

Client Alert: Legal Business Issues raised by the Devaluation of the Egyptian Pound

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Introduction

In a bold step, on 3rd November 2016 the Central Bank of Egypt announced to float the Egyptian Pound (EGP). Before, the exchange rate to the US Dollar (USD) had been tightly managed in order to maintain a stable exchange rate, in the absence of a formal dollar-peg. The liberalization of the exchange rate regime was driven by the hope to revive economic activity and attract foreign investment. The background was a protracted shortage of foreign currency in the local market that was increasingly suffocating economic activity. Moreover, the International Monetary Fund (IMF) had recommended to make the Egyptian currency “more flexible”.

Following the floatation, the exchange rate rose within a few days from EGP 8.8 to the USD to around 16 to the EGP. At present, the exchange rate is around 17.2 to the USD – a very significant devaluation in a short period of time.

Although the devaluation of the EGP may only be temporary, in at least the present term, it has created significant challenges for foreign companies doing business in Egypt. This is particularly true for foreign contractors who are taking on significant costs outside of Egypt and are performing contracts within Egypt. Article 111 (4) of the Egyptian Central Bank Law establishes the principle that all local transactions must be settled in local currency. This means that unless one of the (narrowly defined) exemptions applies, also a contract between the local subsidiary of an international company and an Egyptian contract partner must be discharged in EGP.

Adjustment of Commercial Contracts?

A party adversely affected by the devaluation has limited options to seek protection under Egyptian law.

The Egyptian Civil Code deals with the adjustment of a contract due to changed circumstances (“*imprévision*”) in Article 147 (2) in general and in Article 658 (4) in relation to contracts of work in particular. Both provisions permit the judge to amend a contract in order to restore the contractual equilibrium in the event unexpected circumstances have distorted the economic balance of the contract in a way that one party is threatened with a significant economic loss.

The application to contracts after the devaluation of the EGP will always depend on the concrete case in question. Key issues include:

- There was talk of a devaluation of the EGP latest since the beginning of 2016. This means that the devaluation was not necessarily unexpected.

- The devaluation of the EGP does not directly affect the buying power of the EGP when used inside Egypt. This raises the question as to whether the devaluation actually distorts the equilibrium of the contract. Rather, it can be argued that for a local transaction one must look at inflation, not at the exchange rate.
- The currency and inflation risk normally is a risk borne by the creditor. Only in exceptional instances a devaluation of the currency can justify an amendment of the contract.

Whether or not there is room to invoke doctrine of changed circumstances must be discussed based on the circumstances of each individual case. It further must be noted that a party seeking an amendment of an existing contract must apply for a respective court order. There is no possibility to amend a contract unilaterally.

The devaluation does not create any right of a party to withhold performance.

Contract Drafting

The volatility of the EGP should also be considered when drafting commercial agreements.

- Where a contract has an “international component”, the contract price can – in exception from the general rule – be expressed (partially) in foreign currency (Article 42 b of the Executive Regulation of the Central Bank Law). Setting the debt in EUR or USD is a way to avoid taking on EGP currency risk and protect the interests of a foreign contractor incurring most costs outside of Egypt. The contract price often would be split in a foreign (EUR or USD) and local (EGP) portion.
- To the extent an obligation must be settled in EGP, it is recommendable to provide for a contractual USD or EUR range that allows for adjustment if the exchange rate fluctuates beyond that peg. Under such a clause, the contract price is expressed in USD or EUR and converted into EGP (at the official exchange rate) on the day of payment, subject to the contractually agreed exchange rate.

In addition, any debts should be collected swiftly in order to avoid losses based on a devaluation of the currency.

If you would like more information about this topic then please contact us.

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