

Bankruptcy in the Context of UAE Law No. (18) of 1993 Concerning Commercial Transactions

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Part Five of the Commercial Transactions Law sets out provisions dealing with the bankruptcy procedure for traders who cease to pay their debts. This article will take a look at the bankruptcy provisions of the Commercial Transactions Law.

Definition of Bankruptcy

Section 1 of Article 645 of the Commercial Transactions Law provides:

“Subject to the provisions of preventive composition, any trader who ceases to pay his commercial debts when due because of financial distress and credit issues may be declared bankrupt.”

Accordingly, bankruptcy can be defined as a situation where a trader ceases to pay his commercial debts when due because of financial distress.

“Trader” means an individual or an entity (such as a commercial company).

UAE Courts consistently uphold the definition of bankruptcy in Article 645. The Federal Supreme Court has held: “A trader is subject to bankruptcy provisions if he is unable to pay his debts.” i.e. his debts must exceed his financial capacity. The Federal Supreme Court has also confirmed that a trader’s financial distress would warrant a declaration of bankruptcy (Federal Supreme Court – Appeal 236 of Judicial Year 9 – 12.07.88, which preceded the Commercial Transactions Law and was issued at a time when the courts applied the principles of comparative jurisprudence. See also Federal Supreme Court – Appeal 493 of Judicial Year 18 – 26.10.97).

Conditions for Bankruptcy

Section 3 of Article 645 provides:

“Bankruptcy shall be declared by order of the competent civil court.”

There are three conditions for bankruptcy:

- the debtor filing for bankruptcy must be a trader;
- the debtor must have ceased paying his commercial debts; and
- bankruptcy must be declared by order of the court.

Therefore, the person filing for bankruptcy must be a trader in the sense of being engaged in a commercial activity either as an individual or as a corporate entity (e.g. a company).

This aspect is particularly crucial due to the fact that individuals who are not engaged in trade or a

commercial activity may also become unable to pay their debts due to insufficient financial means. Being non-traders, these individuals are subject to the insolvency provisions of Law No. 5 of 1984 'Concerning Civil Transactions', as amended. This is because a person, other than a trader, who is unable to pay his debts is considered to be in a state of insolvency, not bankruptcy.

Types of Bankruptcy

1. Simple Bankruptcy

Simple bankruptcy occurs when a trader is unable to pay his debts due to circumstances beyond his control.

2. Negligent Bankruptcy

Negligent bankruptcy occurs when the debtor is unable to pay his debts due to personal expenses or spending large amounts of money in fictitious speculations. This form of bankruptcy is a misdemeanour punishable by two years imprisonment or a fine of up to AED 2,000 under Article 880 of the Commercial Transactions Law. Furthermore, according to Section 1 of Article 649 of the Commercial Transactions Law, a trader will be guilty of an offence of negligent bankruptcy if he fails to file for bankruptcy within thirty days from the date on which that trader ceases to pay his debts. This was confirmed by the Federal Supreme Court in Appeal 242-2010 where it held: "A trader shall file for bankruptcy if the condition set forth in Article 649 of the Commercial Transactions Law is satisfied i.e. a trader in financial distress being required to file for bankruptcy within thirty days of ceasing to pay his debts or else be considered guilty of negligent bankruptcy."

3. Fraudulent Bankruptcy

A debtor is said to be fraudulently bankrupt and liable for imprisonment for a term not exceeding five years in the following circumstances:

- the debtor has concealed, destroyed or altered, in whole or in part, its books or business records;
- the debtor has misappropriated or concealed part of its funds to the prejudice of its creditors;
- the debtor has knowingly acknowledged undue debts whether such acknowledgement is made in writing, given verbally, stated in the balance sheet or by abstention from submitting certain papers or explanations; or
- the debtor has fraudulently secured an arrangement with its creditor.

If a company that fraudulently filed for bankruptcy is declared bankrupt by final order of the court, its directors, managers, or liquidators shall be liable to imprisonment for a term not exceeding five years if they commit one of the following acts:

- the books of the company are concealed, destroyed or altered;
- the company's funds are misappropriated or concealed, in whole or in part;
- undue debts of the company are knowingly acknowledged or documents that need to be submitted are withheld even though they are in possession;
- an arrangement with creditors is obtained fraudulently; or
- false information is declared on the subscribed or paid up capital, or fictitious profits are distributed.

It should be noted that the form of bankruptcy has no bearing on the provisions applicable to bankruptcy or its effects. All forms of bankruptcy are governed by the same rules and procedures found in the Commercial Transactions Law. However, as noted, negligent and fraudulent bankruptcy would subject the debtor to imprisonment or a fine.

Bankruptcy Order and the Competent Court

As noted earlier, the conditions for bankruptcy include bankruptcy being declared by order of the competent court pursuant to Section 3 of Article 645 of the Commercial Transactions Law. A debtor is not automatically bankrupt despite having ceased to pay its debts; to be made bankrupt a court has to issue a bankruptcy order against the debtor. The bankruptcy order establishes a state of bankruptcy as an exception to the general rule that court rulings enforce rights.

Furthermore, according to Section 4 of Article 645 of the UAE Commercial Transactions Law, unless otherwise provided by law, the cessation of payment or the use, by a trader, of irregular or illegal means for payment of its debts, does not amount to bankruptcy unless a bankruptcy order is issued (although some jurisdictions do recognise the notion of actual bankruptcy, the UAE does not).

The Civil Court of First Instance has jurisdiction over bankruptcy matters, with the particular court being the local court of the domicile of the debtor or the place where the debtor carries out its commercial activities. If the debtor owns several commercial establishments, the local court of the debtor's principal place of business would have jurisdiction.

Finally, cases of negligent bankruptcy fall under the jurisdiction of the criminal courts, rather than the civil courts according to Articles 418 and 419 of Law No. (3) of 1987 'Promulgating the Penal Code', as amended.

Who May File a Bankruptcy Application?

Article 647 of the Commercial Transactions Law lists the persons who may file a bankruptcy application as follows:

1. The Debtor

The debtor is in the best position to determine its financial state and should therefore consider filing for bankruptcy if it is unable to pay its commercial debts.

2. Creditors

Every creditor, regardless of the size of its claim, may also apply for its debtor to be declared bankrupt, provided that the creditor submits proof that the debtor has ceased payment of its commercial debts.

3. The Court

The court, at the request of the public prosecution department or on its own motion, may declare a debtor bankrupt.

Taking a departure from the legal rule that courts cannot give relief not sought by the parties, the Commercial Transactions Law, exceptionally, allows the competent court to declare a debtor bankrupt of its own accord as bankruptcy rules form part of public policy.

When entering judgment declaring a debtor bankrupt on its own accord, the court should forthwith notify the debtor pursuant to Article 648 of the UAE Commercial Transactions Law.

The Effect of a Bankruptcy Order

A bankruptcy order will have consequences for the debtor and its assets as well as the creditors. In relation to the debtor:

- The bankruptcy judge will, at the request of the public prosecution department or the bankruptcy trustee, or on the judge's own motion, order an attachment against the debtor if it has deliberately concealed its assets or books or has failed to comply with the bankruptcy judge's orders. The judge may also put the debtor under surveillance. The debtor has the right to appeal the bankruptcy judge's order

of imprisonment or surveillance although an appeal would not act to stay enforcement of the imprisonment or surveillance order, according to Sections 1 and 2 of Article 682 of the Commercial Transactions Law.

- The debtor is prevented from administering and disposing assets.
- The debtor loses some professional and civil privileges, i.e. capacity to vote and capacity to be elected to parliamentary councils and chambers of commerce and industry.

The main implication for creditors is that as soon as the bankruptcy order is issued, a group of creditors is established by operation of law. The group of creditors consists of persons who had valid claims on the debtor before the bankruptcy order was issued.

The bankruptcy order also acts to suspend individual proceedings and actions brought against the debtor by ordinary creditors or preferred creditors.

Termination of Bankruptcy

Article 762 of the Commercial Transactions Law stipulates that bankruptcy is terminated after the schedule of debts referred to in Article 757 of the law has been satisfied. These debts would be uncontested and evidenced by proper documentation. At this stage, the debtor may apply to the bankruptcy judge for the bankruptcy to be terminated.

The court cannot enter judgment terminating the bankruptcy on grounds that the group of creditors' interest has ceased until it has reviewed the report of the bankruptcy judge confirming the satisfaction of either of the two conditions set forth in Article 762 of the Commercial Transactions Law. Those conditions are the debtor satisfying all creditor claims submitted against the assets of the bankruptcy or lodging with the court or the bankruptcy trustee money sufficient to discharge those claims (principal, interest due and bankruptcy costs).

Bankruptcy is also terminated on approval of a deed of arrangement, after the bankruptcy judge invites creditors whose debts have been provisionally or finally accepted to attend deliberations on the deed of arrangement under – Section 1 of Article 764 of the Commercial Transactions Law.

Conclusion

In closing, I would point out that bankruptcy rules form part of public policy as they promote creditworthiness. This means that bankruptcy rules apply immediately to effects that have not become finally established which arise after the rules come into force, even from pre-existing legal positions, without the need for this to be specifically stated by law. This has been confirmed by rulings of the Court of Cassation and the Federal Supreme Court in bankruptcy cases.

In a future Law Update issue, I will discuss arrangements and corporate bankruptcy in the context of the Commercial Transactions Law.