

Summary of the draft Bankruptcy law

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The proposed Federal Law on Financial Restructuring and Bankruptcy (the “Law”) revolutionizes bankruptcy rules, for both individuals and companies, currently comprised within the civil law.

The Law provides structured arrangements, administered under direct Court supervision, which seek to balance the debtor’s and creditors’ needs.

The Law applies to:

- companies incorporated under the Commercial Companies Law, establishments and individuals engaged in commercial activity; and
- individuals.

The Law does not apply to Governmental Authorities (although it does apply companies owned by the Government) and entities in financial freezones.

The Law sets up a new regulatory body the “Committee of Financial Restructuring and Bankruptcy”. The Committee must administer the Law and administer the Law’s procedures.

The Law outlines twin gates through which any ‘debtor’ becomes subject to its processes:

- Payment Suspension – (i.e. the debtor has stopped meeting or servicing debts).
- Excessive Indebtedness – (i.e. the debtor’s assets do not cover liabilities)

A debtor in a position of Payment Suspension or Excessive Indebtedness can access the Law’s procedures to protect the debtor from other legal attacks. The Law provides for active involvement by creditors, who can attend meetings, inform court appointed experts of their debt claims, and vote on any proposed restructuring.

Financial ReOrganisation Procedures

The process provides for the Committee approving of a ‘consent agreement’ entered into between the debtor and the creditors under which the parties agree to enable the debtor to satisfy his debtors in part or in whole.

Preventative Composition Procedures

Similar to the Financial ReOrganisation Procedures a debtor, a regulatory authority or a creditor may apply to the Court for (or the Court may instigate itself) a Court sponsored and supervised plan for the restructuring of a debtor’s liabilities (a “Preventative Composition of Bankruptcy Plan”).

The Court will appoint as an agent of the debtor one or more ‘Supervisors of Composition’ (court registered bankruptcy experts and other specialists) to assist the debtor in the restructuring of the debtor’s liabilities. A judge may be appointed to supervise the process in complex cases. A Preventative Composition of Bankruptcy Plan must be lodged with the Court.

From the beginning of the Preventative Composition of Bankruptcy Plan period the debtor shall manage the ongoing conduct of his commercial or financial dealings under the direct supervision of the Supervisors of Composition (who have wide ranging powers to interfere in the conduct of the

debtor's business and affairs).

Creditors can apply for up to five observers to represent them in the Preventative Composition Procedures. The observer's job is to ensure that the views and interests of the creditors as a whole are represented throughout the process.

Bankruptcy Procedures

The Court may, upon a request from the Supervisors of Composition or at its instigation, transfer Preventative Composition Procedures into bankruptcy if it becomes evident that the Preventative Composition of Bankruptcy Plan will not deliver the results promised or that the debtor is in a hopeless position of Excessive Indebtedness. Should the debtor default under the obligations imposed by the Preventative Composition of Bankruptcy Plan this will also result in the termination of the Preventative Composition Procedures and a shift into bankruptcy.

A creditor owed more than AED 10,000 may petition the Court for the debtor's bankruptcy.

Whilst bankruptcy procedures in effect deprive the debtor of the power to manage the debtor's business and affairs; as all such powers are assumed by the Court appointed bankruptcy supervisor.

After a meeting of creditors is convened, the bankruptcy supervisor will produce a plan to the Court which will recommend either a restructuring plan or the liquidation of the debtor's assets. Once approved by creditors and the Court the key terms of the plan are published. The plan will set out time limits for returning the debtor to profit, the provisions recommended by the bankruptcy supervisor for settling all liabilities and the preferential treatment of creditors if justified. The restructuring plan cannot exceed five years in duration.

Liquidation

In the event of termination or vacation of bankruptcy procedures the Court can order the liquidation of the assets of the debtor. This can be by public auction or otherwise and the bankruptcy supervisor is obliged to liquidate all assets necessary to satisfy debts. The distribution of assets is subject to the Court's approval of a distribution plan.

Non-Trading Individuals

The Law also provides for specific provisions in relation to non-trading individuals (who maybe the subject of a liquidation process managed by an expert and involving the involvement of creditors in the drawing up of a plan for the restructuring of debts).

The expert will assist the debtor in satisfying his creditors, whilst at the same time arranging for a reasonable standard of living for the debtor and his dependents. The debtor is deprived of the ability to administer his works and cannot settle any amounts of more than AED 5,000 without the Court's approval.

In the event the liquidation process fails, the Court will order the liquidation of the debtor's assets and the Law provides specific procedures for the conduct of the same.

The Law also provides for the settlement of bankruptcy of a deceased's estate.

The Law contains specific provisions relating to the declaration of bankruptcy in companies and non-trading individuals. These provisions include: a stipulation that the shareholders in a company be a party to the bankruptcy declaration, and that the board of managers and directors are deemed responsible for the settlement of debts when the assets of the company are not sufficient to settle

twenty per cent of the company's debts.

Preferential Treatment of Creditors

The Law provides for prioritization of debts, with debts secured by senior or underlying security satisfied first and other debts in a scheduled order as set out in the Law.

The bankruptcy supervisor or Supervisors of Composition can apply to the Court to set aside any acts of the debtor prohibited by the Law. This has important implications, particularly for banks or trade creditors with exposure to the person in financial difficulty.

The Law also provides for a grievance procedure, an appeal process and criminal penalties and sanctions for the contravention of the Law.

Analysis

The Law represents a sea-change in the approach to the treatment of debtors in the UAE and presents significant implications for the administration of the procedures set out in the Law, not least given the lack of professionals and court officials expert in the handling of bankruptcy.