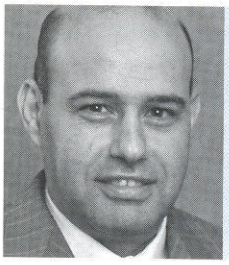
UAE insolvency law exists!



BY MAZEN BOUSTANY
head of banking and finance, Habib Al Mulla & Co

DURING THE BOOM TIMES, DUBAI AND THE UAE seldom experienced insolvency cases, so it became a widespread rumour that the UAE does not have an insolvency law. In addition, it had also been widely speculated that the UAE has a very archaic regime in which debts can lead a debtor to jail.

By opposition to such rumour, an insolvency law does indeed exist and it is shockingly modern in more than one aspect. Looking more deeply at this law might be very useful in the near future, due to the credit and financial crisis that is affecting Dubai and its business sector.

By looking at Federal Law No 18 1993 (Commercial Transactions Law) it is clear that out of 900 articles of which this law is composed, 255 articles are dedicated to insolvency and bankruptcy procedures, which means that almost a third of the Commercial Transactions Law is dedicated to such procedures.[1] This is not bad in a country considered to be without insolvency law.

The provisions apply solely to both individual traders and commercial companies when they have stopped paying their due commercial debts (Articles 645 and 650). The articles are subdivided as follows:

- Articles 645 to 763 are related to insolvency;
- Articles 764 to 799 are related to the arrangement by the court;
- Article 800 relates to small insolvencies;
- Articles 801 to 816 are related to companies insolvency (although Article 801 specifically provides that all above articles are applicable to companies in addition to the articles in this section);
- Article 817 to 830 are related to the rehabilitation of the insolvent individual (such as traders and partners in partnerships);
- Articles 831 to 877 are related to voluntary arrangement; and
- Articles 878 to 900 are related to bankruptcy.

It is clear that this a very comprehensive law with specific procedures. Unfortunately, it remains largely untested and only two judgments are published on the Dubai Courts' website:

1) a Dubai Supreme Court judgment dated 9 September 2008, which provides that a single unpaid commercial debt is enough to provoke the insolvency of a company; and

2) an older, more interesting, judgment by the Dubai Court of Appeal dated 25 May 1998, where the court considered that the insolvency provisions and procedures are of public order since they were meant to promote confidence, and have been put in place to protect the creditors and to safeguard the debtor of good faith).[2]

The above judgment has clearly defined what the UAE insolvency law is all about: protecting the creditors and safeguarding the debtor of good faith.

The different procedures that are outlined in the Commercial Transactions Law are described in the remainder of this article.

BANKRUPTCY

In the event of bankruptcy (whether fraudulent, negligent or gross negligent bankruptcy), the Criminal Court shall be competent and shall sentence the bankrupt trader or manager of a company, or the member of its board or its liquidator, to a prison term that may not exceed five years in the event of fraudulent bankruptcy (Articles 878 and 879). Alternatively, a fine of 20,000 dirhams in the event of a gross negligent bankruptcy (Article 880) and no more than two years of prison or a fine of 10,000 dirhams in the event of negligent bankruptcy (article 881) may be issued.

In addition to the above, Federal Law No 3 1987 (the Criminal Code) contains provisions related to bankruptcy in Articles 417 to 422. Articles 417 to 419 of the Criminal Code are very similar to Articles 878 to 881 of the Commercial Transactions Law, while Article 420 provides:

> 'If a commercial company is bankrupt, its board of directors and managers shall be

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convicted with the sentencing related to fraudulent bankruptcy if it was proven that they have committed any of the acts provided in Article 417 of this Code or assisted in the company ceasing its payment, whether by declaring wrongful facts about its subscribed capital or its paid-up capital, or by publishing wrongful balance sheets or by distributing fictious dividends, or by taking to themselves more than they are entitled to in the company articles of association.'

The discussion in this article does not apply to the member of the board of directors or the manager who proves that they were not involved in the crime or their objection to the resolution that was taken in its respect. It can be deducted from the above provisions that a shareholder of an insolvent company who was not involved in its management may never be considered as bankrupt. The board of directors or managers of a company that never committed any of the actions mentioned above shall never be considered as bankrupt themselves.

INSOLVENCY

Insolvency is covered by Articles 645 to 763, 800 and 801 to 816.

Companies insolvency

Focus shall be made here on the articles more specifically related to companies.

Article 802 provides for the declaration of insolvency of a commercial company when it ceases payment of its commercial debts, due to the disruption of its financial activities.

Article 806 is very interesting, since it entitles the court, *de facto*, or on the request of the company to postpone the declaration of insolvency for a period not exceeding a year, if its financial position is likely to be supported or if the interest of the national economy so requires. The court can order that appropriate measures should be taken for maintaining the assets of the company.

This article is in addition to the provisions related to the arrangement that are discussed later, which gives the company a breath of fresh air, allowing it to arrange itself before being declared insolvent.

Article 809 provides that if the assets of the company are insufficient to satisfy at least 20% of its debts, the court who has declared the insolvency may order the members of the boards of directors, or some or all of the managers, jointly or individually, to pay the debts of the company, in whole or in part, in the cases where they are held responsible, in accordance with the provisions of the Commercial Companies Law (CCL).

The articles in the CCL provide for the liability of the chairman and members of the board of directors towards the company and its shareholders for all acts of fraud and abuse of power, and for any violation to the CCL or the articles of association, or the management violations, and any provisions to the contrary shall be annulled (Article 111 of the CCL).

The liability mentioned in the previous article shall be borne by all the board members if the violation has arisen as a result of a unanimous decision. Otherwise, if the resolution was approved by the majority, the opponents shall be absolved if they prove that they had opposed the resolution in the minutes of a meeting. An absentee may still be liable unless they prove that they were unaware of the resolution or were aware of it without being able to object to it (Article 112 of the CCL).

It is important to remember that Article 237 of the CCL provides that the liability of the manager of a limited liability company is similar to that of the board members and any stipulation to the contrary shall be annulled.

Procedure

The insolvency is declared on the request of the commercial company or on the request of one of its creditors. The court may declare the insolvency on the request of the public prosecution or *ipso facto* (Article 647).

The commercial company may request to be declared insolvent if its financial activities are disrupted and it has ceased paying its debts. Such a request becomes mandatory if 30 days have elapsed since the cessation of payments, otherwise this would be considered a case of negligent bankruptcy (Article 648).

The request shall be submitted within a report explaining the reasons for the cessation of payment and to which shall be attached several documents, such as the accounting books, the last audited financial statements, the profit and loss account, a detailed statement of movable and immovable assets, a statement of the names of the creditors and the debtors, their address, their rights and obligations, and security (Article 648).

In its insolvency judgment the court shall determine a provisional date for the cessation of payment, shall seal the debtors premises and shall appoint a trustee (Article 655).

In all events, the date of cessation of payment may not be deferred back to more than two years prior to the insolvency judgment date (Article 659).

In the insolvency or in a subsequent judgment, the court shall appoint a remunerated attorney to manage the insolvency: the insolvency trustee (Article 668).

The judgment shall be published in the Trade Register and in the Court's Board for 30 days. The trustee shall take care of the publication of the judgment in a daily newspaper, as determined by the court, with all the details pertaining to

the insolvent company and the summon to the creditors to come forward with their debts.

The judgment shall also be published in the name of the Assembly of Creditors at the Land Register within 30 days of the issuance of the judgment (Article 661).

The insolvent shall be prohibited from managing its assets or disposing of them (Article 685).

Article 691 provides that any lawsuit emanating from the insolvent or against them shall be prohibited.

Any activities undertaken by the insolvent that are detrimental to the Assembly of Creditors may be cancelled if the counterparty was aware of the cessation of payment of the insolvent (Article 697).

An Assembly of Creditors shall be created by law on the issuance of the insolvency judgment composed of the insolvent's ascertained creditors. Any holder of mortgage or special privilege shall not be a member of the Assembly of Creditors (Article 703). This is because these secured creditors are at liberty to sue the insolvent individually (in contradiction to Article 691 and 704) and they have preferential rights over the attached assets.[3]

Competent court

As mentioned above, the competent court to oversee the insolvency is the Court of First Instance in whichever jurisdiction the headquarters of the insolvent company is located (Article 653).

In the Dubai Court of Appeal judgment, the insolvency is related to the public order of the state and is therefore closely linked to its judicial system. Any arbitral proceeding should therefore be excluded.

However, Article 747 entitles the insolvency judge, after hearing the supervisor (being the creditors' representative) and the insolvent, to allow the trustee to settle or approve the arbitration in any dispute related to the insolvency, even if related to rights *in rem* (Article 678).

This could mean that the arbitration agreements executed before the launch of the insolvency procedure may still be valid after such a launch. The arbitral tribunal will only be in a position to declare a debt and determine its amount without being able to sentence the debtor to pay.

Nevertheless, providing such a clause in the insolvency law is very innovative of the UAE legislator, considering the public order nature of the UAE insolvency law.

ARRANGEMENT BY THE COURT AND VOLUNTARY ARRANGEMENT

Arrangement by the court

This procedure involves the invitation of the creditors by the insolvency judge to deliberate on the arrangement (Article 764). The creditors may attend personally or through an attorney. However, the insolvent must attend personally (Article 765). It is assumed that in the case of a company, it should be its authorised signatory (ie the manager in an LLC and the chairman of the board or the CEO in a joint-stock company).

The trustee must submit a report to the meeting, related to the insolvency procedure and their opinion about the arrangement. The insolvent shall also be heard (Article 766).

The arrangement shall not be approved unless a majority of creditors, holding two thirds of the debts, agrees. Any creditor not attending the meeting shall be considered as dissenting to the arrangement (Article 767).

The secured creditors are not part of the Assembly of Creditors and shall not be entitled to vote on the arrangement, unless they waive their privileges (Article 769).

However, no arrangement is possible in the event of fraudulent bankruptcy (Article 771), but it is possible in the event of negligent bankruptcy (Article 772).

The arrangement might involve delays for the insolvent to pay its debts or a waiver by the creditors of some parts of the debts (Article 773).

The arrangement shall not be applicable on the secured creditors for the reasons mentioned earlier. Nor on the ordinary creditors where debts have arisen during the insolvency procedure (Article 775).

The arrangement shall remove all effects on the insolvency, without prejudice to any criminal pursuit. The debtor shall be reinstated with all their belongings and effects (Article 777).

This is, when going through the voluntary arrangement, a deficiency in the UAE insolvency law, which has failed to give enough power to the judicial authority, allowing it to take the necessary steps to allow a good company to survive without its failed or dishonest management. Since at the exception of the criminal pursuits that shall *de facto* lead to the insolvency of the company again, no provisions entitled the judicial authority to replace the former management of the company to protect its staff. Indeed, the arrangement shall be dissolved if, after its ratification, the insolvent is condemned with the crime of fraudulent bankruptcy (Article 778).

Voluntary arrangement

46 articles (from Article 831 to Article 877) are related to a voluntary arrangement by the company, with the assistance of a trustee appointed by the court (Articles 843 and 844 of the law). The trustee's role in this procedure is only as formal as

NOTES

1) The word bankruptcy is used to describe fraudulent or criminal insolvency. Insolvency is used to describe the procedure that does not comprise a criminal element.

2) This is understood by the provisions of Article 645 of the Commercial Transactions Law, which provides that any trader that has ceased paying its commercial debts on its due dates may be declared insolvent for the disruption of its financial standing and precariousness of its credit.

3) Article 704 provides that the individual lawsuits and measures taken by ordinary creditors and the holders of general privileges shall be frozen.

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evidenced in Articles 844 and 852, and the trustee will not intervene at all in the management of the company.

The voluntary arrangement may be initiated before or after the launch of the insolvency procedure.

These articles are progressive and protective of the company, provided that the latter submits a comprehensive plan evidencing means to continue operations and secure at least a payment of 50% of its debt within a period not exceeding three years.

Such a voluntary arrangement applies to both secured and unsecured creditors, and thus the secured creditors are bound by the voluntary arrangement and are not at liberty to pursue with their individual lawsuits.

However, as pointed out above, in relation to the arrangement by the court, very little is provided in relation to the management and operation of the company during the voluntary arrangement period. Nothing is provided in relation to the fate of the management of the company, since Article 846 of the law provides that the debtor shall continue to manage its assets and shall perform all regular acts necessary for the management of the business.

In that sense it may be argued that UAE insolvency law is not in tune with modern insolvency laws that have made a distinction between the failed management of a company and its survival, mainly to protect its staff. In other words, in modern legislation, if a company is able to survive, it should do so. However, it should not necessarily survive with the same management that could be subject to civil and criminal sanctions. In this sense the UAE insolvency law does need improvement and evolution.

CONCLUSION

The UAE has a very modern and comprehensive insolvency law, which has unfortunately been unnoticed by the most prominent legal experts, since they ask for its amendment without even having read it.

The main impediment for the application of insolvency law is the security asked by the creditors and mainly post-dated cheques, which if not honored would constitute a crime leading its drawer to jail.

So the creditors, instead of having recourse to the normal insolvency procedure, prefer resorting to a speedier process consisting of filing a criminal complaint for a dishonored cheque, thus avoiding any chance for the company to survive.

Therefore, it is best practice to decriminalise the cheque, and this security may be replaced by other security and further information on the debtors. A credit bureau was envisaged last year by the UAE, which could be the first step towards decriminalising the cheque and towards applying the insolvency law.

By Mazen Boustany,
head of banking and finance, Dubai office,
Habib Al Mulla & Co.
E-mail: mazen.boustany@habibalmulla.com.