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Insight

The UAE's New Bankruptcy Law – A Bankable Solution?

Insolvency and Restructuring

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Introduction

The new UAE bankruptcy law (Federal Law No. 9 of 2016) (the "New Bankruptcy Law") was published on 29 September 2016 and came into effect on 29 December 2016. Although it is still too early to assess the practical effects of the new law, there is general consensus amongst industry practitioners that the new law is a welcome development and is likely to have far reaching effects on the way business is conducted in the UAE.

The New Bankruptcy Law repeals and replaces the bankruptcy and restructuring provisions set out in Chapter V of the Commercial Code (Federal Law No. 18 of 1993) (the "Commercial Code"), bringing about a number of material changes from the previous law.

Wider Application

The New Bankruptcy Law specifically applies to all entities governed by the UAE Commercial Companies Law (Federal Law No. 2 of 2015) (the "**Companies Law**") as well as free zone companies, excluding those in the Dubai International Financial Centre and Abu Dhabi Global Market. The New Bankruptcy Law also applies to licensed civil companies engaged in professional activities, which were previously excluded from the bankruptcy provisions under the Commercial Code. In addition, the New Bankruptcy Law will apply to government owned companies that are not incorporated under the Companies Law provided they are subject to the new law under their founding statutes or constitutive documents. The extent to which the Federal and Emirate level governments propose to amend existing legislation to bring such companies under the New Bankruptcy Law remains to be seen. Such a move would signal to the wider market the government's commitment to, and faith in, the new legal regime. The New Bankruptcy Law, like its predecessor, also applies to individual owners or sole proprietorships engaged in trading activities.

Protective Composition

A notable feature of the New Bankruptcy Law is the creation of a procedure for protective composition under supervision of a financial restructuring committee (the "**FRC**"). The FRC is constituted primarily as a supervisory body whose main purpose is to manage the restructuring process of debtors. The FRC is also tasked with maintaining a register of approved insolvency experts and a list of entities which are restructured pursuant to the New Bankruptcy Law.

The protective composition process may be initiated by a debtor by submission to the court of a shareholders' resolution approving the initiation of such process. Protective composition is only available to solvent debtors that have been in default for not more than thirty consecutive working days. Following submission of the application, the court will appoint an expert to determine whether the conditions for commencement of the protective composition process are fulfilled. If so, the court will allow the application and declare a moratorium over creditor actions.

A court appointed officeholder will supervise and monitor the debtor's affairs, with the debtor being allowed to continue to run and manage its business. The protective composition scheme, prepared by the debtor under the officeholder's supervision, must then be reviewed by the court and thereafter approved by at least two-third by value of each class of creditors. Once approved, the scheme binds all creditors, including objecting minority creditors. The New Bankruptcy Law permits a three year period to implement the preventive composition scheme, which can be extended by a further three years subject to approval of at least two-third by value of unpaid creditors.

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Protective composition under the New Bankruptcy Law is primarily a court driven process, and out-of-court restructuring of debts is not provided for or permitted. Although creditors and debtors could still agree, on a voluntary basis, to restructure facilities out of court, this will need to be done outside the protections and procedures available under the New Bankruptcy Law.

Secured creditors may, subject to court approval, continue to enforce security and in such case, would not be bound by the protective composition process. Where secured creditors are permitted to enforce security, there may be little incentive for unsecured creditors to agree to a protective composition scheme, where, for example, a large part of the cash producing assets are disposed-off to repay the secured creditors.

Bankruptcy Proceedings

An insolvent company cannot seek protective composition and must file for bankruptcy if it has ceased to pay its debts for a period of more than thirty consecutive working days. One or more creditors may petition the court for bankruptcy of the debtor provided (i) the debtor has failed to pay its debts after having been served a thirty working days' notice; and (ii) the outstanding debt due to the creditors is not less than AED 100,000.

The New Bankruptcy Law allows for restructuring of the insolvent company even after initiation of bankruptcy proceedings if the court determines, on the basis of the report from the court appointed officeholder that the insolvent company is capable of being rescued and the debtor is willing to continue the business. The court may approve the preparation of a restructuring plan for approval by the creditors, or order the liquidation of the insolvent company. A restructuring plan approved within bankruptcy proceedings is allowed a longer implementation period of five years.

Where the court orders the liquidation of the insolvent company, the process set out in the New Bankruptcy Law for winding-up of the company will then be followed. The debtor is discharged, after lapse of a certain time, if applicable, following completion of bankruptcy proceedings.

Additional Provisions

Determination of Insolvency

The New Bankruptcy Law expands the insolvency test to include a balance sheet determination, that is, whether a company's assets exceed its liabilities, in addition to the cash-flow test (that is, the ability of a company to pay its liabilities). This is an improvement on the insolvency test under the Commercial Code, which only recognised the cash-flow test of insolvency.

Removal of Certain Criminal Offenses

Although the new law does not entirely de-criminalise bounced cheques, any criminal proceedings will be stayed if a debtor files for protective composition or bankruptcy under the New Bankruptcy Law. Further, the thirty day limit under the Commercial Code, which made it a criminal offense if a company failed to file for bankruptcy within thirty days of defaulting on its debts, has been removed (although failure to file for bankruptcy in time could subject the managers and directors to disqualification).

Director Liability

A director or manager who has acted fraudulently resulting in the bankruptcy of a company can be subject to a fine of AED 1 million and imprisonment of up to five years. Lower penalties and custodial sentences can be levied on any director or manager for mismanagement or other wrongful conduct resulting in the company's bankruptcy. The government will also maintain a register of disqualified directors, who are disqualified from acting as directors of any entities in the United Arab Emirates.

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