

Global Restructuring & Insolvency Guide

United Arab Emirates

Overview

The starting point for advising on issues relating to insolvency in the UAE is to identify the insolvency laws that will apply to the borrower in question. That may in turn depend on where the borrower is located because there are within the UAE a number of designated free zones, certain of which have been exempted from the federal laws of the UAE relating to civil and commercial matters and have developed their own insolvency laws and regulations. The Dubai International Financial Centre is one such free zone which falls within this category (see “Free Zones” below).

Outside of the free zones the federal insolvency laws of the UAE will generally apply. This Guide is concerned primarily with a discussion of those laws. The federal laws provide for bankruptcy, rescue and liquidation procedures. The laws are, to our knowledge, relatively untested: they are inconsistent in certain respects and do not deal with all contingencies. Accordingly, there is a degree of uncertainty as to how the laws would be applied by the local courts in practice. Also, there are a number of provisions which in our view are likely to be of particular concern to creditors. For example, as noted below, following a petition by creditors for a bankruptcy order, the court may postpone making a decision with respect to the company’s bankruptcy for a period of up to one year where the company’s financial position is likely to be supported or if it is in the interests of the national economy for the decision to be postponed.

The above issues, allied with the fact that creditor groups tend to be diverse (often including international banks, local banks, Islamic funders, sukuk holders and trade creditors) and (perhaps) share a cultural preference for privacy in such matters, have militated, so far, against the use of legislative insolvency and restructuring procedures. Informal work-outs have instead been favoured. In the case of major insolvencies, specific state intervention is also possible.

Applicable Legislation

The federal laws of the UAE governing bankruptcy, restructuring and insolvency are set out (primarily) in Federal Law No. 18 of 1993 (the “**Commercial Code**”) and then in Federal Law No.2 of 2015 (the “**Companies Law**”). Certain provisions of Federal Law No. 5 of 1985 (the “**Civil Code**”), Federal Law No. 3 of 1987 (the “**Penal Code**”) and Federal Law No. 11 of 1992 (the “**Civil Procedures Law**”) also apply in relation to bankruptcy. Certain provisions of Federal Law No. 10 of 1980 apply to the liquidation of a bank or financial institution. The new insolvency law is currently in draft form and expected to regulate bankruptcy and liquidation matters in more detail. However, in the absence of the final version of this law, we cannot advise on the definitive position relating to new bankruptcy and insolvency regulation in the UAE.

Liquidation

The Companies Law regulates the dissolution and liquidation of companies. Under UAE law, dissolution is a termination procedure. Liquidation is a radiation procedure for the realisation of a company’s assets and, to the extent possible, the payment of its debts.

A company may be dissolved on any of the following grounds:

- a depletion of the company’s assets rendering the investment of the company’s remaining assets for benefit impossible;
- the expiry of the term of the company as specified in its constitutional documents;
- the fulfilment of the objects of the company as set out in its memorandum of association;

- the amalgamation of the company with another company; and
- a decision of the company's shareholders in accordance with its memorandum of association.

If the losses of a joint stock company amount to half of its share capital or more, the company's board of directors must call a general assembly of the company's shareholders to decide, by special resolution, whether the company should be dissolved. If the board fails to call a general assembly, or if the general assembly is unable to adopt a decision, any interested party may initiate proceedings for the dissolution of the company.

Similarly, if the losses of a limited liability company (the company form most commonly adopted in the UAE in connection with a foreign investment) amount to half of its share capital or more, the managers (directors) must call a general assembly of the partners (shareholders) to decide whether the company should be dissolved. The number of votes required to pass the resolution is the same as the majority specified in the company's constitutional documents for the variation of the company's memorandum. If the losses of the limited liability company equal or exceed three-quarters of its share capital, shareholders holding 25% or more of the company's share capital may initiate the company's dissolution.

The dissolution of a company must be publicly declared by registering it in the Commercial Register and publishing it in two local daily Arabic newspapers. The company will thereafter be considered to be in liquidation and the expression "Under liquidation" must be added to the company's name.

A liquidator is appointed by the company's shareholders acting in general assembly, or where liquidation occurs as a result of a court order by the court. The liquidation will occur in accordance with the Companies Law, although a company's memorandum or articles may specify how the company's liquidation should proceed, or the shareholders may themselves agree on a process for the liquidation of the company's assets.

Once the liquidator is appointed, the powers of the company's board vest in the liquidator. Those powers include the ability to commence or defend legal claims and to take steps necessary for the protection and preservation of the company's assets. The liquidator must complete its duties within the time specified in the document under which the appointment is made or within the time specified by the court.

The liquidator must, following its appointment, ascertain the company's assets and liabilities. The liquidator is also required to collect amounts owed to the company and realise the company's assets for the benefit of the company's creditors. The liquidator will write to known creditors calling for them to submit their claims, and for unknown creditors the notice may be made by publication in two local daily Arabic newspapers. Creditors must submit their claims within 45 days of notice of liquidation being given. If a creditor fails to present a claim or a debt is disputed, the liquidator is required to set aside an amount pending the resolution of the claim or dispute.

If the proceeds of the realisation of the company's assets are insufficient to pay the company's creditors in full, the liquidator pays those creditors ratably according to their claims without prejudice to the rights of priority creditors. The ranking of creditors in a liquidation and bankruptcy is discussed below.

Any proceeds remaining after the payment of creditors will be distributed among the company's shareholders ratably according to their shareholding in the company. Upon the completion of the liquidation process, the liquidator must submit a final account to the shareholders in general assembly, and upon ratification of that final account the liquidation will cease and the liquidation will be noted on the Commercial Register. The company will then be struck off the Commercial Register.

Bankruptcy

Bankruptcy is an insolvency procedure which may apply to a "trader". Under UAE law, a trader includes:

- an individual engaged in commercial activities in his own name and for his own account; and

- every company which undertakes a commercial activity or has adopted one of the forms available under the Companies Law.

The forms of corporate personality available under the Companies Law include:

- joint liability companies;
- limited partnerships;
- public joint stock companies;
- private joint stock companies; and
- limited liability companies.

Circumstances in which a Trader may be Declared Bankrupt

Any trader who has suspended payment of its commercial debts due to its financial position or poor credit may be declared bankrupt. A trader which adopts abnormal or illegal commercial practices indicating poor financial condition shall be deemed to have suspended payment.

Bankruptcy is declared by a court judgment. It may be declared at the initiative of a trader or following a petition by its creditors. A trader must petition for bankruptcy within 30 days of suspending the payment of its commercial debts. If the trader does not do so, the trader (directors) may be guilty of the criminal offence of bankruptcy by negligence. A creditor may petition for bankruptcy in respect of a debt which has become due, or in respect of moneys owing which are not yet due or which are contingently owing where the trader has fled the UAE. However, in each case the creditor must establish that the trader has suspended payment of its commercial debt, i.e. it appears that non-payment of the creditor itself may not be enough, although (depending on the unpaid amount in question) that may go some way towards evidencing a suspension of payment by the trader.

A court may, either of its own accord or as requested by the company, postpone making a decision with respect to the trader company's bankruptcy for a period of up to one year, if the company's financial position is likely to be supported or if it is in the interests of the national economy for the decision to be postponed. If such an order is made, the court is required to make orders necessary to ensure that the assets of the company are maintained during the intervening period.

Bankruptcy Procedure

The court may, following a petition for the bankruptcy of a trader, make orders necessary to protect the assets of the trader. The court may appoint an expert to determine the trader's financial position and to investigate whether the trader has suspended the payment of its debts and, if so, the reasons for such suspension.

If the court is satisfied that the trader should be declared bankrupt, the court passes an order of adjudication declaring the trader bankrupt and appoints a trustee in bankruptcy to administer the bankruptcy.

The court fixes a provisional date for the date on which the company stopped paying its debt, which cannot go back for more than two years from the date of the insolvency judgment and orders that the company's place of business be sealed. A copy of the bankruptcy order will be made available to the Ministry of Economy, the relevant Commercial Register and the UAE Central Bank. The trustee in bankruptcy must within 15 days thereof publish a summary of the bankruptcy adjudication in a daily newspaper specified by the court. The publication must invite the company's creditors to have their debts recorded in the bankruptcy. The court may thereafter of its own accord, or at the request of the trustee in bankruptcy, the company's creditors or other interested persons, amend the date for the company to cease paying its debts, provided that such date is no later than 10 days after the company's debts are verified. Such an order must also be published in a daily newspaper as specified by the court.

The trustee in bankruptcy must do all that is necessary to realise the bankrupt trader's assets, including pursuing claims against third parties on behalf of the trader.

Following the publication of the adjudication of bankruptcy in the local newspaper each of the trader's creditors must submit a statement setting out its claims against the bankrupt trader. If such documents are not received within 10 days, the trustee in bankruptcy should publish a further notice in a local newspaper specified by the judge in bankruptcy and should serve notice on known creditors. Creditors then have 10 days to submit claims (30 days for non-residents). The trustee in bankruptcy may notify a creditor that it objects to any part of a claim or any collateral claimed to be held by the creditor. The creditor then has 10 days (30 days for non-residents) to provide evidence in support of its claim(s).

The trustee in bankruptcy must then deposit with the court a document setting forth the company's creditors and their claims (including claims which it is objecting to and the basis for the dispute) and the securities held against those claims. Dissenting creditors have 10 days (30 days for non-residents) to bring an objection before the court. The court then prepares a document setting forth the claims of creditors which have been accepted, and the court rules on objections.

Creditors who fail to submit claims within the above prescribed periods risk forfeiting their rights or, to the extent they are permitted to lodge claims following the time period(s) for doing so, having those claims postponed to creditors sharing in earlier distributions.

Position of the Trader

Upon the declaration of bankruptcy the bankrupt trader may no longer operate its business. The bankrupt trader may not itself pay any debts or recover any amount owing to it. It would be the trustee in bankruptcy who may act in such circumstances.

Moratorium on Claims

Save for holders of mortgages and certain liens, or with the special leave of the court, creditors are prohibited from pursuing remedies against the trader's estate after bankruptcy is declared. However, if there are insufficient funds in the trader's estate to meet the expenses of the trustee in bankruptcy, the bankruptcy may be terminated and in such circumstances creditors regain the right to proceed individually against the bankrupt trader.

Set-Off

Set-off is enforceable in a bankruptcy only if the set-off constitutes current account set-off or if the set-off is in respect of obligations arising from the same cause (or transaction). Therefore, outside of a banker's right to set-off or combine different current accounts, following the bankruptcy of the trader, set-off may only be available in respect of obligations arising between the creditor and the trader arising out of the same transaction. Set-off in those circumstances may not be available in respect of obligations arising out of different transactions between the creditor and trader, or in respect of multilateral netting arrangements, as are common among participants in a clearing house system.

Call for Unpaid Share Capital

The trustee in bankruptcy may obtain the leave of the court to call for shareholders to pay unpaid share capital up to the amount required to discharge the company's obligations in full.

Effect on Contracts

A declaration of bankruptcy does not automatically result in the termination of contracts to which the bankrupt trader is party. However, if following the declaration of bankruptcy, the trustee in bankruptcy fails to perform the contract, the other party to the contract may terminate the contract provided that the non-defaulting party has provided the trustee in bankruptcy with a grace period within which to cure the default. The length of the grace period is not specified in the legislation. If the non-defaulting party terminates the contract for the trustee in bankruptcy's failure to perform, the non-defaulting party will, in respect of the trader's outstanding obligations, rank as an ordinary creditor in the bankruptcy in competition with other unsecured creditors.

Special rules apply to lease agreements in respect of property from which the bankrupt trader undertakes its business.

Vulnerable Transactions

In addition, any transaction that reduces the claims of creditors generally is liable to be set aside if it occurred during the above-mentioned period and the creditor in whose favour the payment was made or who was otherwise preferred was aware at the time of the transaction that the trader had suspended payment of its commercial debts.

In relation to each transaction mentioned above, a suspect period of two years from the date of the bankruptcy order applies. Accordingly, a trustee in bankruptcy may investigate all transactions of the type mentioned which occurred during that two-year period and seek to have them set aside where that is in the interests of ordinary creditors.

Ranking of Creditors

The payment of the wages of the trader's employees for the 30-day period prior to the declaration of bankruptcy would appear to rank first in priority.

The owner of property that is leased to a bankrupt trader has a lien for a two-year period. The government also has a lien for unpaid taxes during the two-year period preceding the bankruptcy order. The Commercial Code states that public funds that are used to meet the cost of the bankruptcy may be claimed from the first cash which enters the bankrupt estate with priority over all creditors. In liquidation, the expenses of the liquidator have priority over all debts.

The provisions relating to secured creditors are somewhat unclear. Creditors holding security may commonly enforce their security by sale of the secured assets at public auction, outside of the bankruptcy proceedings. Note that there are restrictions on foreign ownership of certain types of property and in such circumstances the pool of potential purchasers and thus the sale price may be reduced.

There are no rules governing the priority between secured creditors in insolvency proceedings, so the position of creditors with competing security over the same asset is also unclear, although possession is often a key component of some forms of security (i.e., effectively preventing multiple security takers over the same asset), and specialist security registers exist for certain types of assets, such as aircraft and real estate.

Position of Directors

As mentioned above, a trader must petition for bankruptcy within 30 days of suspending the payment of its commercial debts. If the trader does not do so, the directors may be guilty of a criminal offence of bankruptcy by negligence.

Also, if following a declaration of bankruptcy, the assets of a company are insufficient to satisfy at least 20% of the company's debts, the court may, if it considers the directors at fault in accordance with the provisions of the Commercial Companies Law governing the liability of directors, declare the directors personally liable for all or certain of the debts of the company.

Directors will also be guilty of a criminal offence if they:

- have concealed, destroyed or altered the company's accounts;
- have misappropriated or concealed the company's property;
- knowingly acknowledged debts that are not payable by the company or withheld documents relevant to the bankruptcy;
- have obtained an advantage through fraud;

- have made a disclosure which is untrue in relation to paid-up capital, distributed fictitious profits or received bonuses in excess of the amount provided for by law or in the company's constitutional documents;
- have failed to keep accounts sufficient to reflect the company's true financial position;
- have failed to comply with a request to provide information to, or have deliberately provided untrue information to, a judge or the trustee in bankruptcy;
- after the suspension of payment of the company's debts, have honoured payment to a particular creditor to inflict harm on other creditors or provided securities or special benefits to any creditors by giving them preference over the company's other creditors;
- have disposed of the company's goods other than on commercial terms in an attempt to delay a suspension of payment by the company of its debts, or a declaration of bankruptcy;
- have acted in a way which is contrary to law or the company's constitutional documents.

The Commercial Code also imposes criminal sanctions with regard to creditors in certain circumstances, including where a creditor enters into a clandestine agreement with an insolvent trader following the suspension by the trader of its debts and the arrangement confers a special benefit on the creditor which the creditor knows will be detrimental to the trader's other ordinary creditors.

Protective Compositions

A protective composition is a court-supervised work-out procedure available prior to the declaration of its bankruptcy or the commencement of its liquidation to a trader whose financial position has deteriorated to a point where it can no longer pay its debts.

It appears that the trader must apply for a protective composition within 20 days of the trader ceasing to pay its debts. A further condition is that the trader has traded continuously during the previous year and has during that time complied with all laws relating to the Commercial Register and the keeping of proper accounts.

The trader's application to the court for a protective composition must set out:

- the cause of the disruption to the trader's business; and
- its proposal regarding the satisfaction of its obligations, which proposal must provide for not less than 50% of its obligations to be discharged within three years.

The proposal must be accompanied by certain specified documents, including a document specifying the trader's creditors and debtors, the amount owed by or to it (as applicable) and collateral existing in relation to same.

If the court approves the application, it will appoint a trustee to administer the arrangement and a judge to supervise the process. A moratorium will apply in relation to claims brought against the trader. Secured creditors may not vote on the composition unless they waive their security.

The trustee must register the decision to open protective composition procedures with the Commercial Register and must publish in two daily newspapers specified by the court an invitation to creditors to attend a meeting to consider the trader's proposal. Thereafter, creditors must provide the trustee with a statement setting out their claims against the bankrupt trader. The process that follows is similar to that described above in relation to the bankruptcy procedure and will similarly conclude with the court preparing a document setting forth the claims of creditors which have been accepted and ruling on objections. Creditors who fail to submit claims within the prescribed periods lose the opportunity to participate in composition proceedings.

After the court has verified all claims, the supervising judge shall fix a time for the creditors' meeting to consider the trader's proposal. The trustee must deposit with the court at least five days before the

date of the creditors' meeting a report on the financial state of the trader, the reasons for its interruption and a list of the names of the creditors entitled to participate in the arrangement proceedings. The trustee's report must also include the trustee's opinion regarding the trader's proposal. Presumably, that report will at the same time be made available to creditors entitled to participate in the creditors' meeting.

The requisite majority for the approval of the proposal for the protective composition at the creditors' meeting is a majority of creditors holding at least two-thirds of the trader's debts and entitled to vote. As referred to above, creditors holding security are not entitled to vote in respect of the debt secured by that security unless they waive the same. Where the trader has issued debentures having a value exceeding 20% of total debts, the proposal must also be approved by a general assembly of those debenture holders.

If the protective composition is approved by the requisite majority, it binds all of the trader's creditors, including the secured creditors.

If the protective composition is passed the court will appoint a controller to supervise the carrying out of the composition in accordance with its terms. Following the approval of the protective composition, the trustee in bankruptcy registers the composition on applicable property registers and such registration will result in the creation of a mortgage over the property recorded in the register securing the payment of creditors in accordance with the terms of the protective composition.

The protective composition will automatically cease in the case of fraud, and where the trader fails to comply with the terms of the protected composition a party may apply for an order for the termination of the composition (and presumably in those circumstances the creditors may petition for a bankruptcy order).

Judicial Compositions

Judicial composition is an involuntary reorganisation proceeding initiated by a judge following a declaration of bankruptcy. A creditors' meeting is formed and the creditors whose claims have been accepted are invited to vote on a judicial composition of the trader's debts.

The requisite majority for the approval of the proposal for a judicial composition is the same as that for a protective composition, namely a majority of creditors holding at least two-thirds of the trader's debts that have been accepted. Creditors holding security are not entitled to vote in respect of the debt secured by that security unless they waive it.

If the judicial composition is approved by the requisite majority, it binds all of the trader's ordinary unsecured creditors. Secured creditors and preferred creditors are not bound by the terms of the protective composition unless they have waived their security and participated in the meeting leading to the vote on the judicial composition. Following the approval of the judicial composition the trustee in bankruptcy registers the composition on applicable property registers and such registration will result in the creation of a mortgage over the property recorded in the register securing the payment of ordinary creditors in accordance with the terms of the judicial composition.

Creditors may have the judicial composition set aside in case of fraud or where the trader fails to comply with the terms of the judicial composition.

Termination following Fraud or Failure

If the judicial composition is terminated, the court appoints a judge and trustee in bankruptcy. The trustee may then realise the trader's assets. Sale proceeds will be distributed: first to meet expenses incurred in administering the bankruptcy, secondly among preferred creditors and thirdly to ordinary creditors ratably according to their claims. There is a degree of overlap between these laws and the laws summarised above in relation to the liquidation process.

Application to Foreign Entities

The UAE courts have jurisdiction to hear bankruptcy proceedings relating to any trader with a branch, agency or office within the UAE, including foreign traders.

The provisions relating to liquidation apply to foreign companies which conduct their principal business in the UAE.

Free Zones

Certain free zones, and most notably the Dubai International Financial Centre ("**DIFC**"), have enacted their own insolvency laws. DIFC Law No. 3 of 2009 and the related Insolvency Regulations (together, the "**DIFC Insolvency Law**") create an insolvency regime that is similar to English law and in particular the Insolvency Act 1986, and provides for company voluntary arrangements, receivership (including the appointment of administrator receivers) and liquidation. Generally, the DIFC Insolvency Law relates only to companies incorporated under DIFC Law No. 2 of 2009 (the "**DIFC Companies Law**") or registered to carry on business in the DIFC pursuant to the DIFC Companies Law. The DIFC Insolvency Law is generally considered to represent best practice in terms of the insolvency procedures applying in Gulf Co-operation Council jurisdictions.

Dubai World

The financial travails of the Dubai World group of companies are well documented and Dubai World represents the most serious corporate disruption in the UAE's relatively brief history.

The Dubai World ("DW") Decree no.57/2009 was issued to facilitate the restructuring of the Dubai World group in the event an informal work-out could not be agreed. The DW Decree is a customised version of the DIFC Insolvency Law but disapplies many of the provisions of the DIFC Insolvency Law, with the apparent intention of ensuring that the restructuring of Dubai World will be carried out in a particular manner. Generally, the DW Decree makes it more difficult to place Dubai World into insolvency and protects Dubai World's officers from liability for certain forms of misconduct. The DW Decree also incorporates certain important features of chapter 11 of the US Bankruptcy Code.

It is interesting to note that not a single insolvency case was filed by a creditor against any of the Dubai World group of companies and that the majority of the cases filed in the Dubai World Tribunal were financial claims cases.

Despite an important number of cases before the Dubai World Tribunal in 2010 and 2011, the Dubai World Tribunal ceased to be active in 2013.

The DW Decree is necessary because Dubai World is a corporation established by special decree. It is not incorporated under the Companies Law and therefore is not subject to the above-described federal law liquidation, bankruptcy and protective composition regimes.

Conclusions and Additional Observations

With the possible exception of the DIFC, lenders and borrowers are likely to continue to agree standstill and work-out arrangements outside of the existing formal insolvency procedures.

The need for insolvency reform has been widely discussed and we expect the UAE government to respond with a new federal framework at some point in the future.

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