

The Access of Corporations to Capital Markets: A Sketch of the Lebanese Microfinance Crisis and the Prospect Solutions

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Abstract

Entitled “The Access of Corporations to Capital Markets: A Sketch of the Lebanese Microfinance Crisis and the Prospect Solutions”, this article will focus first, solely on the challenges hindering lenders, including banks and other non-institutional lenders, from extending loans to corporations and then will explore potential solutions that could empower the latter to navigate and overcome the current microfinance crisis and the existing impediments.

You realize that this topic is complex when you conduct an extensive research on ChatGPT and you do not find any substantial answers to the relevant questions that it raises. Human intelligence still matters! During the last International Monetary Fund (henceforth "IMF") visit to Lebanon two months ago, I attended two sessions with its members at the Ministry of Justice, and one of the topics covered was the microfinance crisis in the Lebanese economy. The delegation performs a field survey on the overall liquidity crisis and its influence on the non-availability of credit finance. The relationship between the way the judiciary tackles matters related to the implementation of contractual monetary commitments and the business cycle is highlighted. In addition, a detailed look was given to prospective legislative reforms that may improve both the capacity and appetite of lenders to provide loans, therefore reactivating the economy on the micro-scale. The collected data and proposals will be included in an IMF report on the rule of law in Lebanon, which is expected to be released next month.

This paper is not intended to be a theoretical academic research paper discussing hypothetical scenarios, but rather a realistic analysis that answers several questions posed by the IMF delegation, with a focus on the ongoing struggle that corporations in Lebanon face in raising capital and the solutions that could provide the private sector with the necessary amount of liquidity in this time of crisis.

Previous to 2019, the majority of investments in Lebanon were done through corporations in which investors participated in the capital and decision-making process¹. In the USA “*interest payments by a corporation are tax deductible; [and] dividend payments are not. This means that interest deductions keep more money in the corporate treasury and hence out of the public treasury. For this reason, an investor considering whether to make a debt or equity investment will prefer debt, all other things equal*”². Same in Lebanon, corporations relied on debt financing rather than equity financing to collect liquidity, with a focus on the non-regulated financial markets. The allotment of shares, like the issuance of bonds on the regulated financial markets³ was not the tool that enabled corporations to finance their

¹ Information mentioned in the determining grounds of the law on “private equity companies” n° 163 dated on 8/5/2020.

² A. R. PALMITER, *Corporations: examples & explanations*, Aspen publishing, 9th ed., 2021, p. 100.

³ Law on “capital markets” n° 161 dated on 17/8/2011.

projects. It was essentially the loans given by banks that provided corporations the necessary means to expand.

Credit was cheap, and corporations could get loans in US dollars at the favorable Average Exchange Rate (henceforth “AER”) of 1,507.5 Lebanese Pound (henceforth “LBP”) to 1 US dollar. Only after LBP was pegged to the US dollar in December 1997, the latter could be obtained for 1,507.5 LBP, which was significantly less than its real value. The subsidized US dollar allowed corporations in Lebanon to increase their profits by avoiding the cost of LBP’s depreciation. *“Lebanese banks lent in large part in dollars and, in some also use hard currencies as means of payments. As such, the dollarization rate of the claims to the private sector stood at 55.11% by March 2022 down from 73.68% in October 2019, and 80.48% in January 2011 of the golden era where foreign reserves and deposits were boosted by massive inflows running away from the global 2008 financial crisis. This downtrend is a logical and understandable reaction to the ongoing economic and foreign liquidity shortage. Banks preferred to be engaged in what were so-called safer placements with the Central bank rather than granting loans to a risky private sector⁴. Hence, the claims on the public sector were relatively lower than the loans granted to the private sector in dollars standing at 29.55% by March 2022⁵”*.

In October 2019, Lebanon plunged into an unparalleled fiscal and economic crisis that put him *"in 4th position for the highest inflation rates in 2020 preceded by Venezuela, Zimbabwe and Sudan; and in 3rd place in 2021, after Venezuela and Sudan⁶"* and *"in second place in 2022 after Sudan⁷"*. This crisis cannot be traced to any of the typical reasons of hyperinflation, such as civil upheaval, foreign military invasion, or oversupply of money and it is unclear what precipitated the sharp fall of LBP. But it is clear that the banking⁸ system's collapse, caused by an uncontrolled - and still ongoing - outflow of foreign currency deposits, resulted in a serious shortage of US dollar banknotes and a decline in confidence in LBP. So far LBP lost more than 98% of its purchasing power and depreciated

⁴ The emphasis does not exist in the original text. I believe that the Central Bank's high interest rates have led banks to quit giving inexpensive lending to the private sector. I disagree with Blom Invest's view; the Central Bank should never have been regarded a safer investment hub than the private sector.

⁵ “Measuring the degree of dollarization in Lebanon”, <<https://blog.blominvestbank.com/44163/measuring-the-degree-of-dollarization-in-lebanon/>>, consulted on 31/3/2023.

⁶ World Bank, “Lebanon Economic Monitor: The Great Denial”, Fall 2021. <<https://openknowledge.worldbank.org/handle/10986/36862>>, p. 15, consulted on 31/3/2023.

⁷ <<https://www.fitchsolutions.com/country-risk>>, consulted on 31/3/2023.

⁸ This collapse has not been crystallized yet by an official declaration of bankruptcy of banks.

to the extent where the Open Market ER (henceforth “OMER”) exceeded LBP 100,000 per US dollar.

At their heart, financial markets should “*provide liquidity to investors, thus enabling investors to be confident that they can quickly dispose of their investments without having to search for purchasers*”⁹. Regrettably, this feature does not apply to the Lebanese financial markets which had a major scarcity of US dollar banknotes after October 17, 2019. Banks imposed a de facto capital control, restricting withdrawals and transfers of US dollar deposits. Those pre-crisis US dollar deposits known as Lebanese dollars or “*lollars*” (a term coined by banker Dan Azzi) can now be withdrawn in LBP at an ER of 15000 LBP per lollar and sold on the market by checks at an 90% discount rate (the 100 lollars' check is currently sold for 15 US dollar bank notes known as “*fresh dollars*”).

The scope of this piece is limited to the obstacles that prevent lenders (banks and other non-institutional lenders) from providing loans to corporations and the solutions that would give the latter the ability to overcome the current microfinance crisis.

I- Credit crunch: aspects and reasons.

Corporations are having difficulty obtaining credit for a variety of reasons: the proliferation of ERs, the unpredictable judiciary, the lack of liquidity in banks, the high opportunity cost for lenders, the drop in real estate prices and the risk of money laundering.

A- Proliferation of ERs

The current crisis led to the proliferation of six ERs, namely:

- a- The “*student dollar*” ER: 1,500 LBP per US dollar¹⁰ (law).
- b- The AER: 15,000 LBP per US dollar¹¹ (BDL declaration).

⁹ W. A. KLEIN et al., *Business Organization and Finance: Legal and Economic Principles*, Foundation press and Thomson Reuters, 11th ed., 2010, p. 422.

¹⁰ Law n° 283/2022 issued on 12 August 2022 (the previous student dollar law is Law n.193 issued on 16/10/2020).

¹¹ AER used to be 1,507.5 LBP to 1 US dollar, which was the equilibrium price of a one dollar US bank note in LBP at the end of the daily foreign currency trading session between BDL and commercial banks from 1997 to 2019. After 2019, despite the fact that BDL is not permitted to set an ER and is only permitted to

- c- Import tariffs' ER: 45,000 LBP per US dollar¹² (decision of the Prime Minister).
- d- The “SAYRAFA” electronic application fluctuating Exchange Rate (henceforth “SAYRAFA ER”), that exceeds currently LBP 80,000 per US dollar¹³ (BDL declaration).
- e- The Emergency Crisis and COVID-19 response Social Safety Net project ER (henceforth “ESSN ER”),¹⁴ and
- f- The OMER¹⁵ that is currently above 100, 000 LBP¹⁶ per US dollar.

What is dangerous about this maze of ERs is:

- a- Lenders who extend credits in US dollars run the risk of being reimbursed in LBP at AER and not at the highest ER, namely OMER, resulting in large losses that can exceed 80% of their investment (this matter will be discussed later in this paper), which will discourage them to extend those credits.

declare and publish the AER resulting from its daily trading of US dollars with commercial banks, it issued circulars and established this AER as a fixed ER to be applied in its operations with commercial banks and in those banks' operations with their clients (basic circular n° 148 dated on 3 April 2020). However, during this period, lollar depositors were allowed to withdraw on a monthly basis certain amounts of their deposits (Intermediary Circular n° 13277 dated on 9 December 2021) in LBP at a specific ER i.e., the Electronic Platform ER (2,400 LBP raised to 3,800 LBP and then to 8,000 LBP for every US dollar). In addition to that, lollar depositors were allowed to withdraw on a monthly basis 400 cash US dollar and the equivalent of this amount in LBP at the ER of 12,000 LBP per US dollar (basic circular n° 158 of 8 June 2021 and intermediate circular n° 626 of 21 June 2022). In February 2023, a unified AER of 15,000 LBP to 1 US dollar was set by a simple declaration of the Governor of BDL. This AER applies to all lollar deposits in including those who wish to withdraw the monthly amount of 400 cash US dollar (intermediate circular n° 13527 of 20/1/2023).

¹² The Prime Minister's letter addressed to the minister of finance dated on 28/2/2023.

¹³ Basic Circular n° 5 of 10 April 2020, Intermediary Circular n° 583 of 10 May 2021 and Basic Circular n° 157 of 10 May 2021. BDL has required the most influential stakeholders in the foreign currency exchange market (commercial banks and exchange bureaus) to trade US dollars and foreign currencies on a platform that is supposed to be more transparent than the black market i.e., the SAYRAFA application. BDL was supposed to publish SAYRAFA ER on a daily basis. However, BDL is setting SAYRAFA ER instead of publishing it. It is no more the result of currency transactions!

¹⁴ Law n° 219 of 8 April 2021. Paragraph C – schedule 2 – of the agreement stipulates that “as long as there is an official peg between the US dollar and LBP, the beneficiaries will receive cash transfers in LBP at the higher of: (a) the constant real exchange rate, and (b) the highest regulated exchange rate vis-à-vis the US dollar, plus sixty percent, such rate being determined in consultation with BDL and adjusted on a regular basis”.

¹⁵ Published on ad-hoc mobile applications.

¹⁶ According to the current speculations it will reach LBP 200,000 per US dollar in mid 2023.

- b- Corporations will incur losses with every sudden raise in import tariffs' ER, which might affect their ability to pay back their credits.
- c- Although ERs should be set only by laws, certain ERs are being set by administrative decisions (Prime Minister and BDL). Therefore, variations of ERs are more than ever easy and unpredictable.
- d- OMER is left to speculative transactions and therefore profoundly unpredictable.

B- Unpredictable judiciary

From October 17th, 2019, the Court of Cassation has issued just one ruling pertinent to the ER matter, in which it applied "*the market rate*" without identifying it and without providing any legal basis¹⁷. The majority of the cases are still being heard in first and second instance courts. So far, practically all rulings¹⁸ have held¹⁹ that payment in LBP of a contractual monetary obligation valued in US dollars²⁰ in internal contracts is permissible. These decisions are based primarily on Article 30²¹ of the Code of Obligations

¹⁷ Judgment n° 14/2022 rendered on 12 April 2022 by the Court of Cassation, 2nd Chamber.

¹⁸ One judgment considered that obligations denominated in US dollar (in an internal contract) should be paid in this currency and not in LBP: judgment n° 199/2019 rendered on 25/11/2019 by the judge of urgent affairs in Nabatyeh.

¹⁹ Judgment n° 17/2021 rendered on 15 April 2021 by the Civil District Judge in Beirut (commercial affairs); Judgment n° 7/2019 rendered on 26 October 2020 by the President of the Court of Appeal of Beirut, 12th Chamber; Judgment rendered on 15 April 2021 by the Civil District Judge of Tripoli (Commercial and Financial Affairs); Judgment n° 289/2020 rendered on 1 December 2020 by the Civil Court of First Instance of Beirut, 5th Chamber (Commercial and Financial Affairs); Judgment rendered on 12 November 2020 by the Execution Judge of Beirut; Judgments n° 160/2020 rendered on 14 October 2020 and n° 167/2020 rendered on 28 October 2020 by the Execution Judge of Beirut.

²⁰ Courts would probably take a different position in cases where Articles 432 and 356 of the Code of Commerce are to be applied. Those articles allow respectively the drawer of a banker's check and of a bill of exchange to ask the drawee to pay either only in a foreign currency or only in LBP according to a determined ER. If this condition is not mentioned, the payment will be made in LBP according to the market ER as determined by the Lebanese custom.

²¹ "*When the debt is an amount of money, it must be performed in the currency of the country. In normal time, and when inconvertibility has not been established for fiduciary money, the contracting parties remain free to agree that payment could be made in a specific metallic currency or a foreign currency*". (Our translation). The original French version of the article is to be taken into consideration because its Arabic translation is inaccurate.

and Contracts,²² Articles 7²³ and 192²⁴ of the Code of Money and Credit,²⁵ and Article 767²⁶ of the Penal Code.²⁷ Nevertheless, courts have not always agreed on the issue of ER; although most have applied AER, others²⁸ have applied the SAYRAFA ER.

Unless the Parliament enacts a law that expressly sets a legal ER that should be applied on all different types of contractual monetary obligations, there will always be a risk that courts will settle the disputes relevant to internal contracts pending before them according to AER. But in all cases, most of the courts will always consider the payment in LBP of a contractual monetary obligation denominated in US dollar to be valid: the lender whose debt is 1,000 US dollar for instance will receive the amount of 15,000,000 LBP, instead of an amount that could exceed 100,000,000 LBP because courts might apply AER i.e., LBP 15,000 per US dollar instead of OMER that exceeds LBP 100,000 per US dollar.

Add to all of this, that over the previous five years, Lebanese judges have gone on strike five times to press for the approval of the "*judiciary independence law*" and the improvement of bad working conditions. In the meanwhile, the judiciary assistants went on strike many times, demanding better pay conditions²⁹. Thus far, and as a result of the current national economic crisis, the wheels of justice are likely to turn considerably slowly

²² Law dated on 9 mars 1932.

²³ "*Banknotes of a value of 500 pounds and over shall be unlimited legal tender throughout the Lebanese territory*".

²⁴ "*Refusal to accept Lebanese money within the framework of conditions laid down in articles 7 and 8 is subject to penalties listed in article 319 of the Penal Code*".

²⁵ Decree n° 13513 of 8 January 1961.

²⁶ "*The person who refuses to accept national currency shall be liable to a fine that ranges between 1000 and 10000 LBP*".

²⁷ Decree-Law n° 340/1943.

²⁸ Judgment n° 62/2021 rendered on 26 October 2021 by the Civil District Judge in Beirut (commercial affairs); Judgment n° 611/2021 rendered on 26 October 2021 by the Court of Appeal of Beirut, 9th chamber; Judgment n° 24/2022 rendered on 22 February 2022 by the Court of First Instance of Beirut (financial affairs); Judgment rendered on 28 April 2022 by the president of the Court of Appeal of Beirut, 12th chamber (this judgment refutes the opinion of professor Hage-Chahine previously referred to in footnote n° 12), Judgment n° 427/2022 rendered on the 6th of September 2022 by the Court of Appeal of Beirut, 11th chamber (rent affairs).

²⁹ In this regard, it is worth mentioning that only 0.5 percent of the annual spending of the Government is dedicated to the Ministry of Justice. Insufficient funds resulted in an infrastructure that is in a quasi-total collapse (run-down courthouses, power cuts ...).

than usual. This prevents lenders from obtaining quick judicial actions in case they raise cases against borrowers (corporations).

C- Shortage in liquidity in banks

After October 2019, institutional lenders i.e., banks suffered from a severe shortage of liquidity in US dollar which affected their ability to meet their funding requirements and mainly deposit withdrawals. Furthermore, the loss of confidence in the banking sector made it difficult for banks to raise funds in order to lend money to borrowers.

Add to this, if banks may respond to a shortage of liquidity by tightening their lending standards. This would mean that they may require borrowers to have higher credit scores, larger down payments, or other factors that reduce the risk of default. This can make it harder for many corporations to qualify for loans.

D- Decrease in real estate prices

Real estate is essential for lenders to secure their loans. *“The concern of lenders when requiring security is to ensure priority in the repayment of their loans notwithstanding the claims of the general body of creditors who are therefore frequently left in the vulnerable position of picking over the few crumbs (if any) remaining of the corporate cake after satisfaction of secured and preferential creditors³⁰”*.

The continuous decrease in real estate prices which reached 50%-70% had several effects on the credit extended by banks and individuals to corporations:

- 1- When real estate prices decreased, the value of this collateral decreased as well, which increased the risk for the lender. This resulted in lenders requiring high down payments or even refusing to extend credit.
- 2- If the value of the collateral (real estate) declines below the loan amount, borrowers may be more likely to default on their loan, as they may not be able to sell the property to cover their debt. This can lead to increased losses for the lenders and a decrease in their willingness to lend.

³⁰ E. FERRAN, *Principles of corporate finance law*, Oxford university press, 1st ed., 2008, p. 93.

Thereby, the continuous decrease in real estate prices increased the risk for lenders and led them to reduce credit availability for corporations.

E- High opportunity cost

In December 2021, BDL declared that commercial banks could convert cash LBP into cash US dollar – sourced from the BDL’s foreign currency reserves – using the Sayrafa platform: BDL will sell cash US dollars and buy cash Lebanese pounds at the SYARFA ER. Individuals³¹ are allowed to sell up to one billion cash LBP (for each account) to banks and will be paid within 3 working days in cash US dollar at SAYRAFA ER.

Therefore, individuals prefer to speculate in the currency market. Instead of extending a 1,000 US dollar loan to a corporation and incur the risk of getting reimbursed in LBP at AER and therefore losing 90% of the investment, a potential lender would rather buy 100,000,000 LBP from the open market at OMER (100,000 LBP for every US dollar) and then buy 1,111 US dollar from banks based on SAYARFA ER (90,000 LBP for every US dollar). He would make an immediate 11% profit and hence avoid a high opportunity cost of lending money to corporations³².

F- Risk of money laundering

The current situation is extremely tempting to implement money laundering. In principle, corporations that receive credit in cash should take steps to ensure that the funds are legitimate and not the proceeds of illegal activities. This may involve conducting due diligence on the source of the funds, verifying the identity of the customer, and monitoring transactions for suspicious activity.

Corporations should be cautious when receiving credit in cash because of the potential risk of money laundering which is a criminal activity that involves disguising the

³¹ Companies can sell up to ten billion LBP in cash.

³² The lender can ask numerous owners of bank accounts to execute this operation for his account.

proceeds of illegal activities as legitimate funds (Law No 44 of November 24, 2015 “Fighting Money Laundering and Terrorist Financing³³”).

Suspicious cash credit could therefore incriminate corporations as borrowers involved in money laundering activities, which would discourage them from accepting this type of credit.

II- Credit crunch: interim solutions

Three key measures may be implemented to address certain hurdles to successful corporate finance. To begin, lenders might add specific contractual clauses allowing them to be repaid for loans denominated in US dollars in sums denominated in the same currency without undue delays. Second, the legislature is anticipated to enact laws enabling lenders to be reimbursed in US dollars if their debts are denominated in that currency. Finally, the judiciary is urged to accept "*new checks*" as a means payment to preserve US dollar liquidity in the banking system.

A- Contractual clauses³⁴

Lenders should be keen to avoid as much as possible judgments that could settle disputes with corporations by exonerating the latter if they pay in LBP or in lollar, contractual monetary debts denominated in US dollars. Three sets of contractual clauses allow lenders to achieve their objectives either in whole or in part while avoiding being paid in LBP or in lollar.

³³ Article 2 reads “*Money laundering is any act committed with the purpose of:*

1. *Concealing the real source of illicit funds, or giving, by any means, a false justification regarding the said source, while being aware of the illicit nature of these funds.*
2. *Transferring or transporting funds, or substituting or investing the latter in purchasing movable or immovable assets or in carrying out financial transactions for the purpose of concealing or disguising the such funds’ illicit source, or assisting a person involved in the commission of any of the offences mentioned in Article 1 to avoid prosecution, while being aware of the illicit nature of these funds.”*

³⁴ M. FAWAZ, “Drafting contracts in Lebanon during hyperinflation: preventive clauses”, *Sader Legal*, October 2022. An extensive survey is outlined in this article relevant to the preventive clauses that would allow creditors to avoid the side effects of hyperinflation in Lebanon.

a- The first set of contractual clauses

If the corporation's assets are located in a foreign country and the lender can assume the expenses of foreign court proceedings, the lender in US dollar should include foreign jurisdiction and governing law clauses. If he desires confidential and faster proceedings, he can substitute an arbitration clause for the foreign jurisdiction clause in this case. The rules governing the arbitration should be a foreign law or a-national rules of law. These provisions will eventually result in international judgments or arbitral decisions in which the amount to be paid is denominated in US dollars rather than LBP. Such international judgments and arbitral awards will be enforced against the corporations' assets on foreign land without the assistance of the Lebanese court. Hence, the lender will receive the payment in fresh dollar with no intervention of Lebanese judiciary.

b- The second set of contractual clauses

If the corporation's assets are in Lebanon, the lender in US dollar should include an arbitration clause, a cross-border clause, and a governing law clause in the contract (a foreign law or a-national rules of law or the Lebanese law). In this case, the arbitral award will require a payment in US dollars to be transferred into a foreign bank account. After granting the exequatur, the corporation will be forced to perform the transfer of the amount of fresh dollars to the foreign bank account. In case the lender adds a foreign jurisdiction provision instead of the arbitration clause, the foreign judgment will require the corporation to transfer an amount of money in US dollar to a bank account outside Lebanon. This international judgment will be carried out in Lebanon in the same manner as the previously described arbitral decision, and the lender will get fresh dollars in the foreign bank account.

c- The third set of contractual clauses

If the lender in US dollar cannot afford the expenses of arbitration and foreign judicial proceedings and the borrower does not have assets abroad, there should be inserted a cross-border payment clause. This clause will force the Lebanese judiciary to render

judgments that allow the creditor to be reimbursed by a transfer of the fresh dollar amount to a foreign bank account.

It is worth mentioning a practical case relevant to the importance of cross-border payment clauses. In a meeting held at the Ministry of Justice with key decision makers on 24 March 2022 to discuss the drafting of “*standard form US dollar denominated loan contract*” between the Government and BDL, I suggested -among many other proposals- to amend its article 6 that reads “*the borrower [the government] is bound to reimburse the loan and interests from its income in US dollar (...). The borrower is allowed with the approval of BDL to reimburse in LBP according to SAYRAFA ER*”. My suggestion was to make the reimbursement in US dollar “*in the BDL’s foreign accounts*” and to remove the option of payment in LBP. This suggestion was taken into consideration in article 5 of the loan contract (50 million US dollars) that will be signed by the Central Bank (lender) and the Government (borrower) in accordance with Council of Ministers Decision n° 19 dated on 27/2/2023. Being a cross-border payment clause, the article 5 makes from the loan an international contract which will enable courts to render judgments that oblige the government to reimburse the loan in fresh dollar and not in LBP or in lollar. This contractual provision is crucial to preserve the foreign reserves in foreign currency of BDL.

B- Legislative dollarization

The Beirut Traders Association (BTA) is advocating for a draft law entitled “*encouraging the injection of new liquidity in the economy*”, that would require borrowers to repay loans made in US dollars in the same currency.

The determining grounds of the law focused on the fact that (our translation):

“1- *The liquidity problem, as well as the government's default on Eurobonds in 2020, prompted the central bank to issue multiple temporary instructions in order to deal with the situation, including establishing different exchange rates for the Lebanese Pound against the US dollar*³⁵.

2- *The central bank's interim measures to safeguard monetary stability and the banking sector resulted in multiple legal judgments exonerating debtors by adopting exchange rates for the Lebanese Pound that deviated from the OMER.*

³⁵ This emphasis and the following ones do not exist in the original document.

3- *The financial crisis caused severe and rapid variations in the Lebanese Pound's exchange rate versus the US dollar. The economic cycle was crippled as a consequence of a credit crunch caused by lenders' concern of debt depreciation, whether they were banks or individual merchants.*

4- *Since Lebanon has laws that reflect its free economic system and the free movement of capital.*

5- *Since the dispersed judicial judgments and temporary monetary policies have bred uncertainty, the financial industry has been unwilling to extend new loans in US dollars. The Lebanese banks give loans out of deposits received from their customers; if the loans are in US dollars, the banks must be certain that the loans denominated in US dollars will be returned in US dollars. The economic cycle cannot be stimulated as long as merchants require direct cash payments to prevent exchange rate increases between the date of delivery of products and the date of payment, and as long as they are obliged to recover their debts at a rate smaller than the OMER”.*

The first article of this draft law reads (our translation): *“Notwithstanding any provision to the contrary, the contractual clause stating that any contractual obligation denominated in a recognized foreign currency should be executed in the payment of bank notes in that same foreign currency or by a monetary transfer from outside Lebanon in that same foreign currency is considered valid and binding. Any execution of this obligation does not exonerate the debtor, unless it is made in accordance with the aforementioned contractual clause, including the case where the payment is made in the Lebanese Pound”.*

The second article of his same draft law reads (our translation): *“Article 1 of this law governs obligations arising from bank accounts denominated in a recognized foreign currency and financed in that currency after 9 April 2020, whether in bank notes or through bank transfers from outside Lebanon”.*

If implemented, this law will allow lenders to be compensated in US dollars while avoiding the danger of ERs' volatility, and it will encourage them to make loans in US dollars. Not only that, lenders will avoid the risk of getting paid in checks that could either be either without provision or in lollars. This is a one step ahead towards a cash economy that could on the short term increase the volume of liquidity in circulation and therefore reactivate the business cycle.

The corporations will be able:

- 1- To receive loans in US dollar that could enable them to import equipment and materials from abroad.

- 2- To make sure that their customers will pay back their debts in the currency of the sale/service contracts (US dollar), allowing them to repay their lenders in US dollar.
- 3- To expand their projects with no fear that their collateral (plants, real estate ...) will be seized by their lenders due to the non-payment of debts.

The lender-corporation-customer cycle will be financed in cash US dollars, regenerating wealth on a national level.

C- “*New checks*”

Several judgments considered lately that checks are no more means of payments³⁶. Debtors are allowed to reimburse their debts only in cash. The main focus of all those judgments was on the fact that:

- 1- Banks refuse to pay the check on presentment.
- 2- Banks refuse to deposit checks into the beneficiary's bank account.
- 3- The beneficiary is considered to be legally paid on the day he receives the provision subject matter of the check, not on the day he receives the check itself.
- 4- The beneficiary has the right to receive the provision in cash and he is not obliged to be a bank depositor.

It is apparent that existing jurisprudence is hostile to checks. All checks are no longer accepted. Would this mean that a lollar bank deposit is similar to a fresh dollar bank deposit? Would courts still decline checks even if the relevant bank deposit was made with fresh US dollars (henceforth “*new checks*”)? A careful examination of the aforementioned judgments reveals that courts primarily focus on the fact that checks are no longer payable upon presentation due to banks' significant liquidity deficit. How can a court still deny a

³⁶ Judgment dated on 26/5/2022 rendered by the Court of Appeal of Beirut, 11th chamber; Judgment dated n° 319/2022 dated on 19/6/2022 rendered by the judge of urgent affairs in Beirut; Judgment dated n° 463/2022 dated on 2/8/2022 rendered by the judge of urgent affairs in Beirut; Judgment dated n° 77/2022 dated on 26/5/2022 rendered by the execution judge in Beirut; Judgment dated n° 63/2022 dated on 14/4/2022 rendered by the execution judge in Beirut; Judgment dated n° 64/2022 dated on 14/4/2022 rendered by the execution judge in Beirut; Judgment dated n° 54/2022 dated on 30/11/2021 rendered by the execution judge in Beirut; Judgment dated n° 247/2022 dated on 5/11/2021 rendered by the execution judge in Beirut.

check payment if there is proof that the necessary provision exists "*realistically*" in the account? Refusing new checks will not only be unlawful, but it will deplete the banks' remaining cash.

Given the critical importance of sustaining liquidity in the banking system, courts are urged to accept new checks as payment in order to avoid cash withdrawals from bank accounts, even if only for a limited period of time. Courts may request a bank letter proving that the provision subject matter of the check is made up of fresh dollars rather than lollars.

Accepting new checks will help to preserve the fresh dollar liquidity in the banking sector, encouraging banks to provide corporate loans if the aforementioned procedures are applied.

Conclusion

All the above mentioned measures are only effective for the current transition period. These are quick fixes that enable only for the managing of certain aspects of the financial crisis namely, the credit crunch. However, a macro-level solution is required to restore trust in the Lebanese economy and, as a result, raise the volume of liquidity in the overall market.

Why are those solutions considered as interim? First, while signing an international contract with a cross-border payment clause would preclude payment in lollar or LBP, the enactment of the long-awaited capital control law will prevent corporations from honoring their financial commitments to their lenders, by withdrawing their fresh US dollar' deposits, whether in cash or in new checks. Despite the fact that the present draft of the capital control law stipulates that it only applies to lollars and not to post-2019 US fresh dollar deposits, it is quite probable that it will not pass in parliament since the IMF would not consider it the reform law required to reach the final agreement with the Lebanese government.

Second, the draft law about "*encouraging the injection of new liquidity in the economy*" will only increase the dollarization of the Lebanese economy which will undermine faith in the local currency. After the civil war ended in 1990, there was no clear

response to the question of whether Lebanon should de-dollarize its economy and if he has the resources to do so. At that time the IMF indicated that *“In view of the evidence provided in this paper, should Lebanon try to de-dollarize its economy? And if so, how could such a policy look like? the answer to the first question is of largely political nature. Evidence from other countries can at best be called mixed. And economic literature on this issue offers broad and often contradictory views, with recommendations ranging from aiming at a complete dollarization to a complete de-dollarization of the economy. ... The answer to the second question involves ... an elementary precondition to effectively and sustainably induce a de-dollarization of the economy which is to create a politically and economically stable environment with solid government finances and low inflation rates. All other de-dollarization measures will fail, if this basic precondition is not met, as illustrated by the experience of several Latin American countries with similar episodes of high currency substitution and dollarization³⁷”*. The recent crisis demonstrated that the dollarization of the Lebanese economy was one of its key structural flaws. As a result, any further dollarization would certainly cause stakeholders to lose faith in LBP. Add to that the rush to black markets for US dollars, which will only increase ERs and therefore undermine the Lebanese currency. It seems unlikely that a non-productive economy like Lebanon will ever recover from having a weak domestic currency.

Add to that the fact that payment by bank transfer from outside Lebanon may be prohibited due to international restrictions. In July 2022, I attended a meeting with the delegation of The Middle East & North Africa Financial Action Task Force (MENAFATF) during its last on-site visit to Beirut, and one of the primary subjects discussed was the dramatic increase in cash-based transactions. Lebanon was on the list of complying nations in the last assessment; however, the upcoming evaluation may place Lebanon on the gray or even black list, forcing correspondent banks to suspend business with Lebanese banks.

Many drastic measures need to be made in order to restore trust in the Lebanese economy and thereby restart corporate bank credit. On a macro-level, the two key pillars of any recovery strategy would be to restore creditworthiness and infuse liquidity. Lebanon suffers from high inflation rates and a large public sector and therefore needs the intervention of a lender of last resort i.e., IMF that imposes structural economical changes.

³⁷J. MUELLER, “Dollarization in Lebanon”, October 1994. Available on <https://www.imf.org/en/Publications/WP/Issues/2016/12/30/Dollarization-in-Lebanon-1045>, p. 25, consulted on 31/3/2023.

“Despite the increased criticism of IMF programs in recent years, many still believe that the organization boosts the credibility of borrowing governments in financial markets. It entices capital inflows by acting as an international lender of last resort and by providing liquidity in times of crisis. Investors may retain their investment in a country under an IMF program because they believe that the IMF is in effect insuring that investment. Although critics denounce IMF-backed funding as creating ‘moral hazard’, proponents interpret such externally induced confidence as desirable. They argue that the insurance against liquidity risks provided by the IMF defends the financial systems of fledgling economies from speculative attacks and encourages them to implement reform policies. The IMF further helps to coordinate the expectations of other official lenders, who extend their financial support to borrowing countries when an IMF program is agreed upon³⁸”.

Three additional laws should be enacted namely, *“addressing the situation of banks in Lebanon and their reorganization”*, *“restoring balance to the financial system in Lebanon”* and *“the sovereign fund³⁹”* that are currently being discussed at the parliamentary committees⁴⁰.

Until macro-level reforms are adopted, which is an unheard-of scenario in the country of procrastination, the measures detailed in this paper might help corporations to get the necessary capital to overcome the existing impediments.

³⁸ H. JEE CHO, “Impact of IMF Programs on Perceived Creditworthiness of Emerging Market Countries: Is There a “Nixon-Goes-to-China” Effect?” *The Hong Kong University of Science and Technology, International Studies Quarterly* (2014) 58, 308–321, p. 310. Available on <<https://academic.oup.com/isq/article/58/2/308/1789417>>, consulted on 31/3/2023.

³⁹ Providing that the oil and gas revenues will flow as soon as Lebanon can start selling futures on it.

⁴⁰ The legal consultation delivered n° 713/2022 dated on 1/12/2022 by the Department of legislation and consultations at the Ministry of Justice tackles those two draft laws and provides several observations of their content.

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