

The New Saudi Arabian Bankruptcy Law

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These days it seems as if all roads in Saudi Arabia lead to Saudi Vision 2030 and the National Transformation Programme (NTP), the government's strategy to modernise and diversify the Saudi economy.

Amongst other things, the government has signalled that it wants to see a far greater level of private sector participation in many areas of the economy than has previously been the case. This has led to a number of reforms designed to facilitate and pave the way for that investment and especially foreign investment.

Investors want to know how their investment will be protected and how effective those protections will be if they need to be relied upon. Amongst other things, this includes knowing what their rights and obligations will be if their investment runs into financial difficulty.

The lack of a modern fit-for-purpose insolvency regime has been a major bugbear for businesses, professional advisors and others doing business in Saudi Arabia. Some of the problems encountered include the following:

- Disorderly collection of debts resulting in some creditors being paid but others missing out entirely;
- Little scope for workouts with the result that creditors and debtors may both be disadvantaged;
- Reduced prospects of survival of a viable business experiencing a temporary hiccup;
- Lack of or no information on whether a proposed counterparty was insolvent;
- A large number of lawsuits resulting from a multiplicity of legal claims (this has been a feature of several large corporate insolvencies in Saudi Arabia); and
- Debtors attempting to defeat creditors' claims by concealing assets or disposing of them prior to insolvency at less than fair value or for no value at all.

In 2016, the Saudi Arabian Ministry of Commerce and Investment (MOCI) announced plans to issue a Bankruptcy Law and published a draft of the proposed Law. This followed on from a policy paper published by MOCI in 2015, which sketched the broad outline of a proposed Bankruptcy Law.

The long awaited new Bankruptcy Law (New Law) was published in the Official Gazette on 23 February 2018, and is expected to come into force by no later than the third week of August 2018.

Saudi courts have traditionally been reluctant to make an order declaring a debtor to be bankrupt, until all feasible methods of debt enforcement have been exhausted. Even then, some judges have been unwilling to make a bankruptcy order. This had resulted in protracted and in many cases unsuccessful debt enforcement.

There has also been little or no effective protection for a debtor whose business is facing financial difficulties, but which remains financially viable. In practice, where there are several creditors there may be no scope for that debtor to trade his way out of those difficulties and restore the financial health of his business. However, preserving the business in some form may be in the best interests of most if not all creditors and this especially the case with small creditors - even if it means receiving less than their due.

The New Law contains many of the features of a modern western styled insolvency regime reflecting the extensive benchmarking process, which occurred prior to it being drafted as part of its development. As

well as establishing some new forms of insolvency administration, the New Law tidies up some issues which have caused problems to creditors when dealing with insolvent debtors.

The New Law runs to 231 Articles and this article summarises the headline changes.

Aims of the New Law

The New Law aims to:

- Help a bankrupt or insolvent debtor who is expected to suffer financial disruption to reorganise his financial position, resume his activities and contribute to economic support and development;
- Ensure fair consideration of creditors' rights and ensuring the equitable treatment;
- Maximise the value and regular sale of assets in bankruptcy, as well as ensure fair distribution thereof to creditors upon liquidation;
- Reduce the cost and length of legal proceedings and enhance their effectiveness; and
- Provide a simplified liquidation of debtors whose assets, if sold, are not expected to be sufficient to meet the expenses of liquidation.

To whom does the New Law apply?

The New Law has an extended reach and applies to:

- Individuals/ Corporations carrying on commercial, professional or for-profit businesses in Saudi Arabia; and
- Non-Saudi investors who have assets in Saudi Arabia or carry on commercial, professional or for-profit business through a licensed entity .

The New Law will also apply to regulated entities such as banks, insurance companies and telecommunications companies. However, it preserves the right of certain regulators (for example, Saudi Arabian Monetary Agency and Capital Market Authority) to issue regulations for their own regulated entities covering bankruptcy issues. They may make regulations excluding regulated entities from provisions of this law or impose additional regulations, obligations or requirements.

Insolvency and Bankruptcy

The New Law distinguishes between a person who is "Insolvent" and a person who is "Bankrupt". An "Insolvent" is a debtor who fails to discharge a debt on its due payment date. It is unclear whether this is intended to be a departure from the generally understood meaning of insolvency being an inability to pay debts as they fall due. The definition in the New Law might be read as suggesting that the failure to pay any debt on its due date means he is "insolvent". It remains to be seen whether the Saudi courts take that view.

A "Bankrupt" is a debtor whose debts have consumed all his assets.

Logically a Bankrupt must also be an Insolvent. However, an Insolvent will not be a Bankrupt unless he has no his assets. Taken literally this suggests that the existence of any assets would preclude a debtor being a Bankrupt.

The New Law establishes work out procedures which are intended to forestall the need for liquidation where a person is Bankrupt or Insolvent. These are summarised below:

Preventative Settlement

The debtor may apply to the Court for the initiation Preventative Settlement Procedure if:

- It is likely he will experiencing financial issues and insolvency is a concern;
- He is Insolvent;
- He is Bankrupt.

The debtor may request a suspension of claims and the court may order a temporary extension for up to 90 days which can be extended, provided the period of suspension does not exceed 180 days. During the period of suspension, claims against the debtor and enforcement procedures are stayed. Subject to stated exceptions:

- The application for the initiation of the Preventive Settlement Procedure does not have any impact upon contracts to which the debtor is a party or accelerate payment liability and any condition to the contrary is void;
- Contracts to which the debtor is a party remain in full force (provided the debtor continues to perform his contractual obligations).
The stated exceptions are contracts with financing companies and government procurement contracts.

Financial Restructuring

This is defined as follows:

“Procedure that aims at facilitating the debtor’s coming to terms with his creditors regarding the financial restructuring of his business under supervision of a Financial Restructuring Officer.”

The debtor, a creditor or the regulator of the debtor, may make the financial restructuring application.

The court and creditors whose claims represent two thirds of the value of debts in the same class must approve the financial proposal.

The request for a financial reorganisation results in the suspension of claims until:

- the date of the request is rejected;
- the request is approved by the court; or
- the earlier termination of the financial reorganisation without approval of the court.

If the court approves the Financial Restructuring Proposal it will appoint a trustee (the Financial Restructuring Officer) who will, amongst other things, supervise the debtor’s activity during the financial restructuring to ensure fairness of the procedure and its execution. The debtor will also need to obtain the trustee’s approval before undertaking any of a large number of specified actions that may have an impact on his asset and liability position.

Once the court approves the financial structuring, it applies to all creditors.

Liquidation

The debtor, a creditor or the regulator of the debtor may apply to the court to initiate a liquidation procedure for the debtor if the debtor is insolvent or bankrupt. This can be done where:

- The debtor is insolvent or bankrupt;
- The debtor believes – based on the information he has – that it is impossible to continue his business with his assets being sufficient to cover the expenses of the liquidation procedure; or
- In the case of an application made by a creditor it is able to satisfy a number of formal requirements, notably that the debt is due and is for a definite amount.

Given the alternative forms of insolvency administration provided for by the New Law, liquidation should be regarded as last resort procedure.

A liquidation trustee is appointed and the trustee will assume the management of the debtor’s assets.

Liquidation will result in the assets of the bankrupt being sold and the proceeds distributed amongst the creditors under the management of a liquidation trustee.

The liquidation trustee will liquidate the debtor’s assets, list debts, and distribute proceeds of liquidation between creditors according to their debt’s priority.

Upon completion of liquidation, if there are no surplus assets, the liquidation trustee will take the necessary measures to wind up the company (if the debtor is a company).

There are special arrangements for the liquidation of small debtors.

Other Noteworthy Changes

- **Set-off and Debt Mutualisation:** The New Law regulates rights of set-off in order to maintain equity between creditors. It prohibits set-offs once preventive settlement and financial reorganisation have been commenced. However, set-offs which occur automatically are allowed.
- **Priority of Debts**

For the first time an order of priority is established with a “higher priority debt” being paid before a “lower priority debt”, in accordance with the following order:

 - In-kind guaranteed debts;
 - Certain types of “guaranteed finance” obtained in preventive settlement and financial restructuring procedures;
 - Debts due to employees’ equivalent to 30 days remuneration;
 - Family costs prescribed under a judgment;
 - Expenses necessary for the continuation of the debtor’s activity during the procedure;
 - Wages of previous employees;
 - Non-guaranteed debts; and
 - Non-guaranteed governmental fees, subscriptions, taxes and dues as specified in the Regulations.
- **Certain Transactions may be set aside**

Transactions done with the intent to defraud creditors, conceal debtor’s assets, or harm creditors and stockholders are prohibited. The court may set aside actions or transactions, which have the effect of violating this requirement and order the recovery of any debtor’s assets and the payment of compensation.

Violations are subject to stiff penalties including:

 - Imprisonment for a term not exceeding five years and/or a fine not exceeding five millions Saudi Riyals;
 - Restrictions on carrying on, managing or co-founding certain businesses.
- **Bankruptcy Register**

A Bankruptcy Registry will be established in which the provisions of the Law shall be recorded. Regulations (which have not yet been published) will specify what is to be recorded in the Bankruptcy Register. The bankruptcy register will be open to public inspection.