RIAA Barker Gillette

Insolvency and restructuring law and practice in the UAE

Overview

What is the principal current legislation relating to insolvency in the UAE?

The present insolvency framework is contained in the UAE Commercial Transactions Law (Federal Law No.18 of 1993) ("Law No. 18"). The UAE Commercial Companies Law (Federal Law No.8 of 1984) ("Law No. 8") lays down the procedure for the dissolution of a company. The UAE Civil Code also provides for limited provisions covering individuals who become insolvent. This note does not address the insolvency laws of the Dubai International Financial Centre. The DIFC insolvency regime is primarily contained in DIFC Insolvency Law (No. 3 of 2009), the DIFC Insolvency Regulations and the DIFC Preferential Creditor's Regulations.

What is the importance of insolvency and restructuring laws in the UAE market?

As a general premise, insolvency law should be able to protect the interests of creditors by efficient allocation of resources in a cost effective manner, whilst balancing the debtor's interests by helping in the restructuring and/or reorganization of a debtor's business, where possible. Jurisdictions where the insolvency laws are better developed typically attract investments and credit flows, as they are efficiently able to preserve and protect the rights of various stakeholders.

The insolvency and restructuring legal systems in the UAE are what might be described as "evolving". It would be fair to say that certain of the laws that were drafted many years ago now need to be extensively updated to keep up with the rapid pace of development of the markets, legal structures and increasingly complex and esoteric financial products. The current laws can be opaque and difficult to interpret and very often, simply do not address or provide guidance as to how to deal, in practice, with the legal or practical issues that arise when a debtor (particularly corporate entities) finds itself in financial difficulties.

In the absence of clear and well-developed laws, the problems faced by debtors, creditors, their lawyers and other professional advisers are compounded by the fact that many of the projects and transactions undertaken in the UAE and indeed, broader Middle East and North Africa market, are increasingly very large, complex and often funded on a multi-source and multi-tranche basis and are cross-border in nature – at least, in so far as they typically involve participants from multiple jurisdictions. The process of trying to put together the deals in the first place often pales in comparison to the complexity of trying to unravel, restructure or "repair" the deal when it goes wrong or borrowers are unable to meet their contractual or other obligations, as one grapples with the application and interpretation of intertwined systems of law or what lawyers refer to as "conflicts of law". Most large financings will involve core documentation governed by English (or sometimes New York) law but guarantees and collateral will be governed by local law and, in some instances, that structure will also be wrapped or overlaid by the need to observe and comply with the principles of the Islamic Shari'ah.

What are the main features of the present insolvency system in the UAE?

Applicability

The present Law No. 18 has limited applicability and covers only specific debtors, and does not envisage or address the situation of an individual who becomes bankrupt.

Procedure

It is a slow and often bureaucratic regime heavily dependent on court procedure and gives very little room to the debtor to state its case. The regime is outdated in that it provides for winding up of the bankrupt companies without providing much room for reorganization and restructuring.

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The law does provide for Protective Composition to protect the debtor's business and prevent bankruptcy proceedings, however it does not apply to joint stock companies and companies in liquidation. Moreover, before the court's approval for such a composition can be obtained, it needs to be approved by a majority of its creditors holding at least two-thirds of its debts; and any creditor not attending the meeting will be considered as dissenting to the composition arrangement being voted upon.

Criminal liability

Another big drawback of the present regime is the criminal liability potentially attracted under the provisions of penal law.

If a debtor fails to repay its creditor(s), there is only a window of thirty days for that debtor to come under the court's umbrella and file for bankruptcy. Beyond this period of thirty days, the debtor would be committing an act of negligent bankruptcy by default, and it is criminally liable under the provisions of the UAE Penal Code. UAE Penal Code imposes a fine and imprisonment for issuing dishonoured cheques (although changes to this policy have been considered by the UAE authorities in relation to specific circumstances).

The criminal colour given to the insolvency regime deters debtors from having recourse to the insolvency process and many of them (mainly foreign nationals) instead leave the country to prevent themselves from being subjected to imprisonment.

How has the insolvency and restructuring market evolved in the UAE?

The "market" in the UAE and indeed, the wider GCC is, in reality, one, in the context of obligations in default and borrowers in financial hard straits, historically more focused on and active in the restructuring, rescheduling and workout arena. The occurrence of significant true insolvencies – i.e. receivership, administration or liquidation (or local equivalents) – is actually quite rare or, at least, not something which tends to be regularly in the public eye.

The successive shocks of the global financial crisis, the ensuing liquidity crunch and then the bursting of what had become a real estate bubble, left many UAE based companies (some of which are very significant entities) wrestling with debt mountains and multiple obligations to multiple creditors which, ultimately, they were unable to service.

Nevertheless, in the vast majority of cases, those debtors have been able to put in place initial standstill arrangements and then, by way of often tortuous but largely consensual processes, to agree various means by which those obligations could be restructured, deferred, be the subject of "haircuts", be re-collateralized and/or otherwise put back on a footing, designed to achieve a hopefully, substantial pay-out to creditors.

However, the journey along that restructuring path has led to frequent and vocal criticism of the local laws, particularly the opaqueness, paucity and lack of fitness for purpose in a 21st century business environment, of the UAE's insolvency law.

Hence, in many respects, the real evolution of insolvency law in the UAE is only just beginning. That process has been driven by a realization that an improved legal regime and greater certainty of the application of that law, will be of benefit to both creditors and debtors.

What will be the potential impact of the UAE's proposed new insolvency law?

The UAE's proposed new insolvency law is in draft form and is expected to be issued soon. The new law is intended:

- to be less draconian than the existing legislation;
- to move away from the perceived stigma attaching to businesses or individuals that get into financial difficulties;
- to provide new and quicker reorganization and rehabilitation processes, which will be implemented and overseen not by the "slow-moving" courts but by an independent commission; and
- ultimately, to be more "debtor friendly".

Applicability

The new law will apply to any entity established under the UAE Commercial Companies Law and any person practicing business activity for profit. The law will however, not apply to government entities or entities incorporated in the free zones.

Procedure

Bankruptcy proceedings shall be instituted if (a) a debtor fails to pay his debts; or (ii) if the debtor's liabilities exceed its assets.

A Financial Restructuring and Bankruptcy Committee has been proposed to be established, which will take care of financial reorganizations procedure and also maintain a list of insolvency experts to help in the speedier implementation of the law.

Two streamlined procedures namely:

(i) Financial Reorganization; and
(ii) Protective Composition have been incorporated.

Financial Reorganization is an out-of-court reorganization process proposed to be available to those commercial debtors who are at the brink of insolvency but not yet insolvent. The Financial Restructuring and Bankruptcy Committee will assign an assistant or an expert to assist the debtor and creditors to come to a viable settlement. This approach may help those debtors who could still be pulled out of their insolvency without entailing a winding up procedure.

Under Protective Composition process, a moratorium on legal proceedings where the court may order the rescheduling of a debtor's liabilities and the proceedings may be initiated by a court, a debtor or a concerned party. A formal insolvency proceeding could lead to a rescue procedure or a liquidation of the debtor's business.

Comments

As to the new processes for "Financial Reorganization" (for companies in difficulty but not insolvent) and "protective composition" (allowing debtors to reach a compromise avoiding formal insolvency), they have clear parallels and similarities with a number of Western concepts such as administration in the UK and Europe and Chapter 11 of the US Bankruptcy Code.

On the one hand, it seems sensible that companies which have genuinely viable and inherently good quality businesses should not be driven into insolvency, by what may be relatively short term financial difficulties or market "shocks". Indeed, many of the companies in the UAE that did default or came near to defaulting in recent years, had good quality assets in their portfolios. However, in many instances (for example with real estate or private equity holdings) those assets were either illiquid or simply not producing sufficient income in a bear market.

Fire sales of those assets

Whether agreed or on enforcement and even if possible - would likely have achieved very poor levels of realisation, thus ultimately producing a result favouring neither the debtor seller, nor its creditors.

A managed process to allow breathing space to such debtors and in which their obligations are either temporarily suspended (e.g. through a statutory moratorium) and/or deferred or rescheduled, will hopefully allow such businesses to get back on an even and financially healthy footing and mean they can eventually repay all (or substantially all) of their borrowings.

However, and particularly from the banks' perspective, care needs to be taken not to allow the pendulum to swing too far in the favour of debtors. Management must take ultimate responsibility for its stewardship of a business. The US, in particular has seen companies bounce in and out of Chapter 11, sometimes on multiple occasions.

A sensible balance must be drawn between saving "good" businesses that may be affected by macro-economic factors outside stakeholders' control and providing banks and other institutions that provide credit with proper and effective recourse, in default situations.

That means not only having clear and workable insolvency laws and regulations but also having a system of civil and commercial law generally which is transparent and comprehensive and in particular, a robust system within which collateral can be obtained, registered or otherwise perfected and when necessary, effectively enforced.

Criminal liability

Though the new law is aimed at addressing most of the ills, some areas still remain difficult to tackle, especially the criminalization of dishonoured cheques (as noted above, policy changes have been considered by the UAE authorities in relation to specific circumstances). Also, the window of thirty days for a debtor to approach the courts to file bankruptcy is proposed to be extended to forty-five days.

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