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Restructuring Across Borders

Dubai International Financial Centre (DIFC):

Corporate restructuring and insolvency procedures | June 2021

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Contents

Introduction

The Dubai International Financial Centre (the **DIFC**) was established in 2004 as a financial free zone in the United Arab Emirates (the **UAE**). Established as an independent jurisdiction within the UAE, the DIFC is empowered to create its own legal and regulatory framework for all civil and commercial matters. Accordingly, the DIFC has promulgated its own laws relating to insolvency and corporate restructuring. Onshore UAE laws relating to the same subject matter therefore do not apply in the DIFC.

The principal restructuring and insolvency options under DIFC law are:

- company voluntary arrangements;
- rehabilitation plans;
- administration;
- receivership/administrative receivership; and
- liquidation.

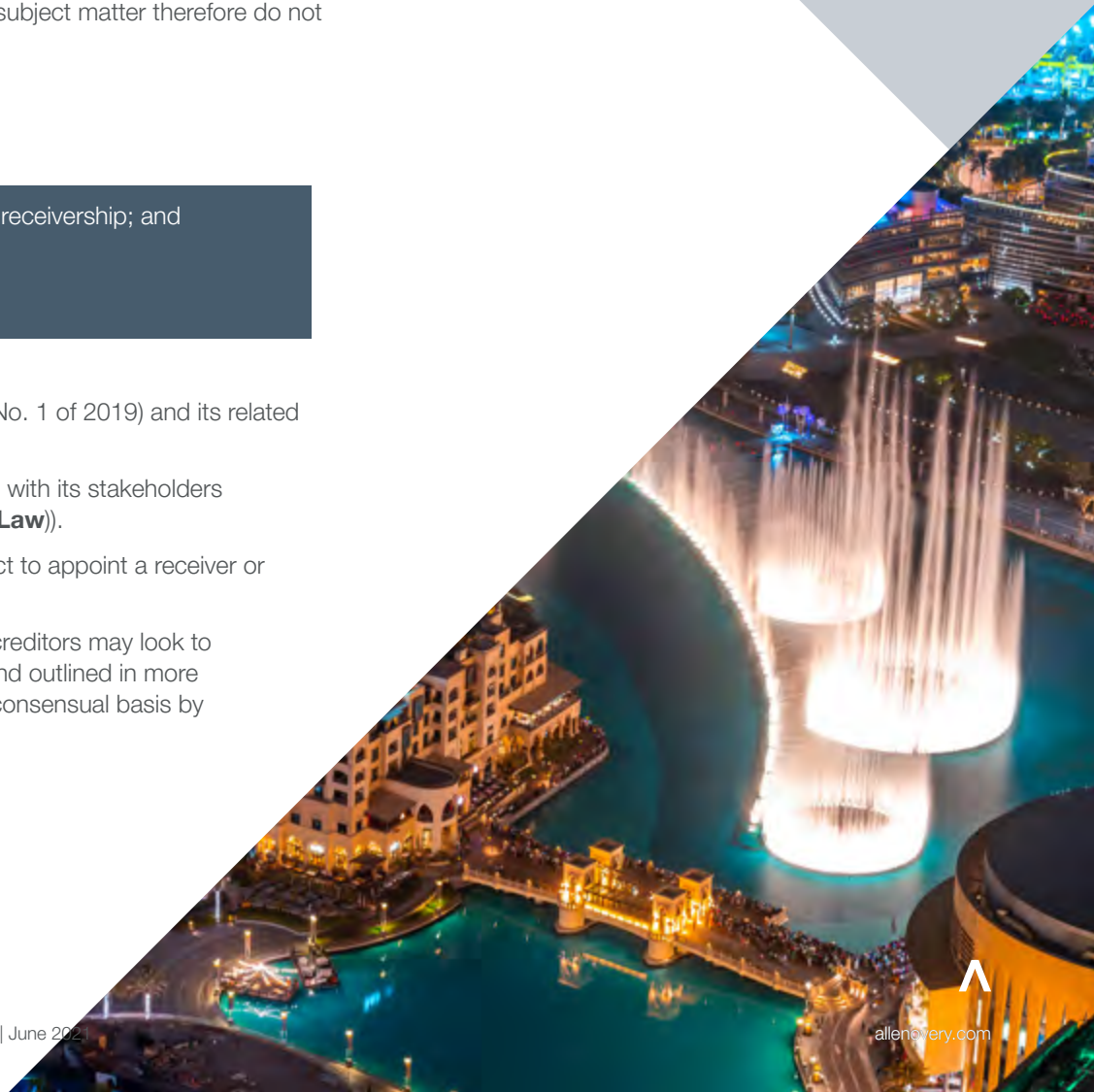
Each of the processes noted above are governed by the DIFC Insolvency Law (DIFC Law No. 1 of 2019) and its related regulations (the **DIFC Insolvency Law**).

DIFC law also provides flexibility for a company to enter into a compromise or arrangement with its stakeholders (governed by the DIFC Companies Law (DIFC Law No. 5 of 2018) (the **DIFC Companies Law**)).

Creditors which hold security interests have the right to directly enforce that security or elect to appoint a receiver or (in certain circumstances) an administrative receiver.

If there is considered to be a viable business which can be rescued, the company and its creditors may look to rehabilitate the company via one of the formal restructuring processes referred to above (and outlined in more detail below) or via an informal workout (ie a restructuring of the company on an informal, consensual basis by agreement between the company and its creditors).

An end-of-the-road liquidation process is also available for appropriate situations.



Enforcement of security

The DIFC has its own laws in relation to the creation and enforcement of security (distinct from onshore UAE laws). The principal legislation is the DIFC Law of Security (DIFC Law No. 8 of 2005) (the **DIFC Law of Security**). There is a separate law dealing with security over real estate in the DIFC (DIFC Law No. 10 of 2018) (the **DIFC Real Property Law**).

The most commonly seen forms of security available under DIFC law are:

– mortgages over land or other real property interests;

– security interests over shares; and

– security interests over moveables (the most common of this sub-category being security interests over bank accounts and similar investments).

As a matter of DIFC law, it is possible to create security over present and future assets.

Security interests over the same assets rank according to the date on which they were perfected and, subject to certain exceptions, perfection will require a financing statement to be filed with the DIFC Registrar of Security.

A secured creditor need not apply to any court to enforce its security interest. In practice, a secured creditor would most likely appoint a receiver or administrative receiver to collect in and dispose of an asset which is subject to DIFC law security although the secured creditor could, if it so wished, take possession and dispose of the relevant asset itself.

While the above-mentioned routes of enforcement are the most obvious, DIFC law recognises that the parties may agree such other enforcement routes as they see fit.

DIFC law requires any enforcement of security to be carried out in a manner which is commercially reasonable.

Company voluntary arrangements

The purpose of the company voluntary arrangement process (**CVA**) is to rehabilitate the debtor (although, strictly, there is no requirement for a debtor to be insolvent at the time of initiating the CVA).

A CVA may only be initiated by the debtor itself and, importantly, cannot be initiated by any creditor of the debtor.

The DIFC Insolvency Law is not prescriptive as to the form that a CVA must take so it is open to the debtor to formulate a proposal which is then presented to the creditor body.

Any proposal must be presented to the debtor's creditors as a whole and will only become effective if it has been approved by creditors representing 75% in value of the creditors present and voting on the resolution. If the approval threshold is achieved, the CVA will bind all of the debtor's creditors who were entitled to vote other than secured and certain limited preferential creditors (unless such creditors have positively consented to the CVA). As a result, it is not possible to 'cram-down' the interests of secured or preferential creditors via a CVA.

DIFC law does not automatically invoke a moratorium on proceedings being brought against a debtor at any stage of a CVA. A debtor may, however, apply to the court requesting that such a moratorium be invoked (subject to certain exceptions).

A DIFC-licensed insolvency practitioner must be appointed to present and, if approved, monitor and report to the creditor body on the implementation of the CVA.

Rehabilitation Plan

Subject to certain limited exceptions, a debtor is eligible to apply for a rehabilitation plan (**Rehabilitation Plan**) if: (i) it is, or is likely to become, unable to pay its debts; and (ii) there is a reasonable likelihood of a successful Rehabilitation Plan being agreed between the debtor and its creditors and shareholders.

A Rehabilitation Plan may only be initiated by the debtor itself and, importantly, cannot be initiated by a creditor of the debtor.

As is the case with CVAs, the DIFC Insolvency Law is not prescriptive as to the form that a Rehabilitation Plan must take.

From the date on which an application is made to the court for a Rehabilitation Plan, an automatic moratorium will apply in respect of the debtor. Subject to certain exceptions (including in relation to financial collateral arrangements), the moratorium will restrict: (i) proceedings being initiated against the debtor; and (ii) security interests and rights of set-off being enforced against the debtor. Unless otherwise agreed by the court, the moratorium will apply for a period of 120 days. In addition, the acceleration of any debt or termination of any agreement by reference to the Rehabilitation Plan (and the associated moratorium) shall, as a matter of DIFC law, be void insofar as it is stated to occur during the moratorium period.

While the debtor is required to appoint a rehabilitation nominee (**Rehabilitation Nominee**) as part of any application, existing management will (in the absence of fraud, dishonesty or mismanagement) retain control of the business throughout the process (mirroring the hallmarks of other 'debtor in possession' processes).

Any proposal must be presented to all of the debtor's creditors and shareholders. For voting purposes, stakeholders will be separately classified as secured creditors, unsecured creditors and shareholders. It is not clear whether sub-division of creditors, within these three broad categories, is permissible or required.

Prior to any vote being carried out, the Rehabilitation Nominee must confirm that: (i) the Rehabilitation Plan has a reasonable prospect of being approved and implemented; (ii) the debtor is likely to have sufficient funds available to it during the moratorium to allow it to carry on its business; and (iii) he or she supports the summoning of creditor and shareholder meetings.

A Rehabilitation Plan can be approved by the court if either: (i) the Rehabilitation Plan has, in respect of each class, been approved by creditors or shareholders (as applicable) representing 75% in value of the creditors or shareholders (as applicable) (present and voting) in that class; or (ii) if a class of claims is impaired under the plan, at least one impaired class has approved the plan (applying the 75% test noted above).

In each case, any class of creditor or shareholder which is not impaired by the proposed Rehabilitation Plan will be regarded as having accepted the Rehabilitation Plan and will not be entitled to vote.

In addition, the court's approval of the plan will also be subject to (among other things): (i) stakeholders in each 'dissenting' class being no worse off than they would have been in a winding up of the debtor; and (ii) stakeholders which are 'junior' to stakeholders in a 'dissenting' class not receiving any amount before the stakeholders in such 'dissenting' class have been paid in full. The law is not prescriptive as to what is meant by 'junior' claims.

Once approved by the court, the Rehabilitation Plan will bind each of the debtor's creditors and shareholders. If the Rehabilitation Plan is not approved by the court, the DIFC Insolvency Law states that the court is required to proceed to wind up the debtor.

As part of a Rehabilitation Plan application, the court may also sanction the provision of 'priority funding' to the debtor which will take priority over the debtor's unsecured debt. If it is not possible for the debtor to avail funding in the circumstances outlined above (ie ranking ahead of unsecured creditors but behind secured creditors), the court may authorise funding which is secured against property which is already secured to another creditor. Such security may rank equally with, or senior to, the existing security but, in any case, will only be authorised by the court if either: (i) the original secured creditor has been adequately protected against any diminution in the value of its claim; or (ii) the original secured creditor has consented to such arrangement.

Administration

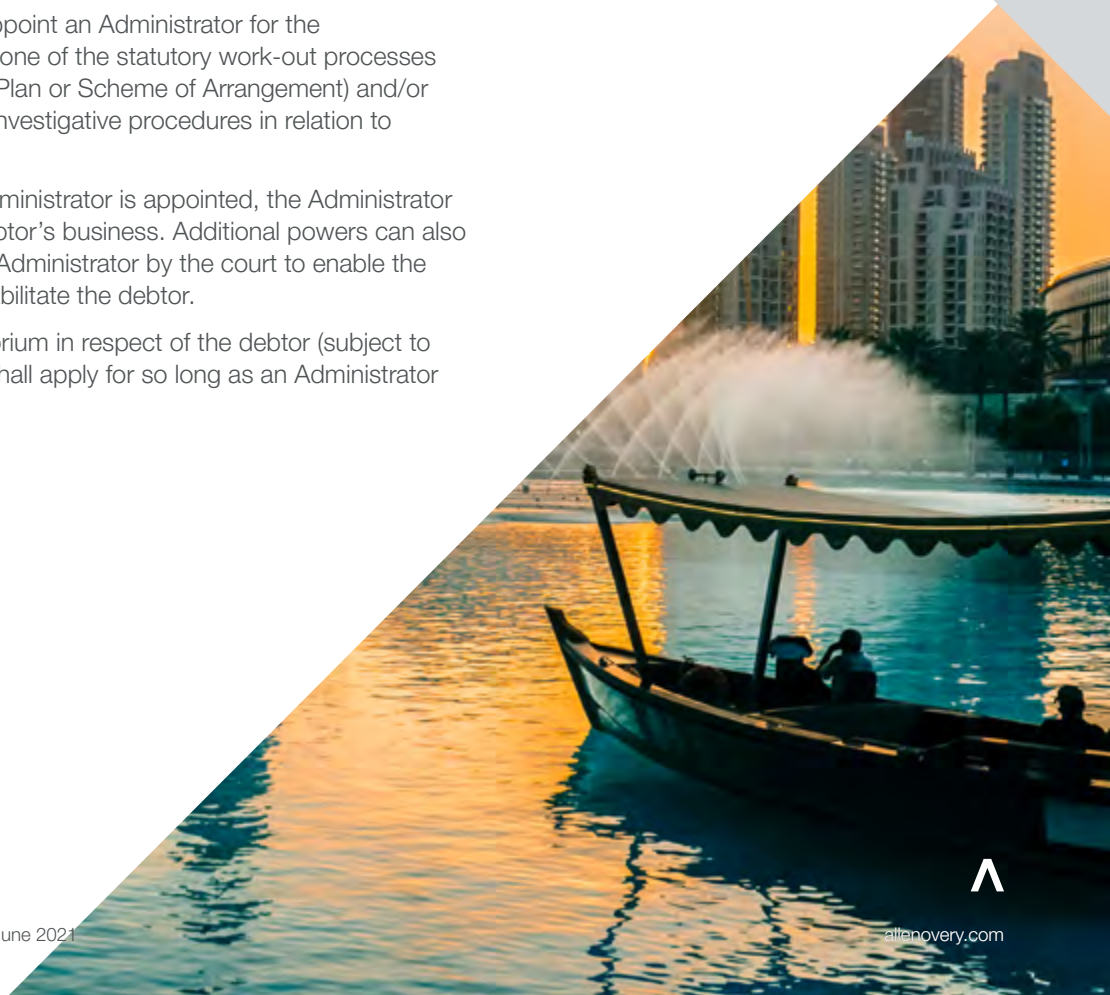
The DIFC Insolvency Law contemplates that an administrator (**Administrator**) may be appointed where an application for a Rehabilitation Plan has been made and there is evidence of misconduct on the part of management. The application to appoint an Administrator may be made by one or more creditors of the relevant debtor. The appointment of an Administrator outside the limited circumstances referred to above does not appear possible (although the DIFC Insolvency Law is not entirely clear on this point).

Any Administrator must be a DIFC-licensed insolvency practitioner.

The court will only appoint an Administrator for the purpose of pursuing one of the statutory work-out processes (CVA, Rehabilitation Plan or Scheme of Arrangement) and/or carrying out certain investigative procedures in relation to the debtor.

For so long as an Administrator is appointed, the Administrator shall manage the debtor's business. Additional powers can also be conferred on the Administrator by the court to enable the Administrator to rehabilitate the debtor.

An automatic moratorium in respect of the debtor (subject to certain exceptions) shall apply for so long as an Administrator is appointed.



Receivership/administrative receivership

The DIFC Insolvency Law expressly contemplates that a secured party may appoint a receiver for the purposes of realising and disposing of secured assets and applying the proceeds in reduction of the secured liabilities.

If a receiver is appointed in respect of assets which comprise all or substantially all of the assets of the debtor, such receiver will be deemed an administrative receiver for the purposes of the DIFC Insolvency Law.

The main implications of the appointment of an administrative receiver under the DIFC Insolvency Law are that:

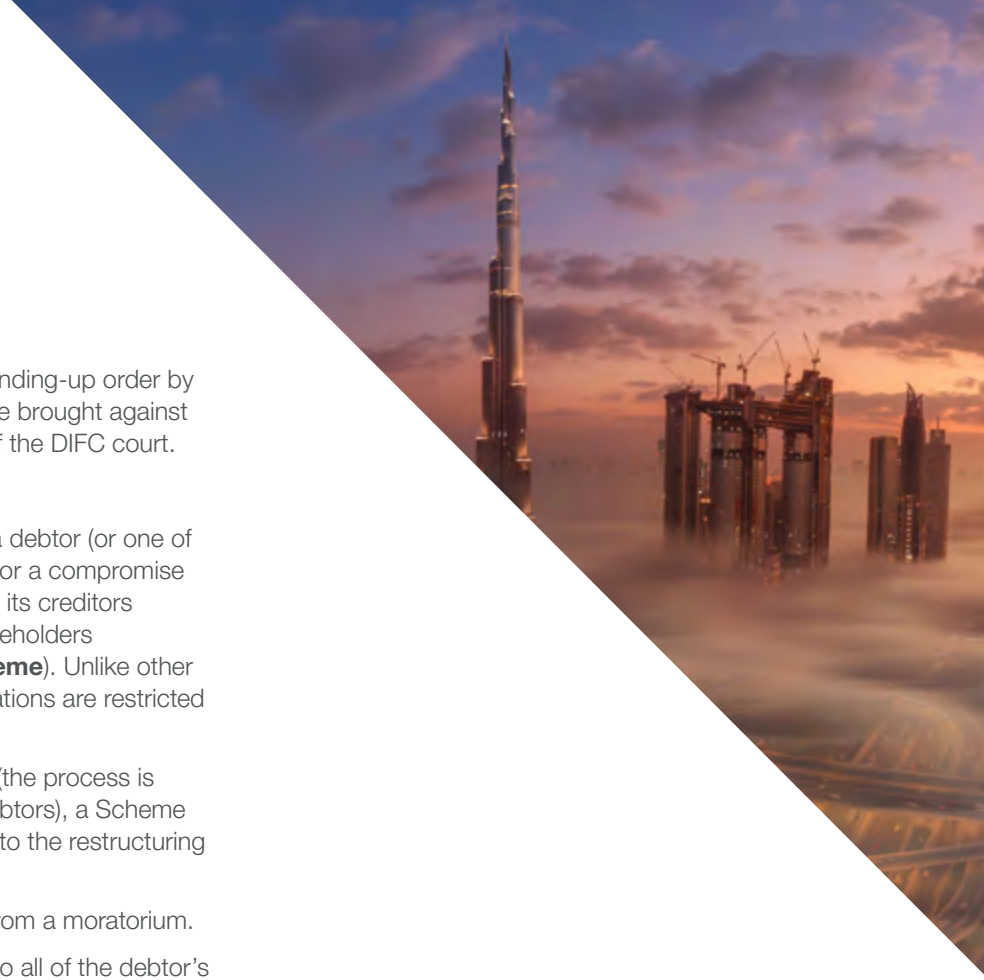
- the appointment of an administrative receiver will override any prior appointment of a receiver and will prevent any other receiver from being appointed;
- an administrative receiver is entitled to apply to the court to dispose of secured assets which were not the subject of his/her appointment;
- the administrative receiver must make certain reports available to all creditors of the relevant obligor detailing (among other things) the events which related to his/her appointment, the amount owed to the secured parties and the amount likely to be available to be paid to other creditors; and
- the administrative receiver will automatically receive certain additional statutory powers (over and above those which a non-administrative receiver would statutorily receive).

While certain powers are statutorily afforded to a receiver under the DIFC Insolvency Law, the DIFC Insolvency Law expressly permits a secured party and a security provider to agree that a receiver will have additional powers over and above what is expressly set out in the DIFC Insolvency Law. The additional statutory powers which are afforded to administrative receivers may therefore prove less of a distinction in practice.

The DIFC Insolvency Law intimates in a number of places that the role of a receiver is to coordinate the ultimate disposal of the secured asset but does not (in contrast with the statutory position of administrative receivers under (say) English law) expressly contemplate a receiver or administrative receiver "managing" assets other than in connection with an ultimate disposal. While, as noted above, the parties could seemingly agree that such a power be afforded to a receiver or an administrative receiver, it is unclear how a DIFC court would approach this question.

Other than (in relation to an administrative receiver) the obligation to (i) provide periodic reports to the wider creditor body; and (ii) summon a meeting of unsecured creditors for the purposes of discussing such a report, the DIFC Insolvency Law is silent on the nature and extent of the duties which are owed by a receiver or an administrative receiver and also, on the question of who those duties might be owed to. As a result, it is unclear how a DIFC court may consider this question.

Liquidation



The DIFC Insolvency Law provides a framework for an orderly liquidation and winding up of a debtor's assets.

A liquidation may be proposed by the debtor itself or by any creditor of such debtor if one or more of the following criteria have been satisfied:

– the debtor has resolved that it be wound up;

– the debtor is unable to pay its debts (either on a cash flow or balance sheet basis or following a failure to pay a debt of more than USD2,000 within three weeks of formal demand);

– a CVA has not been approved following lapsing of a moratorium (see above);

– a Rehabilitation Plan has not been approved by the court (see above); or

– a DIFC court is of the opinion that it is just and equitable that the debtor be wound up.

Any liquidation must be formally approved by the DIFC courts and, if so approved, will be binding on the debtor and all of its creditors. If approved, a DIFC-licensed liquidator (**Liquidator**) will be appointed to realise the assets of the debtor and distribute the proceeds to the creditors (although the creditors may request that an alternative liquidator (or a liquidation committee) be appointed to carry out such duties).

Once a liquidation has been approved by the court, creditors wishing to share in the proceeds of the liquidation will need to prove in the insolvency within a time-frame determined by the court.

Immediately following the issuing of a winding-up order by the court, no further proceedings may be brought against the debtor except with the permission of the DIFC court.

Schemes of arrangement

Pursuant to the DIFC Companies Law, a debtor (or one of its stakeholders) can apply to the court for a compromise or arrangement between the debtor and its creditors (or any class of its creditors) and/or shareholders (or any class of its shareholders) (a **Scheme**). Unlike other jurisdictions with similar regimes, applications are restricted to DIFC incorporated debtors.

While not strictly an insolvency process (the process is equally open to solvent and insolvent debtors), a Scheme provides further optionality with regards to the restructuring of a debtor's business.

The Scheme process does not benefit from a moratorium.

A proposal for a Scheme can be made to all of the debtor's creditors and shareholders or, alternatively, only certain classes of creditors and/or shareholders. The Scheme will only be approved by the court if it has been approved by stakeholders representing 75% in value and a majority in number of each class of stakeholder (present and voting on the resolution) to which the Scheme relates. If approved, the Scheme will bind all stakeholders who were entitled to vote on the scheme.

There is no requirement for a Scheme to adopt a particular form and there is no statutory guidance on how stakeholders should be classified for voting purposes.

Voidable transactions

The DIFC Insolvency Law provides that a Liquidator or an Administrator may make an application to the court to set aside the following transactions:

– transactions at an undervalue; and

– preferences.

In order to constitute a transaction at an undervalue or a preference: (i) a Liquidator or Administrator must have been appointed in respect of the debtor; and (ii) the relevant transaction must have been entered into (in the case of a transaction at an undervalue or a preference which is given to a connected person) within the two-year period preceding the onset of insolvency or (in the case of a preference which is given to an unconnected person) within the six-month period preceding the onset of insolvency. Transactions entered into in the period between presentation of a petition for the making of a liquidation order and the order being given will be caught also.

A transaction will constitute a "transaction at an undervalue" if the debtor has made a gift to a person or otherwise entered into a transaction with a person on terms that provide for the debtor to receive no consideration, or consideration the value of which, in money or money's worth, is significantly less than the value, in money or money's worth, of the consideration provided by the debtor.

No order will be made in respect of a transaction at an undervalue if the court is satisfied that: (i) the debtor entered into the transaction in good faith and for the purposes of carrying on the business of the debtor; and (ii) at the time of the transaction, there were reasonable grounds for believing that the transaction would benefit the debtor.

A transaction will constitute a "preference" if: (i) the debtor enters into a transaction with one of the debtor's creditors; and (ii) the effect of the transaction is to place that person in a position which, if the debtor were placed into insolvent liquidation, would be better than the position it would have been in had that transaction not been entered into.

No order will be made in respect of a preference unless the court is satisfied that the debtor was influenced by a desire to prefer the relevant person. In the case of a transaction entered into with a connected person, there will be a rebuttable presumption that such a desire existed.

In addition to transactions at an undervalue and preferences, a security interest which is granted over all or substantially all of the assets of a debtor will be invalid if:

– the security interest was created in favour of a connected person and was created within the two-year period prior to a Liquidator or Administrator being appointed;

– the security interest was created within the one-year period prior to a Liquidator or Administrator being appointed and the debtor was, at such time, unable to pay its debts as they fell due; or

the security interest was created after the commencement of a CVA (see above).

Ranking of creditors

In an insolvent liquidation, secured creditors will rank ahead of unsecured creditors to the extent of the value of the relevant secured asset and as between other secured creditors in respect of the same secured asset in the order in which those security interests were perfected (see above).

Amounts owing to certain preferential creditors (broadly limited to end of service gratuity payments and certain other forms of employee remuneration) will, however, rank ahead of amounts owing to a creditor which are secured against all or substantially all of the undertakings or assets or the debtor. While our expectation is that this principle should only apply in respect of the assets which are generally subject to a "universal" security interest and should not serve to taint a creditor's priority in respect of specifically identified assets over which it also holds security (eg a bank account or shares in a subsidiary), this is not, in our opinion, clear from the law and would remain to be determined by a court.

Unsecured creditors will rank pari passu in respect of any amounts which remain after payment of the amounts referred to above. To the extent that a secured creditor has not been repaid in full from the proceeds of the applicable secured asset, such secured creditor may prove for the balance owing to it as an unsecured creditor.

If the assets of the debtor are insufficient to pay the costs and expenses of the liquidation in full, the court may make such order as it sees fit in relation to the payment of such costs and expenses. The ranking of such costs and expenses of the liquidation are not otherwise hard-coded into the DIFC Insolvency Law.

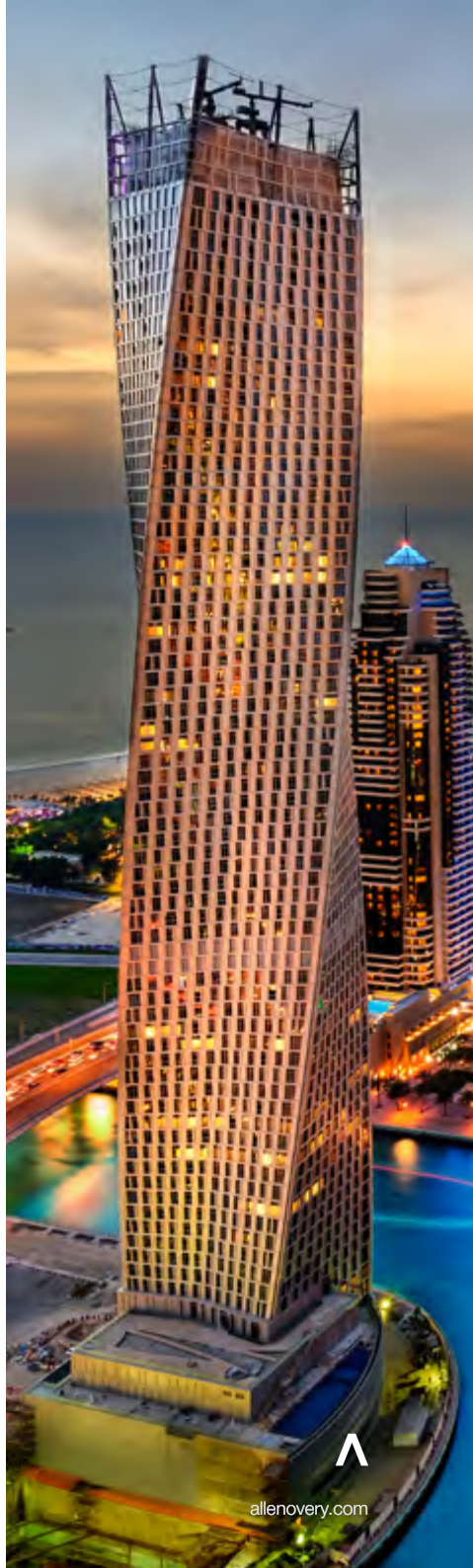
Cross-border recognition

The DIFC has adopted the UNCITRAL Model Law on Cross Border Insolvency (subject to certain modifications). Accordingly, foreign insolvency officials may apply for recognition of insolvency proceedings commenced in other jurisdictions and for the cooperation of the DIFC courts in connection with such insolvency proceedings.

In addition, where a foreign company is the subject of insolvency proceedings in its jurisdiction of incorporation, the DIFC Insolvency Law requires the DIFC courts to assist the foreign courts with the gathering and remitting of the assets of that foreign company which are maintained in the DIFC. While the DIFC Insolvency Law contemplates that further regulations may be enacted to deal with the above matters and the wider issues which might arise in connection with such cooperation, we are not aware of any such regulations having been enacted.

In relation to a foreign company which is registered to carry on business in the DIFC, the DIFC Insolvency Law expressly permits such a company to be wound up in accordance with the DIFC Insolvency Law, notwithstanding that it may be in the process of being wound up or may have already been wound up under the laws of its jurisdiction of incorporation.

So far as we are aware, cross-border insolvencies with a DIFC nexus remain untested in the DIFC courts, so it is difficult to predict with certainty how the same would play out in practice.



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Further information

Developed by Allen & Overy's market-leading Restructuring group, Restructuring Across Borders is an easy-to-use website that provides information and guidance on all key practical aspects of restructuring and insolvency in Europe, Asia, the Middle East and the U.S.

To access this resource, please click **here**.

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