Three Years On: The Bankruptcy Regime in the United Arab Emirates

As we approach the third anniversary of the implementation of the Bankruptcy Law, Charles Laubach and Rahat Dar take a look at the current insolvency framework available in the UAE (including in the two financial free zones: Dubai International Financial Centre and the Abu Dhabi Global Market, each of which has adopted its own insolvency rules) to consider whether the aspirations underpinning the Bankruptcy Law have been realised.

À l'approche du troisième anniversaire de la mise en œuvre de la loi sur la faillite, Charles Laubach et Rahat Dar se penchent sur le cadre actuel applicable en matière d'insolvabilité aux EAU (y compris dans les deux zones franches financières : le Dubai International Financial Centre et le Abou Dhabi Global Market, dont chacun a adopté ses propres règles en matière d'insolvabilité) pour déterminer si les aspirations qui sous-tendent la loi sur la faillite ont été réalisées.

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The previous insolvency regime in the United Arab Emirates, much of which was adopted in 1993, was never popular in the business or legal community, as it failed to provide any practical guidance on a number of key issues, including the treatment of creditors' claims by the courts, the evidence required to support a debt claim, or even the likely timeframe and costs associated with a bankruptcy. Indeed, many commentators identified the lack of an adequate insolvency framework as one of the main factors contributing to the high number of corporate failures during the economic slowdown, which affected the UAE from 2009 to 2011. In the wake of the slowdown, the UAE government implemented Federal Decree-Law 9/2016 on Bankruptcy (the "Bankruptcy Law"), which came into effect on 31 December 2016, repealing the previous insolvency regime and signaling a move away from a creditor-friendly regime to one that favours the debtor, with a focus on restructuring and corporate rescue.

As we approach the third anniversary of the implementation of the Bankruptcy Law, we take a look at the current insolvency framework available in the UAE (including in the two financial free zones: Dubai International Financial Centre (DIFC) and the Abu Dhabi Global

Market (ADGM), each of which has adopted its own insolvency rules) to consider whether the aspirations underpinning the Bankruptcy Law have been realised.

1

Bankruptcy Law

The Bankruptcy Law applies to any company governed by the provisions of Federal Law 2/2015 on Commercial Companies (as amended), (the "Commercial Companies Law"), businesses formed in the free zones (except those in the DIFC and ADGM), licensed civil companies, some public sector companies (i.e., those wholly or partially owned by the federal government or an emirate government), and individual traders. Civil companies were sometimes viewed as falling outside the previous insolvency regime, since they engaged in "civil" as opposed to "commercial" activities. In contrast, the public sector is now almost completely exempt from the new Bankruptcy Law, unless and until a public sector company undertakes the amendment of its founding statute or constitutive and governing documents so as to make it subject to the new Bankruptcy Law.

The Bankruptcy Law provides for three options for companies in financial distress, namely preventive composition ("Preventive Composition"), restructuring and bankruptcy.

Under the Bankruptcy Law, a debtor may apply for Preventive Composition rather than having to proceed directly (or at all) to bankruptcy proceedings.

A. PREVENTIVE COMPOSITION

Under the Bankruptcy Law, a debtor may apply for Preventive Composition rather than having to proceed directly (or at all) to bankruptcy proceedings. During the implementation of the Preventive Composition scheme, the debtor will be under court protection from individual creditor claims, while it tries to reach an agreement with its creditors for the repayment of its debts. This option is only available to debtors if they have not been in default for more than 30 consecutive business days and are not insolvent. Once the Preventive Composition scheme is in place, the debtor cannot dispose of any property, stocks or shares, make any borrowings, or (if it is a company) change ownership or corporate form. The debtor must also continue to perform its obligations under any of its contracts, provided that the court has not issued a judgment of stay of execution owing to its failure to perform its obligations under such contract.

In order to initiate Preventive Composition, the debtor must make an application to the court, which must include, among other things, a description of its economic and financial position, details of its moveable and immoveable properties, employees and creditors, and its cash flow and profit and loss projections for the 12 months following the date of its application.

A trustee will be appointed by the court to facilitate the Preventive Composition process, and such trustee will have the right to request the court to rescind any contract if that is in the best interests of the debtor and its creditors and provided that it does not substantially harm the other contracting party's interests. The trustee must within five business days of its appointment publish in two daily local newspapers (one Arabic and one English language) a summary of the decision approving the Preventive Composition, with a request that all creditors file appropriate claims along with supporting documentation within 20 business days. The trustee must prepare and submit the draft Preventive Composition scheme to the court, which will then have ten business days to make its decision to approve or reject it (taking account of any creditor objections). If the court approves the draft scheme, the trustee will (within five business days of such approval) publish in two daily local newspapers (one Arabic and one English language) an invitation for the creditors to attend a meeting to discuss and vote on the draft scheme. Once the scheme has been approved by the unsecured creditors, it will be submitted to the court for final approval. Once approved, the trustee must (within seven business days) publish the court's decision in two daily local newspapers (one Arabic and one English language), including the most important conditions of the scheme. Thereafter, the trustee is responsible for supervision of the scheme throughout the implementation period, including submission of quarterly reports to the court detailing progress and any failures by the debtor to implement the scheme. The scheme must be implemented within three years of the date of court approval. This term can be extended for a further three-year period if a two-thirds majority of the unpaid creditors consent to such extension. The trustee may apply to the court for any amendments to be made to the scheme if it considers it necessary at any point during the implementation period.

Even after the Preventive Composition scheme has been approved, the court may, either at the request of an interested party or in exercise of its own discretion, initiate the termination of the scheme and convert it into a bankruptcy proceeding if:

(i) it is proved that the debtor was in payment default for more than 30 consecutive business days or was insolvent on the date of commencement of the Preventive Composition, or if this became clear to the court during the course of the Preventive Composition, or

(ii) it becomes impossible to apply the scheme, and ending the same would result in payment default for more than 30 consecutive business days or result in the debtor's insolvency. The Bankruptcy Law does not provide any guidance as to what constitutes "impossible."

It is now possible for a debtor company, its creditors, the competent controlling body of the debtor company and the public prosecutor to apply to the courts for a bankruptcy order.

B. BANKRUPTCY

The Bankruptcy Law has expanded the number of parties that may apply for the bankruptcy of a company. It is now possible for a debtor company, its creditors, the competent controlling body of the debtor company and the public prosecutor to apply to the courts for a bankruptcy order. Bankruptcy applications from the above parties will be subject to different requirements. A creditor or group of creditors making a bankruptcy application against a debtor must show that:

(i) the debtor remains in default 30 consecutive business days after the creditor has sent a written notice of the overdue debt to the debtor; and

(ii) the debt meets the minimum threshold of AED 100 000. This AED 100 000 threshold may prove challenging for smaller trade creditors who are unlikely to meet this threshold and may not be able to identify other creditors to join in taking action, in particular as the annual accounts of most UAE companies are not publicly available.

The creditor's bankruptcy application must be accompanied by:

(i) the aforementioned notice to the debtor;

(ii) information on the debt and any related guarantees; and

(iii) a payment or bank guarantee for AED 20 000 to meet the expenses and costs on initial procedures for deciding the application. This provides a much more debtor-friendly position than under the old bankruptcy regime.

Within ten business days of receiving a bankruptcy application, the court will appoint an expert (ideally from its approved list of experts) to help the court evaluate the position of the debtor. The expert will prepare a report for the court outlining the debtor's financial position and provide an opinion on the possibility for restructuring of the debtor. The court will make a determination on the bankruptcy application within five business days of the later of the receipt of the application or the expert report.

The court will decide the degree of priority if there are many secured creditors for the same asset.

Upon receipt of the bankruptcy application, the court may take such measures (either at its own initiative or at the request of an interested party) as are deemed necessary to maintain or manage the properties of the debtor while it makes its decision (including sealing the place of business of the debtor). While the court evaluates the bankruptcy application, the secured creditors can still enforce pledges or liens as and when they become enforceable. The court may grant permission within ten business days of the application from the secured creditor to the court. The court will decide the degree of priority if there are many secured creditors for the same asset.

If the court accepts the bankruptcy application the court may appoint one or more trustees to administer the bankruptcy. A trustee has various responsibilities including:

- publishing a summary of the court's decision to initiate bankruptcy proceedings in two local newspapers;
- notifying known creditors;
- reviewing the claims and supporting documentation from creditors;
- providing updates to the court on the bankruptcy;
- maintaining a record of creditors and debtors of the bankrupt company; and
- submitting a list of creditors to the court.

The court will approve the final list of approved creditors, having reviewed any objections received following the publication of the debts. Certain persons may not act as trustees, for example, a creditor of the debtor, a spouse or fourth degree relative of the debtor, or a convicted felon, fraudster or perjurer.

Once a bankruptcy judgment is delivered, the trustee will publish a notification of the judgment in two newspapers and ask all creditors to file a final claim within ten days of the publication. All late filings of debt will be disregarded, unless the court decides otherwise. The Bankruptcy Law sets out the procedure and timetable for the verification of debts of creditors by the trustee in bankruptcy and the establishment of a final schedule of uncontested debts by the judge supervising the bankrupt's estate. In the case of companies, debentures issued by the same in accordance with the Commercial Companies Law are not subject to the procedures for the verification of debts. Such debentures are to be accepted at their nominal value after deduction of any amounts paid by the company.

The trustee may sell all assets of the debtor at auction, under the supervision of the court.

The trustee may sell all assets of the debtor at auction, under the supervision of the court. The trustee must update the court on a monthly basis and distribute the proceeds from the sale of the debtor's assets to the creditors. Any interested party may also submit a grievance with the court if the trustee:

(i) has acted or has proposed to act unfairly, to the detriment of the interested party;

(ii) fails to perform its tasks with due diligence; or

(iii) abuses or retains any monies or properties of the debtor or breaches any other obligations to the debtor.

A bankruptcy judgment will have the following effect on the relevant parties:

Debtor: With certain exceptions, the debtor will be prevented from administering and disposing of assets. At the request and under the supervision of the trustee, the court may give the debtor six months (extendable by two years) to sell all or part of its business, if this serves the interests of the creditors or the public. All monetary debts owed by the bankrupt will become payable, whether ordinary or guaranteed by lien. The court may grant approval to the following categories of persons to purchase the debtor's properties if this will satisfy the creditors' interests:

(i) spouse, relative by marriage or up to fourth degree relative;

(ii) any person who was a partner, employee, accountant or agent of the debtor (within two years prior to the date of judgment); or

(iii) any person who works or worked as the auditor following the initiation of bankruptcy proceedings.

Upon request by the trustee, the court may order the rescission of any contract to which the debtor is a party, provided such rescission is necessary to enable the debtor to transact its business or if it would fulfil the interests of all of the creditors and not significantly prejudice the other contracting party's interests.

Creditors: A group of creditors is established, consisting of persons having valid claims on the bankrupt dating from before the bankruptcy judgment. The pronouncement of the bankruptcy judgment results in the suspension of individual proceedings and actions brought against the bankrupt by ordinary creditors or preferred creditors. When a bankruptcy judgment is pronounced, all monetary debts owed by the bankrupt become payable, whether ordinary or secured by a general or particular charge. Secured creditors enjoy priority of repayment from the proceeds of sale of the secured assets. If the sale proceeds of secured assets do not fully satisfy the relevant secured debt, then any outstanding amount under such debt will be treated as ordinary debt. If the sale of the secured asset produces a surplus (after settlement of the relevant secured debt), such amount will be for the account of the unsecured creditors.

C. PREFERENTIAL PAYMENTS

In the course of Preventive Composition or restructuring proceedings, preference is given to the following:

a– judicial fees or charges, or fees and costs of any appointed trustee;
b– fees, expenses or costs incurred owing to supplying the debtor with services or to continue performance of any contract, to the extent such fees, expenses or costs are to the benefit of the business or properties of the debtor; and
c– any non-guaranteed new finance (including the principal debt, interest, and unpaid related expenses).

In the course of bankruptcy proceedings, preference is given to the following class of debts:
a– any judicial fees or charges (e.g., fees of trustees and experts and expenses paid for the benefit of the common interest of the creditors to maintain or liquidate the debtor's properties);
b– wages and salaries due to workers and staff for the period of 30 days prior to the declaration of bankruptcy;
c– debts of maintenance paid by the debtor under a judgment delivered by a competent court;
d– any amounts payable to governmental bodies; and
e– any fees, costs or expenses incurred:

- after the date of decision of initiating procedures to procure commodities or services to the debtor, or to continue the performance of any other contract that fulfils the benefit of business or property of the debtor; or
- to continue the course of the business of the debtor after the date of initiating procedures.

All transactions made by the debtor during the two-year period preceding the initiation of bankruptcy proceedings may be reviewed by the trustee to determine whether these should be set aside as having been an "unfair preference".

The Bankruptcy Law retains the two-year rule regarding "voidable" or "fraudulent" preferences. Consequently, all transactions made by the debtor during the two-year period preceding the initiation of bankruptcy proceedings may be reviewed by the trustee to determine whether these should be set aside as having been an "unfair preference", and the Bankruptcy Law lists the types of transaction that the court will consider as representing unfair preference, including donations or gifts, payment of debts when such payments were not yet due, or the creation of any new guarantee on the debtor's properties. The court will consider whether such transaction was "detrimental" to the creditors and if the transacting party knew (or ought to have known) when entering into the transaction that the debtor was in financial difficulty and, thereafter, make its judgment on whether it should be set aside.

D. MARKET RECEPTION

The Bankruptcy Law is a welcome development for the UAE's insolvency regime and addresses, at least on paper, some of the key limitations under the old insolvency regime. However, it also contains certain limitations; for example, the fact that secured creditors are not bound by proceedings commenced under the Bankruptcy Law may limit its effectiveness in large financing transactions, where the bulk of the debtor's assets or receivables may already be pledged in favour of a few (or even one) secured creditors.

Structured training is vital if we are to have consistency both in the interpretation and implementation of the Bankruptcy Law.

To date we are only aware of a handful of applications under the Bankruptcy Law (mostly for Preventive Composition). The extent to which parties in the UAE choose to engage with the new insolvency regime will depend on how effectively it is applied in practice. At this stage, it is a mixed picture. In particular, we note that while the Bankruptcy Law outlined clear and detailed bankruptcy procedures (including clear timeframes for court reviews and actions), these procedures and timeframes are not being adhered to in practice, although this may change as the related parties accumulate more experience. While the new regime relies heavily on the local court systems and court-appointed advisors, we have seen little evidence of any significant investment in the support structures and education or training for the judiciary and the court-appointed experts. In particular, structured training is vital if we are to have consistency both in the interpretation and implementation of the Bankruptcy Law. Other initiatives may also help enhance confidence in the new regime; for example, applying the principle of legal precedent for applications under the Bankruptcy Law could increase efficiency and consistency in judgments.

2

The Commercial Companies Law

In addition to the Bankruptcy Law, onshore limited liability companies may be dissolved in certain prescribed circumstances in accordance with the provisions of the Commercial Companies Law. This includes, for instance, where the losses to a limited liability company amount to half of its capital, whereupon the company's manager will be required to ask the general assembly to consider the issue of voluntary dissolution. Similarly, if the losses of a limited liability company reach three-quarters of the capital, the shareholders holding one-quarter of the capital of such company may demand to dissolve the company.

The authority of the manager(s) and the board of directors will terminate immediately with the dissolution of the company, and all debts of the company become due and owing upon an application for the company's dissolution. If the company's assets are not sufficient to meet all of the debts, then the liquidator is required to make proportional payment of such debts, without prejudice to the rights of preferred creditors. Every debt arising from acts of liquidation must be paid out of the company's assets in priority over other debts. Following settlement of all debts, the remaining assets of a limited liability company will be divided among all the shareholders. Each shareholder, upon division, will obtain an amount equal to his or her share in the capital, and the rest shall be divided among the shareholders *pro rata* of their share in the profits. If the net funds of the company are not sufficient to pay the shares of the shareholders in full, the loss will be distributed among them in *pro rata* to their prescribed rate for the distribution of losses.

3

Financial Free Zones

As discussed earlier, the Bankruptcy Law does not apply in the two financial free zones in the UAE—the DIFC and ADGM—which have adopted their own insolvency rules and regulations.

A. DIFC

A new insolvency regime was introduced in the DIFC with the enactment of Insolvency Law 2019 (DIFC Law No. 1/2019) (the "DIFC Insolvency Law"), in June 2019. The DIFC Insolvency Law was introduced to modernise the restructuring and insolvency regime in the DIFC, and provide an effective framework to facilitate the rescue of businesses in financial difficulty. The DIFC Insolvency Law introduced two new procedures—being rehabilitation and administration—while retaining the existing voluntary arrangement, receivership and winding-up procedures with minimal changes. The DIFC Insolvency Law incorporates aspects of the UNCITRAL 1997 Model Law on Cross-Border Insolvency, which aims to facilitate the process and procedure relating to cross-border insolvencies, including in relation to the recognition of foreign proceedings. This is particularly important, given the high concentration of foreign companies operating in the DIFC.

Similar to Preventive Composition, the primary objective of the rehabilitation procedure is to introduce a court-supervised pre-insolvency procedure that rescues debtors in financial difficulty.

Similar to Preventive Composition, the primary objective of the rehabilitation procedure is to introduce a court-supervised pre-insolvency procedure that rescues debtors in financial difficulty. This procedure is very similar to the concept of "debtor in possession" found in the US bankruptcy law, which means that a debtor who has filed a bankruptcy petition remains in possession of its business assets upon which a creditor(s) has a security interest. This procedure is only available to debtors who are or are likely to become unable to pay their debts, but there is a reasonable likelihood of a successful rehabilitation plan (as proposed by the director(s) of the debtor) being approved by the debtor and its shareholders and creditors. As with Preventive Composition, the DIFC Insolvency Law features a moratorium (for 120 days following the debtor notifying the DIFC Court of its intention to propose a rehabilitation plan to its creditors) on any enforcement of claims, protections against certain contractual and/or statutory provisions (including provisions which provide for (i) undue debts falling due and payable or (ii) termination of contracts; following the commencement of insolvency proceedings), and the ability for a debtor to obtain new secured or unsecured funding with DIFC court approval. Once the rehabilitation plan has been approved by the creditors and ratified by the DIFC Court, the plan shall bind all creditors that have or could have a claim against the debtor before the date of the DIFC court's ratification.

In theory, the director(s) of a debtor that is in a rehabilitation procedure can continue to manage the affairs of the debtor. However, the creditors may make an application to the DIFC Court for an administration procedure where there is evidence of fraud, dishonesty, incompetence/mismanagement, or where a specified offence has been committed by the directors. If the DIFC court approves the application, an administrator will then manage the business and assets of the debtor and a moratorium will be imposed. Alternatively, the DIFC Court may dismiss or adjourn the application, or make any other order that it thinks fit, including a winding-up order. The DIFC Court may approve the application if:

- the debtor is or is likely to become unable to pay its debts; and
- the appointment of an administrator would be likely to achieve one or more of the specified purposes, such as the approval of a rehabilitation plan, a voluntary arrangement or a scheme of arrangement or to assist in the protection of assets.

Like the DIFC Insolvency Law, the ADGM Regulations are largely based on English insolvency laws and incorporate aspects of the UNCITRAL 1997 Model Law on Cross-Border Insolvency.

B. ADGM

As with the DIFC, the ADGM has adopted its own laws and regulations in relation to insolvency and restructuring. The Insolvency Regulations 2015 (as amended) (the "ADGM Regulations") aim to provide the companies in the ADGM with a structured and reliable insolvency framework, while fostering a debtor-friendly environment for companies in financial difficulty. Like the DIFC Insolvency Law, the ADGM Regulations are largely based on English insolvency laws and incorporate aspects of the UNCITRAL 1997 Model Law on Cross-Border Insolvency. However, the ADGM Regulations also include other features, drawing on the flexibility of the deed of company arrangement used in Australia.

The main insolvency and bankruptcy options available in the ADGM include:

1- Receivership / administrative receivership: The self-help remedies of receivership and administrative receivership are included within the ADGM Regulations but with limited application (see below), probably to encourage creditors to use the administration process instead (see below). A receiver may be appointed by a secured creditor to collect and sell any of its secured property on its behalf, provided that such appointment is included in the relevant security document. An administrative receiver may be appointed by a secured creditor which holds security over the whole or substantially the whole of the assets of the debtor company and where such appointment relates to a capital market arrangement involving a debt of USD 50 million or a project financing which includes step-in-rights and is expected to incur debts of USD 50 million.

2- Administration: An administrator may be appointed to manage the debtor company in accordance with the provisions of the ADGM Regulations, either by:

(i) the ADGM Court following an application by the debtor company, its directors or one or more creditors of the debtor company, provided that the ADGM Court is satisfied that the debtor company is unable or is unlikely to be able to pay its debts;

(ii) the debtor, if it is unable or unlikely to be able to pay its debts as they fall due, or

(iii) a creditor which holds security over the whole or substantially the whole of the debtor company's assets, where the security document contemplates the appointment of an

administrator and where the relevant security has become enforceable. Unlike a receiver or administrative receiver, an administrator must act in the best interests of all the creditors.

3- Deeds of Company Arrangement ("Deed"): After a debtor has been placed into administration under the ADGM Regulations (see above), it may enter into a Deed (which is a binding arrangement) with its creditors. Once the Deed is approved by the creditors holding a majority (in value) of the voting, it will (with limited exceptions) be binding on all unsecured creditors; however, secured creditors will only be bound by the Deed if they voted in favour of the same or the ADGM Court (on the application of the administrator) makes an order to that effect.

4- Liquidation: A debtor, its directors or its creditors may propose the liquidation of the debtor company. The ADGM Courts will generally approve the proposal if:

(i) there is a shareholders' resolutions approving the winding-up;

(ii) a debtor is unable to pay its debt of more than USD 2 000 within three weeks of a formal demand;

(iii) the ADGM Court is able to make such order under any other ADGM law; or

(iv) the ADGM Court believes that the winding-up is just and equitable.

Once formally approved by the ADGM court, the winding-up order will be binding on all parties.

5- Schemes of arrangement: Unlike the above options, schemes of arrangement are governed under the ADGM Companies Regulations 2016. Similar to the English law scheme of arrangement, this procedure enables the debtor and its creditors to enter into binding arrangements. In order to be binding, the scheme of arrangement must be approved by 75% (in value) of each class of creditors and the ADGM Court.

Like the Bankruptcy Law and DIFC Insolvency Law, the ADGM Regulations also contain provisions regarding voidable transactions (generally covering transactions that are deemed to be at an undervalue or preferences, as identified in the ADGM Regulations), ranking of creditors (e.g., in an insolvent liquidation, unsecured creditors will rank below secured creditors (in connection with the value of secured asset) and preferential creditors).

As mentioned above, the ADGM Regulations also incorporate and apply the UNCITRAL Model Law on Cross-Border Insolvency (1997). As a result, foreign insolvency officials may apply to the ADGM Court to have foreign insolvency proceedings recognised and of the ADGM Courts determine that the "centre of main interest" for the insolvency is a foreign jurisdiction, the ADGM Court should recognise the foreign proceedings as being the "foreign main proceedings", which would have the effect of staying or suspending insolvency proceedings the relevant ADGM debtor or its assets within the ADGM.

3

Netting

There has always been some uncertainty regarding the enforceability of close-out netting (i.e., an arrangement where counterparties agree to offset their obligations under one or more agreements, following an event of default or termination event), particularly in a situation of potential or actual insolvency of a UAE (onshore) counter-party. Close-out netting is commonly used to manage default risks in derivative contracts in over-the-counter derivatives transactions and is one of the key credit-risk considerations for any party entering into a derivative or similar transaction.

Under the Bankruptcy Law, a debtor and creditor may only set off obligations:

(i) if the conditions for exercising the set-off are satisfied before initiating procedures under the Bankruptcy Law;

(ii) if conducted as part of the implementation of a Preventive Composition or restructuring scheme; or

(iii) as approved by the court.

Furthermore, futures, margin trading and derivatives transactions were generally viewed as potentially unenforceable under UAE law, due to perceived *gharar*, an unacceptable level of risk or uncertainty that undermines contract formation. For this reason, there was a risk—and UAE courts have held in some instances—that derivatives would be unenforceable "contracts of risk," even when used to manage risk (as in hedging contracts) rather than to create risk or to speculate. Even for Sharia-compliant hedging products in the market (for example, the ISDA/IIFM Tahawwut Master Agreement), which were supported by *fatwas* confirming that such products are Sharia-compliant and free of *gharar*, there was no certainty on how the courts would hold.

The above limitations were seen as an obstacle to the UAE government's ambition of developing the UAE as a major centre for derivatives transactions. In response, the UAE issued Federal Decree-Law 10/2018 on Netting (the "Netting Law"), which came into effect on 30 October 2018 (the "Effective Date"). It was a significant development to the derivatives framework in the UAE, in terms of both the legal enforceability of such arrangements and the ability to implement close-out netting, particularly following the bankruptcy of one of the parties. The Netting Law is closely modelled on the 2018 ISDA Model Netting Act and Guide (as published by ISDA) and applies to all qualified financial contracts, netting agreements or collateral arrangements (each as defined in the Netting Law) entered into by a person or entity in the UAE (other than persons and entities located in financial free zones, i.e., the DIFC and ADGM, which have separate netting regulations).

The Netting Law, in line with the 2018 ISDA Model Netting Act, allows parties (including corporate entities and individuals located onshore in the UAE) to enter into netting arrangements (including close-out netting) under netting agreements for the purposes of netting off their payment and delivery obligations under qualified financial contracts. Under the Netting Law, netting agreements include:

a- any agreement between two parties for netting of present or future rights to or obligations for payments or delivery, or transfer of title arising in connection with one or more qualified financial contract between the parties;

b- any collateral arrangement[1] such as credit support annexes or a credit support deed related to a netting agreement;

c- any Sharia-compliant agreement or arrangement which is intended to have a similar effect as a an agreement under points (a) and (b) above; and

d- any agreements, contracts or transactions which falls within the definition of a qualified financial contract.

1. The Netting Law defines a collateral arrangement as a margin, variation margin, collateral or security procedure or other credit enhancement tool relating to a netting agreement or qualified financial contract, including (a) pledges, mortgages and charges (whether possessory or non-possessory), (b) Title Transfer Collateral Arrangements (as defined in the Netting Law) and (c) any guarantee, letter of credit or reimbursement obligation by or to a party to in connection with such Qualified Financial Contract.

The Netting Law provides that the provisions of a netting agreement will be deemed final and enforceable (including against a third-party security provider, even if such third party becomes insolvent), even following the insolvency of one of the parties thereto.

The Netting Law provides that the provisions of a netting agreement will be deemed final and enforceable (including against a third-party security provider, even if such third party becomes insolvent), even following the insolvency of one of the parties thereto. The arrangements under a netting agreement may not be suspended, delayed or made conditional merely by the appointment of a liquidator or the initiation of bankruptcy proceedings or under any other law applicable to insolvent parties. Insolvency and/or bankruptcy proceedings will not affect the netting arrangements under a netting agreement or a qualified financial contract (or any other financial contract) to which a netting agreement applies. Similarly, the provisions of a netting agreement will not be affected by any limitations on setoff or netting imposed under any insolvency or bankruptcy laws.

In case of procedures under the Bankruptcy Law, the liquidator or trustee of a party to a netting agreement (the "Insolvent Party") may annul, stop or refuse the performance of a transaction constituting a preference to a non-insolvent third party (the "Third Party"). For example, such a transaction could be the transfer of cash, assets, property or collateral from the Insolvent Party to the Third Party under a netting agreement. However, the liquidator or trustee may do so only on the basis of clear and convincing evidence that such Third Party entered into the transaction with the intention to prevent, hinder or delay debt recovery by a current or future creditor of the Insolvent Party. There is no definition of "clear and convincing evidence" (a term that has no antecedent in UAE law), but the concept would appear to present a higher hurdle than a mere preponderance of evidence. Significantly, there are no other grounds in the Netting Law for a liquidator or trustee to fail to implement netting arrangements.

The Netting Law currently identifies 23 categories of agreements as qualified financial contracts (which create either a right to receive or an obligation to make a payment or delivery or to transfer title to assets/commodities for consideration) including all types of swaps (in relation to currencies, interest rates, basis rates or commodities), forward rate agreements, currency or interest rate futures, currency or interest rate options, derivatives (relating to bonds, energy, bandwidth, freight, emissions and property index), securities contracts, collateral arrangements, commodities related contracts and any Sharia-compliant equivalent of the above agreements. This list may be expanded by the Committee for Designation of Qualified Financial Contracts.

In line with the 2018 ISDA Model Netting Act and Guide, the Netting Law has recognised Multi-Branch Netting Agreements (MBNA) as netting agreements under which a party can enter into qualified financial contracts through its Home Office (i.e., the office in its Home Country) and one of its branches or agencies in countries other than its Home Country (i.e., the jurisdiction where such party is incorporated regulated or duly registered).

In the event of the insolvency of a foreign party's branch/agency (the "Branch"), its liability (or the liability of its liquidator in the UAE) to the non-insolvent counterparty (the "Counterparty") will be calculated on the date of the termination of the Qualified Financial Contract under the MBNA and limited to the lesser of:

(i) the foreign party's net payment obligations[2] (as adjusted by any payments to the Counterparty and the fair market value of any collateral provided by the foreign party under the MBNA) or

(ii) the Branch's net payment obligation.[3]

The foreign party's net payment entitlement[4] from the Counterparty (as adjusted by any payments made to the liquidator of the foreign party and the fair market value of any collateral provided by the Counterparty under the MBNA) will be netted against the Counterparty's net payment entitlement from the foreign party. The Counterparty may liquidate any collateral (provided under an MBNA) and apply the proceeds against settlement of sums due from the foreign party under any related qualified financial contracts. Any excess collateral shall be returned.

The Netting Law has also minimised, if not eliminated, the uncertainties regarding the enforceability of derivatives type financial contracts by providing that qualified financial contracts shall not be void, unenforceable, or not final by reason of *gharar*.

While the Netting Law represents a welcomed development for, among others, participants in the derivatives markets, it remains to be seen how the Netting Law will be implemented by the courts in specific cases. However, it is expected that financial contracts concluded before the Effective Date that qualify as netting agreements or qualified financial contracts should now be enforceable, even though enforceability might have been uncertain when the contracts were first concluded. Proceedings under the Bankruptcy Law will be governed by the Netting Law as of the Effective Date, but trustee, liquidator or court actions taken before the Effective Date would presumably remain undisturbed even if inconsistent with the Netting Law.

The DIFC and ADGM have also developed their own netting regimes under DIFC Netting Law No. 2/2014 (the "DIFC Netting Law") and the ADGM Regulations, respectively. As with the Netting Law, the DIFC Netting Law and relevant provisions of the ADGM Regulations are based on 2018 ISDA Model Netting Act, such as the recognition and enforcement of netting agreement (even against an insolvent party located in the DIFC or ADGM (as applicable)), limitations on the application of the relevant insolvency regime and limitations on a liquidator's power to challenge a netting agreement (generally limited to instances of fraud or preferential transactions).

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2. The aggregate of all amounts owed by the foreign party (including subsidiaries and affiliates) to the Counterparty after giving effect to the netting provisions under the MBNA and all related qualified financial contracts.

3. The amount (if any) owed by the Counterparty to the Branch under a MBNA after giving effect to the Netting provisions under all related Qualified Financial Contracts between the Counterparty and Branch.

4. (i) The aggregate of all amounts owed by the Counterparty (including to any subsidiaries and affiliates of the foreign party) to the foreign party after giving effect to the Netting provisions under the MBNA and all related Qualified Financial Contracts or (ii) the aggregate amount owed if the MBNA contained provisions providing for payments to the parties, upon termination of related Qualified Financial Contracts.

بينما نقترب من الذكرى الثالثة لتطبيق قانون الإفلاس، يلقي كل من شارل لوباخ وراهات دار نظرة على إطار الإعسار الحالي المتاح في الإمارات العربية المتحدة (بما في ذلك في المنطقتين الماليتين الحرتين: مركز دبي المالي العالمي وسوق أبوظبي العالمي ، وقد اعتمد كل منها قواعد الإعسار الخاصة به) للنظر في ما إذا كانت التطلعات التي يقوم عليها قانون الإفلاس قد تحققت.

BIOGRAPHY

CHARLES LAUBACH is a Partner at, Afridi & Angell in Dubai. He has been practising as a legal consultant in the UAE since 1986. He advises on general corporate matters, contracts and government procurements, project finance, employment, and international trade controls. Mr. Laubach has been involved in numerous high monetary value financing and re-financing transactions. Mr. Laubach has been advising clients on the handling of insolvencies in the UAE going back to the bankruptcy of Bank of Credit and Commerce International (BCCI) in the early 1990s. In addition, for the past 20 years, he has advised clients and authored the firm's UAE law netting opinions on the enforceability of the Global Master Repurchase Agreement and the other standard industry agreements that are used to document cross-border financial transactions.

RAHAT DAR is a Senior Associate at Afridi & Angell. His practice includes banking and finance, mergers and acquisitions, and general corporate matters. He has advised companies and financial institutions on a range of financing transactions, including conventional and Islamic finance. He has extensive experience of working with bank Sharia and Fatwa supervisory boards, and independent Sharia scholars, in structuring a variety of Islamic financing transactions (including *Istisna'a, Ijara, Murabaha, Musharaka and Mudaraba*). Mr. Dar has also advised local and overseas companies on a range of corporate and capital markets transactions including cross-border acquisitions, disposals, joint ventures, distribution and IPOs.

Prior to joining Afridi & Angell, Mr. Dar worked as a corporate associate in the London offices of Hogan Lovells and Dorsey & Whitney, where he advised on a wide range of international mergers and acquisitions, IPOs and secondary offerings in the United States and the United Kingdom (AIM and the Official List).