

Recent Trends in the United Arab Emirates Bankruptcy Regime

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The year 2021 witnessed an influx in the number of bankruptcy and restructuring cases in UAE courts largely in the trading, education and healthcare sectors. The primary reason behind such an increase is the significant decrease in cash flows, accounting mismanagement and in certain instances financial fraud. The financial distress was further exacerbated by the impact of the ongoing COVID-19 pandemic that led to a global financial crisis, which, resulted in a number of companies/debtors filing for bankruptcy. In view of the increase in the number of bankruptcy filings and decided cases, the Federal Decree Law No. (9) of 2016 concerning Bankruptcy (the “**Bankruptcy Law**”) was recently amended to stipulate the conditions under which directors or managers of an insolvent company can be held liable.

While bank creditors are still reluctant to file bankruptcy cases and are being compelled to participate in bankruptcy proceedings triggered by debtors whether in a creditors committee (appointed by the trustee in bankruptcy) or ultimately in the liquidation proceedings of such debtor, there have been some instances where certain creditors have filed bankruptcy proceedings against debtors.

In this article, we examine the recent trends relating to the Bankruptcy Law that have emerged in the last year and explain how these trends will impact corporate entities.

The Marka PJSC Bankruptcy Case

A bankruptcy case was filed against Marka PJSC and other group companies (the “**Marka Group**”) by a creditor which was accepted by the Dubai Court of First Instance (the “**Court**”). Pursuant to this, the Court following the due process of law, appointed a trustee who collected proof of debts from the creditor and submitted its report indicating that restructuring was not a viable option.

The Court eventually ruled that the directors and managers of Marka Group were liable in the insolvent situation of the foregoing company. While making its decision, the Court referred to Articles 144 and 201 of the Bankruptcy Law and while deciding penalties, referred to Article 162 of the of Federal Law No. 2 of 2015 on Commercial Companies, as amended by Decree Law No. 26 of 2020 (the “**Companies Law**”).

In its decision, the Court relied on the applicable provisions of the Bankruptcy Law and emphatically declared that company does not have sufficient assets to cover at least 20% of its debts and its directors and managers have breached the law by not furnishing to the trustees the company’s audited financial statements, commercial books, and inventory reports. The Court further declared that the management concealed the company’s assets and accounts receivable without providing any justification for the alleged lack of assets despite the company’s extensive operations and huge turnover. Moreover, the Court decided that the management mismanaged the company, to the detriment of the interests of shareholders and creditors and the interests of the company itself and its subsidiaries and as a result held the company’s

directors and managers jointly liable for its debts up to an amount of approximately AED 448,000,000. In addition to the pecuniary liabilities, the Court also stripped the directors and managers of all rights to manage the company and its subsidiaries, imposed attachments/freezing orders on the personal assets of the directors and managers as well as ordered to notify the Public Prosecutor of such directors and managers breaches.

This decision of the Court remains subject to appeal and therefore, it is necessary to exercise caution while assessing the implications of this decision particularly in view of the recent amendments to the Bankruptcy Law (discussed below). Furthermore, one needs to consider the particular facts applicable to this case and the decision, including the reasoning behind it, which contains elements of punishment for failing to cooperate, coupled with the conclusion that there were actual breaches and mismanagement. It is also not clear whether this decision will be upheld if and when the directors and managers challenge the same. Ultimately, as it is not a strict liability, there has to be a finding of actual breaches and mismanagement. Notwithstanding this, the decision of the Court corroborates that the directors and managers of a company can also be held liable. It also serves as a reminder for directors and managers to fulfil their obligations and to take extra precaution during any period of financial instability, in particular when dealing with the antecedent transactions as stipulated in the Bankruptcy Law.

Federal Decree by Law No. (35) of 2021 Amending Provisions of the Bankruptcy Law

In order to bring clarity towards the situations in which the directors and managers of a bankrupt debtor will be held personally liable in the event that a debtor is not able to pay its debts, the Bankruptcy Law was amended by the Federal Decree Law No. (35) of 2021 (the “**Amendment**”), which came into effect on 1 November 2021.

Before the Amendment, Article 144 of the Bankruptcy Law imposed a personal liability on the directors and managers of a debtor on a discretionary basis when the debtor was not able to meet a minimum of 20% of its liabilities and where the directors and managers responsibility for the losses was evident in accordance with the provisions of the Companies Law.

The Amendment removes the reference of the Companies Law from Article 144 of the Bankruptcy Law and instead imposes personal liability on the directors and managers which is limited according to their responsibility for these debts directly linked to the following actions of such managers and directors:

- Undertaking excessive risks through commercial means, e.g. disposing assets below market value to acquire the assets with a view to avoid bankruptcy proceedings or delaying such proceedings;
- Entering into transactions with third parties to dispose of assets at no cost or for inadequate consideration without benefits proportionate to the debtor’s assets;
- Settling debts of any creditors with intent to cause damage to other creditors, during the period of the debtor’s cessation of payment or if such debtor is balance sheet insolvent.

It is important to note that unlike the time period of two years prescribed for antecedent transactions under the Bankruptcy Law, the Amendment does not appear to provide for any timelines for the above actions.

In addition, Article 201 of the Bankruptcy Law was also amended to impose a criminal liability on the directors, managers and liquidators of the bankrupt company by punishing them with imprisonment for a period not exceeding two years and a fine not exceeding AED 100,000 or with either penalties in case they commit any of the acts stipulated in this Article.

The Amendment follows the approach taken by the court in the Marka judgement which created a liability on the directors and managers of Marka Group.

Restructuring Case KBBO

In a well publicized case, an application was submitted by Khaleefa Butti Omair Yousif Almuhaire, a natural person (the “**Applicant**”) engaged in trade for the commencement of proceedings pursuant to the provisions of Part IV (Bankruptcy) of the Bankruptcy Law. It is interesting to note that this application was submitted under the Bankruptcy Law instead of the Federal Decree Law No. (19) of 2019 on Insolvency (which regulates the insolvency cases of a natural person) (the “**Personal Bankruptcy Law**”) on the basis that the Applicant is engaged in various businesses, is the owner and partner in numerous companies and business enterprises, based on which he had obtained commercial loans and bank guarantees. The Applicant had established that he had applied under the Bankruptcy Law in his capacity as a trader who is unable to pay the entire value of the debt demanded by the creditor banks because of a severe decline in his financial resources due to a decrease in the revenue of the companies which he owns or owns shares therein. Although, this unique aspect of the bankruptcy proceedings was challenged by certain designated creditors in order to remove the companies from the current proceedings and render the Applicant subject to the Personal Bankruptcy Law, the court accepted Applicant’s original application under the Bankruptcy Law.

In addition, it is also relevant to note that in the present case the court had appointed a natural person as the trustee, which was contested by various creditors, as they preferred the appointment of a specialist legal person rather than a natural person given the volume of debt. This view of the creditors was accepted by the court and two individuals from a prominent international chartered accountancy firm were appointed as additional trustees in this case.

Furthermore, while accepting the application, the court had also ruled to publish its decision to allow proceedings to continue along with the invitation to the creditors to file the proof of debt in an English and Arabic daily local newspaper. This turned out to be a challenge for the creditors based overseas with limited access to local newspapers. Contrary to global accepted practice, the trustees did not provide any guidance on submission of proof of debt which ultimately posed as a challenge to cross-border creditors as there was no clarity on whether to file proof of debt in English or Arabic. It is understood that the trustee is currently undertaking a debt mapping exercise (under the court’s supervision) and has circulated a provisional accepted creditors list for the Applicant.

Conclusion

It will be noteworthy to see how the cases and the Amendment mentioned in this article will unfold in 2022 and how they will affect the debtors and creditors as the resulting cases will establish precedents for future bankruptcy and restructuring cases. It is also important to note that while the UAE Central Bank’s stimulus package in the form of Targeted Economic Support Scheme applicable only to local banks is valid till 30 June 2022, the moratorium on filing of bankruptcy under the Cabinet Resolution 5 of 2021 on account of *Emergency Financial Crisis* expired on 31 July 2021.

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