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Client Alert Commentary

Latham & Watkins Restructuring & Special Situations 2 July 2019 | Number 2519

New DIFC Insolvency Law: 4 Key Features

Legislation seeks to balance debtor and creditor needs and help businesses and investors operate with confidence in the Middle East.

On 11 June 2019, the Dubai International Financial Centre (DIFC) introduced a new insolvency law (DIFC Insolvency Law No. 1 of 2019 and associated DIFC Insolvency Regulations 2019), which became effective on 13 June.

The DIFC Insolvency Law comes hot on the heels of recent updates to onshore bankruptcy and insolvency legislation in both the United Arab Emirates (UAE) and the Kingdom of Saudi Arabia. The law represents a significant advance in insolvency legislation in the Middle East.

The newly enacted law complements the DIFC's commitment to international best practice and aims to balance all stakeholder needs in distressed and bankruptcy-related situations. Facilitating a more efficient and effective bankruptcy restructuring regime will give leading global institutions the certainty, transparency, and predictability they need to operate across the Gulf Cooperation Council (GCC) region. The recent insolvency law adheres to international trends and best practices (practitioners familiar with the US Chapter 11 regime and English law schemes of arrangement will recognize certain elements). Furthermore, the significant focus on restructuring and rescuing businesses, rather than liquidating companies, places the legislation at the forefront of international debt restructuring innovation.

The DIFC Insolvency Law enhances and supplements the restructuring tools available to debtors and creditors. In particular, the new rehabilitation (debtor-in-possession) and administration processes supplement existing procedures — such as company voluntary arrangements, receiverships, and liquidations — which are retained and/or updated in Parts 2, 5, and 6 of the DIFC Insolvency Law. The four key features of the law are summarised below.

1. Facilitating Cross-Border Coordination

Part 7 of the new DIFC Insolvency Law adopts the UNCITRAL Model Law on Cross-Border Insolvency — the provision encourages cooperation and coordination between multi-jurisdictional insolvency proceedings and aligns with the DIFC's overall goal to achieve recognition as an international business hub. The inclusion should help to ensure a more coordinated and predictable approach to multi-jurisdictional restructurings and insolvencies for the many cross-border businesses in the DIFC.

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2. Introducing a Rehabilitation Regime

Part 3 of the law introduces a "rehabilitation" regime. Under the law, when a company cannot pay its debts — and a reasonable likelihood exists that the company's creditors and shareholders can reach agreement — the debtor can apply for rehabilitation. The company's directors must notify the court in writing that they intend to make a proposal to the creditors under the regime. Rehabilitation allows creditors to vote on a rehabilitation plan proposed by the debtor with a view to restructuring the debtor's business. Rehabilitation benefits include:

- An automatic stay of 120 days from the date the directors notify the court of the intention to propose a rehabilitation plan
- Protections against contractual termination in respect of insolvency clauses and other terms (noting that the court can order relief from the moratorium for specific creditors in limited circumstances)
- Cram-down mechanics — a popular inclusion in other insolvency regimes (but not included in the recent onshore UAE insolvency law) which allows the court to impose a rehabilitation plan on a dissenting minority of creditors notwithstanding those creditors' lack of consent to the plan

The rehabilitation regime requires the company to appoint an insolvency practitioner as a Rehabilitation Nominee. The directors can continue to manage the company (subject to the Administration regime below), but the Rehabilitation Nominee will possess certain company rights and duties. When the directors are ready to present a plan to the creditors and shareholders, the Rehabilitation Nominee must file a statement with the court confirming that the proposed plan is reasonably likely to succeed, that the company has sufficient funds available during the moratorium, and stating whether the debtor plants to convene creditor and shareholder meetings.

The court then invites creditors to consider and support the plan, categorising creditors into different classes to formally vote on the plan. In certain circumstances, the court may determine that the plan does not impair a class, so will not require a vote from that class. The plan requires both 75% of creditors in each class that are present and voting to support the plan, and the approval of the court. After the hearing and creditor vote, the law requires the court to sanction the plan if the court finds all of the following apply:

- The plan complies with the law and the debtor proposed the plan in good faith.
- The arrangement is not unfairly prejudicial to each class of creditors and to the general body of creditors taken as a whole.
- Either (A) all classes of creditors have voted to accept the plan (or have been deemed to accept the plan) or (B) at least one class of creditors which would be impaired by the plan approves it.
- No creditor is worse off than that creditor would have been in a winding-up of the company.
- The holder of any claims junior to any dissenting class will not be paid out any amount before the debtor pays the dissenting class in full.

Therefore, the court has powers to approve the plan in a range of situations — notably if one impaired class has agreed to the plan but other classes have not.

The inclusion of a rehabilitation regime is in line with developments across Europe and in the United Kingdom to introduce regimes similar to Chapter 11, in particular, the European Union and the United Kingdom are currently in consultation to introduce similar laws. The inclusion of such regimes within the laws of a country will help improve the ranking of that country in the World Bank insolvency regime rankings.

In addition, the court can permit new priority funding during the rehabilitation process. This debt can be unsecured or secured, and if so secured, such security can be over previously unsecured assets, on a junior basis to existing security, or on a senior or *pari passu* basis with existing security (the latter only in certain circumstances such that adequate protection for the secured parties exists). The new funding takes priority over other unsecured debt, but the regime ensures protection of existing secured creditors.

3. Appointing Independent Administrators

Part 4 of the DIFC Insolvency Law allows the court to appoint an independent administrator if a debtor files an application for rehabilitation and evidence of misconduct exists.

The appointed administrator, an insolvency practitioner, is authorised to manage the company's affairs, business, and property to facilitate a voluntary arrangement, a rehabilitation plan, or a scheme of arrangement under the Companies Law.

4. Streamlining Winding Up

Part 6 of the DIFC Insolvency Law updates the existing rules and procedures for the winding up of companies — modernising and streamlining the procedures.

Conclusion

Whilst obviously untested, the new DIFC Insolvency Law clearly draws from international best practices and promises to be a useful tool in insolvency and restructuring matters in the DIFC and GCC. Companies can handle cross-border matters can efficiently and more predictably, which will improve market confidence when conducting business in the region. The law's rehabilitation process includes key features from other international regimes (automatic moratoriums, contractual termination protections, and cram-down mechanics), which have proved very popular amongst insolvency and restructuring professionals, to enable a focus on the rehabilitation or rescue of the business rather than a winding up. The new law provides key tools for creditors and debtors and seeks to ensure an appropriate balance between helping debtors seeking to restructure and protecting creditors.

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