

## Bankruptcy Law for Companies in the United Arab Emirates

As is the case for businesses around the world, the economic effects of the COVID-19 pandemic have put bankruptcy-related aspects into the spotlight in the United Arab Emirates ("UAE"). Whilst natural persons are covered by Federal Decree-Law No. 19 of 2019 on Insolvency, which only became effective at the beginning of this year, companies are subject to Federal Decree-Law No. 9 of 2016 on Bankruptcy, which had entered into force in December 2016 and was subsequently amended by Federal Decree-Law No. 23 of 2019 ("Bankruptcy Law"). We have prepared an overview on basic principles of this important regulatory framework for business transactions in the UAE:

### 1. Background

Prior to the Bankruptcy Law coming into force on 29.12.2016, the UAE Commercial Transactions Law contained most of the stipulations on bankruptcy. However, in legal practice, these provisions were rarely applied because of their limited scope of application and various legal uncertainties. During the financial crisis 2008/2009, the economic effects of an insufficient bankruptcy regime became apparent when due to a lack of restructuring opportunities corporate debts forced companies to permanently cease operations. Company representatives were under threat to be subject to travel bans and fines or imprisonment in the event of non-payment and, thus, chose in some instances to flee the country or ended up being detained. Unpaid debts weighed on the banking sector, businesses and individuals.

The adoption of a uniform bankruptcy legislation was therefore seen as a major step forward. In fact, the Bankruptcy Law, which is influenced by and conceptually based on proven bankruptcy law regimes in other jurisdictions, such as Chapter 11 of the US Bankruptcy Code, protects both creditor and debtor interests. With the introduction of restructuring procedures, the law encourages the early restructuring of distressed companies. These developments have also been recognised by the World Bank: After the UAE was only ranked 92nd in the Resolving Insolvency Index of the Doing Business Report 2015 prior to the Bankruptcy Law coming into force, there was an improvement to rank 80 in the year 2020.

### 2. Scope of Application

Previously, the provisions on bankruptcy were applicable to so-called traders only. Now and in contrast, the Bankruptcy Law additionally covers a number of different types of companies and, thus, is wider in its application.

The law captures natural persons acting as traders and civil companies engaged in professional activities. It also applies to companies subject to the provisions of the UAE Commercial Companies Law ("CCL"), i.e. companies that are registered in mainland UAE.

Free zone companies are subject to the Bankruptcy Law if incorporated in a free zone that has not enacted its own

comprehensive bankruptcy legislation. The Bankruptcy Law is, as a consequence, not applicable to companies registered in the Dubai International Financial Centre or the Abu Dhabi Global Market. The regulations of the Dubai Multi Commodities Centre ("DMCC") contain a few stipulations on bankruptcy, however, without providing for a comprehensive bankruptcy law regime. Hence, it is currently unclear whether the Bankruptcy Law is applicable to companies in DMCC.

The Bankruptcy Law is further applicable to companies not established in accordance with the provisions of the CCL but wholly or partially owned by the federal or a local government of the UAE, provided that the articles of association of the respective company call for the application of the Bankruptcy Law.

### 3. Types of Proceedings

The Bankruptcy Law sets out two different procedures for companies in financial distress, namely protective composition proceedings and bankruptcy proceedings.

#### a. Protective Composition Proceedings

Protective composition proceedings are debtor-led, court-supervised proceedings previously unknown to UAE law.

The objective is to rescue the company in order to maintain and continue business operations based on a settlement agreement between creditors and debtor. Protective composition proceedings, thus, serve to avoid a judgment declaring the debtor's bankruptcy.

#### aa. Application

An application for protective composition proceedings can be made only by those debtors who have ceased to pay due debts for a period of not more than 30 consecutive working days caused by the instability of their financial position, however, who are not yet in a state of over-indebtedness. If more than 30 working days have already passed, a debtor can only apply for bankruptcy proceedings.

Creditors or other third parties do not have the right to file an application for protective composition proceedings.



#### **bb. Procedure**

Upon receipt of the application, which is to be submitted along with comprehensive documentation, the court decides on the initiation of proceedings. Following the court's decision to commence procedures, a moratorium on all unsecured creditors' claims will be imposed. The court may appoint an expert to prepare a report on the debtor's financial position. The court will reject the application if, amongst others, the debtor is already subject to other proceedings under the Bankruptcy Law or if the court finds that protective composition proceedings are inappropriate for the debtor.

If the court decides to accept the debtor's application, it appoints at least one trustee responsible for, inter alia, the publication of the decision initiating protective composition proceedings in two newspapers, one in Arabic and one in English, as well as for preparing a draft protective composition plan together with the debtor. The plan must be prepared within 45 working days from the date of publishing the decision, with the possibility of an extension of up to 20 working days. The court decides within ten working days whether the draft protective composition plan will be released for creditor voting. If the majority vote of the creditors approves the draft plan, it must be submitted to the court for approval and entered in the Commercial Register or Professional Register, among others. Finally, the trustee supervises the implementation of the plan.

As a general rule, the protective composition proceedings are to be carried out within three years after the court has ratified the plan. However, an extension of the deadline may be granted under certain conditions. For the duration of the proceedings, management powers remain with the debtor and its employees, but are to be exercised under the trustee's supervision.

#### **b. Bankruptcy Proceedings**

Pursuant to Art. 68 para. 1 Bankruptcy Law, a debtor must file for bankruptcy if the debtor is in a state of over-indebtedness or if the debtor has ceased payment of due debts for more than 30 consecutive working days caused by the instability of its financial position. Under such circumstances, protective composition proceedings can no longer be applied for.

##### **aa. Application**

In contrast to protective composition proceedings, third parties - and not only the debtor - may also file an application for bankruptcy proceedings.

A creditor who is owed at least AED 100,000 can make an application if a written notice had been served on the debtor to settle the due debt and the debtor failed to settle such claim within 30 working days. In addition, under certain conditions, a competent regulatory authority of the debtor and the public prosecution may file an application if it is in the public interest.

#### **bb. Procedure**

Bankruptcy proceedings are conducted either with the objective to restructure a company or to liquidate its assets.

##### **(1) Restructuring**

Restructuring procedures are available to companies fulfilling the conditions set out in Art. 68 para. 1 Bankruptcy Law, provided that the court is of the opinion that there is sufficient prospect of continuing operations in a profitable way. Further, the debtor must show its capability and ability to continue the business.

The court may appoint an expert to assess the debtor's financial situation and whether a restructuring of the debtor would be possible. The decision whether to approve restructuring procedures is made in a court hearing in the presence of the debtor, the expert and the creditors.

The restructuring is subject to a five-year period from the date of ratification of the restructuring plan, which may under certain conditions be extended for another three years. As of the date of the decision initiating the proceedings, the company representatives lose control of the management, unlike in the case of protective composition proceedings.

##### **(2) Liquidation**

In contrast to protective composition proceedings and restructuring procedures, both of which aim at rescuing the company, the primary purpose of asset liquidation is to pay the creditors, which may ultimately result in a liquidation of the company.

A declaration of the debtor's bankruptcy and a liquidation of the debtor's assets is ordered by the court if, amongst others, a restructuring plan is rejected by the court, a restructuring plan is not approved by the necessary majority vote of creditors or if ongoing protective composition proceedings are terminated by the court.

Following the judgment for liquidation of assets, the trustee undertakes selling the debtor's assets under court supervision. Liabilities become due immediately.

A debtor declared bankrupt is generally rehabilitated after five years from the completion of bankruptcy proceedings and the liquidation of assets.

#### **4. Liability Risks for Company Representatives**

In the context of bankruptcy, company representatives may be subject to both criminal and civil liability.

##### **a. Criminal Liability**

The Bankruptcy Law provides for a comprehensive catalog of penalties for company representatives and repeals some previous bankruptcy-related criminal offences.



Failure to file for bankruptcy within the 30-day time period no longer incurs criminal liability. The rationale mainly being to create an additional incentive for company representatives to actually initiate procedures provided under the Bankruptcy Law, if and where required.

On the other hand, company representatives can still face prosecution for, amongst others, failure to keep commercial books sufficient to reflect the company's financial position, disposing of company assets or undertaking business activities in relation to the company's assets to the detriment of creditors.

The Bankruptcy Law generally does not decriminalise bounced cheques. However, under the Bankruptcy Law, aspects of criminal procedure in relation to bounced cheques have been partially amended. Any criminal proceedings initiated or to be initiated against the debtor relating to bounced cheques are to be suspended if the cheque had been drawn prior to the commencement of protective composition proceedings or restructuring procedures. In the event of a liquidation of assets, however, a suspension of criminal proceedings is not possible.

#### b. Civil Liability

Should a company be declared bankrupt, the court may, among others, order at its discretion the personal liability of managers or members of the board of directors for company debts. Such liability may be triggered, for instance, where the company's assets are insufficient to cover at least 20% of its liabilities or the managers or members of the board of directors were in breach of their duties as set out in the CCL.

A debtor who has been declared bankrupt may be disqualified by court decision from participating in the management of any company and conducting business activities for a period of up to five years if the debtor did not file for bankruptcy within the requisite timeframe according to Art. 68 Bankruptcy Law and if it is proven that the act or omission led to the declaration of its bankruptcy and liquidation of assets.

Civil liability may further result from stipulations of the CCL. Under these provisions, members of the board of directors of a

public joint stock company are liable to the company, the shareholders and third parties for fraudulent acts, abuse of power or violations of provisions of the CCL or the articles of association as well as for errors in management. The same applies to limited liability companies.

#### 5. Conclusion

The UAE Bankruptcy Law can generally be regarded as a modern bankruptcy law for distressed companies. It significantly improves the legal position of debtors by providing for a new regime of restructuring options.

In practice, the Bankruptcy Law appears to remain rather untested till date. According to media reports, the first restructuring proceedings under the Bankruptcy Law were concluded in May 2019 at the Bankruptcy Department of the Abu Dhabi Court of First Instance. Other than that, however, legal publications make reference to a few pending cases only.

Overall, the skepticism of debtors and creditors towards publicly-conducted court proceedings, which may sometimes be perceived as stigma and loss of reputation, still seems to be quite prevalent and the conclusion of consensual settlement agreements out of court is likely to continue to be a preferred means of restructuring liabilities. Lastly, the risk for managers of being personally liable as well as loss of management authority to a trustee in bankruptcy proceedings may also be reasons for a remaining reluctance to make use of procedures provided for by the Bankruptcy Law.

Figures presented in the Resolving Insolvency Index of the World Bank's Doing Business Report 2020 seem to support this impression: According to the Index, the repayment rate in the UAE is still only 27.7 cents per US dollar even following the enactment of the Bankruptcy Law - a rather low figure compared to the 92.9 cents per US dollar achieved by front-runner Norway.

Whether the effects of the COVID-19 pandemic will lead to a significant increase in proceedings pursuant to the Bankruptcy Law remains to be seen.

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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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