

January 2017

*Practice Group:*  
*Banking & Asset*  
*Finance*

## New UAE Insolvency Law

*By Simon Mabin*

### Executive Summary

The new UAE bankruptcy law was published in the *Official Gazette* dated 29 September 2016 following the issuance of Federal Decree Law No.9 of 2016 on Bankruptcy (the “**Bankruptcy Law**”) and became effective in late December 2016.

The Bankruptcy Law has an increased focus on restructuring and protective composition procedures which suggests that companies will have greater opportunities to instigate protective compositions and work alongside creditors throughout restructuring proceedings. This is in contrast to the previous regime which placed greater emphasis on creditor protections and formal bankruptcy proceedings alongside criminal penalties.

### Highlights

#### *Applicability*

The Bankruptcy Law is wider in application than the previous insolvency regime and applies to all entities subject to the Commercial Companies Law No. 2 of 2015 (the “**Commercial Companies Law**”). The Bankruptcy Law also applies to decree companies whose constitutional documents stipulate that the Bankruptcy Law is to be applicable and free zone entities to the extent that they are not subject to free zone-specific bankruptcy regulations (such as those in the Abu Dhabi Global Market and the Dubai International Financial Centre). The Bankruptcy Law is also applicable to individuals who qualify as traders and civil companies licenced to carry on professional activities.

#### *Financial Reorganisation Committee*

The Bankruptcy Law has introduced a new “Committee of Financial Reorganisation”. This committee will, amongst other tasks, supervise the management of financial reorganisation procedures that appear to be external to the court system with assistance from experts. The committee is to be established by resolution of the UAE Cabinet which will regulate the executive and procedural rules that the committee operates under.

#### *Procedures under the Bankruptcy Law*

The Bankruptcy Law primarily provides three mechanisms to assist businesses in financial difficulty: (i) protective compositions, (ii) restructuring proceedings and (iii) bankruptcy with liquidation proceedings.

##### a. Preventative / Protective Composition:

The protective composition regime aims to assist debtors in financial difficulty that are not yet insolvent. A debtor can apply to the court for an order of protective composition if it is facing financial difficulties with its creditors but has not (i) failed to pay due debts for more than 30 consecutive working days or (ii) become insolvent. It is not permissible for creditors to apply for protective composition on behalf of a debtor.

The debtor must submit supporting documents with its application, including an implementation agenda, alongside a monetary sum or bank guarantee (as determined by the court) to cover the costs and expenses of the protective composition including any fees of an appointed expert. Upon its review of an

## New UAE Insolvency Law

application, the court may decide to take any measures necessary to maintain or manage the debtor's assets. The court will appoint an independent expert to oversee proceedings who can submit a request to the court for the debtor to obtain further funds - which will have priority over any existing unsecured debt - whilst the protective composition is in place to ensure continuity of the debtor's business.

If the court upholds the application, all litigation, judicial and enforcement procedures relating to the debtor's assets will cease, unless the court determines otherwise. The protective composition requires a majority approval from two-thirds by value of the creditors whose debts have been accepted by the court. It is understood that secured creditors do not have voting rights unless they first waive their rights to security. The implementation timetable cannot exceed three years from the date of the court's approval unless further extended with creditor approval.

### b. Restructuring Proceedings:

The bankruptcy procedures under the Bankruptcy Law aim to assist a debtor to restructure its business (if possible) or declare bankruptcy and fairly liquidate any assets to fulfil the debtor's obligations. A debtor that has failed to pay its due debts for more than thirty consecutive working days due to financial difficulties must apply to the court to initiate bankruptcy procedures.

The application process is similar to a protective composition however, creditors with aggregate debt of at least AED100,000 can apply to initiate bankruptcy procedures. Prior to submitting an application, the creditor must warn the debtor to settle any debt within thirty working days. The applicant, whether a debtor or a creditor, must submit to the court a bank guarantee which can be an amount of up to AED20,000. As with the protective composition regime, the court may appoint an expert to opine on the debtor's financial position and the feasibility of restructuring the debtor's business.

The timetable for implementation of the restructuring plan cannot exceed five years from the date of the court's approval but can be extended by a further three years with consent of the majority creditors owning two-thirds of the debt then due. The restructuring plan requires a majority approval from two-thirds by value of the creditors whose debts have been accepted by the court. It is understood that secured creditors do not have voting rights unless they first waive their rights to security.

### c. Bankruptcy with Liquidation:

If a proposed protective composition or restructuring proceedings are not approved by the creditors and/or court, or are terminated, the court can issue an order to wind up a debtor's business and liquidate the assets for distribution to creditors.

The court can reject applications for various reasons including the debtor acting in bad faith, convictions of fraud, robbery, fraud or embezzlement, incomplete supporting documentation in relation to an application or failure to provide a security deposit and/or bank guarantee.

The court will then declare the debtor bankrupt and appoint an independent official to manage bankruptcy proceedings and liquidate any assets. The court official must distribute any proceeds among creditors, taking into consideration any priority rights. If it is evident that liquidation proceeds do not cover 20% of the company's debts, the court may order the members of the board of directors or the managers to pay all or part of the company's debts if they were evidently responsible for the company's losses.

## New UAE Insolvency Law

	Protective Composition	Restructuring Plan
<b>Overview</b>	Debtor-led. Aims to assist a debtor in financial difficulty that is not yet insolvent.	Debtor or Creditor led. Aims to assist a debtor to restructure its business (if possible) or declare bankruptcy and fairly liquidate any assets to fulfil the debtor's obligations.
<b>Requirement</b>	Debtor entitled to apply if facing financial difficulties but not yet insolvent.  A debtor that has failed to pay due debts for more than thirty consecutive working days cannot apply.	A debtor that has ceased to pay due debts for more than thirty consecutive working days due to financial difficulties <u>must</u> apply to the court to initiate bankruptcy procedures.
<b>Who can apply</b>	Debtor only.	Debtor <b>or</b> creditor(s) with aggregate debts of at least AED100,000. Prior to submitting an application the creditor(s) must provide a written warning to the debtor to settle any debt within thirty working days.
<b>Security Deposit</b>	Debtor must submit a monetary sum or bank guarantee (in manner and date determined by the court) to cover the costs and expenses of the protective composition including any fees of an appointed expert.	The applicant (either the debtor or a creditor) must submit to the court a monetary sum or bank guarantee (in manner and date determined by the court) which can be up to AED20,000.
<b>Required Approval<sup>1</sup></b>	Majority approval from two-thirds by value of the creditors whose debts are accepted by the court.	Majority approval from two-thirds by value of the creditors whose debts are accepted by the court.
<b>Timetable for implementation</b>	Cannot exceed three years from the date of the court's approval.	Cannot exceed five years from the date of the court's approval.
<b>Extension</b>	Can extend for a further three years with consent of the majority creditors owning two-thirds of the debt to be paid under the scheme.	Can extend for a further three years with consent of the majority creditors owning two-thirds of the debt to be paid under the restructuring plan.

<sup>1</sup> It is understood that secured creditors do not have voting rights in relation to a proposed protective composition or restructuring plan unless they first waive their rights to security.

## New UAE Insolvency Law

If the protective composition scheme or restructuring plan is not appropriate, terminated or rejected by the creditors/court (see below), the court will declare the debtor's bankruptcy and order the liquidation of any assets and distribution of proceeds to its creditors.



- Rejection reasons include: the debtor acting in bad faith, convictions of fraud, robbery, fraud or embezzlement, incomplete supporting documentation in relation to an application or failure to provide the stipulated security deposit and/or bank guarantee.
- The court will declare the debtor bankrupt and appoint an independent official to manage bankruptcy proceedings and liquidate any assets.
- The court official must distribute any proceeds among creditors, taking into consideration any priority rights.
- If it is evident that liquidation proceeds do not cover 20% of the company's debts, the court may order the members of the board of directors or the managers to pay all or part of the company's debts if they were evidently responsible for the company's losses.
- The Bankruptcy Law contains various offences that are punishable by fines and/or prison sentences such as concealing or destroying records, knowingly acknowledging unpayable debts, applying for protective composition or a restructuring scheme via fraudulent means, causing bankruptcy by gross negligence and otherwise causing harm to creditors by making disposals below market-value or providing special treatment to a particular creditor.

### Conclusion

The new regime can be viewed as a positive step towards encouraging businesses to actively seek assistance in times of financial difficulty by working alongside their creditors with guidance from the courts (if required) by allowing them to manage and structure their businesses in such a manner to realise their full potential in the future.

#### Author:

**Simon Mabin**  
simon.mabin@klgates.com  
+971.4.427.2730

# K&L GATES

Anchorage Austin Beijing Berlin Boston Brisbane Brussels Charleston Charlotte Chicago Dallas Doha Dubai  
Fort Worth Frankfurt Harrisburg Hong Kong Houston London Los Angeles Melbourne Miami Milan Munich Newark New York  
Orange County Palo Alto Paris Perth Pittsburgh Portland Raleigh Research Triangle Park San Francisco São Paulo Seattle  
Seoul Shanghai Singapore Sydney Taipei Tokyo Warsaw Washington, D.C. Wilmington

K&L Gates comprises approximately 2,000 lawyers globally who practice in fully integrated offices located on five continents. The firm represents leading multinational corporations, growth and middle-market companies, capital markets participants and entrepreneurs in every major industry group as well as public sector entities, educational institutions, philanthropic organizations and individuals. For more information about K&L Gates or its locations, practices and registrations, visit [www.klgates.com](http://www.klgates.com).

This publication is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer.

© 2017 K&L Gates LLP. All Rights Reserved.