



# Insolvency Law: The Need of the Hour

As the enactment of UAE's new insolvency law draws closer to reality, TLA takes a look at the most notable features of the long-awaited regime.

## THE CURRENT UAE INSOLVENCY REGIME: THE NEED FOR MODERNISATION

Essential to any market economy is the ability of companies to take risks and the existence of a legal framework that adequately addresses such risks as well as potential failures.

While insolvency legislations in Europe and in the US have developed into a regime that supports the rise, fall and reemergence of companies, the concept of a supportive insolvency regime in the United Arab Emirates ("UAE") has only recently emerged.

The existing UAE insolvency regime as set out in Book Five of Federal Law No. 18 of 1993 (the "Current Law") has often been termed as outdated and not in sync with the modern realities of companies facing insolvency. As a result, most companies often tend to seek recourse in arrangements with their creditors outside of the Current Law's legal framework to avoid the cumbersome and outdated legal procedure available under said law. However, they find themselves facing situations which are not governed by a particular legal framework given that the Current Law does not provide for restructuring options.

In order for the UAE insolvency regime to catch up with internationally accepted practices, voices have arisen calling for the introduction of a new insolvency regime adopting a more pragmatic approach, less punitive for the business owners and aimed, to the extent possible, to preserve the company and its running as a going concern. A modern UAE insolvency regime would be beneficial for companies facing financial difficulties and will in addition promote economic growth in the UAE. By pushing companies to face reality early on and preventing the tie up of capital, which can be reinvested into the national economy, a modern UAE insolvency regime can reap perpetual benefits.

## DUBAI WORLD'S RESTRUCTURING: AN EXAMPLE TO FOLLOW

It is generally believed that the Current Law is unequipped to handle the financial reorganisation of UAE companies. This became clear in 2009, when a government-owned company, Dubai World, was unable to pay off its debts. In order to restructure Dubai World's debts in the context of a legal framework that offered no such option, the Ruler of Dubai issued a new decree ("Decree 57"), a law specific to Dubai World's restructuring, which established an independent forum, the Dubai World Tribunal, responsible for dealing with financial disputes related to Dubai World's delayed debt payments. Decree 57 has

been drafted closely based on the DIFC insolvency laws and English common law and includes some elements similar to those found in US Chapter 11 such as permitting voluntary arrangements to be approved without the unanimous consent of the creditors in order to support complex financial restructurings. In January 2015, Dubai World announced it reached a formal restructuring agreement with 100 per cent of its creditor banks in respect of its proposal to amend and extend the terms of its USD14.6 billion debt (including a USD4.4 billion loan due in May 2015 and a USD10 billion loan due in 2018). The restructuring plan proposes an early repayment of the USD4.4 billion loan originally due in May 2015 to encourage the creditors to accept the extension of the maturity of the USD10 billion loan to 2022.

The Dubai World financial restructuring agreement became a model for a successful insolvency regime. In some respects, the spirit behind Decree 57 has been the basis for the preparation of new insolvency legislation (the "New Law"). However, it is worth noting that some advantages provided for in Decree 57 are not reflected in the New Law. For example, as we will see in part 3 below, the possibility for the debtor to obtain approval of the financial reorganisation plan from the creditors with a qualified majority (i.e. 66.67 per cent) provided for in Decree 57 is not mentioned in the New Law which requires instead the unanimous approval of the creditors.

## A NEW GUIDELINE: FINANCIAL REORGANISATION PROCEDURE

Approved by the Council of Ministers during the first week of July 2015, the New Law aims at providing a clearer path for distressed companies seeking consensual settlement.

Preserving *Shari'ah* law principles and yet influenced by Anglo-American insolvency regimes, the New Law offers multiple options for debtors and creditors outside informal consensual reorganisation.

In particular, the New Law sets out three main procedures: "Financial Reorganisation Procedure", "Preventative Composition" and "Bankruptcy". Amongst these procedures, Financial Reorganisation stands out as an out-of-court procedure whereby the debtor retains control of the business and which involves the formation of a non-judicial committee, whereas Preventative Composition and Bankruptcy (already provided under the Current Law) are court supervised procedures. Nevertheless, the New Law reduces the involvement of the court in Preventative Composition, thus embracing

the realities of the modern international business. For instance, Preventative Composition procedures involve an indirect supervision of the court which appoints an independent Composition Trustee to assist the settlement process and a committee of five creditors to supervise the financial restructuring plan. The debtor remains in control of the business under the supervision of the Composition Trustee.

The Financial Reorganisation Procedure is perhaps the most notable feature of the New Law, as it establishes an out-of-court procedure that affords debtors the option to financially restructure their liabilities without being forced to liquidate or file for bankruptcy. The Financial Reorganisation Procedure is thus designed to encourage formal and consensual settlement and aid debtors in maximising the value of their assets.

Although not explicitly provided for in the Financial Reorganisation Procedure, there are several types of restructuring options available to a company seeking reorganisation, depending on its financial health. The total debt may be reduced if creditors settle for a portion but final satisfaction of their claims against the debtor. Alternatively, debt may be converted into equity if rescuing the company outweighs the benefits of the financially troubled company facing bankruptcy. However, such restructuring option results in the dilution of the control by the original shareholders, as creditors generally obtain control of the company. Additionally, a common restructuring path in the Middle East remains extending the length of the loan or lowering the interest rates. Such latter option, while more favourable to the debtor, is generally an inefficient outcome for creditors, as they risk to lock underperforming loans and remain prevented from lending to more profitable businesses.

Although the Financial Reorganisation Procedure

does not involve the court, the New Law provides that the Council of Ministers upon the Ministry of Finance's request will form the "Financial Restructuring and Bankruptcy Committee" (the "Committee")<sup>1</sup>. The Committee's function is to support the reorganisation process in several important ways; in addition to general managerial and administrative responsibilities, the Committee will be responsible for (i) reviewing and approving the debtor's application for financial reorganisation; (ii) creating a list of bankruptcy experts; and (iii) appointing an expert from said list with the experience and qualifications required for bankruptcy and restructuring procedures to assist the debtor in his settlement negotiations and in reaching an agreement with the creditors.

As with all financial reorganisation procedures, the debtor is not guaranteed complete financial restoration and should consider certain aspects of the New Law prior to applying to the Committee. Firstly, the debtor must consider whether it is eligible to apply for a Financial Reorganisation Procedure. For instance, a debtor is ineligible to apply if (i) it has ceased to make payments of debts "in an excessive manner" for a period of 45 consecutive days; (ii) it has been under financial reorganisation procedure during the preceding six months; or (iii) it is currently under Preventative Composition or Bankruptcy Proceedings. Secondly, based on the current draft of the New Law, it does not appear that the new regime provides for the option to impose the financial reorganisation procedure on dissenting creditors. Commentators have interpreted the silence of the New Law as to whether the financial reorganisation plan may be approved by a lower percentage of creditors as a requirement for the debtor to obtain unanimous approval of all creditors whose claims it is seeking to restructure pursuant to the Financial



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Reorganisation Procedure. In our view, this reasoning is in line with the spirit of the New Law<sup>2</sup>. However, given that this is a crucial point of the new regime, it is prudent waiting for the final version of the New Law to be published in order to see whether any last minute amendments have been introduced lowering the percentage required to approve the procedure.

Finally, the Financial Reorganisation Procedure does not provide for the declaration of moratoria during the procedure. Thus, the financial reorganisation process does not prevent new claims from being submitted to the court to initiate Preventative Composition or Bankruptcy Procedures<sup>3</sup>.

Nevertheless, the Financial Reorganisation Procedure has certain advantages that undoubtedly appeal to financially distressed companies. For

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the debtor to retain full control over the operations of the company. In fact, the appointed expert does not get involved in the management of the company’s affairs unless he has obtained the prior approval of the debtor. Importantly, the debtor’s obligation to file for bankruptcy is suspended during the procedure, albeit subject to the revocation of the suspension if the procedure fails.

In terms of interplay between the New Law and the Current Law, it is believed that the New Law will replace completely the Current Law. In case of inconsistency between the New Law and other insolvency-related provisions in other UAE laws (i.e. the UAE Civil Code, the UAE Commercial Companies Law and the UAE Penal Code), the New Law will probably prevail. For instance, commentators have noted that the New Law includes important

instance, the reorganisation procedure must take place within a time limit of four months. Said time limit is favorable for companies that cannot afford time consuming and expensive court proceedings. However, it is worth noting that the procedure may be extended to an additional four months unless the procedure is terminated due to an inability to reach a settlement.

Additionally, the Financial Reorganisation Procedure permits

provisions regarding the decriminalisation of bounced cheques. However, bounced cheques are still criminalised in the UAE penal code. Hence, it remains to be seen whether the relevant UAE penal code provisions will become inapplicable and repealed by the New Law.

#### THE FUTURE OF UAE INSOLVENCY

The success of the new insolvency regime is not independent of the UAE’s political, social and economic environment. Historically, cultural stigma surrounding insolvency and fear of facing criminal liability has led to the reluctance of debtors to consider restructuring procedures. Also, the lack of specialised courts equipped to resolve complex reorganisation procedures remains an obstacle. However, notwithstanding the uncertainty of its implementation, the New Law seems to go in the right direction for shaping a strong support mechanism for financially troubled companies, which in turn will help increasing investors’ confidence and hence attract more domestic, regional and international direct investments in the country. ➔

1. The number of members of the Committee will be determined by the decision issued by the Council of Ministers. The Committee must be composed of members drawn from the Central Bank, the Securities and Commodities Authority, the Ministry of Economy, the Ministry of Finance; and the Ministry of Justice.
2. In fact, if on one side the draft New Law expressly provides that Preventative Composition Procedures must be approved by the majority of creditors holding at least two third of the total debt, on the other side it remains silent on the majority required to approve Financial Reorganisation Procedures. This leads to the conclusion that if the legislator wanted to introduce a lower percentage for the approval of Financial Reorganisation Procedures it would have stated it explicitly.
3. Article 12-2 of the Arabic version of the draft law (dated 2011) expressly provides that: “notwithstanding the provisions of article 12-1, the acceptance of the debtor’s application by the Committee does not prevent new requests from being submitted to the court in order to initiate preventative composition or bankruptcy procedures”. Article 12-1 provides that the notification of the acceptance of the debtor’s application issued by the Committee results in the suspension of the debtor’s obligation to file for bankruptcy during the financial reorganisation procedures.



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