

inBrief



Amendments to management liability under the Bankruptcy Law

By Chatura Randeniya and Rahat Dar | 6 December 2021

This inBrief examines the latest amendments to the Bankruptcy Law (Federal Decree Law No. 9 of 2016, as amended) introduced under Federal Decree Law No. 35 of 2021 (the **New Law**) and their impact on the personal liability of the board of directors and managers of bankrupt companies. The New Law came into effect on 1 November 2021.

In contrast with earlier amendments to the Bankruptcy Law (such as Federal Decree Laws No. 23 of 2019 and No. 21 of 2020), which were focused on assisting companies in financial distress through difficult times (such as the COVID-19 pandemic) the New Law is focused on amending and clarifying the scope of the personal liability of directors and managers of companies in bankruptcy, specifically under Articles 144 and 201 of the Bankruptcy Law.

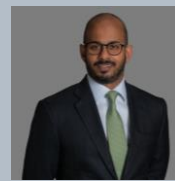
The key amendments under the New Law are discussed below.

Amendments to Article 144

Under the old Article 144 of the Bankruptcy Law, if the value of the assets of a company in bankruptcy were insufficient to settle at least 20 per cent of its liabilities, the court could order some or all of its board members and managers to pay some or all of the company's debts, provided that they were found liable for the losses of the company under the Commercial Companies Law (Federal Decree Law No. 2 of 2015, as amended). Article 1 of the New Law introduces the following changes to Article 144 of the Bankruptcy Law:

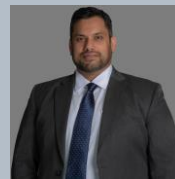
- (a) The requirement to establish liability for losses under the Commercial Companies Law is replaced with the requirement to establish that the directors and managers have committed any of the acts under Articles 147(a) through (c) of the Bankruptcy Law. Under Article 147 of the Bankruptcy Law, the directors or managers of a company in bankruptcy may be liable to pay the

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company's debts if they have; (i) used commercial methods of ill-considered risks, such as disposing of the goods at prices lower than their market value, in order to obtain assets, with a view to avoid bankruptcy procedures or delay the commencement thereof; (ii) entered into transactions with a third party to dispose of the assets at no charge or for an inadequate charge and without any certain benefit or a benefit that is commensurate with the debtor's assets and/or; (iii) fulfilled a particular creditor's debts with the intent to cause damage to other creditors, during the period of cessation of payment or during insolvency; in each case during the period of two years following the initiation of bankruptcy proceedings.

In addition to severing the cross-liability link between the Commercial Companies Law and the Bankruptcy Law, this amendment to Article 144 of the Bankruptcy Law also limited the scope of the liability from all past and future acts (as under Article 162 of the Commercial Companies Law) to just current and future acts under Article 147 of the Bankruptcy Law (i.e., limited to actions of the directors and managers following the initiation of bankruptcy proceedings). This will be a welcome development for directors and managers, as now any breach of the broader liability provisions under the Commercial Companies Law will not expose them to the risk of having to pay the bankrupt company's debts under Article 144 of the Bankruptcy Law.

- (b) New Article 144(2) of the Bankruptcy Law provides the directors and managers of a bankrupt company with a right to appeal any judgement of liability issued under Article 144 of the Bankruptcy Law. An appeal will not result in the (i) stay of execution of the judgement; or (ii) a stay of the bankruptcy proceedings or compromise its validity.

The substitution of the broader scope of liability under the Commercial Companies Law for the narrower scope under Article 147 of the Bankruptcy Law, the defence under Article 147(2) (i.e., a person cannot be judged to have breached Article 147(1) if such person has taken all possible precautionary measures to reduce the potential losses that may affect the assets of the debtor company or its creditors), the exemption under Article 147(3) (i.e., directors and managers shall not be liable for any of the acts under Article 147(1) if they can establish that they did not participate in such acts or provided their reservations to such acts (e.g., by lodging their objection at the relevant directors' meeting(s)) and the right to appeal any court judgement under Article 144 of the Bankruptcy Law all combine to reduce the risk exposure for directors and managers of bankrupt companies. However, it should be noted that any wrongful acts (leading to losses for the bankruptcy company), committed outside of the period under Article 147 of the Bankruptcy Law may still attract liability under other legal provisions.

Amendments to Article 201

Article 1 of the New Law also introduces some minor amendments to the old Article 201 of the Bankruptcy Law, principally to Articles 201(1) and (2), which, when read together with the updated start of Article 201 of the Bankruptcy Law, now provides that the directors and/or managers of a bankrupt company shall be punished by imprisonment for a period not exceeding two years and/or a fine not exceeding AED 100,000 if they **deliberately**:

- (a) fail to maintain commercial books that are sufficient to reveal the company's financial position or did not conduct inventory-taking as imposed by under the law, with the intent of harming the company or its creditors (Article 201(1)); or
- (b) refrain from providing the data required by the trustee appointed according to the provisions of Title 4 of the Bankruptcy Law or the court, or intentionally provides incorrect data (Article 201(2)).

The key amendments to Article 201 of the Bankruptcy Law are the inclusion of the AED 100,000 fine and the requirement to demonstrate an intention to deliberately perform the acts under Article 201(1) and (2), on the part of the directors and/or managers.

Conclusion

Although the New Law may have dislodged the Court's ability to use a director's or manager's liability under the Commercial Companies Law as a segue to possible liability for the bankrupt company's debts under Article 144 of the Bankruptcy Law, it does not eliminate the risk of liability for directors or managers who have acted in a dishonest or fraudulent manner.

It should be remembered that the Bankruptcy Law and its application in practice is still in its infancy. In our experience the courts have used their wide discretion in interpreting and applying the Bankruptcy Law and have displayed an indication to examine the role played by the management of a bankrupt company and impose penalties. In light of the above, it would be prudent for management of companies considering initiating, or which have already initiated, bankruptcy proceedings to seek legal guidance and plan a clear strategy to address all potential liability. ■

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