IN-DEPTH

Restructuring

UNITED ARAB EMIRATES

Restructuring

EDITION 17

Contributing Editor
Peter K Newman
Skadden Arps Slate Meagher & Flom LLP

In-Depth: Restructuring (formerly The Restructuring Review) is an insightful guide to help general counsel, government agencies and private practice lawyers understand the prevailing conditions in the global restructuring market. It examines the most significant recent legal and commercial developments and provides an overview of the restructuring and insolvency legal framework in each jurisdiction.

Generated: July 26, 2024

The information contained in this report is indicative only. Law Business Research is not responsible for any actions (or lack thereof) taken as a result of relying on or in any way using information contained in this report and in no event shall be liable for any damages resulting from reliance on or use of this information. Copyright 2006 - 2024 Law Business Research

Explore on Lexology

United Arab Emirates

Rahat Dar
Afridi & Angell

Summary

INTRODUCTION
YEAR IN REVIEW
LEGAL FRAMEWORK
SIGNIFICANT TRANSACTIONS, KEY DEVELOPMENTS AND MOST ACTIVE INDUSTRIES
INTERNATIONAL
OUTLOOK AND CONCLUSIONS

Introduction

A structured and well-functioning bankruptcy regime is key to assisting companies in financial distress, for protection of creditors and, in the case of failing businesses, is an organised mechanism for their liquidation that minimises the negative impact not only for their immediate creditors and stakeholders but also for the broader economy. The absence of a reliable bankruptcy regime was highlighted as one of the key contributors to the high levels of corporate failures during the 2010–2012 financial crisis in the United Arab Emirates (UAE). Since then, the UAE government sought to implement a modern bankruptcy regime by issuing Federal Law No. 9 of 2016 on Bankruptcy (the Old Law), which was recently replaced by Federal Decree-Law No. 51 of 2023 Promulgating the Financial Reorganisation and Bankruptcy Law (the Bankruptcy Law).

Year in review

Overview of restructuring and insolvency activity

While certain sectors of the economy (e.g., real estate and construction) have rebounded from the damage inflicted by the covid-19 pandemic, the predicted slowdown in the global economy and tensions in the Middle East mean that many businesses continue to face significant challenges in cash flow, revenue and bad debts. The global downturn has also prompted foreign companies with branches or subsidiaries in the UAE to review the need to maintain a presence in the UAE, particularly where such branches or subsidiaries are not directly engaged in income-generating activities or require considerable administrative and financial resources. The introduction of corporation tax in the UAE also means that UAE subsidiaries no longer serve a broader tax efficiency framework for overseas corporations. Creditors (particularly overseas financial institutions) are continuing to favour bankruptcy proceedings, notwithstanding the uncertainty associated with the Old Law and the untested Bankruptcy Law, particularly in emirates where creditors are effectively discouraged from pursuing alternative civil actions as a result of the high court fees for such actions. For example, in the emirate of Ras Al Khaimah, civil court fees are equal to 10 per cent of the value of the dispute – depending on the value of the debt – so initiating bankruptcy proceedings could be a significantly cheaper alternative.

Recent legal developments

On 31 October 2023, the Bankruptcy Law was published in the UAE Federal Gazette and came into force on 1 May 2024. While the Bankruptcy Law has repealed the Old Law, all resolutions, regulations and decisions issued in connection with the Old Law shall continue to be in effect until such time that they are replaced under the Bankruptcy Law. Furthermore, a number of key issues relating to the implementation of the Bankruptcy Law shall be provided under the Implementing Regulation to the Bankruptcy Law (the Regulation), which will be issued at a future date.

The Bankruptcy Law has introduced a number of key developments.

1. A dedicated Bankruptcy Court (the Court) will specialise in managing proceedings under the Bankruptcy Law. All existing proceedings before the local courts under the Old Law shall be transferred to the Court. The Court will have broad powers and discretion on a range of matters, including:
    - approving or rejecting applications under the Bankruptcy Law;
    - decisions on permitting new lending to the debtor;
    - determining which creditors have the right to vote on proposals and plans;
    - appointment and determining the extent of the duties and powers of a trustee; and
    - discretion to amend any proposal or plans and send them back for creditors' further vote.
2. The Court will be aided by experts, trustees (as necessary), a bankruptcy administrator (which will be based in the headquarters of the Court and shall be responsible for, among other things, receiving, verifying and registering applications, managing notifications to concerned parties on the decision of the courts and otherwise, monitoring and managing the debtor's business and assets and implementing any precautionary measures) (the Administrator) and a unit under the name of the Financial Reorganisation and Bankruptcy Unit (which will be responsible for, among other things, coordinating communications between the Court and any supervisory body (federal or local – these will also be identified under the Regulations) that has authority over the debtor, in connection with bankruptcy proceedings, approving the register of experts, trustees and other advisers, establishing and organising a bankruptcy register to record applications and decisions, and coordinating the training of judges, trustees and lawyers in line with international standards) (the Unit). The absence of a stand-alone bankruptcy court and specialised training for legal and administrative professionals was seen as a key shortcoming under the Old Law.
3. An automatic stay on creditor claims is imposed following the date of the decision to commence proceedings. The time frame for the moratorium will depend on the type of proceedings (moratoriums are discussed in further detail below).
4. Once the Court approves a request to initiate preventive settlement or restructuring, it may (at the request of the debtor) permit the debtor to obtain new financing. Such financing (1) may be requested at the initial application stage (prior to the relevant proposal or plan being approved) or following the initiation of the relevant proceedings, (2) shall rank in priority to unsecured debts, (3) may be secured as a first ranking charge over the unencumbered assets of the debtor and (4) may be secured over encumbered assets of the debtor (where the debtor will be a second ranking security holder, unless the holder of the first priority security consents to the lender having the first ranking charge).
5. In relation to voting at creditors' meetings to approve preventive settlement proposals, restructuring plans or liquidation and distribution plans, only ordinary unsecured creditors, privileged creditors (e.g., governmental taxes and other dues) and secured creditors (if the relevant proposal or plan impacts their security interest or they surrender their security interest in favour of the ordinary creditors) may vote.

For such meetings, the quorum will require attendance of creditors representing 50 per cent of the approved debts. Creditors holding two-thirds of the debts represented at the meeting may approve the proposal or plan. This can, theoretically, enable a situation where a debtor can prepare a proposal or restructuring plan and have this approved with the cooperation of just one-third of the eligible creditors. Perhaps this is why the Court has introduced a fairness standard test for before ratifying any proposals or plans approved by the creditors.

6. The minimum amount of unpaid debt that will be required to initiate proceedings under the Bankruptcy Law will be identified under the Regulation. A creditor (or group of creditors) may file an application to open restructuring or bankruptcy proceedings only if (1) the debtor has stopped paying the debts; (2) the debt is unconditional, undisputed and due for payment; (3) debt is not less than the threshold that will be identified in the Regulation; and (4) the creditor had sent a notice of the overdue debt to the debtor and the debtor has not settled the debt within 30 days of the date of such notice. The additional barriers for a creditor to file an application against the debtor is one example of the debtor-friendly regime under the Bankruptcy Law.
7. The decisions of the Court shall be deemed a writ of execution and immediately enforceable (without the requirement to be served). This is one example of how the Bankruptcy Law seeks to speed up bankruptcy proceedings. The Court retains the discretion to reverse or suspend its decisions (either on its sua sponte or at the request of the debtor, a creditor, a trustee or another interested party). The Court of Appeal may also order suspension of the enforcement of the decision. Under certain circumstances, a security holder may also enforce its security interest through the Court and trustee (as applicable), without having to commence separate enforcement proceedings.

Legal framework

Overview

The most widely applied insolvency regime in the UAE will be under the Bankruptcy Law, which covers any company governed by the provisions of Federal Law No. 32 of 2021 on Commercial Companies (as amended) (the Commercial Companies Law), businesses formed in the free zones that do not have rules regarding the procedures under the Bankruptcy Law (this is commonly a reference to the financial free zones of the Dubai International Financial Centre (DIFC) and the Abu Dhabi Global Market (ADGM), which have their own bankruptcy rules), licensed civil companies and individual traders. In contrast, the public sector is now almost completely exempt from the new Bankruptcy Law, particularly where such entities are subject to special laws regulating the type of proceedings provided under the Bankruptcy Law. The Commercial Companies Law also contains provisions for the dissolution of a company.

The Bankruptcy Law

The Bankruptcy Law provides three options for companies in financial distress, namely preventive settlement, restructuring and bankruptcy. In comparison with the Old Law, the Bankruptcy Law is another move towards a more debtor-friendly bankruptcy regime, where the parties have greater scope to reach settlement (e.g., the debtor can agree to settle debts through a reconciliation process, even after a final bankruptcy judgment has been issued). The procedures are less court managed and more court supervised (e.g., in comparison with the preventive composition process under the Old Law, the new preventive settlement process does not require the appointment of a trustee and allows the debtor to continue to manage its business operations, with limited exceptions).

Preventive settlement

Under the Bankruptcy Law, a debtor can apply for preventive settlement in order to reach a settlement of its debts with creditors (albeit with a restructuring of the debt terms, often involving a haircut), in accordance with an approved preventive settlement proposal. The debtor must still have a viable business (e.g., this option is not available to an insolvent company with no prospects of recovery). The debtor shall continue to retain management and operational control of its business, provided that its actions do not harm the interests of the creditors. This option to file an application within 60 days of the date it has ceased paying all or some of its debts or the date on which it was apparent that it may cease payment of future debts (although it seems that filing an application after this time frame will not impact the application) is in contrast to the 30-day hard deadline for filing a preventive composition application under the Old Law, which made the preventive composition option impractical for businesses.

To initiate preventive settlement, the debtor must make an application to the Court that should include, among other things, evidence of the circumstances resulting in the application, a description of its economic and financial position, summary of agreements to which it is a party, details of its movable and immovable properties, and details of employees and creditors. The debtor must prepare a settlement proposal including, among other things, the debtor's plan to conduct its business, a list of known creditors and debtors, their details, details of the creditors' committee, and terms and conditions for the settlement of any obligations. The debtor must submit a copy of the preventive settlement proposal to the Administrator within three months of the decision to commence proceedings (can be extended by the Court for additional one-month extensions, provided that the total period does not exceed six months). The creditors will then review and vote on the preventive settlement proposal (see above) and, if approved, it shall be sent to the Court for ratification (which will be based on the Court's assessment standards, including the fairness standard). Once ratified by the Court, the debtor shall implement the preventive settlement proposal in accordance with its terms.

Initiating the preventive settlement process shall not affect any agreements to which the debtor is a party. All such agreements shall continue as normal, and the above processes shall not result in an acceleration of any due dates or suspension of any interests under the agreements. All provisions to the contrary shall be null and void. However, during preventive settlement proceedings, a debtor may request the Court to terminate an agreement to which it is a party, if this is necessary for the continuation of its business or is otherwise in the interests of the creditors. The Court shall not terminate such agreements if it believes

that termination would lead to serious harm for the relevant counterparty, unless it decides to compensate the counterparty in a fair manner.

An automatic three-month moratorium on creditor claims commences from the date of the decision to commence proceedings, which can be extended by the Court for additional periods of one month, provided that the total moratorium period does not exceed six months. The moratorium period may also come to an end once the preventive settlement proposal is approved by the Court or the Court decides to terminate the preventive settlement procedure. The moratorium does not extend to employees and personal status (e.g., divorce and child custody) claims. This could cause a problem for companies with a large number of labour disputes (particularly companies in the real estate, construction, and food and beverage sectors).

Restructuring

Under the Old Law, it was not possible for the parties to apply for restructuring directly; rather, the parties needed to make a bankruptcy application and the court could (at its absolute discretion) direct the company to be placed into restructuring if it believed that the debtor's business could be saved through a restructuring of its debts and business. Like the preventive settlement process, the restructuring option allows debtors to reach a settlement with creditors, thus ensuring that the creditors are repaid (albeit with a restructuring of the debt terms, often involving a haircut) in accordance with the agreed restructuring plan.

A debtor, creditor or supervisory entity of the debtor (as to be identified under the Regulation) may initiate restructuring proceedings. A debtor may initiate proceedings if the debtor has ceased payment of debts and is suffering from financial difficulties (e.g., this option cannot be used merely to restructure debts that can otherwise be paid by the debtor). The application will include the documents required for a preventive settlement application, plus a brief explanation of the restructuring plan. As under the preventive settlement process, the debtor must submit a restructuring plan within three months of the decision to initiate the restructuring process (this can be extended by the Court, provided that the total time frame does not extend beyond six months). The restructuring plan shall contain information generally provided under a preventive settlement proposal. The creditors will then review and vote on the restructuring plan (see above) and, if approved, it shall be sent to the Court for ratification (which will be based on the Court's assessment standards, including the fairness standard). Once ratified by the Court, the trustee shall supervise the implementation of the agreed restructuring plan in accordance with its terms (which may include a sale of part or all of the business of the debtor).

Following the decision to initiate restructuring proceedings, all agreements of the debtor remain in effect, and the debtor will continue to manage the businesses, although under the supervision of the Court-appointed trustee, and provided that its operations do not harm the interests of the creditors. The Resolution shall provide further guidance on which actions of the debtor will require the consent of the trustee. The appointed trustee is required to announce the decision, which must include an invitation and notification (for creditors whose e-mails are known) to the creditors to submit their claims and supporting documents. The trustee shall also verify the debts and deposit the list of debts with the Administrator, announce the list and indicate the amounts they deem acceptable.

The above efforts shall be supported by an automatic moratorium on civil claims, which commences on the date of the decision to initiate restructuring proceedings and ends on the date that the restructuring plan is ratified by the Court or the restructuring procedures are terminated by the Court. The restructuring plan should be submitted to the Court within three months of the date of the decision to commence proceedings, although this can be extended by the Court, provided that any extension that results in the total period exceeding six months is also approved by a majority of the creditors. If the restructuring plan is not submitted to the Court within the specified time frame, the Court may terminate the restructuring proceedings. As with preventive settlement, the moratorium does not apply to labour or personal status claims.

Application for initiation of bankruptcy proceedings

A debtor, creditor or supervisory entity of the debtor (as to be identified under the Regulation) may initiate bankruptcy proceedings provided that (1) the debtor has suspended paying its debts due to financial difficulties, (2) the debtor's business is not viable and (3) the relevant applicant meets the applicable requirements to initiate proceedings under the Bankruptcy Law (see above).

Once a decision to open bankruptcy proceedings is issued by the Court, the debtor shall not be able to operate its business or manage or dispose of its assets, and the trustee shall assume effective control of the business operations. In some instances, a debtor may be permitted to continue practising its business if this is in the public interest (this would probably cover instances such as medical services providers with patients under treatment).

Unlike preventive settlement and restructuring, all agreements of the debtor come to an end, except for limited cases such as employment, lease and other services contracts, subject to the Court's instructions. The trustee may request the transfer of certain agreements of the debtor to new parties if it believes that this is in the interests of bankruptcy proceeds. The trustee shall be required to provide evidence of the ability of the transferee to comply with the requirements under the relevant contract. The Court may reject such transfers if it shall result in gross injustice to the other contracting party. However, it is not possible to transfer loan agreements or contracts providing credit facilities to the debtor and where the personality of the debtor is an asset under the contract. Following the issuance of a bankruptcy judgment, all monetary debts owed by the bankrupt become payable, whether ordinary or guaranteed by lien.

The trustee shall prepare a liquidation and distribution plan (the Liquidation Plan) containing, among other things, information regarding the debtor's assets and latest valuations, the method to liquidate the assets, a proposal to distribute assets to creditors in kind and a statement of how the liquidation proceeds will be distributed among the creditors. The trustee shall call a meeting of the creditors to discuss and vote on the Liquidation Plan. If approved, the Liquidation Plan shall be sent to the Court for ratification and then implemented by the trustee.

The names of the secured creditors with a mortgage or lien, or by a mortgage over real property, shall have priority of repayment from the proceeds of sale of the relevant secured assets. If the sale proceeds of secured assets do not fully satisfy the secured debt, then any outstanding debt shall be treated as ordinary debt. If the sale of the secured asset

produces a surplus (after settlement of the relevant secured debt), such amount shall be for the account of the unsecured creditors.

Proceeds from the sale of the debtor's assets shall be distributed among the preferred creditors as follows:

1. 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 assets);
2. debts of maintenance paid by the debtor under a judgment delivered by a competent court;
3. any amounts payable to governmental bodies;
4. end of service benefits, wages, salaries and other amounts due to employees, limited to three months of salary. The Court may permit the trustee to pay workers and staff for the period of 30 days from debtors' assets available to the trustee;
5. fees and charges of any expert or other professionals appointed by the debtor following the initiation of proceedings; and
6. any fees, costs or expenses incurred:
    - after the date of decision of initiating the bankruptcy procedure 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.

Even following the issuance of a final bankruptcy judgment, the debtor may still settle its debts with creditors via a reconciliation process, provided that the debtor has not been sentenced to fraudulent bankruptcy.

The Commercial Companies Law

The Commercial Companies Law provides for the dissolution of a company in certain prescribed circumstances. This includes, for instance, when the losses to a limited liability company amount to half of its capital, whereupon the company's manager shall 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 a company may demand to dissolve the company.

The authority of the manager or managers and the board of directors shall terminate immediately on 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 the settlement of all debts, the remaining assets of a limited liability company resulting from liquidation shall be divided among all the shareholders. Each shareholder, upon division, shall obtain an amount equal to their share in the capital, and the rest shall be divided among the shareholders pro rata of their shares in the profits. If a shareholder fails to appear to collect their share, the liquidator shall deposit such a share in the treasury of the competent court. If the net funds of the company are not sufficient to pay the shares of the shareholders in full, the loss shall be distributed among them in accordance with the prescribed rate for the distribution of losses.

Significant transactions, key developments and most active industries

Given that the Bankruptcy Law, and much of the framework thereunder, has still to be established and implemented in practice, there are no significant consequences or developments to speak of at this time. We expect a temporary lull in bankruptcy proceedings pending the implementation of the Bankruptcy Law, but then we expect a continuation of earlier trends, including (1) the courts favouring restructuring or corporate rescue over bankruptcy, with judges regularly appointing external financial experts to work alongside the trustee to examine the possibility for salvaging businesses in distress, and (2) the trustees and judges actively looking for grounds to attribute liability on the managers (the definition of 'manager' under the Bankruptcy Law extends beyond the immediate board of directors and could, theoretically, include anyone who is involved in the management (including directing the managers) of a bankrupt company, particularly where the assets of such company are insufficient to meet at least 20 per cent of its recognised debts, and there is evidence that the manager's conduct (this could include action or inaction alike) has resulted in losses to the bankrupt company). We also expect, for the next few years at least, to see instances of misinterpretation and misapplication of the Bankruptcy Law (as was the case with the implementation of the Old Law) and, in most cases, such judgments being overturned on appeal – although this is little comfort for the relevant managers, as a considerable amount of time and money (most of which cannot be reclaimed, even if the appeal is successful) will be required to pursue the appeal.

There will be limited means to gauge market trends in respect of proceedings under the Bankruptcy Law because, generally, little information is published or released regarding businesses facing financial difficulties. However, as noted above, we have seen a significant increase in legal action under the Bankruptcy Law, particularly by overseas creditors. There continues to be a significant cultural aversion to the concept of bankruptcy, and the formal insolvency regime is avoided for that reason as well (in addition to potential criminal penalties for managers or directors of bankrupt businesses). As such, there is little in the way of information regarding significant transactions or active industries.

International

The UAE has not entered into any international treaties specifically covering insolvency or restructuring. The Bankruptcy Law does not envisage how judicial assistance would

be provided in the UAE to proceedings commenced in another jurisdiction, even though the new definition of 'debtors' assets' includes a reference to local and foreign assets of the debtor. It is disappointing that the UAE has not taken this opportunity to adopt the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency into the Bankruptcy Law (as is the case for the DIFC and ADGM free zones) given the UAE's drive to adopt best international standards across all areas of the economy. This would have also enhanced the cross-border application of the Bankruptcy Law and increased the UAE's appeal to overseas investors. It is hoped that adoption of the UNCITRAL model will be the next logical step in the evolution of the UAE's bankruptcy regime.

Outlook and conclusions

The introduction of the Bankruptcy Law is another step towards the modernisation of the bankruptcy regime in the UAE and introduces a number of positive developments. As discussed above, the new bankruptcy regime seems to have leaned further in favour of the debtor and settlement of debts through restructuring. Furthermore, it is anticipated that there will be a temporary lull in bankruptcy proceedings while the legal and business communities wait to see how the framework under the Bankruptcy Law will be established and implemented in practice in the coming months and years. In particular, we need to see the establishment of the Administrator and the Unit, in addition to the publication of the Regulation, which will provide guidance on a number of key issues, such as the debt thresholds required to initiate proceedings and the actions of a debtor (subject to a restructuring procedure) that will require the approval of the trustee.

Afridi &Angell

Rahat Dar rdar@afridi-angell.com

Afridi & Angell

Read more from this firm on Lexology