



THE UAE BANKRUPTCY LAW

What Every Director and Manager
Needs to Know

The UAE is developing its business law framework and a modern insolvency regime is vital. Bankruptcy law reform holds out the prospect of rescuing stressed businesses and enhancing transparency for unpaid creditors, and it was a necessary step towards enhance the UAE's standing in the 'Ease of Doing Business' global rankings. Business failure is a fact of life in a modern and innovative economy. Therefore, there is a need for a well-developed legal framework for closing businesses which do not succeed; and for treating their creditors fairly.

The UAE Bankruptcy Law (2016) now tackles business insolvency. Previously, the insolvency laws were spread across multiple parts of the UAE statute book, namely the Commercial Transactions Law, the Companies Law and the Penal Code.

This report examines the new Bankruptcy law, the three pathways an insolvent business can take, and important features of this Law of which everyone in business should be aware.

Executive Summary - What does the Bankruptcy Law mean for UAE Business?

- Insolvent businesses are now under a legal duty to file for bankruptcy where they realise they are or have become insolvent – and their directors and managers can be sued by creditors or the company for breach of their own duties under the Commercial Companies Law if they fail to ensure their company files for bankruptcy when it should;
- Insolvent companies can obtain timely protection from the Court against legal claims, including criminal proceedings against their officers for dishonoured cheques.
- Creditors can initiate a bankruptcy application if any debt of AED 100,000 or more is overdue by 30 business days, which may trigger a rapid chain of events, commencing with the appointment of an expert by the Court to review and report to the Court the debtor's overall financial position within a matter of weeks;
- Banks, shareholders and suppliers may all be exposed, in bankruptcy scenarios, to the "claw back" of past receipts and dispositions;
- The advent of VAT will place pressure on the cash flow of businesses in the UAE, as creditors will have to pay 5% VAT on all their invoices, paid or unpaid, and this will incentivise some creditors to use the Bankruptcy Law as a point of leverage against debtors.

Which Businesses are Covered by the UAE Bankruptcy Law?

The law applies to:

- i. Commercial ("*onshore*") companies;
- i. any person (corporate or natural person) deemed a "*trader*" by UAE law;
- ii. civil companies/professionals;
- iii. UAE free zone entities (subject to exceptions, e.g. entities established in financial free zones); and
- iv. arguably, branches of foreign companies registered and operating in the UAE.

Three Pathways for Distressed Businesses

The First Pathway: Preventive Composition

This is a financial rehabilitation process conducted through the Court which can be initiated only by a debtor "*anticipating*" financial difficulties. In theory, the process is not available where a business is not insolvent, only where insolvency is in view. This pre-insolvency pathway is intended to give distressed businesses breathing space and time to reach agreement with its creditors under Court supervision. A Court-appointed trustee must also supervise and assist. Creditors cannot initiate preventive composition proceedings.

Once the application to begin the preventive composition process is granted by the Court, all legal proceedings against the debtor are suspended. This can include criminal proceedings against signatories of dishonoured cheques issued on behalf of the business. The debtor's management still retains day to day control of the business, but with the Court appointed trustee's oversight.

Under this process, the trustee, the debtor and the creditors work together to develop a composition scheme. If accepted by the creditors and approved by the Court, the scheme will be binding on all creditors.

Unsecured creditors can vote on any composition plan in one class (although creditors can be divided into committees for the purpose of consultation). Approval of the plan requires the support of a majority in number of creditors representing at least two-thirds in value of all admitted unsecured debts (rather than a majority based on creditors present and voting) and also approval by the Court.

Strict deadlines are imposed by the Law for stages in the process. The plan must be implemented within three years (extendable to six years). The debtor can, with Court approval, obtain new finance as part of this process which would carry priority over existing debt.

The Second Pathway: Restructuring

Restructuring begins as a bankruptcy application based upon insolvency. The application can be brought before the Court by the debtor itself or by any creditor with a debt of AED 100,000 or more which has been overdue by 30 business days (i.e. 6 calendar weeks) or more; and for which formal written demand has been made.

In the case of creditor requests, unless there is a dispute over any debt relied on by the requesting creditor (or the debt is paid or settled at any early stage), the Court would be expected to appoint an expert to report to the Court on the solvency of the debtor within only 10 business days; and recommend whether restructuring is viable or whether liquidation is more appropriate. The Court is then expected to make a determination within a further 5 business days.

There is a provision in the law which enables UAE '*regulators*' to apply for the bankruptcy of companies under their supervision, but the scope of this power remains undefined.

Restructuring is a rescue procedure under which the control of the debtor passes to a Court-appointed trustee. The trustee negotiates, on behalf of the debtor, a restructuring plan which must be voted on by unsecured creditors, then approved by the Court. A moratorium applies to any legal proceedings against the debtor (which extends to criminal proceedings relating to dishonoured cheques) and secured creditors require Court permission to foreclosure on their secured property during the restructure period. Strict deadlines are imposed and the plan must be approved by creditors representing at least two-thirds in value of all admitted unsecured debts.

The Third Pathway: Liquidation

If restructuring is judged by the Court to lack viability, the Court appoints a trustee who must proceed to liquidate the business and assets.

Key Provisions in the Bankruptcy Law

Order of priorities in liquidation and bankruptcy

The provisions on the ranking of creditors, as set out in Article 185 and 189 of the Bankruptcy Law, contain some ambiguities. However, in our view the order of priorities is as follows:

1. Court and insolvency trustee fees;
2. Government taxes, employees, family alimony;
3. Repayment of any new unsecured funds advanced on a superiority basis as approved by the Court;
4. Secured creditors (to be realised value of the secured assets); and
5. Unsecured creditors.

Directors' liabilities

Article 144 of the Bankruptcy Law empowers the Court, in circumstances where the directors of a company are found responsible for the losses of a company and the company's assets are insufficient to pay 20% of the company's debts, to oblige all or some of the directors to pay all or part of the company's debts.

Articles 198 and 201 of the Bankruptcy Law introduce a range of new criminal offences for directors and managers of bankrupt companies, including concealing assets, making false statements to the Court or creditors failing to keep adequate business records, preferring some creditors over others and inappropriately disposing of or dissipating assets.

The commencement of formal bankruptcy processes can relieve directors from ongoing and future responsibility because control shifts to a Court-appointed trustee. The other side of this equation is the new potential liability of directors, where they neglect to initiate formal Court processes when their company becomes insolvent.

Claw- back Provisions in the law

With respect to antecedent transactions and dealings by a debtor, the Bankruptcy law includes:

- a two year "look back" period (from the date of initiating procedures) conferring jurisdiction on the Court to set aside and reverse past transactions and payments in favour of debtor's bankrupt estate;
- transactions will be exposed to "claw-back" where:
 - the disposition of property or moneys was detrimental to creditors or preferred one over the other;
 - the recipient or counterparty was, or should have been, aware at the time that the debtor was unable to pay its debts;
- examples of exposed transactions include dividends, early loan repayments or sales of assets at an undervalue.
- Defences are available, namely:
 - the debtor made the disposition in good faith and in the ordinary course of its business; and
 - at that time, there were grounds for the debtor believing that the relevant transaction would benefit the debtor's business.

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