficient companies (zombie companies). See: Rebecca Parry and Yingxiang Long, 'China's Enterprise Bankruptcy Law, Building an Infrastructure towards a Market-based Approach' (2019) 20 J Corp Law Stud 157, 175; Kenneth Ayotte and David Skeel, 'Bankruptcy or Bailouts' (2010) 35 J Corp L 469, 470-71

[88] See the resolution (no 104 of 2007) regarding Liquidation of State-owned Companies Fund, Art 3(z). Also see above Sec 1.2.3 (Insolvency Law under the Transition Economy)

[89] Which would create the problem of zombie companies.

6.6.1. Enhancing the Social Safety Net System

Enhancing social protections or social safety net systems (SSN) are important because they play a vital role in helping individuals to manage the economic shocks that may result from the economic transition process. Social protections can include supporting effective education, healthcare systems and ensuring social welfare and minimum standards of living in general.[90]

Enhanced social safety net systems are closely relevant to the application of insolvency and rescue laws. To detail, the application of the insolvency law may lead to job reductions either through the liquidation or the sale as a going concern. Adequate social protections are fundamental in ameliorating social instability that may be caused by job reductions. But without such protections, it would be difficult, and maybe impossible, for a country to accept such outcomes due to the fear of social and political unrest. This as such would prevent the application of an insolvency reform from reaching its full effect.[91]

This matter should be given great attention in Libya because the Social Security Fund that is responsible for providing social protections for individuals in the country provides inadequate social protections and wellbeing for individuals.[92] Because of the lack of an adequate social protection system, Libya is considered one of the countries that are vulnerable to economic shocks and other crises due to weak SSN systems.[93] Enhancing social protections has recently become a very sensitive matter more than ever in Libya. According to a study, the 2011 revolution in Libya was primarily driven

[90] Joana Silva, Victoria Levin and Matteo Morgandi, *Inclusion and Resilience: The Way Forward for Social Safety Nets in the Middle East and North Africa* (World Bank 2013) 35

[91] See for example the delay caused in China by such concerns: Rebecca Parry and Haizheng Zhang, 'China's New Corporate Rescue Laws: Perspectives and Principles' (2008) 8 J Corp Law Stud 113, 137

[92] World Bank, Libya Economic Report 2006, 97

[93] Silva, Levin and Morgandi (n 90) 3-4

by the population's sense of a growing inequality, unfair social treatment and dissatisfaction with the quality of life provided by the State.[94]

6.6.2. Reforming the Judiciary System

It is admitted that insolvency law does not exist in an institutional vacuum. Rather, it is necessary to build effective institutions with efficient mechanisms alongside the legislative reform in order to achieve a meaningful insolvency and rescue regime.[95] The primary aims of an insolvency system, such as implementing the procedures in a timely manner and achieving an appropriate balance between the various stakeholders and between rescue and liquidation, rely on a sound judicial system.[96]

To enhance institutional capacity in the insolvency field, judges and trustees/ practitioners, accountants, asset valuers and other professionals involved in the insolvency procedures must be provided with adequate insolvency and credit related training and capacity building programmes. This is particularly important because it is said that the successful implementation of an insolvency law and the development of a sufficient culture of business rescue are dependent on the implementation of a sound judicial system with insolvency specialised and trained judges and practitioners.[97] Issues of partiality and personal quality of judges and practitioners are equally important for the judiciary to ensure fair procedures. This is very important to gain

[94] Elena Lanchovichina, Lili Mottaghi and Shantayanan Devarajan, *Inequality, Uprisings, and Conflict in the Arab World* (World Bank 2015) 29

[95] Jingxia Shi, 'Twelve Years to Sharpen One Sword: The 2006 Enterprise Bankruptcy Law and China's Transition to a Market Economy' (2007) 16 Norton Journal of Bankruptcy Law and Practice 5, 23

[96] Sumant Batra and Robert Sanderson, 'The Import of the Insolvency Professional' in Survey on Insolvency Systems in the Middle East and North Africa, at 9 <www.oecd.org/daf/ca/corporategovernanceprinciples/44375185.pdf> accessed 9 Oct 2017

[97] Kenneth Ayotte and Hayong Yun, 'Matching Bankruptcy Laws to Legal Environments' (2007) 25 JL Econ & Org 2, 3

legitimacy over insolvency cases and support from key stakeholders.[98] Further programmes may also include programmes to educate the public and other interested parties in order to reduce the sense of stigma traditionally associated with business failure and to destigmatise rescue laws and encourage the view that they are designed to facilitate rescue rather than liquidation.[99] The public and interested stakeholders would appreciate rescue laws given their potential to have beneficial contributions to the welfare of the public by preserving insolvent yet viable businesses which would in turn lead to job preservations, maximising the value of the estate for creditors and the enhancement of the economic growth and maintenance of public order in the community.

As the entire insolvency procedures in Libya are carried out under extensive court involvement, reforming the judicial system is very relevant to the country where the attraction of foreign investment has become necessary. As acknowledged, sufficiently skilled courts and judges in applying fair treatment in insolvency procedures can ensure better enforcement and high recovery rates for creditors. It is widely acknowledged that there is a strong relationship between the quality of institutions and efficient legal systems and the ability of a country to attract foreign direct investment and investment flows; better and efficient institutions and legal systems will attract foreign investment.[100]

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[98] Terence Halliday, 'Lawmaking and Institution Building in Asian Insolvency Reforms: Between Global Norms and National Circumstances' (5th Forum for Asian Insolvency Reform, Apr 2006) at 29 <http://siteresources.worldbank.org/GILD/Resources/Halliday5.pdf> accessed 02 Aug 2018

[99] Nathalie Martin, 'The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation' (2005) 28 BC Int'l & Comp L Rev 1, 76-77

[100] Mustafa El Hamoudi and Nagmi Aimer, 'The Impact of Foreign Direct Investment on Economic Growth in Libya' (2017) 2 IJELS 144, 147. Also see: Giuseppina Talamo, 'FDI, Mode of Entry and Corporate Governance' in Neri Salvadori, Pasquale Commendatore and Massimo Tamberi (eds), *Geography, Structural Change and Economic Development: Theory and Empirics* (Edward Elgar 2014) 30-46

Sadly, the judiciary system in Libya is inadequate to deal with business or insolvency cases. The judiciary system in the country has been built on general courts in which judges have general knowledge in all law branches, lack specialised training and experience and they are occasionally rotated between different courts and divisions with different subject matter.[101] Observers believe that the vast majority of judges in Libya lack the essential knowledge and experience in dealing with the level of complexity and overlap of up-to-date commercial practices, such as security transactions, banking law, intellectual property and insolvency processes.[102]

Because of this situation in the country, the vast majority of business disputes in general are settled away from the courts due to the courts' inefficiency and weaknesses.[103] Despite this abandonment of the formal litigation by businesses, the Libyan courts remain subject to excessive delays because of a backlog of cases which makes the court unattractive to resort to.[104] A possible reform response would be the establishment of separate commercial courts or insolvency divisions that would excessively deal with insolvency cases. This can be both more responsive to business and also would not be subject to the backlog from non-commercial disputes. In 2008, Libya was advised by the WB to establish commerce-specialised courts as a way to reform its judicial system in order to enhance the capability of judges to deal with business disputes to boost the confidence of investors.[105]

Nonetheless, as the court and practitioner infrastructure in Libya is not yet sufficiently developed, achieving a fair balance between the various stakeholders may

[101] Faraj Ma'rouf, 'Specialised Courts as a Mechanism to Improve Justice in Libya' (The Supreme Courts in Arab Countries conference, Doha, Sep 2013) at 2-3 <https://carjj.org/sites/default/files/wrq_ml_lyby-_lmhwr_lthlth.docx> accessed 9 Sep 2017
[102] World Bank, *Modernising the Legal Environment* 2008, 18
[103] World Bank, Libya Economic Report 2006, 67-68
[104] Ma'rouf (n 101) 5
[105] World Bank, *Modernising the Legal Environment* 2008, 18

not be possible which may result in re-allocating the risk of insolvency to the secured creditors. This situation would be undesirable because it will likely lead to the public and investors losing their confidence in the courts. In such a scenario where courts still lack the knowledge or experience necessary to balance the various stakeholder interests, it may not be desirable to undertake such a complex task according to the court's wide discretion. Therefore, a system that builds on judicial discretion should arguably be avoided.[106] This may lead to the argument also that, until the courts are developed, a system with increased focus on creditors' interests may, in practical sense,[107] be desirable because this is essential to enhance the availability of credit.[108] Giving the secured creditors a strong role to play in the process has been the approach that is adopted even in jurisdictions with developed rescue systems and effective and well developed institutions like in the UK.[109]

6.6.3. Encouraging Informal Workouts

Given the weakness of institutions as illustrated above and the distrust of the formal insolvency system by the business and financial community in Libya, it might be important to encourage the development of informal workouts to further encourage business rescue to take place in the country. Informal workouts or restructurings are recognised to have a particular importance in countries that have inadequate formal procedures and institutions because they can provide quick and flexible resolutions for

[106] UNCITRAL Legislative Guide, Part One, Chap III, para 6

[107] Obviously, there is a tension created by the need of courts to provide a fair treatment to the interests of stakeholders in the community and the insufficiency of courts to achieve that goal. This is to acknowledge that weak institutions will add to the pressure of achieving the fair balance between all various interests.

[108] Ayotte and Yun (n 97) 25; Ziad Azar, *Guidelines for Efficient Bankruptcy and Creditor's Rights Reform* (LAP 2013) 33

[109] See above Sec 4.6

companies to emerge from their financial difficulties.[110] Informal approaches to rescue are favoured by both debtors and creditors because they avoid the high costs and publicity that are associated with the formal procedures and thus preserve the commercial reputation of debtors.[111] In the London Approach for example, the entire process of a workout is kept secret between the banks and the debtor company without other creditors, employees and shareholders being aware that a restructuring workout is in process.[112]

Informal workouts are praised for their flexibility to encourage voluntary access to the restructuring process before the business becomes insolvent. This is useful to address the business's distress at an early time before it is complicated and before the position deteriorates past the point of no return. Another attraction to the informal restructuring is the encouragement of creditors to participate by ensuring that their new funding, where necessary, will have a priority ahead of the existing debts. Informal restructurings tend to increase returns to secured creditors because costs of renegotiations tend to be reduced. This will incentivise all secured creditors to support and participate in the process if they knew that the business will generate higher returns to them in informal processes than in liquidation. Furthermore, such approaches are attractive to secured creditors because they will spearhead the negotiations in light of better information about the financial situation of the business being made available to all creditors and this will enable them to sufficiently protect their interests.[113]

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[110] Rebecca Parry, 'Introduction' in Katarzyna Broc and Rebecca Parry (eds), *Corporate Rescue: An Overview of Recent Developments* (2nd edn, Kluwer Law International 2006) 8

[111] Régis Blazy, Jocelyn Martel and Nirjhar Nigam, 'The Choice Between Informal and Formal Restructuring: The Case of French Banks Facing Distressed SMEs' (2014) 44 JBF 248, 250

[112] John Armour and Simon Deakin, 'Norms in Private Insolvency: The "London approach" to the Resolution of Financial Distress' (2001) 1 J Corp Law Stud 21, 37

[113] On the advantages of the London Approach see: ibid 34-39

It should be acknowledged that informal workouts, such as the London Approach,[114] are considered a matter of culture that is long practiced in a local economy by interested parties, such as the bankers and lenders, to suit their flexibility in extending support to their debtor companies, and they tend to develop through a series of cases and experiences rather than being established in a single case. Therefore, they have no formal status, nor do they consist of set of certain rules and conventions.[115]

6.7. Conclusion

This Chapter has built upon the work done in previous chapters and analysed and discussed prospects of applying an efficient and effective application of the insolvency law theories and benchmarks. In doing so, it has acknowledged that it is necessary for the country to take lessons and experience from other countries that have enacted sound insolvency regimes. It was also important for this Chapter to situate the Libyan insolvency law within a theoretical foundation. It was concluded that the general legal system in Libya suffers from inconsistency between the different branches of laws. It was concluded that by using theory, such a situation can be appropriately addressed by relying on the view offered by a theory like the TPT. Moreover, a proposal for reform has been made to improve a regime of business rescue in the country. Some points were made in relation to developing the structure of the composition regime itself (encouraging the early access to the process, strengthening the moratorium and the role of the secured creditors) and promoting the institutional support in the issue of business viability.

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[114] Historically, the Bank of England played a crucial role in co-ordinating the London Approach and the activities of creditors participating in the Approach. However, due to the change in the market, a result of which is the increasing diversification of lending, the ability of the Bank to co-ordinate between creditors has become more difficult. For details see: Vanessa Finch, 'Corporate Rescue in a World of Debt' (2008) 8 JBL 756, 770-71

[115] John Flood, 'The Vultures Fly East: the Creation and Globalisation of the Distressed Debt Market' in David Nelken and Johannes Feets (eds), *Adapting Legal Cultures* (Hart Publishing 2001) 263

Furthermore, a sound reform for insolvency and rescue law in general requires the legislatures to ensure that harmonisation between the insolvency law and secured transactions law is achieved. This is because these debtor-creditor related systems should work in harmony and any shortcoming in one system would pose restrictions on the application of the other system.[116] In Libya, harmonisation between the secured transactions law and the insolvency law is lacking. Considerable inconsistency between the two systems has been noted especially in terms of security enforcement. Without working on the harmonisation between secured transactions laws and insolvency laws in particular, the effective application of secured transactions laws would be hard to achieve.[117] In addition, it was important in this Chapter to highlight the problem caused by overprotecting some interests that are based on objectives of social justice (privileged claims) prejudicing the commercial-based interests (secured creditors). It was argued that such a position will lead to the dysfunction of the legal system in general and the insolvency and rescue law in particular.

This Chapter has also concluded that a meaningful reform does not rely only on introducing new legislations, but it also needs to have effective institutions that are in charge of implementing the rule of law in the market. An effective application of an insolvency law reform depends heavily on reforming the judicial system so as to provide adequate training programmes and capacity building for court staff such as judges, as well as insolvency practitioners and accountants that deal with insolvency cases in order to ensure effective and quick decisions. Effective institutions may also entail having a sound social security system in the country to facilitate the application of the reform. As we have previously seen, governments will otherwise be reluctant to apply insolvency systems that encourage wide spread liquidations of non-viable

[116] Harmer (n 73) 100
[117] See above Sec 6.5.2

businesses for the fears of social unrest.[118] Further, because of the situation of the weak institutions in Libya, it was suggested that informal workouts of business rescue should be encouraged in order to support the possibilities for business rescue to take place in the market.

[118] See above Sec 6.6.2

Chapter 7 Conclusion

This thesis has considered, by reference to theoretical perspectives and international benchmarks, the need for and the importance of reforming the insolvency law in Libya. Since embarking on economic reform in the country, the situation in the country has changed requiring reforms to the insolvency law. For a long time, Libya adopted a socialist economy in which the insolvency law was not required because businesses were not allowed to fail. Notwithstanding, the movement of the country towards the market economy in more recent years has resulted in revisiting the socialist influenced laws and policies towards adopting a more business-friendly environment in the country where a raft of business-related laws was introduced, including the secured transactions law and the investment incentives law. However important to accelerate the process towards the economic reform, the insolvency law was not considered in the reform agenda in Libya. This research thus highlighted the need for and the importance of reforming the current, long in force, insolvency law in the country during this period of economic transition. This research has examined the current business insolvency regime in Libya with the aim of exploring whether the current insolvency regime supports the business environment and maintains social justice taking into account all domestic situations in Libya.

This research has particularly highlighted the increasing recognition of implementing effective business insolvency laws in general and rescue systems in particular in playing an essential role in the development of the economy and business environment and influencing investment decisions in a particular country. The research has emphasised that an effective application of the insolvency and rescue regimes cannot be achieved without examining the efficiency of the secured transactions law. This is

because both of these systems regulate the relationships between debtors and creditors and inefficiency of one system would have an effect on the efficiency of the other, thus the reform has to achieve a degree of harmony between these two systems.

This research project aimed to discuss how to implement objectives that both promote efficient and effective business insolvency and rescue laws and make the right balance between all stakeholders' interests affected by insolvency in Libya, in particular with regard to Libya's status as a developing country. To do so, the study measured the principles of the Libyan insolvency law against the insolvency law theory and international benchmarks with particular reference to the UNCITRAL *Legislative Guide*.[1] The research, when relevant, referred to the experience and lessons that may be considered in some other jurisdictions in implementing their insolvency laws. Using theory and global experiences of the international benchmarks was vital to the study to evaluate the insolvency framework in Libya and to appreciate how the national jurisdiction may be able to develop the existing laws and policies and possibly to make helpful suggestions. In doing so, taking into account lessons from the global perspectives on how to deliver a meaningful insolvency and rescue law that is suitable for a developing country.

This final Chapter concludes the research. It is divided into three main sections. It starts with highlighting the main insights of the study and it considers whether the objectives of the thesis were met. It then highlights its originality and contribution to knowledge. The limitations of the study and the possible directions for future research are mentioned in the last section.

[1] UNCITRAL, *Legislative Guide on Insolvency Law* (United Nations 2005)

7.1. Main Insights of the Thesis

The thesis centered on reforming the insolvency and rescue system in Libya. It focused on a reform of the insolvency law in general and a reform that particularly promotes objectives that are geared towards rescuing financially distressed business and the importance of that for developing the business environment in the country. In doing so, it takes into account all existing economic and social realities in the country. This section will be divided into two subsections. The first part focuses on the purposes that the insolvency law in Libya should cater for, while the second part will focus on how the insolvency law can achieve those purposes through the reform. By responding to these research objectives as set out in Chapter One, the thesis attempted to answer the main research question of how can the Libyan insolvency law best be reformed considering all circumstances that exist in the country?

To do this, the thesis set out five sub-questions. Chapter Two discussed the theory of insolvency which is very important to the thesis. By analysing the different theories and approaches to insolvency, Chapter Two responded to the research sub-question 1, which sets out to define the role that should be played by the insolvency system from a Libyan perspective. It also responded to sub-question 2, which considers what approach that should be subscribed by the insolvency law in defining the boundaries of the affected stakeholders to be protected by the insolvency law, taking account of the theoretical perspectives and social and economic circumstances of Libya.

Chapter Three measured the Libyan insolvency system against the international benchmarks of insolvency (leaving the subject of business rescue and the rights and priorities of creditors for a more detailed consideration in the following two Chapters) to examine whether or not the current insolvency law is adequate to achieve the sought-

after objectives as identified in the theoretical discussion in Chapter Two. This Chapter responded to sub-question 3 whether the insolvency and rescue framework in Libya, with consideration of the existing institutions, plays the role in promoting the objectives as defined by the theories and international benchmarks on insolvency. Since Chapter Four examined business rescue in Libya in light of the international benchmarks, it stands with Chapter Three as the response to the sub-question 3 above. Chapter Five investigated the secured transactions system in the country (using the Objective Eight of the UNCITRAL Legislative Guide and the theory of insolvency as a guide for the Chapter). This Chapter responded to sub-question 4 in defining whether the secured transactions law has any relevance in promoting the interests and objectives that should be protected by the insolvency law in Libya. Finally, sub-question 5, considering how the insolvency law and institutions in Libya can best achieve the protection of those affected interests and the promotion of objectives identified as important to Libya, was considered in Chapter Six (which provided insights for a reform as to how to overcome the deficiency of the Libyan insolvency law and institutions).

7.1.1. Purposes and Objectives that the Insolvency Law of Libya Should Serve

The research by discussing the theories of insolvency in Chapter Two and by examining the UNCITRAL Legislative Guide key principles in each of Chapter Three, Chapter Four (with reference to Objective Three) and Chapter Five (by considering Objective Eight) met the first objective of determining the purposes of the insolvency law. In Chapter Two, it explored how insolvency law theories have been used to determine what purposes the insolvency law serves, or should serve, in the scenario of default. Exploring theories of insolvency law was important to this study because theories offer theoretical understanding of how the law should function during times of

distress. Inasmuch as the thesis adopted the usage of the international benchmarks as guidelines for domestic reforms due to the flexibility they offer,[2] it acknowledged that applying the principles of such benchmarks into a national reform may lead to skewed reform outcomes if insufficient attention is paid to the domestic context.[3] It was important before exploring the international benchmarks, therefore, to highlight a need for determination of what objectives a country should subscribe to. The thesis accommodated this by using the insolvency law theories to inform the choices made in applying the principles and objectives of the international benchmarks. The combination of both the theory and international benchmarks as such was carefully pursued throughout the research to that end.

The investigation of the leading theoretical views was used to refine insolvency law theories to suit Libya's own domestic context in the efforts to ensure both an encouraging business environment and maintaining objectives of social justice in the country. These are the important objectives that the insolvency law should seek to achieve in Libya.[4] It was evident in the research that efforts to maintain these two objectives simultaneously can be very hard to achieve because they often contradict each other. Therefore, there is a need to make an appropriate balance between these goals in the reform. To do that, it was necessary to investigate leading theories of insolvency law.

It was established that the theoretical debates on insolvency law have been dominated by two main schools of thought characterised in literature as Proceduralists and

[2] Gerard McCormack, 'Criticising the Quest for Global Insolvency Standards' (2018) 8 KJLL 1, 28; Jenny Clift, 'International Insolvency Law: The UNCITRAL Experience with Harmonization and Modernization Techniques' in Andrea Bonomi and Paul Volken (eds), *Yearbook of Private International Law,* vol 11 (SELP 2009) 408. See further discussion in Sec 3.2

[3] Terence Halliday, 'Lawmaking and Institution Building in Asian Insolvency Reforms: Between Global Norms and National Circumstances' (5th Forum for Asian Insolvency Reform, Apr 2006) at 33 <http://siteresources.worldbank.org/GILD/Resources/Halliday5.pdf> accessed 02 Aug 2018

[4] See above discussion in Sec 2.5

Traditionalists.[5] While the former group advocates that insolvency law should focus on promoting private rights and protecting non-insolvency entitlements of secured creditors, the other camp rejects the narrowness of this approach and holds the view that the law should respect the interests of other stakeholders and the wider community interests that are affected by insolvency to achieve objectives beyond protecting the private rights of creditors. The thesis established that the approaches offered by both groups of thought (proceduralists and traditionalists) should be recognised in the insolvency law reform in the country. Unlike the traditionalist approach, the proceduralist theory has been criticised for being a narrow and incomplete response to the problem of distress because it neglects the protection of social objectives in the community. The thesis acknowledged, nonetheless, that the model has been fruitful because it shows how and why insolvency can lead to suboptimal outcomes when non-insolvency entitlements of creditors are not well respected. Such an aspect, indeed, is of particular and close relevance to Libya. This is because there have been attempts in Libya to reform its legal system with the aim to create an attractive environment for investment. The thesis established, however, that the reform attempts failed to achieve that goal due to a failure to provide adequate protections to secured creditors whose position is undermined by the dominance of the social justice theory within the Libyan legal system. Investigating such a challenge is best understood, and then resolved, from the perspectives of a theory like Creditors' Bargain Theory. Therefore, the consideration of this approach is important to Libya especially from the standpoint of promoting credit inflows and enhancing the domestic economy, which were identified as important objectives to the country.[6]

[5] Douglas Baird, 'Bankruptcy's Uncontested Axioms' (1998) 108 Yale LJ 573, 576
[6] See above Sec 2.5

As the thesis revealed, values in Libya are not confined to the desire to promote the economic and business environment, but they also urge consideration of social objectives for many social constituencies in the country. But these aims fall beyond the scope of the proceduralist approach, hence its incompleteness. The investigation, therefore, appreciated the consideration of the approaches of traditionalists. The advantage offered by such approaches is the encouragement of business rescue to take place in the society which can help in mitigating some domestic challenges such unemployment and in enhancing objectives such as of the economic growth and stability. A potential problem with these approaches is that they offer undisciplined treatment of the situation of business failure and the application of such treatment would potentially generate an imbalanced reform by encouraging social objectives but at the expense of the economic ones, a resolution which is also undesirable to Libya. The thesis in Chapter Two revealed that an approach that is provided by the Team Production Theory (TPT) best meets the domestic concerns in Libya because its approach for business rescue is well balanced. It offers special and fair treatment for important social considerations and it also has features that can encourage private business investments and promote economic development and growth.[7]

Such a balanced approach is reflected in the international benchmarks. As has been seen from a perspective of the Legislative Guide, insolvency law should not be limited to serve the interests of creditors only, but it should also be directed to respect wider stakeholder interests in the community. This is achieved by encouraging business rescue to take place as much as possible as an alternative to liquidation. However, this objective is carried out with an emphasis particularly placed on protecting and prioritising the private proprietary rights and the commercial bargaining of secured

[7] See discussion in Sec 2.6

creditors ahead of other stakeholders by subordinating business rescue to the maximisation of returns to secured creditors.[8] The thesis revealed that such a balanced approach to insolvency and business rescue may be appropriate to the reform in Libya because it offers treatment under which all interests and objectives can be maintained without overemphasising one over the others. This is advantageous to achieve the identified objectives in the country (promotion of business environment and economic growth by increasing flows of capital and attracting investors both locally and internationally[9] and maintenance of social justice and stability by considering stakeholders such as the employees, the suppliers and customers and the community at large).

Insomuch as the international guidelines as embodied in the UNCITRAL Legislative Guide are considered very informative, the research furthered the investigation on these guidelines in Chapter Three, Four and Five. The research examined the Legislative Guide's eight principles and applied them to the Libyan context. The application of the principles of the UNCITRAL Legislative Guide was important to the research to establish whether or not the current insolvency law framework in Libya is suitable to achieve its purposes as identified by the theory and international guidelines on insolvency.[10] The eight key objectives of the Legislative Guide were divided between Chapters Three, Four and Five and the investigation of these objectives was carried out in light of the theoretical perspectives as outlined in Chapter Two. The thesis discussed the objectives that relate to the general matters of insolvency in Chapter Three whereas Chapter Four was devoted to analyse business rescue procedures in Libya with reference to Objective 3 (striking a balance between rescue and liquidation) and

[8] See above Sec 2.3 and Sec 4.2 (Objective Three of the UNCITRAL Legislative Guide)
[9] Halliday (n 3) 33
[10] See sub-question 3.

Chapter Five examined the Libyan secured transactions law in light of Objective 8 of the UNCITRAL Legislative Guide (recognition of the rights and priorities of existing creditors).

The investigation of the principles of the UNCITRAL Legislative Guide in Chapters Three, Four and Five revealed that the current insolvency law in Libya is inefficient and ill-equipped with outdated and inadequate principles to achieve the objectives of the country. The examination revealed that such inefficiency is widely attributable to the insolvency system and procedures in Libya accommodating features that starkly deviate from the key objectives as encouraged by both the theories and Legislative Guide of insolvency. The investigation of the Libyan insolvency law as measured against the remaining key objectives of the UNCITRAL Legislative Guide carried out in Chapter Three established that the insolvency law is associated with profound shortcomings that deter it from achieving its objectives. Equally, it was revealed that the institutions are not sufficiently adequate to apply the insolvency law effectively and fairly.[11] This resulted in creditors' recovery from the procedures being very low.[12] For that, the Libyan insolvency law, according to the WB *Doing Business* 2018 report, shares a very low rank among worldwide insolvency systems at 168th out of 190 for resolving insolvency cases.[13]

The thesis emphasised particularly Objective Three and Objective Eight, which were examined in Chapter Four (which focused on business rescue in Libya) and Five (which investigated the rights and priorities of creditors in Libya) respectively. These two objectives were very important to the investigation in the thesis for two reasons.

[11] These aspects were summarised in detail above in Chapter Six. See Sec 6.3

[12] Mahesh Uttamchandani, 'No Way Out: The Lack of Efficient Insolvency Regimes in the MENA Region' (2011) 1 World Bank Policy Research Working Paper No 5609, at 30 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1794914> accessed 4 Jan 2019

[13] World Bank, *Doing Business 2018: Reforming to Create Jobs* (World Bank 2018) 174

First, the objective of business rescue as determined by both the theory and the international guidelines is important to protect multiple social interests in the society and it is also important to promote economic growth by encouraging distressed businesses which are yet viable to remain in business. Second, recognition of the rights and priorities of creditors (Objective Eight of the Legislative Guide) is vital to promote a healthy business environment by providing lenders and creditors with legal certainty as to what will happen in the event of failure. This would incentivise such economic players to lend and invest. The achievement of these objectives was subject of detailed investigation in Chapters Four, Five and also in Chapter Six as outlined below.

7.1.2. Achievement of the Identified Purposes through the Reform

The evaluation of the insolvency law philosophy and the international benchmarks in Chapter Two and Three was useful to the study to develop its examinations in the rest of the thesis. Chapters Four, Five and Six met the research objective of how to achieve the purposes and objectives as identified in theory and international benchmarks through the reform. It was established that the Libyan system in the area of insolvency and property law is inadequate to maintain the objectives of promoting social justice and enhancing the economic growth in the country. It was established that the key features relevant for this purpose were the weakness of the insolvency law (part of which was carried out in Chapter Three as well) and the inadequacy of the composition system as a rescue procedure, the inefficiency of institutions and the inadequacy of the secured transactions law by its failure to protect the secured creditors and its failure to achieve harmony with business rescue. This is detailed below:

In Chapter Four, the thesis evaluated the rescue system in Libya in light of both the theoretical debate on insolvency law and the approach offered by the Legislative Guide.

The examination in Chapter Four established that the rescue system through the composition procedure is equipped with outdated and inadequate mechanisms for effective business rescue as an alternative to liquidation. For example, issues in relation to allowing voluntary filing for the composition procedures at an early stage,[14] problems with the wide discretionary power of the courts in determining the feasibility test of the composition proposal,[15] the over-protected position afforded to secured creditors in the composition system by excluding their interests from the procedures (by means of Articles 1002 and 1009 of the CCA 2010),[16] and the failure to ensure adequate protections for the employees' interests in the future of their jobs either under the composition procedures or under the provisions of Code of Employment Relationships 2010 under which unfair dismissal for employees in business rescue can possibly happen.[17]

It was evident in the study that such features of the composition scheme would frustrate an effective application of business rescue leading to more frequent liquidations in the country.[18] This is one of the major shortcomings that are associated with the Libyan insolvency regime which, from the perspectives of insolvency law theories and international benchmarks, should promote business rescue, a failure of which is a failure to promote economic growth and to maintain social stability as objectives to be achieved by the insolvency law.[19] This is because liquidation is not always favorable because it leaves some stakeholders vulnerable to the situation of insolvency caused, for example by, job losses. Also, it can cause distress, poverty and long term unemployment for individuals. Besides, it can result in destruction of the

[14] See above Sec 4.3.2
[15] See above Sec 4.3.3
[16] See above Sec 4.3.5
[17] See above Sec 4.7
[18] Uttamchandani (n 12) 30
[19] See Sec 4.2 regarding objective no 3 of the UNCITRAL Legislative Guide.

economy and de-industrialisation especially for an oil rich State which is liable to the 'resource curse'.[20] Therefore, it was established that reforming the composition system in Libya is vital in order to accomplish the law's purposes.

Chapter Five examined the secured transactions law in Libya. Examining the secured transactions law is closely relevant to this study to appreciate whether the law takes into consideration the relationships with the insolvency law, especially with regard to the objectives that should be protected by the insolvency law, and whether the reform of this system can promote business rescue in the country. Libya reviewed its secured transactions law in light of reports of the World Bank in order to improve the credit inflows and create a friendly business environment in the country. For that, several statutes were enacted in 2010 including, for example, the CCA 2010, the FLA 2010, Promotion of Investment Act 2010. However, the examination established that the reform did not have any regard to a big issue that affects this field of law which is the rights of lenders and creditors against the insolvency of their borrowers and debtors. This is manifested by the wide application of the privileges regime which regards some types of unsecured creditors a privilege status to be paid in insolvency ahead of secured creditors who are supposed to be the most favoured beneficiaries of property law, thus deviating from its main purposes. This significantly limited the function of property law to provide adequate protections to secured creditors' rights and priorities which is recognised both in theory[21] and international benchmarks[22] as one of the key objectives that the law should accommodate. As a result of this treatment, the rights of secured

[20] This term 'resource curse' refers to the negative effects of a country's natural resources on its economic development. It refers to the paradox that countries with an abundance of natural resources tend to face more problems of economic development than natural resource-poor countries. See generally: Richard Auty and Raymond Mikesell, *Sustainable Development in Mineral Economies* (OUP 1998)

[21] The CBT emphasises that the non-insolvency rights of secured creditors must be protected. See Sec 2.2.1

[22] See discussion on Objective 8 of the UNCITRAL Legislative Guide at Sec 5.2

creditors are prejudiced which undoubtedly leads to undermining certainty for creditors and lenders who are always passionate about getting their interests adequately protected in and outside of the insolvency of their debtor.[23] Such a legal system, unsurprisingly, failed to provide incentives to creditors and lenders and owing to this Libya attained a very low rank on the ease of doing business and getting credit and on the protection of creditors, being 185th worldwide,[24] and, as a consequence, foreign investment inflows in the country remain significantly small.[25]

A sound reform of the secured transactions regime is also important to enhance the adequacy of the insolvency and rescue regimes. This is because protecting the private rights and priorities of creditors in insolvency will ensure legal certainty and predictability which will increase confidence in the law among investors.[26] As Jackson asserted in his Creditors' Bargain Theory, insolvency law functions in the shadow of substantive non-insolvency law.[27] This being the case, the question arises as to what purposes remained for the Libyan insolvency law to serve if the rights of creditors under the substantive non-insolvency law are profoundly ill-positioned. Further, the thesis established that a sound property law can be very helpful in supporting business rescue in the country. The examination in Chapter Five revealed that the secured transactions law in Libya failed to function in harmony with the insolvency law. This can be seen in the enforcement process of the going concern security and the financial lease. The former process can result in a piecemeal sale of the business's assets even

[23] Marek Dubovec and Cyprian Kambili, 'Using the UNCITRAL Legislative Guide as a Tool for a Secured Transactions Reform in Sub-Saharan Africa: The Case of Malawi' (2013) 30 Ariz J Int'l & Comp L 163, 183

[24] World Bank, *Doing Business 2018: Reforming to Create Jobs* (World Bank 2018) 174; World Bank, *Doing Business 2017: Equal Opportunity for All* (World Bank 2017) 220

[25] UNCTAD, *World Investment Report 2019: Special Economic Zones* (United Nations 2019) 212, Annex Table 1

[26] See discussion above in Sec 3.4.1 (Objective One of the UNCITRAL Legislative Guide)

[27] Thomas Jackson, 'A Retrospective Look at Bankruptcy's New Frontiers' (2018) 166 UPL Rev 1867, 1873

though a going concern sale may still be achievable,[28] while the latter procedure allows the lessor (as a creditor) to enforce its rights against the lessee in the event of insolvency even though the rescue procedures and a moratorium are taking place.[29]

As it appears from the above narrative in the previous few paragraphs, the Libyan legal system is associated with a problem of ideological incoherence. This is witnessed in features of the insolvency law which places a great emphasis on protecting the secured creditors especially in the composition procedures as a primary objective of the law, corresponding closely with a theory like the CBT. Such an associated feature is undesirable to Libya where the law has to aim to promote wider interests in the country beyond those of creditors. Oddly enough, pursuing this objective of the insolvency law is even frustrated because it contradicts significantly with the influential application of the privileges system as a feature of social justice theory of the CC 1953 under which secured creditors' rights and priorities are jeopardised for the benefit of the socially weak parties in the community. The application of a system as such leads to inefficient insolvency and rescue laws by subordinating the interests of creditors to primarily achieve social and political objectives (by the operation of the privileges and the notion of supporting the weak).

The thesis revealed that these two objectives cannot function simultaneously because the application of social justice theory deviates the law dramatically from achieving the other objectives that are identified in the thesis as important to the country to promote economic growth and to incentivise business and investment environment. It has been argued in Chapter Two accordingly that the effect of insolvency and business failure should not be considered solely from the perspectives of social justice and protections

[28] CCA 2010, Art 479(1). For further details see above Sec 5.6.2.1
[29] FLA 2010, Art 17(5)

(by the notion of supporting the weak such as maintaining jobs for employees). Looking at the effect of insolvency from an economic perspective, the examination concluded that the individual justice for creditors is an important cog in the wheels of the insolvency and rescue laws. Nonetheless, the emphasis on the rights of secured creditors as encouraged by the insolvency system is unfavourable because of its unfair treatment of the vulnerable stakeholders in the insolvent business.

Relying on the theoretical discussion, the features of such conflicting ideologies within the legal system in Libya have to be readdressed if a reform is aimed to achieve the identified two objectives of the law. The thesis established that such a problem can be rectified by relying on perspectives of a theory like the TPT. It was established in Chapter Six (section 6.2. Aligning the Libyan Insolvency Law with Theory) that the reliance on the approach of the TPT would help resolve the conflicting ideologies and achieve coherence within the legal system across different branches of the commercial law in Libya by providing a framework through which social objectives of some weak parties in the community and economic interests of creditors can equally be respected; without privileging one party in the team over the other without a solid reason. The interesting point in this theory is that it gives special treatment to the weak party which has been a matter of grave concern to the Libyan community and the legal system in general. This can be achieved by ensuring that the interests of those vulnerable people in the future of the business in which they have invested will continue and by ensuring that their rights are dealt with under substantive legal guidelines rather than under judicial discretion. This would provide all stakeholders with the necessary legal

certainty and predictability. The thesis established, therefore, that the TPT is the most productive approach around which to design a reformed insolvency law for Libya.[30]

The thesis revealed that the insolvency and property laws contain weaknesses and do not achieve what they are intended to achieve. The thesis in Chapter Six then follows to draw the research together by synthesising all the discussion in theory and international benchmarks in previous Chapters within the domestic context of Libya. The Chapter shed light on what the insolvency law structurally needs to revisit in order to improve in compliance with the key objectives as widely recognised by the international benchmarks as crucial for an effective and efficient insolvency law. It established that the Libyan insolvency and rescue regimes are associated with features that profoundly negate an efficient application of the system. Measured against the Key Objectives of the UNCITRAL Legislative Guide, the thesis revealed that the underlying cause of insolvency is still perceived as connoting fraud or mismanagement, hence the focus on liquidation. Other features such as inefficient institutions, the weak protection of going concern value by encouraging secured creditors to enforce their claims in the process, delay on resolving insolvency cases due to procedural weaknesses and the wide discretion of courts in this regard, the insufficient system of transaction avoidance necessary for equitable distribution to creditors, unpredictability and non-transparency of the insolvency law. Finally and most importantly is the weak position offered to secured creditors caused by the influence of social justice theory and its application to the privileges system which hinders the effective operation of *pari passu* distribution to similarly situated creditors and the maximisation of the asset value for secured creditors, creates legal uncertainty and leads therefore to inefficiency of the insolvency

[30] See above Sec 6.2

and rescue system in the country.[31] Such a feature would continue to result in dysfunction of the insolvency and rescue system for a long time to come if not reviewed by policymakers in the country.

The theoretical discussions in Section 6.2 above together with the international guidelines as investigated in the previous Chapters were the bridgehead from which the rest of Chapter Six sections progressed offering the policymakers commendable insights as to how to implement a suitable reform for Libya's context, both legislatively and institutionally. In the following three main Sections (6.4, 6.5 and 6.6), the thesis offered solutions to improve business rescue in Libya by reconsidering matters in the composition scheme, in the secured transactions law as well as in the level of institutions.

The Chapter recommended that the composition regime and procedures could be improved mainly: by encouraging voluntary entry to the procedures at an early stage, reconstituting the moratorium regime to be effective against secured creditors, allowing and encouraging creditors particularly secured creditors to play an active role in the process to avoid the undesirable discretionary power of courts and to ensure that their rights are protected,[32] and finally enabling effective mechanisms for determining business viability.[33] Regarding secured transactions law, the examination revealed that the secured transactions law needs to ensure that secured creditors are well positioned and protected by ensuring that their rights are effectively prioritised in liquidation over other stakeholders because this is the historical purpose behind the existence of secured transactions systems.[34] It was established also that the secured transactions regime in

[31] See above Sec 6.3
[32] UNCITRAL Legislative Guide, Part Two, Chap III, para 77
[33] See above Sec 6.4.1, 6.4.2, 6.4.3 and 6.4.4
[34] Gerard McCormack, *Secured Credit under English and American Law* (CUP 2004) 5-7

Libya needs to achieve harmonisation with the insolvency law to promote more business rescue for example by encouraging going concern sales under the going concern security and preventing the lessor in the financial lease from repossessing its property where the leased property is necessary to the rescue process.[35] This Chapter recommended also that a reform at the institutional level is important to effectuate the reform of the substantive law. This includes reforming the social safety net, 'SSN', system and the judiciary system. It was evident in the study that the problem of institutional inefficiency in Libya can be partially mitigated by encouraging informal workouts of business rescue between creditors and debtors.[36]

7.2. Contribution to Knowledge by this Thesis

The thesis has used insolvency law theories and international benchmarks to critique existing Libyan insolvency laws and their existing theoretical foundations, as well as to suggest a way forward for the reform of these laws, tailored to the specific Libyan context. By using this approach, the thesis has made original contributions to human knowledge in two respects. The first is the identification of the ideological incoherence within the current legal system that regulates creditor-debtor relationships in Libya. The thesis established that the Libyan insolvency law draws upon an ideology of 'social justice' theory to protect the socially weak parties in the society and this is implemented either through substantive legal provisions of the secured transactions law (the privileges system which affords some types of unsecured claimants a priority status in liquidation ahead of the secured creditors) or through the discretion of the court under the provisions of the contract law which emphasises protection of the socially weak party (in which creditors are not counted thus they are not protected).

[35] See above Se 6.5.2
[36] See Sec 6.6.1, 6.6.2 and 6.6.3

As demonstrated in the thesis, the recognition of the social justice ideology is incompatible not only with the philosophy of the current insolvency law which prioritises the economic interests of creditors, but it would also be incompatible with the objectives that the insolvency and rescue law should promote in the country, as identified using theories and international benchmarks on insolvency. Therefore, the thesis concluded that the Libyan legal system is not suitable for use within the Libyan society as long as such an ideological inconsistency is not resolved. The challenge identified in this thesis in responding to such an intrinsic issue is its acknowledgement of the importance to keep the legal commitment to social justice in the society, without undermining the necessary commercial certainty and predictability. By doing so, the thesis offered an informative solution that can help in rectifying the incoherence of the Libyan law, informed by the insolvency theories and international benchmarks which provide protections to other important stakeholders who represent economic interests. The response of the thesis to the coherence problem in Libya provided policymakers with valuable insights about how to achieve a coherent reform within the secured transactions law and the insolvency and rescue regimes if the reform is to have any hope for successful implementation.

The second contribution to knowledge by this thesis is its examination of the present discretionary aspect of the law which allows courts to achieve the objectives of the law at their own discretion and interpretation in applying principles of the social justice aspect of the CC 1953. According to the draftsman of the CC 1953 Professor al-Sanhuri, the judge is given wide discretionary powers to implement the social justice objective of the law (by protecting the weak) in accordance with the circumstances and

situations existent in the society.[37] Who is regarded as weak and how courts should provide protection to its interests, remain matters of discretion by the court. The thesis acknowledged the importance of providing protection to the vulnerable parties for the achievement of social justice and maintenance of social stability. However, it offered a response by which protecting the socially weak parties is rather turned into a substantive aspect of the law because this is what can promote certainty and predictability in the country. The thesis used the Team Production Theory to reconceptualise the Libyan insolvency law by defining clearly who the weak or vulnerable parties are (being the people who have business-specific investment) and how to provide proper protections to their interests (by protecting their future interests in the business).[38]

By operating at the three levels of evaluation (using insolvency theory together with the international benchmarks to evaluate the Libyan insolvency laws in light of the domestic context), the thesis has broadened its research scope far beyond its initially intended limit as a project evaluating a legal system of a developing country that has been influenced by its colonial legal legacy and different circumstances. Using such an evaluative method in this context is new to the academic literature in Libya and has not been done before, contributing to the lack of scholarship in this field. It enabled the research to identify what problems underpin the domestic legal system of Libya, thereby offering realistic insights on how to synthesise and reconceptualise different approaches of insolvency law with objectives of a domestic country through the use of the insolvency theories and the international benchmarks as well as experience of selected jurisdictions, where relevant. The thesis claims also that it has added a

[37] Abdulrazzaq al-Sanhuri, *General Commentary on the Civil Law: Theory of Obligation in General*, Vol 1 (2ed edn, Arab Heritage 1967) 92-93
[38] See discussion in Sec 6.2

contribution not only to legal scholarship and decision making in Libya, but it offers potential for future research, as it can also be a useful reference for other jurisdictions in the MENA region which are part of the same legal family and are influenced by the same social justice theory within their Civil Codes as inherited down from the Egyptian Civil Code 1948. The thesis attempted to raise awareness among these jurisdictions about the detrimental impact on the market-friendly reforms of integrating the principles of this theory in an unstructured and potentially arbitrary fashion. This is also a contribution to knowledge.

7.3. Limitations and Future Research

This thesis has examined the Libyan formal insolvency and rescue system as enacted by the CCA 2010. The study, therefore, focused on the insolvency framework and procedures that are available for all businesses as provided by the law and which are normally carried out through court control. The study acknowledges, nevertheless, that there is another important approach to resolve insolvency issues out of the formal collective insolvency procedures. This approach is commonly termed as 'informal workouts'.[39]

Much as the study acknowledges that, the lack of market statistics on how informal workouts are practised and what forms and modes they take in Libya limits the scope of the thesis on the formal procedures. The examination of this balance between formal and informal business rescue methods, therefore, requires further study including empirical research to explore the market practice and culture in regard to informal workouts and how they are relevant to the development of a rescue culture in Libya.

[39] Rebecca Parry and Yingxiang Long, 'China's Enterprise Bankruptcy Law, Building an Infrastructure towards a Market-based Approach' (2020) 20 J Corp Law Stud 157, 161

Further research would be to extend the examination of the impact of Professor Sanhuri's theory of 'social justice' on the legal systems of the Arab jurisdictions who transplanted the Civil Code of Egypt of 1948. Such an issue has received, up till very recently, no particular attention by researchers and policymakers in the region. For example, a study published in 2020[40] to evaluate recently reformed insolvency and restructuring systems in some Arab countries has identified that insolvency regimes in those countries are still associated with profound weaknesses in delivering adequate protections especially to creditors. Yet, the study lacked the examination of whether or not the social justice theory of the Civil Codes in those jurisdictions has any impact on this matter. Accordingly, a further research will be conducted to examine whether or not the application of the theory has a similar effect in the same way it has in Libya and also whether the same proposal would be suitable for each of those jurisdictions.

[40] Adam Al-Sarraf, 'Bankruptcy Reform in the Middle East and North Africa: Analyzing the New Bankruptcy Laws in the UAE, Saudi Arabia, Morocco, Egypt, and Bahrain' [2020] Int'l Ins Rev 1, 8

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