ALLEN & OVERY

Restructuring Across Borders

United Arab Emirates:

Corporate restructuring and insolvency procedures | June 2021

allenovery.com

Contents

Introduction	3
Enforcement of security	4
Preventative composition	5
Restructuring scheme	6
Emergency financial crisis	7
Declaration of bankruptcy & insolvent liquidation	8
Financial Restructuring Committee	9
Unenforceable transactions	9
Liquidation	10
Ranking of creditors	10
Cross-border recognition	11
Key contacts	12
Further information	13

Introduction

When a corporate borrower in the United Arab Emirates (the UAE) experiences financial difficulties, the principal restructuring and insolvency options are:

– preventative composition (a formal restructuring proceeding initiated by the debtor prior to the debtor satisfying certain insolvency tests);

– restructuring scheme (a formal restructuring proceeding initiated by a debtor, one or more of its creditors or certain other parties, in each case, in circumstances where the debtor has satisfied certain insolvency tests);

– emergency financial crisis proceedings (a formal restructuring proceeding initiated by a debtor during a "public condition" that effects trade or investment, such as the outbreak of an epidemic, natural or environmental disaster or war, the cause and duration of which shall be determined by a Cabinet resolution based on the approval of the Minister of Finance);

– insolvent liquidation (a process involving an insolvent winding-up of a debtor that can be initiated by the debtor, a creditor or by the court, in each case, where the debtor has satisfied certain insolvency tests), which is governed by the UAE Federal Decree-Law No (9) of 2016 (as amended) (the **Bankruptcy Law**); and

– liquidation (dissolution of foreign companies that conduct their principal activity in the UAE or have their central management in the UAE), which is governed by the Commercial Companies Law (UAE Federal Law No(2) of 2015) (the **Companies Law**).

From a creditor's perspective, the choice of procedure will primarily depend on whether adequate security has been granted. If adequate security has been granted, direct enforcement of the security may be the most appropriate choice although enforcement may be subject to restrictions including the need for court approval of such enforcement.

The choice of procedure will depend on whether there is a viable business to be rescued. If so, an informal workout (ie a restructuring of the company on an informal, consensual basis by agreement between the company and its principal lenders or creditors) may be appropriate. Alternatively, a restructuring or rescue may be conducted using one of the formal rescue procedures (ie preventative composition, restructuring scheme or emergency financial crisis proceedings). If, however, a rescue is not possible, liquidation may be most appropriate.

The UAE is a federal state made up of seven individual emirates. There are some differences in the laws of each emirate, however, for the most part, the laws governing insolvency and restructuring are of general application and are contained in the Bankruptcy Law and the Companies Law.

There are also a number of "free zones" or special economic zones within the UAE. The Bankruptcy Law applies to commercial companies established in accordance with the Companies Law, and to companies and establishments in the free zones that are not governed by special provisions specifically applicable within that free zone regulating financial rehabilitation or insolvency. The Abu Dhabi Global Markets (the **ADGM**) and the Dubai International Financial Centre (the **DIFC**) are financial services "free zones" and are subject to their own legal systems including insolvency and restructuring laws. This note does not deal with entities incorporated within these two free zones, or incorporated by decree (see below). Please see the specific 'Restructuring Across Borders' briefing notes on the ADGM and DIFC.

Many state owned entities are incorporated by decree rather than under the Companies Law. Such decrees may contain specific provisions relating to the procedures for restructuring and insolvency of such entities. These specific provisions are subject to change as illustrated by Decree No. 57 of 2009 announced by the Government of Dubai which established a special reorganisation process for the Dubai World group of companies. Where the establishing decree does not include such provisions, it may be that the entity is not subject to any rehabilitation or insolvency law as the Bankruptcy Law applies to a decree company only if its constitutional documents specifically 'opt-in' to the law.

Enforcement of security

The main forms of security available under UAE law are:

– mortgages over real property (and associated rights such as usufruct rights and *musataha* rights which are akin to leasehold interests);

– commercial mortgages over moveable assets;

– pledges over shares (in respect of limited liability companies, public/private joint stock companies and companies incorporated in certain free zones);

– non-possessory movables security over certain moveable assets (including bank accounts); and

– assignments of rights under contracts (although strictly, the legal regime for creating a valid assignment before such assignment is perfected remains unclear, and given the lack of sufficient judicial precedents on this, there is a risk that a court re-characterises such assignment as being an absolute assignment which does not constitute a security interest).

The Bankruptcy Law recognises and gives effect to the priority of secured creditors (insofar as it relates to the secured asset and subject to the discharge of any administrative costs in dealing with the enforcement).

Historically, security could only be enforced with the permission of the court and only through a court-approved auction process. Whilst that remains true for most security interests, for certain assets which are subject to movable security (including bank accounts), self-help remedies, as well as an alternative court process (not requiring a court-approved auction), are available to the secured creditor. That said, the law on movables security is relatively new and, from an enforcement perspective, relatively untested so far as we are currently aware.

Preventative composition

Preventative composition is a formal process under the Bankruptcy Law with similarities to Chapter 11 proceedings in the United States. A preventative composition allows a relevant entity to enter into a compromise with its creditors and/or members.

Preventative composition is only available to debtors facing financial difficulties. For a preventative composition application to be accepted however, the applicant debtor must not be more than 30 consecutive business days overdue in the payment of its debts. If the court accepts the initial application, a moratorium will automatically apply on all unsecured creditors' claims (secured creditors may still enforce their security with the court's permission) and the debtor will generally be restricted from disposing of its assets. The moratorium will cease to apply from the date on which the application is finally accepted or rejected by the court.

Simultaneously, the court will appoint one or more composition trustees (*ameen soleh*) who will then prepare an inventory of the debtor's assets and properties. For this purpose, the composition trustee will invite the creditors to submit their debts and supporting documents. The composition trustee, assisted by the debtor, will then prepare a draft preventive composition scheme and submit it to the court for its approval (the Scheme). The debtor may nominate a person to serve as composition trustee (although the court will make the ultimate decision as to who is appointed as trustee).

The duration of the Scheme cannot exceed three years (although it is not clear in the law exactly what must have been achieved within three years). The law contemplates that the duration can be extended with the approval of a simple majority (by number) of the creditors whose debts are outstanding and who hold a minimum of two-thirds (by value) of the aggregate outstanding debt. Whilst it is not entirely clear, our view is that any extension would need to take place after the initial approval of the Scheme (ie a Scheme with a duration of more than three years could not be approved at the outset).

Following approval of the Scheme by the court, the Scheme must be approved by a simple majority (by number) of the creditors whose debts have been finally admitted and who hold a minimum of two-thirds (by value) of the admitted debts. If a creditor's debt has not been finally accepted by the court at the time of voting and is subject to appeal, the court may temporarily admit such debt for voting purposes (subject to such conditions as the court may attach).

As for secured creditors, they would only be entitled to vote if: (i) the proposed Scheme affects their secured rights; or (ii) they have waived their security interest. If a secured creditor elects to vote in either of the above scenarios, the expectation is that they would be bound by such Scheme (if approved). It is not entirely clear, however, whether a Scheme (which is otherwise approved by creditors electing to vote) could impact the rights of a secured creditor who did not elect to vote on such Scheme.

The Scheme needs to be finally approved by the court for it to become effective. For this purpose, the court would verify that no creditor would be in a worse position than it would otherwise be if the assets of the debtor were to be liquidated on the date on which the Scheme was voted upon.

We note that filing for a preventative composition will not, in principle, prohibit the debtor from continuing to run its business under the supervision of the composition trustee.

The court may also (at the request of the debtor or the trustee) permit the debtor to procure new financing with priority over its existing unsecured debt. The new money may also be secured over the debtor's unsecured or secured assets (however where the assets are already secured, only to the extent that either: (i) those assets are deemed to have a higher value than the amount of the existing secured debt and the new security ranks behind the existing security (unless the existing secured creditor(s) agree otherwise) or (ii) where the new security is to rank ahead of the existing security, the court determines that the affected secured creditor will be no worse off as a result).

If the court terminates or rescinds the Scheme, the court may initiate insolvent liquidation proceedings (please see section titled "Declaration of bankruptcy & insolvent liquidation" below).

Restructuring scheme

The Bankruptcy Law provides for two separate processes under the heading of "Bankruptcy": a restructuring scheme and insolvent liquidation. Unlike insolvent liquidation which results in the dissolution of a company, a restructuring scheme aims to rehabilitate a financially distressed debtor.

Strictly speaking, the Bankruptcy Law requires a debtor to file for one of these "Bankruptcy" processes if it has, by reason of financial difficulty, failed to pay its debts for a period exceeding 30 consecutive business days from the date on which they fell due or where its assets are not or will not be sufficient to cover its due liabilities. We are not aware, however, of the courts having considered if this (a) requires a debtor to file immediately following the expiry of the 30 consecutive business-days period or (b) if there is a certain degree of latitude permitted in terms of the timing of the filing.

Similarly, a debtor can only voluntarily file for one of these "Bankruptcy" processes if it has, by reason of financial difficulty, failed to pay its debts for a period exceeding 30 consecutive business days from the date on which they fell due or where its assets are not or will not be sufficient to cover its due liabilities. The initiation of the process by a corporate debtor requires a resolution to that effect issued by the debtor's shareholders (by way of extraordinary general assembly). The debtor may specify in its "Bankruptcy" application to the court whether it seeks a restructuring scheme process or, alternatively, an insolvent liquidation process to dissolve its business and liquidate its assets.

Insofar as the aim of rehabilitating the distressed debtor is concerned, the restructuring scheme is similar to the preventative composition. Many other similarities exist between the two processes. The restructuring plan resulting from the restructuring scheme (the Restructuring Plan), is also supervised by a trustee and, for it to be implemented, must be approved by a simple majority (by number) of the creditors whose debts have been finally admitted and who hold a minimum of two-thirds (by value) of the admitted debts. The treatment of secured creditors and "temporarily admitted" creditors is the same as for a preventative composition, as is the application of the moratorium.

However, there exist several differences between the two processes.

Unlike a preventative composition, the restructuring scheme may be commenced by one or more unsecured creditors (or secured creditors whose debt is not fully collateralised) owed a debt exceeding, in aggregate, AED 100,000 and which is more than 30 consecutive business days overdue following a formal notice sent by that creditor to the debtor. The process can also, in certain circumstances, be commenced by the public prosecutor or the regulator of a regulated corporate debtor.

In a restructuring scheme or insolvent liquidation, the debtor or (as the case may be) creditor(s) making the application may nominate the proposed trustee to be used (although the court will make the ultimate decision as to who is appointed as trustee).

A key difference between a preventative composition and a restructuring scheme is that the latter does not permit the debtor to continue to run its business which will instead be managed by the trustee.

Similar to a Scheme under preventative composition, the law imposes strict timeframes for the duration of a Restructuring Plan. In the case of a Restructuring Plan, this must not exceed five years. The law contemplates that this period may be extended for up to a further three years with the approval of a simple majority (by number) of the creditors whose debts are outstanding and who hold a minimum of two-thirds (by value) of the aggregate outstanding debt. Whilst it is not entirely clear, our view is that any extension would need to take place after the initial approval of the Restructuring Plan (ie a Restructuring Plan with a duration of more than five years could not be approved at the outset). Similar to the timeframes imposed in respect of a Scheme under preventative composition, it is not clear exactly what needs to have been achieved within the stated timeframes.

As is the case for a Scheme, the court may permit the debtor to procure new financing having priority over its existing unsecured debt. The new money may be secured over the debtor's unsecured or secured assets (however where the assets are already secured, only to the extent that either: (i) those assets are deemed to have a higher value than the amount of the existing secured debt and the new security ranks behind the existing security (unless the existing secured creditor(s) agree otherwise) or (ii) where the new security is to rank ahead of the existing security, the court determines that the affected secured creditor will be no worse off as a result).

If the Restructuring Plan is not approved by the creditors or the court, or if the court terminates or rescinds it, the court may declare the debtor bankrupt and convert the restructuring scheme into an insolvent liquidation process.

Emergency financial crisis

A new "bankruptcy proceeding in emergency financial crisis" (**Emergency Financial Crisis Proceeding**) was introduced by amendments to the UAE Bankruptcy Law passed in 2020.

An emergency financial crisis is a "public condition" that affects trade or investment in the UAE, such as the outbreak of an epidemic, natural or environmental disaster or war, which case and duration shall be determined by a Cabinet resolution approved by the Minister of Finance (an **Emergency Financial Crisis**).

Where the Emergency Financial Crisis Proceeding is available, a debtor who has failed to pay its debts for more than 30 consecutive business days or whose assets are not or will not be sufficient to cover its due liabilities as a result of an Emergency Financial Crisis shall have its obligation to apply for the commencement of a restructuring scheme or insolvent liquidation process temporarily suspended until the expiry of the Emergency Financial Crisis period. In addition, the court shall postpone the adjudication of applications filed by any creditor applying for a restructuring scheme or insolvent liquidation proceeding to be initiated against *any debtor* (regardless of its circumstances) until the expiry of the Emergency Financial Crisis period.

If the debtor files an application to commence an Emergency Financial Crisis Proceeding, the court may accept that application and take such proceedings as it thinks fit, which may include initiating proceedings without the need to appoint an expert or a trustee (in contrast to an ordinary restructuring scheme or preventative composition). However, the debtor must prove that its financial position has resulted from the Emergency Financial Crisis.

If the court accepts the debtor's application to commence an Emergency Financial Crisis Proceeding, the debtor may apply to the court to be granted a period of not more than 40 business days to negotiate with its creditors.

The "period of debt settlement" offered by the debtor must not exceed twelve months from the date of the court's approval, although it is not clear exactly what must be achieved during this period.

Notably, the "settlement agreement" only requires the approval of creditors holding two-thirds of the aggregate outstanding debt and there is no numerosity test (as is the case for the approval of a Scheme or Restructuring Plan).

The court may reject the "settlement agreement" if it finds that it is inconsistent with good faith in the discharge of the obligations.

Where a debtor ceases payment of its debts due to an Emergency Financial Crisis, the directors and managers shall have no liability if they choose to dispose of the debtor's assets to pay unpaid wages of employees which are necessary to continue works during the Emergency Financial Crisis.

Where the debtor's application for an Emergency Financial Crisis Proceeding is accepted, it is also possible for it to avail of priority financing, subject to the approval of the court. Whilst the new financing can be secured on the same basis as is described above in respect of preventive composition or restructuring scheme proceedings, it is expressly stated that existing security can only be "primed" to up to 30% of the value of the secured property and with the approval of the court. It is not clear whether this operates to restrict the general power of the court (under Article 182 of the UAE Bankruptcy Law) to permit security to be "primed" (without any cap on value) provided that the affected secured creditor is no worse off as a result.

Article 170(8) of the UAE Bankruptcy Law (as amended) also provides that unless "special provisions" are provided for under Part 4 of the UAE Bankruptcy Law and the decisions issued for its implementation, the provisions of the UAE Bankruptcy Law will apply to Emergency Financial Crisis Proceedings. It remains unclear how a UAE court would interpret this provision in practice. However, in our view, a better interpretation of that provision is that the moratorium provided for under Article 162 of UAE Bankruptcy Law (which applies to all judicial proceedings against the debtor and any execution against its assets) also applies to debtors subject to Emergency Financial Crisis Proceedings.

As at the time of writing, the only Cabinet resolution that has been passed and which would cause an Emergency Financial Crisis Proceeding to be available is the Cabinet resolution No. 5 of 2021 which provides that the situation resulting from the COVID-19 pandemic between 1 April 2020 and 31 July 2021 is considered an "Emergency Financial Crisis" for the purposes of the UAE Bankruptcy Law.

Declaration of bankruptcy & insolvent liquidation

A debtor may be declared bankrupt and an insolvent liquidation may be initiated by the court if:

– the court terminates or rescinds a Scheme which has been proposed;

– the debtor is the applicant in a preventative composition or restructuring scheme and has acted in bad faith or made such application to evade its financial obligations;

– a Restructuring Plan is proposed and is considered inappropriate for the debtor (including where the trustee considers it impossible to restructure the debtor's debts);

– a Restructuring Plan is proposed and is not approved by the requisite majority of creditors; or

– the court, at its discretion, rejects or terminates a Restructuring Plan.

In addition, the Bankruptcy Law contemplates that the debtor or a relevant creditor (being a creditor owed a debt exceeding, in aggregate, AED 100,000 that is more than 30 business days overdue following a formal notice sent by that creditor to the debtor) may request that the court approve an insolvent liquidation. It is not entirely clear, however, whether the court will proceed straight to insolvent liquidation without first having considered the possibility of a restructuring scheme.

Upon the declaration of bankruptcy and the commencement of the insolvent liquidation process, the court shall appoint a trustee to determine, liquidate and monetise the assets of the debtor under the court's supervision.

The proceeds are then distributed to creditors according to the priority ranking of their claims (please see section titled "Ranking of creditors" below).

Where a company is declared bankrupt, criminal and civil sanctions may be imposed on its directors and managers for their wrongful acts, such as: disposing of assets at less than market value in order to delay the onset of bankruptcy proceedings, entering into transactions at an undervalue with third parties and preferring the debts of one creditor to the detriment of others.

These civil and criminal sanctions will not apply if the directors and managers can show that they did not participate in any of the sanctioned acts, objected to decisions leading to such acts or if the court is satisfied that they had taken all possible precautions to reduce the losses to the company's creditors.

Financial Restructuring Committee

The Bankruptcy Law provides for the establishment of a Financial Restructuring Committee (the **FRC**). The mandate of the FRC was originally to mediate consensual resolutions between a financial institution and its creditors in times of financial difficulty. In 2019, this was extended beyond financial institutions to include all establishments which are regulated by a regulatory authority in the UAE.

The Bankruptcy Law is relatively clear that the role of the FRC is one of a mediator as opposed to the FRC having powers to compel resolutions between a debtor and its creditors. Engaging with the FRC does not impose a moratorium on any other proceedings being initiated against a debtor – in fact, the commencement of one of the other insolvency processes would immediately terminate the process being run by the FRC.

At the time of writing, we are aware of the FRC's acceptance of debtor-led applications to oversee two major UAE restructurings. One of those situations involves a UAE entity listed on the Dubai Financial Market and regulated by the Securities and Commodities Authority, whilst the other involves unlisted UAE entities.

Unenforceable transactions

The Bankruptcy Law provides that, unless otherwise allowed by the court, certain actions are *unenforceable* against the creditors if these actions are carried out by the debtor within two years preceding the date on which any of the above processes was initiated. These actions include:

– making donations, with the exception of small customary gifts;

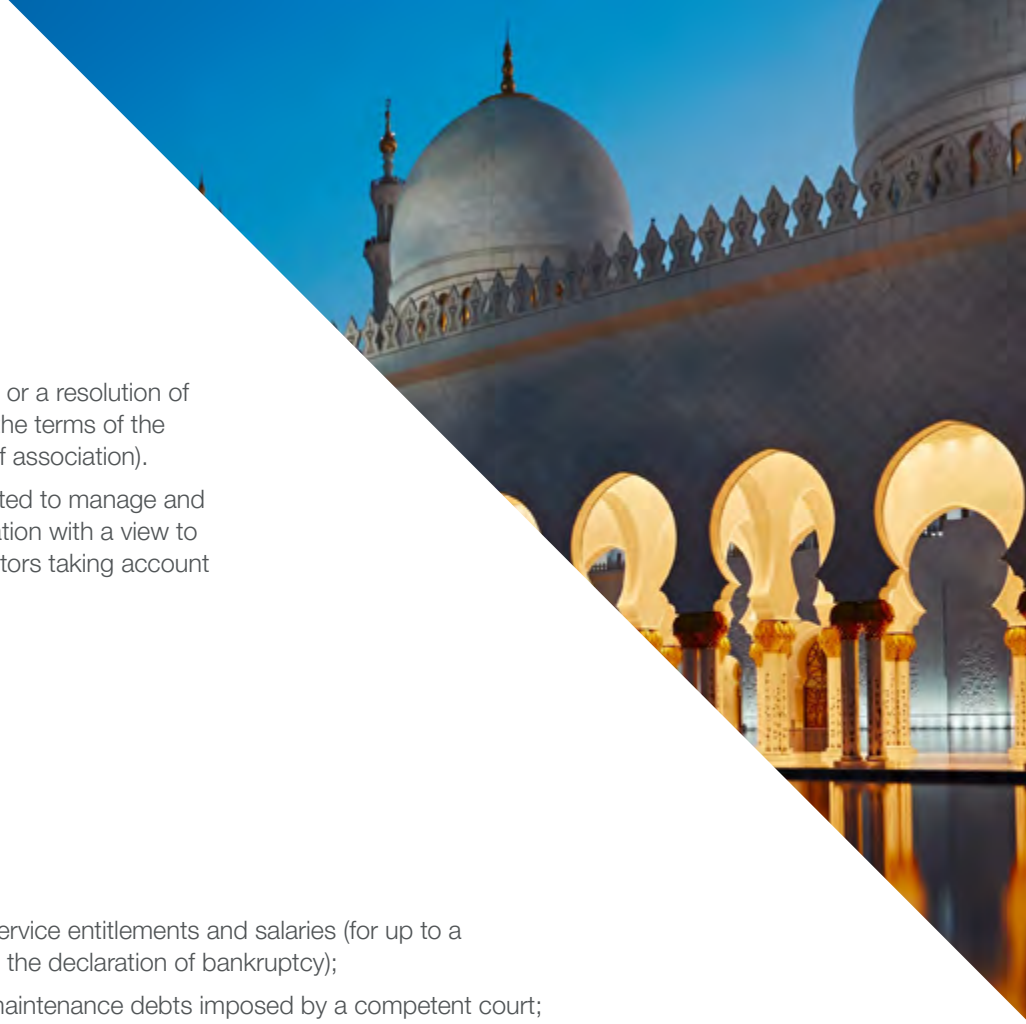
– transacting at a significant undervalue;

– paying any term debt (by whatever means) prior to the due date;

– paying immediate debts other than in the form agreed (with payment by means of trade bills or bank transfer deemed to be cash payment); and

– granting new collateral to secure a pre-existing debt.

In addition, the court has an unfettered discretion to find any other transaction entered into by the debtor *unenforceable* if (i) such transaction was detrimental to the debtor's creditors and (ii) the counterparty to the transaction was aware, or should have been aware, of the debtor's insolvency at the time of the transaction.



Liquidation

Liquidation is the formal dissolution procedure for companies under the UAE Companies Law.

The reasons for liquidation under the UAE law will vary dependent on the type of company and may include: the expiry of the company's term, the completion of the company's objectives, the loss of most of its assets rendering the investment of the remainder of such assets non-feasible, merger or amalgamation or a resolution of the shareholders (in accordance with the terms of the company's memorandum or articles of association).

One or more liquidators will be appointed to manage and realise the company's assets in liquidation with a view to distribution of such assets to the creditors taking account of the ranking of creditors

Ranking of creditors

The proceeds of an insolvent liquidation following a declaration of bankruptcy are required to be distributed to creditors in the following order of priority:

– the claims of secured creditors (in respect of the proceeds of the relevant secured asset) provided that any fees and expenses incurred by the trustee in connection with the disposal of that secured asset shall be paid prior to distribution to the relevant secured creditor;

– preferred creditors (as more particularly outlined below); and

– unsecured creditors.

Preferred creditors comprise, and shall be paid in the order of priority, set out below:

– court fees and fees and expenses of any court appointed trustee or expert as well as costs and fees paid to maintain and liquidate the assets of the debtor;

– employees' end of service entitlements and salaries (for up to a 3-month period before the declaration of bankruptcy);

– alimony and family maintenance debts imposed by a competent court;

– amounts due to government authorities;

– fees agreed between the debtor and any expert appointed by the debtor from the date of commencement of the proceedings (including legal fees); and

– any fees, costs and expenses arising after the commencement of the insolvency procedures: (a) in relation to goods and services supplied to the debtor to continue its business; or (b) for the purposes of continuing the business activity of the debtor.

Cross-border recognition

The UAE has not adopted the UNCITRAL Model Law on Cross Border Insolvency. There are no provisions in the UAE law for recognition of insolvency proceedings commenced in other jurisdictions or for co-operation with the courts of other jurisdictions. The UAE courts may recognise a foreign judgment of insolvency on a reciprocal basis. However such recognition is subject to a number of conditions, including being compliant with public policy in the UAE, both parties having obtained adequate representation and the judgment being obtained from a jurisdiction which enforces UAE judicial rulings. As a matter of practice, however, it is thought that UAE courts will generally seek to assert their jurisdiction over any matter involving UAE parties and it is not likely that enforcement of a foreign judgment will be obtained in the UAE.

Key contacts

If you require advice on any of the matters raised in this document, please call any of our partners or your usual contact at Allen & Overy.

Samer Eido
Partner
Tel +971 4 426 7258
samer.eido@allenovery.com

Joe Clinton
Partner
Tel +971 4 426 7177
joe.clinton@allenovery.com

Adam Fadian
Partner
Tel +902123712918
adam.fadian@allenovery.com

Randal Weeks
Partner
Tel +44 20 3088 2661
randal.weeks@allenovery.com

Joel Ferguson
Partner
Tel +44 203 088 2414
joel.ferguson@allenovery.com

Kathleen Wong
Partner
Tel +44 20 3088 4281
kathleen.wong@allenovery.com

Nick Charlwood
Partner
Tel +44 20 3088 4106
nicholas.charlwood@allenovery.com

Anthony Traboulsi
Partner
Tel +971 4 426 7188
anthony.traboulsi@allenovery.com

Anthony Mrad
Senior Associate
Tel +971 4 426 7139
anthony.mrad@allenovery.com

Adam Banks
Counsel
Tel +971 4 426 7253
adam.banks@allenovery.com

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**.

For more information, please contact:

Dubai

Allen & Overy LLP
11th Floor
Burj Daman Building
Al Mustaqbal Street
Dubai International Financial Centre
PO Box 506678
Dubai
United Arab Emirates

Tel +971 4 426 7100
Fax +971 4 426 7199

London

Allen & Overy LLP
One Bishops Square
London
E1 6AD
United Kingdom

Tel +44 20 3088 0000
Fax +44 20 3088 0088

GLOBAL PRESENCE

ROW
CS2106_CDD-64679_UAE

allenovery.com