



NEW UAE BANKRUPTCY LAW: WHAT DOES ONE NEED TO KNOW

A new bankruptcy regime has been introduced in the UAE with the issuance on 29th December 2016 of Federal Decree Law No. (9) of 2016 concerning Bankruptcy (the “New Bankruptcy Law”) 2016.

1. Why a need for a new law?

- Because of the lack of stand-alone law for bankruptcy until now. The previous regime was governed by the bankruptcy provisions of the UAE Commercial Code, which are now repealed;
- Because the previous regime contemplated court-driven and creditor-friendly insolvency procedures, which prioritized the realization of assets to satisfy the claims of creditors, as opposed to preventive assistance to debtors in financial difficulties;
- Because the previous regime was flawed – as evidenced by the poor number of cases brought before the UAE courts and the low recovery rates.

2. Overview of the New Bankruptcy Law

Although still court-driven, the New Bankruptcy Law aspires to be much more practical. Inspired by European (France, Germany and the Netherlands) and Japanese practices, it modernizes restructuring and insolvency procedures in the UAE. The New Bankruptcy Law seeks to promote a “rescue culture” by setting out a process of “preventive composition” (for financial situations not yet amounting to insolvency) and a “restructuring scheme” (for bankruptcy procedures). Additionally, it sets forth solutions to avoid bankruptcy, e.g.: financial reorganization, pre-emptive settlement, financial restructuring and raising new funds. It also foresees that both debtors and creditors, under certain conditions, may file petitions for bankruptcy.

3. Key changes

Businesses in financial difficulty (now) have options:

Protective composition procedure (the “PCP”)

A rescue scheme for businesses in financial difficulty but not yet insolvent, or in a state of over indebtedness, or cessation of payments for less than 30 consecutive business days. It cannot be applied for if bankruptcy proceedings have already started.

The PCP must be implemented within 3 years of court approval, extendable for a further 3 years upon creditors’ approval. Upon implementation of the scheme, a court-appointed expert shall report the financial condition of the debtor and assess whether the same qualifies for PCP and whether the debtor has enough funds to cover the costs of the process. Then – to prevent additional claims against the debtor – a moratorium will apply and the creditors shall file proof of claim within the allotted timeframe. With the guidance of the officeholder, the debtor shall conceive a restructuring plan, subject to the authorization of the court and a vote in favour of the plan from the majority of the creditors (holding at least 2/3 of the outstanding debt).

Insolvency with restructuring

A “rescue within bankruptcy” type of scheme. The court deems the debtor capable of being rescued despite his insolvency. It is similar to the PCP as it requires the same voting threshold but it is implemented for a longer period (5 years extendable to a further 3 years).

Insolvency and liquidation

The last option, implemented whenever the two first options are not conceivable (where the debtor does not qualify or has already completed one or the other), or in situations where the debtor acts in bad faith to be released from financial obligations. In this case, the court will order the liquidation of the company.

Higher standard of corporate governance

The New Bankruptcy Law encourages higher standard of corporate governance, subject to application of penalty should the company fail to maintain sufficient commercial records. Importance shall be given to the (i) residence of the company’s directors; (ii) location of the board and shareholder’s meetings; and (iii) expertise, quorum and frequency of the company’s board meetings. Further details on corporate governance may be found in our factsheet *Post-licensing requirements for New Businesses in the UAE*.

New balance sheet test

To supplement the existing cash-flow test to assess the company’s assets ability to cover liabilities.

Cash flow test: from a creditor’s perspective, AED 100,000 worth of ordinary debts is the new threshold required for creditors to be able to initiate bankruptcy proceedings.

Balance sheet test: this can only be invoked by the over-indebted trader or a regulator, if any. It only applies to due and payable debts as opposed to the prospective liabilities.

Financial Restructuring Committee

Formed by a Cabinet Resolution under the authority of the Ministry of Finance. It will maintain an approved list of insolvency experts along with a register of insolvencies.

Extension of insolvency procedures

To a wider class of persons: it now applies to companies governed by the New Commercial Company Law and traders as per the Commercial code definition.

Preferential claims

Debts have to be paid by order as follows: (i) those due to secured creditors; (ii) costs and expenses involved in the liquidation process; (iii) those due to employees (statutory rights); (iv) judgment debts; (v) amounts due to governmental bodies; (vi) fees, costs and expenses which arise in connection with the provision of goods and services to continue the business of the debtor after proceedings have been initiated.

Decriminalization

The failure to file for bankruptcy (“bankruptcy by default”) within 30 days of incapacity to pay due debts may now only result in a disqualification order against the debtor. Additionally, although criminal liability may still be engaged for bounced cheques, proceedings will now be stayed once a PCP or restructuring scheme is commenced.

Along with companies expressly governed by the New Commercial Company Law, the New Bankruptcy Law also applies to most Free Zone companies, sole establishments,



and civil companies conducting professional business. Government-owned companies not established under the New Commercial Company Law may choose to be governed by the New Bankruptcy Law subject to the inclusion of an express provision in their constitutional documents.

Federal Law No. (2) of 2015 on Commercial Companies (the “New CCL”). Please refer to our factsheet on the New CCL to have a detailed insight of the key changes.

Applicable offences

May be subject to imprisonment (up to 2 years):

- (i) granting preference to a creditor over others after the cessation of payment of debts;
- (ii) benefiting certain parties over others;
- (iii) selling the company’s assets at an undervalue – in bad faith and/or aiming at delaying bankruptcy proceedings;
- (iv) undertaking activities non-core to the business while facing financial difficulties;
- (v) disguising a company’s financial situation - fraudulent record keeping, falsified accounting.

The New CCL should be read in conjunction with the New Bankruptcy Law – and vice versa – as they both contain provisions outlining the risks of directors’ and managers’ personal liability for financial loss. Some of these include the general directors duties (duty to exercise standard of care and diligence when performing a managerial role), the LLC manager liability (such as the liability for “gross

error”), and the low recoveries (where the court may order the director to pay a contribution to the company’s debts if the assets cover less than 20% of its liabilities). Along with managers and board directors, individuals involved in corporate decision making may be held liable for the decisions made as well.

Penalties

Under the new regime, sentences can go up to 5 years imprisonment and AED 1,000,000 fine. In line with the UAE’s efforts to promote better practice of corporate governance, a sentence of 1 year imprisonment and/or a fine (up to AED 30,000) will apply to those unable to evidence their financial situation prior to their insolvency.

4. In a nutshell

Directors should take proactive steps and plan ahead their plan of action to address any financial difficulties. Before reaching the bankruptcy stage, a high degree of corporate governance should be maintained and professional advice must be sought at an early stage to minimize liabilities. As stated above, assets should be professionally evaluated to be sold and debtors must refrain from granting preferences.

This factsheet should be read in line with our factsheets on Post-licensing requirements for New Businesses in the UAE and on the New CCL to have a comprehensive overview of the new legal requirements for companies in the UAE.

Who we are

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