

Bahrain Introduces New Insolvency Regime

- Manama, Bahrain

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In line with Bahrain's Economic Vision 2030, the Kingdom of Bahrain recently introduced Law No. (22) of 2018 promulgating the Restructuring and Insolvency Law ('New Law'), as a step towards strengthening the legal framework and business ecosystem in Bahrain. The New Law is expected to boost transparency and efficiency in the insolvency process and improve the ease of doing business in Bahrain.

Published on 30 May 2018, and coming into force on 30 November 2018, the New Law repeals the old Bankruptcy and Composition Law (Law No. (11) of 1987).

The Ministry of Justice and Islamic Affairs ('Ministry') will be in charge of matters relating to restructuring and insolvency, and the competent court will be the High Civil Court of Bahrain ('Court').

Bolstering Good Practices

This article focuses on the ways in which the New Law will bring in reforms to bolster globally accepted good practices in Bahrain that include:

- promoting reorganisation or liquidation procedures;
- regulating the profession of insolvency administrators;
- strengthening creditors' rights;
- clarifying rules for commencing insolvency proceedings;
- improving provisions applicable to treatment of contracts and voidable transactions; and
- introducing provisions on post-commencement financing.

Application of the New Law

The New Law defines 'debtors' in insolvency proceedings as:

- commercial companies established in Bahrain (including those established by virtue of law or decree); and
- natural person traders who either do business or have their headquarters in Bahrain.

Two noteworthy aspects of the New Law are it:

- does not apply to entities licenced and regulated by the Central Bank of Bahrain ('**CBB**'); and
- provides for cross border insolvency proceedings where a foreign element is involved (elaborated on further below).

Commencing Insolvency Proceedings

An action to commence insolvency proceedings may be instituted by either a debtor or a creditor upon satisfaction of the insolvency test. A debtor satisfies the insolvency test if the:

- debtor is unable to pay its debts on the maturity dates or fails to pay such debts within 30 days of their maturity or from date of the creditors' notice to pay; or
- value of the debtor's financial obligations exceeds the value of its assets.

The Court, before approving an application by either party to commence insolvency proceedings, will verify whether the conditions stipulated above are satisfied and will provide the debtor (where a creditor institutes an action) or a creditor (where a debtor institutes an action) the opportunity to object to such action.

The New Law compels the Court to decide on an application for restructuring before hearing an application for liquidation. The Court is bound to agree to restructuring if:

- by doing so, it achieves a settlement more favourable to the creditors than liquidation; or
- it is economically justifiable for the debtor to continue its business.

By promoting and prioritising debt restructuring proceedings over liquidation procedures, the New Law aims to prevent the liquidation of businesses with potential and reduce failure rates amongst small and medium-size enterprises.

However, in cases where the Court approves the commencement of liquidation proceedings, the debtor is deemed bankrupt and must declare its bankruptcy.

The New Law also provides affected stakeholders with a right to object to the Court's decisions regarding the commencement of proceedings and sets out grounds on which the Court's decisions may be challenged before the Supreme Civil Court of Appeal.

The Insolvency Trustee (alternatively referred to as a Restructuring Trustee or a Liquidator where relevant) is appointed by the Court to perform related duties and tasks in liquidation or restructuring proceedings.

The Court may appoint an Insolvency Trustee based on one of the following:

- the nominations by a creditors' committee (which may be formed to represent unsecured creditors);
- nominations by the creditors that own at least ten percent of total unsecured debts; or
- the Court's own discretion.

The powers of the Insolvency Trustee are regulated by the New Law and include, amongst others:

- the right to submit a request to the Court for a stay of judicial proceedings and procedures;
- abatement of the legal or contractual interests;
- termination of the contracts concluded by the debtor;
- non-enforcement of any dispositions made by the debtor; or
- other requests deemed necessary for the performance of the Insolvency Trustee's duties.

Insolvency assets

The New Law significantly widens the net of assets which may now be subject to insolvency proceedings. These include:

- debtor's movable and immovable properties located in Bahrain and/or abroad;
- properties acquired after commencement;
- debtor's rights in properties owned by third parties;
- funds and proceeds generated by the continuation of the debtor's business operations;
- proceeds from the insolvency assets of all kinds and nature; and
- funds recovered through avoidance proceedings.

Stay of Proceedings and Moratoria

The commencement of insolvency proceedings automatically causes a stay of any other judicial proceedings or execution procedures on the insolvency assets, such as any debt enforcement procedures against the debtor's insolvency assets, any attachment or enforcement on encumbered properties of the debtor, or any acquisition over any 'insolvency asset' (as defined above).

Unless the Court specifies otherwise, the moratorium continues until:

- the scheme of restructuring comes into force;
- the termination of liquidation; or
- upon the sale or exclusion of debtor's properties from the insolvency assets.

Set-Off Rights

Set-off rights arising prior to the commencement of insolvency proceedings may be invoked against the insolvency assets if they are effective under the applicable law, but are subject to the stay of proceedings and moratoria, as discussed above.

However, the Court may, at the request of an unsecured creditor, terminate the stay of unsecured claims if both the:

- debt is subject to a right of set-off, and
- set-off effectively enhances the administration of the insolvency assets.

Doing Business

Importantly, commencement of insolvency proceedings does not prevent the debtor from continuing its day-to-day business as well as utilising its properties for necessary transactions, if carried out in the ordinary course of business.

In the case of a restructuring, the Insolvency Trustee may, with due authorisation, manage the debtor's business and execute unperformed contracts concluded by the debtor in the ordinary course of business. Whereas, at a liquidator's request, the Court may approve the operation of the debtor's business for a limited period if doing so maximises the value of the assets.

The Insolvency Trustee may, with the Court's approval:

- assume or assign an unperformed contract to which the debtor is a party to, if the contract is in the best interests of the insolvency assets; and/or
- terminate an unperformed contract if proven that the contract is not in the best interests of the

insolvency assets.

The disposal of insolvency assets outside the ordinary course of business may be undertaken with the Court's approval, if such disposal is considered to be in the best interests of the insolvency assets. A disposal of a secured asset may be done free of security only with a creditor's consent, and if:

- the cash proceeds are not less than debt or market value; and
- the asset is disposed of under a scheme of restructuring.

If the asset is disposed of free of security, then security will be granted over the proceeds from the disposal. A secured creditor may also purchase assets and set off the disposal amount against the secured claim.

Voidable transactions

The Insolvency Trustee may, with the Court's approval, invalidate any disposition performed or obligation of the debtor if it:

- were performed with the intent to defraud creditors; or
- involved an unfair consideration that resulted in the debtor's insolvency.

The voidable transaction(s) must have occurred in the six month period prior to commencement (i.e. the clawback period).

Restructuring

The New Law stipulates that the Restructuring Trustee may submit the proposed scheme of restructuring to the Court after consultation with the debtor, the secured and unsecured creditors, and any other stakeholders. Alternatively, creditors (whose claims amount to at least one third of the total claims) may, with the Court's approval, submit the restructuring scheme if the Restructuring Trustee fails to make appropriate progress and the scheme is in the best interests of the debtor's assets.

The scheme of restructuring will be subject to a vote by the creditors whose rights are affected by the scheme and the Court may either ratify or reject the scheme. Ratification of the scheme will discharge the debtor from all financial obligations and rights arising prior to such ratification. The Restructuring Trustee is responsible for making the distributions to all creditors in accordance with the scheme.

Liquidation

The Liquidator is responsible for selling the insolvency assets in accordance with a scheme for such sale and must submit an application to the Court along with a report that determines:

- the properties available for distribution; and
- the proposed amounts to be distributed to creditors and other claimants.

The priority of creditor distributions is set out in the New Law in the following order:

1. secured creditors;
2. unsecured financing obtained after commencement of insolvency proceedings;

3. administrative costs and claims of the insolvency proceedings;
4. employee claims for due wages and financial benefits (not exceeding BHD 3,000 per employee);
5. customer claims for advance payment made to debtor for purchase of goods & services (not exceeding BHD 1,000 per customer);
6. claims of government agencies for taxes and/or fees (not exceeding BHD 10,000 per agency);
7. unsecured claims arising prior to the commencement of insolvency proceedings;
8. unsecured claims arising prior to the commencement of insolvency proceedings not filed within the stipulated time frame but filed in a timely manner to determine right of distribution;
9. claims of foreign government agencies (if any) for taxes and/or fees;
10. unsecured claims of shareholders as compensation for late payment; and
11. claims of shareholders for their ownership of shares.
12. Another key aspect of the New Law is the provision that permits the conversion of the restructuring into a liquidation (and vice versa) if it is in the best interests of the debtor's assets.

Cross-border Insolvency

A feature of the New Law that particularly stands out is the provision of a mechanism for cooperation between courts and competent authorities in foreign countries and Bahrain which are involved in cross-border proceedings.

The cross-border insolvency provisions in the New Law apply to:

- assistance applications submitted by a foreign court or representative in connection with any foreign proceedings;
- assistance applications submitted in a foreign country in connection with insolvency proceedings under the New Law;
- any foreign proceedings initiated against a debtor at the same time as proceedings initiated with respect to the same debtor under the New Law; and
- applications submitted by a creditor or any foreign stakeholder for the initiation of or participation in insolvency proceedings against a debtor under the New Law.

A 'foreign proceeding' is defined as any judicial or administrative proceeding taken in accordance with the foreign country's insolvency law, and in which the debtor's properties and affairs are subject to the supervision of a foreign court. Foreign proceedings are further classified into:

- "Foreign Main Proceedings": proceedings in a country where the debtor has main interests; and
- "Foreign Non-Main Proceedings": proceedings initiated in a country where the debtor has a presence.

Foreign creditors are accorded equal rights and treatment as creditors in Bahrain with respect to the commencement and participation in insolvency proceedings under the New Law.

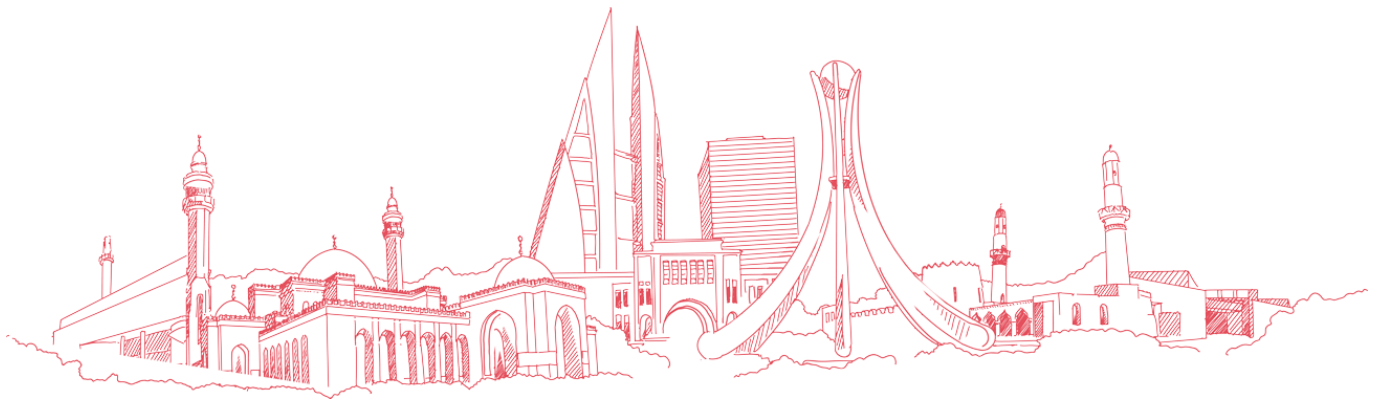
For recognition of foreign proceedings, the foreign representative must apply to the Court, upon which the Court will classify proceedings either as a 'foreign main proceeding' or as a 'foreign non-main proceeding'. The recognition of a foreign proceeding as a 'foreign main proceeding' will result in the stay of judicial or enforcement proceedings against the debtor's assets and is proof of the debtor's insolvency.

The provisions governing cross-border insolvency will be interpreted in accordance with the guidelines of the UNCITRAL Model Law on Cross-Border Insolvency.

Other Noteworthy Aspects

- **Insolvency Register:** the Ministry has established an insolvency register called the Bankruptcy Record, which will reflect all relevant details of every bankruptcy case (such as information on the debtors, relevant parties, the trustee, etc.) and will be available online for public access.
- **Financial Derivatives Contracts:** these are exempt from any stay of proceedings or moratoria prescribed by the New Law upon the commencement of insolvency proceedings. The New Law does not delay, stay or limit the exercise of rights of the other contracting party against a debtor arising from a financial derivatives contract.

The New Law is a significant step towards dissolving the stigma of insolvency amongst businesses operating in Bahrain, by providing efficient exit frameworks, whilst allowing lenders in the market to make significant recoveries. An effective insolvency system enables capital and labour reallocation as well as the re-entry of entrepreneurs into the economy when small and medium-sized businesses fail, thus preventing the loss of investments, jobs and viable businesses.



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