

ALLEN & OVERY

Restructuring Across Borders

United Arab Emirates:

Corporate restructuring and
insolvency procedures | March 2020





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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);
- 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 (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 security has been granted. If 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, 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 or restructuring scheme). 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:

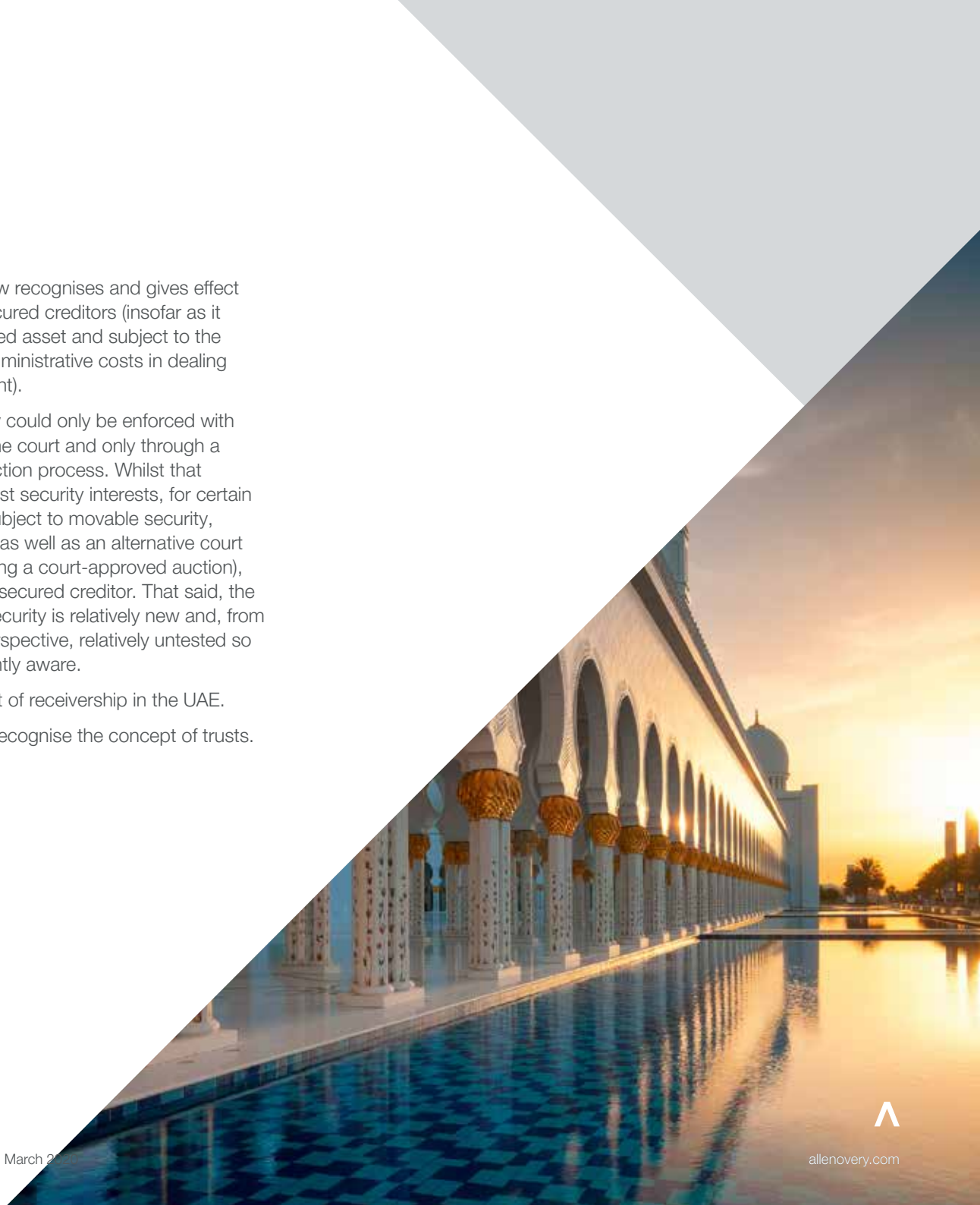
- mortgages over real property (and associated rights such as usufruct rights and *musataha* rights which are akin to leasehold interests);
- commercial mortgages over movable assets;
- pledges over shares (in respect of limited liability companies, public/private joint stock companies and companies incorporated in certain free zones);
- since 2017, non-possessory movables security over certain movable assets (including bank accounts); and
- absolute assignments of rights under contracts (although strictly, this 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, 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.

There is no concept of receivership in the UAE.

UAE law does not recognise the concept of trusts.



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 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 preventative 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. While 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.

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 business days from the date on which they fell due. We are not aware, however, of the strict nature of this test having been considered by the courts.

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 business days from the date on which they fell due. 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).

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, AED100,000 that is more than 30 business days overdue following a formal notice sent by the said creditor to the debtor. The process can also, in certain circumstances, be commenced by the public prosecutor or the regulator of a regulated debtor.

In a restructuring scheme or insolvent liquidation, the debtor or (as the case may be) creditor (or creditors) 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).

Other differences between a preventative composition and a restructuring scheme include the inability of a debtor to continue to run its business in the latter process as the business of the debtor under a restructuring scheme will 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). As with 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.

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.



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 via 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, AED100,000 that is more than 30 business days overdue following a formal notice sent by the said creditor to the debtor) may request that the court approve an insolvent liquidation. It is not entirely clear, however, whether the court can 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 licenced by the competent supervisory authorities. It is not entirely clear which entities would be caught by this extension.

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 not aware of the FRC having been involved in any particular situation of substance.

Voidable transactions

The Bankruptcy Law provides that, unless otherwise allowed by the courts, 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 a 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 as unenforceable if such transaction was detrimental to the debtor's creditors and 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 three-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 cooperation with the courts of other jurisdictions. The UAE courts would 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.



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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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