

## Insolvency Law for Individuals in the United Arab Emirates

Federal Decree-Law No. 19 of 2019 on Insolvency ("Insolvency Law") is the first comprehensive insolvency law for individuals in the United Arab Emirates ("UAE"). The law aims at distributing the consequences of financial distress and indebtedness more appropriately than before between debtors and creditors.

### Why was the Insolvency Law enacted?

Before the Insolvency Law came into force, the UAE did not provide for a legal framework for the insolvency of individuals. Neither an orderly procedure for indebted individuals to restructure their debts nor a procedure allowing for a rehabilitation of the debtor was available. The Insolvency Law closed this gap.

### To whom does the Insolvency Law apply?

The law applies to indebted individuals who do not fall within the scope of Federal Decree-Law No. 9 of 2016 on Bankruptcy ("Bankruptcy Law"). Hence, in principle, the Insolvency Law does not apply to those natural persons who are active as so-called traders as traders are already subject to the Bankruptcy Law. Whilst debts incurred in the course of a trader's activities thus fall within the scope of the Bankruptcy Law, the Insolvency Law is likely to apply to debts incurred by a trader in his personal capacity.

The Insolvency Law defines the term debtor as a natural person who is in insolvency. Insolvency is defined as a state in which a debtor faces actual or potential financial difficulties that make the debtor unable to settle his debts.

### What types of proceedings does the Insolvency Law set out?

The Insolvency Law provides for two procedures with different objectives.

#### a. Procedure of settlement of financial liabilities

The procedure of settlement of financial liabilities is available to a debtor who is currently or may be experiencing payment difficulties in respect of claims already due or which may become due in the future and whose inability to pay has lasted for no more than 50 consecutive working days. The procedure is a debtor-led procedure that enables the debtor to settle his debts on the basis of a court-approved settlement plan within a maximum period of three years under court and expert supervision. The procedure serves to protect the debtor from a declaration of insolvency and liquidation of his assets.

#### b. Procedure of insolvency and liquidation

The insolvency court may not initiate a procedure for the settlement of financial liabilities if the debtor has not paid due debts for more than 50 consecutive working days as a result of his inability to pay such debts. The debtor must rather apply to

the competent court to initiate insolvency and liquidation proceedings for the repayment of his debts.

It is currently unclear whether the debtor's obligation to file an application extends to small claims as well because the exact value of debts requiring the debtor to submit an application is yet to be determined by way of a Cabinet Resolution.

### Which steps need to be followed in a procedure of settlement of financial liabilities?

Only the debtor himself can file an application for the opening of a procedure of settlement of financial liabilities. Creditors or third parties are not entitled to submit such application. The application must be accompanied by extensive documentation, such as a list of creditors and a list of assets.

During the proceedings, a settlement plan has to be drawn up by a court-appointed expert and subsequently implemented under the supervision of the expert. For this purpose, the expert sells the assets specified in the plan at the best possible price that can be achieved taking the market conditions prevailing at the time of the sale into account. Every three months, the expert must submit a progress report to the court. The debtor remains authorised to manage his affairs during the proceedings. If the debtor ceases to make payments due for more than 50 consecutive working days because of his incapacity to fulfil these debts, the court must order the termination of the proceedings.

### Are third parties entitled to apply for the commencement of insolvency and liquidation proceedings?

An application for the commencement of insolvency and liquidation proceedings can be filed not only by the debtor himself but also by third parties. One or more creditors are entitled to file an application if there are (joint) claims of at least AED 200,000 against the debtor, a notice for repayment had been made and no repayment of the claim was affected within 50 consecutive working days from the date of notice.

In addition, the court itself may initiate such proceedings, for example in case of termination of a procedure of settlement of financial liabilities or a cancellation of a settlement plan.

### What is the process for the liquidation of assets?

The liquidation of the debtor's assets is managed by the trustee.



In principle, all assets of the debtor are subject to liquidation. Under strict conditions, the house which the debtor takes as domicile may also be liquidated. Pension payments and social benefits as well as funds of the debtor that are determined by the court to be necessary for the needs of living of the debtor and his dependants are protected from being subject to liquidation.

The debtor's assets are generally sold in an auction. The proceeds are distributed to the creditors in accordance with a specific order of priority regulated by law.

### **What are the consequences of the commencement of insolvency and liquidation proceedings for the debtor?**

Following the court's decision to commence insolvency and liquidation proceedings, the debtor is subject to extensive legal restrictions. For example, all debts become due immediately and the debtor is largely prohibited from disposing of his funds and properties. He is further restricted from making any payments exceeding an amount of AED 5,000 without the consent of the trustee.

As a result of the determination of insolvency and implementation of the liquidation of the debtor's assets, the debtor is prohibited from obtaining new loans or financing for a period of three years from the judgment of insolvency and from entering into other obligations for a period of three years from the judgment of the debtor's insolvency and liquidation of assets. Amounts required to meet the necessary needs of the debtor and his dependants are exempt.

In addition, any debtor whose insolvency has been judicially determined and whose assets have been ordered to be liquidated is to be entered in a special insolvency register yet to be created.

### **When is a debtor subject to rehabilitation?**

Rights that the debtor has been deprived of as a result of the insolvency and liquidation proceedings are restored after three years from the date of the completion of the proceedings. If the debtor has settled 50% of his debts, the period is reduced to two years. A reduction to one year is granted if the debtor has repaid 75% of his debts.

The debtor's rights are to be restored regardless of the lapse of a specific period of time, provided that he has settled all debts previously accepted by the court prior to its ruling on the declaration of insolvency and liquidation. The same applies if the debtor enters into a settlement with his creditors and abides by the covenants set out therein or if the debtor proves that all creditors have discharged him of all debts due after the court declared the insolvency and liquidation.

### **Are debtors at risk to face criminal prosecution?**

An important new development under the Insolvency Law is that

debtors may be protected from prosecution for issuing bounced cheques for the duration of both proceedings mentioned above. However, the issuance of bounced cheques remains a criminal offence under UAE law even for indebted private individuals. If the court commences one of the insolvency proceedings, it may order, at its own discretion or at the debtor's request, the suspension of criminal proceedings for issuing bounced cheques, provided that the cheque was issued before the application for commencing one of the proceedings set out in the Insolvency Law. In the event of a suspension of criminal proceedings, the beneficiary of the bounced cheque is considered a creditor and his claim becomes part of the debtor's total debt.

### **What is the effect on civil proceedings?**

During the procedure of settlement of financial liabilities, a moratorium protecting the debtor is generally applicable. The effect of such moratorium is that, amongst other things, the creditors' right to request the execution of the debtor's assets is generally suspended.

For the duration of insolvency and liquidation proceedings, all legal or judicial proceedings against the debtor, including enforcement proceedings against his assets, are suspended in general as well, however, with the exception to guaranteed claims.

It is currently unclear whether debtors will continue to be subject to the imposition of travel bans.

### **In how far has the legal position of debtors and creditors changed under the new regulations?**

The enactment of the Insolvency Law significantly improves the legal position of indebted individuals in the UAE. For the first time, the UAE law provides for a comprehensive set of rules that enables debtors to either restructure their debts or to file for insolvency in accordance with a statutory-prescribed procedure. In addition, debtors can be protected from imprisonment for bounced cheques issued in any amount for the duration of the insolvency proceedings.

The legal position of creditors is likely to improve under the Insolvency Law as well because they are now generally entitled to apply for the commencement of insolvency proceedings. Such right can possibly be used as leverage in negotiations with defaulting debtors. At present, however, the effect of the partial decriminalisation of the issuance of bounced cheques on creditors remains to be seen. The enacted changes could prove less beneficial if debtors - knowing that they no longer necessarily have to expect imprisonment if a cheque is not covered - were to issue cheques more recklessly in the future than they have done in the past. On the other hand, it is also conceivable that the procedural adjustments will increase the chance for creditors to at least partially realise outstanding



claims. This would require, however, that fewer debtors than before decide to flee the country or are detained and instead, at a rather early stage of their financial difficulties, opt to enter into settlement negotiations with their creditors or file for insolvency.

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**Do you have questions? – We would be glad to answer them!**

From our office located in the heart of Dubai, our team of German attorneys has been advising small and medium-sized companies, corporations and individuals on the laws of the United Arab Emirates for more than 15 years. Our areas of expertise include corporate law (in particular business set-up), commercial agency law, employment law as well as tenancy and real estate law. We would be happy to attend to your questions as well. Contact us!

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