
THE RESTRUCTURING REVIEW

SECOND EDITION

EDITOR
CHRISTOPHER MALLON

LAW BUSINESS RESEARCH

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RESTRUCTURING
REVIEW

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Chapter 29

UNITED ARAB EMIRATES

*Bashir Ahmed and Aly Shah**

I OVERVIEW OF 2008/2009 RESTRUCTURING AND INSOLVENCY ACTIVITY

The last quarter of 2008 and the first half of 2009 have been a difficult period for the United Arab Emirates ('the UAE') from an economic standpoint. The second half of 2009 is also expected to be a difficult period. The global economic slowdown has also had an impact on the UAE. Liquidity shortfalls have had an adverse impact on UAE based businesses and various markets (including the financial and real estate markets). There are limited means to gauge market trends with respect to restructuring procedures as generally little information is published or released with respect to businesses facing financial difficulties. Likewise, there is little information available on the number of formal insolvencies or restructurings entered into or existing during 2008 or the first half of 2009. In fact, there is little evidence of the laws relating to restructuring and insolvency having been tested in the UAE and it is difficult to tell as to how the UAE courts would approach such matters.

II GENERAL INTRODUCTION TO THE RESTRUCTURING AND INSOLVENCY LEGAL FRAMEWORK

i Overview

The UAE provides a framework for the restructuring and insolvency of commercial companies and traders,¹ which is contained in UAE Federal Law No. 18 of 1993

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1 The term 'trader' is defined in the Commercial Code to include (i) any person who works in his own name or to his advantage in commercial activity while possessing the required legal capacity, provided he adopts this activity as a profession and (ii) any company that undertakes

promulgating the Code of Commercial Practice (‘the Commercial Code’). The UAE Federal Law No. 8 of 1984 on Commercial Companies (as amended) (‘the Commercial Companies Law’) contains provisions for the dissolution of a company.² The Penal Code of the UAE (contained in Federal Law No.3 of 1987) also contains criminal sanctions for bankrupts.³

ii The Commercial Code

Company bankruptcy

In terms of the Commercial Code, with the exception of share partnership companies,⁴ any commercial company (hereafter referred to as a ‘company’) may be declared bankrupt (even when a company is in the process of liquidation) if it ceases to pay its commercial debts when they fall due because of the disruption of its financial affairs. If an application is made to have a company declared bankrupt, it is necessary to cease examination of any application to liquidate the company or to place it in receivership. The managing director or the liquidator (as the case may be) of a company may, subject to certain conditions, apply for the company to be declared bankrupt. The creditor of a company may apply to have the company declared bankrupt even if the creditor is a partner of a company.

Bankruptcy of a trader

In terms of the Commercial Code, any trader may be declared bankrupt if such person fails to pay commercial debts by their due dates on account of the disruption of the trader’s financial position and the uncertainty of the trader’s credit. Any trader who in payment of its debts uses unusual or unlawful means suggesting a poor financial situation is deemed equivalent to one who has ceased payment. A trader may be declared bankrupt upon the trader’s own application or upon an application by one of its creditors or upon a UAE court declaring a trader bankrupt at the request of the Public Prosecution Service or of its own accord. Every creditor with an immediate commercial or civil debt may also apply for a judgment to declare the trader bankrupt, provided that the creditor submits proof that the debtor has ceased payment of the commercial debt.

commercial activity or takes one of the forms stipulated in the Commercial Companies Law. In this article, commercial companies have also been dealt with separately where required.

2 The above framework does not apply to all free zones within the UAE. The Dubai International Financial Centre (the ‘DIFC’ – a financial free zone) is one such instance, which for example has developed its own insolvency law and insolvency regulations for DIFC entities.

3 The criminal sanctions relating to bankrupts under UAE law are not elaborated upon in this chapter, the focus being on the restructuring and insolvency framework in the UAE.

4 This Commercial Companies Law provides for the following types of companies: (1) limited liability companies, (2) private shareholding companies, (3) public shareholding companies, (4) partnership companies, (5) limited partnership companies, (6) share partnership companies, (7) joint venture companies and (8) foreign companies.

Bankruptcy proceedings and declaration of bankruptcy

The court within the jurisdiction over the place where the business of the debtor is located has jurisdiction to declare a bankruptcy. A judge is appointed as the bankruptcy judge. Under the Commercial Code, a declaration of bankruptcy may be made where the debtor has a branch, agency or office within the UAE, even if the debtor has not been declared bankrupt by a court of a foreign state.

If a bankruptcy judgment does not specify a date for the suspension of payments by the debtor, the date on which the judgment was pronounced is deemed the provisional date for the suspension of payments. The date for suspension of payments may not be referred back to more than two years from the date the bankruptcy judgment is pronounced.

If a partnership is declared bankrupt, all the general partners must be declared bankrupt, including general partners who have left the company after the suspension of payments, provided that no more than a year has elapsed since the date on which notice of their departure from the company was entered in the commercial register.

Once the bankruptcy judgment is pronounced, no set-off is permitted between what is owed to or by the bankrupt unless there is a connection between them.

If the debtor becomes capable of paying all debts before final execution of the bankruptcy judgment, the court must cancel the judgment and the debtor must pay the cost of the action.

Administration of bankrupt's estate

The court appoints a 'trustee in bankruptcy' to manage the bankrupt's estate. The Commercial Code provides a process for matters relating to the administration of the bankrupt's estate, which includes the continuance of the operation of the business of the bankrupt if the general interest of the bankrupt debtor and the creditors necessitates the same.

Effects on debtors

As soon as a bankruptcy judgment is pronounced, the bankrupt is, with certain exceptions, prevented from administering and disposing of assets. Any disposals made on the day of the judgment are deemed to have been made after the bankruptcy judgment was pronounced. If a disposal is not concluded and enforceable by a third party until after registration or other formality, it is not binding on the group of creditors of the bankrupt unless the registration or other formality is completed prior to the pronouncement of the bankruptcy judgment. Once the bankruptcy judgment has been pronounced, the bankrupt may no longer pay its debts or collect sums due to it.

The prohibition on administration and disposal by the bankrupt covers all assets owned by the bankrupt at the date on which the bankruptcy judgment is pronounced and any assets that revert to the bankrupt's ownership while the bankrupt remains in a state of bankruptcy. However, the prohibition on administration and disposal does not cover the following:

- a* assets that are not subject to legal distraint and any allowance granted to the bankrupt;
- b* assets owned by third parties other than the bankrupt;

- c* rights connected with the marital status of the bankrupt;
- d* compensation due to the beneficiary of a guarantee in a contract validly concluded by the bankrupt prior to the issue of the bankruptcy judgment. However, unless otherwise stipulated by law, the beneficiary is obliged to return to the bankrupt's estate any instalment payments made under such contract by the bankrupt from the date appointed by the court for the suspension of payments; and
- e* the prohibition on administration and disposal by the bankrupt does not include rights connected with the person of the bankrupt, with his position as head of a household or with any purely moral interest.

Equally, the prohibition does not cover profits that may accrue to the bankrupt from his activities or industry, to the extent that the judge considers appropriate in relation to the needs of the bankrupt and the support of himself and his family.

Following the pronouncement of the bankruptcy judgment, legal actions may not be brought or pursued by the bankrupt or brought or pursued against the bankrupt with the exception of the following:

- a* actions connected with assets, rights and disposals that are not covered by the prohibition preventing the bankrupt from administration or disposal;
- b* actions that the law permits the bankrupt to bring in connection with the bankruptcy proceedings;
- c* actions under criminal law; and
- d* actions preparatory to a judgment to close proceedings.

If after the date of suspension of payments and prior to the bankruptcy judgment, the bankrupt takes any of the following actions, they are not binding on the group of creditors established (see below for details on the establishment of the group of creditors):

- a* the making of any donations, with the exception of small customary gifts;
- b* the payment of any term debt, by whatever means, prior to the due date;
- c* the payment of immediate debts, other than in the form agreed; and
- d* entering in to any mortgage or other agreed charge secured on the debtors assets to guarantee a prior debt.

Any disposals made by the bankrupt during the said period, other than those referred *supra*, may be adjudged unenforceable *vis-à-vis* the group of creditors if such a disposal is harmful to them and if the party to whom the disposal was made was aware at the time that the bankrupt was insolvent. In any of the cases referred *supra*, the creditors may bring an action for restitution.

Further, mortgages or liens secured on the assets of the bankrupt may be adjudged unenforceable *vis-à-vis* the group of creditors if they are registered after the date of suspension of payments. However, a creditor having a second mortgage following a mortgage being ruled unenforceable *vis-à-vis* the group of creditors is entitled to receive from the proceeds of the sale of the asset on which the mortgage or lien is secured only what the bankrupt would obtain on the assumption that the prior mortgage was enforceable, and the difference goes to the group of creditors.

If a disposal is ruled to be unenforceable *vis-à-vis* the group of creditors, the party to whom the disposal was made must return to the bankrupt's estate whatever was obtained from the bankrupt by virtue of the disposal or the value of the thing at the time it was received. The party is also obliged to repay any yield received from the date of receipt and any consideration for its use. The party to whom the disposal was made is entitled to the return of the consideration provided to the bankrupt if such consideration is itself present in the bankrupt's estate. If it is not present, the party concerned is entitled to seek from the group of creditors the benefit obtained from the disposal and to share in the bankrupt's estate as an ordinary creditor for any amount in excess thereof.

In the case of a company, if it appears that the company's assets are insufficient to meet at least 20 per cent of the company's debts, the court that pronounced the bankruptcy judgment may order the members of the board of directors or some or all of the managers, whether jointly or otherwise, to pay some or all of the company's debts in cases where they are proved liable in accordance with the Commercial Companies Law.

Effects on creditors

As soon as the bankruptcy judgment is pronounced, a group of creditors is established. The group of creditors consists of persons having valid claims on the bankrupt dating from before the bankruptcy judgment. The pronouncement of the bankruptcy judgment results in the suspension of individual proceedings and actions brought against the bankrupt by ordinary creditors or preferred creditors. When a bankruptcy judgment is pronounced, all monetary debts owed by the bankrupt become payable, whether ordinary or secured by a general or particular charge. However, any interest on ordinary loans due to the group of creditors ceases when the bankruptcy judgment is pronounced. Interest may not be claimed on loans secured by a mortgage or lien, except in respect of sums arising from the sale of the assets on which the loans are secured.

Effects on creditors with debts secured by a chattel mortgage or lien

The names of creditors of the bankrupt who have debts secured by a chattel mortgage or lien are entered in the group of creditors with reference to the mortgage or lien. At the proposal of the trustee in bankruptcy, the judge supervising the bankrupt's estate may, where necessary, order that the first funds entering the bankrupt's estate be used to pay the sums due to creditors with debts secured on the chattels of the bankrupt (provided that their names are included in the final list of uncontested debts). After obtaining permission from the judge supervising the bankrupt's estate, the trustee in bankruptcy may at any time pay debt secured by such a mortgage and return the object of the mortgage to the account of the group of creditors. If a mortgage chattel is sold at the request of the mortgagee (i.e., the mortgage creditor) and the price exceeds the debt, the trustee in bankruptcy must receive the surplus for the account of the group of creditors. If the price is less than the debt, the mortgage creditor shares in the bankrupt's estate for the remaining amount as an ordinary creditor, provided that the debt arose in accordance with the provisions of law.

Effects on secured creditors with a mortgage or lien on real property

If a dividend or distribution is paid for the proceeds of real property before the proceeds for chattels or if the two are paid together, mortgage creditors or preferred creditors that have not been paid some or all of their debts out of the proceeds of the real property may share with the ordinary creditors for the outstanding amount in the dividend or distribution due to the group of creditors, provided that their debts have been verified.

If one or more dividends or distributions are paid in respect of the proceeds of chattels before a dividend or distribution in respect of the proceeds of real property, mortgage creditors or preferred creditors may share in the dividends or distributions for all their debts, provided that the debts have been verified.

After the sale of real property and final settlement in accordance with the rank of the mortgage and preferred creditors, no one qualified by rank to receive the whole of the debt from the proceeds of the real estate is permitted to collect the debts until deduction of the amount received by such creditor from any dividends for chattels. This amount is returned to the group of ordinary creditors.

Should the rank of a creditor entitle such a creditor to receive only a part of the debt, the creditor must return to the group of ordinary creditors any amount received in excess of this amount if the dividend or distribution in respect of real property subject to mortgage or lien is paid prior to the dividend for chattels. Such a creditor may seek the remainder of the debt from the bankrupt's estate.

Mortgage creditors and preferred creditors who receive nothing from the proceeds of the properties on which they have a charge are deemed ordinary creditors and are subject to all the effects arising from the work of the group of creditors and, where applicable, a judicial arrangement.

Effects on concluded contracts

The pronouncement of a bankruptcy judgment does not generally result in the rescission of a contract to which a bankrupt is a party. However, if the trustee in bankruptcy does not perform the contract or will no longer continue to do so, the other party may seek rescission of the contract. In such case, the contracting party is entitled to share in the bankrupt's estate as an ordinary creditor in respect of compensation arising from the rescission.

Preferential payments

In the course of bankruptcy proceedings, preference is given to the following:⁵

- a wages and salaries due to workers and staff for the period of 30 days prior to the declaration of bankruptcy;

5 The Commercial Code does not set out an exact order of priority of payments as set forth above. However, UAE Federal Law No. (8) of 1980 on Regulating Labour Relations does refer to certain payment priorities, and Article 4 thereof states as follows: 'All amounts due to the employees according to the provisions of this law or due to his inheritors, shall have priority over the employer's property including movables and estates. They shall be settled immediately after judicial expenditure and amounts due to treasury and alimony awarded to wife and children.'

- b* amounts due to a trustee in bankruptcy where the trustee in bankruptcy pays a debt of the bankrupt from his own funds or if the debt is paid by another person, his debt is paid from the first monies to enter the bankrupt's estate;
- c* payment of government taxes due from the bankrupt for the two years preceding the pronouncement of the bankruptcy judgment; and
- d* certain rents payments to the owner of premises leased to the bankrupt.

Restitution

Any person is entitled to restitution from the bankrupt's estate in respect of specific items which such person can prove he owned at the time of the bankruptcy judgment.

Verification and schedule of debts

The Commercial Code sets forth the procedure and timetable for the verification of debts of creditors by the trustee in bankruptcy and the establishment of a final schedule of uncontested debts by the judge supervising the bankrupt's estate.

In the case of companies, debentures issued by same in accordance with the Commercial Companies Law are not subject to the procedures for the verification of debts. Such debentures are to be accepted at their nominal value after deduction of any amounts paid by the company.

Judicial composition

Following the establishment of a final schedule of uncontested debts, the judge supervising the bankrupt's estate is required to invite creditors whose debts have been finally or provisionally accepted to attend deliberations on a composition. It is not permitted to contract a composition with a bankrupt who has been convicted of fraudulent bankruptcy. A composition can only take place with the agreement of creditors and the fulfilment of the conditions prescribed by the Commercial Code. A composition may be concluded on condition of payment if the debtor becomes solvent within five years of the date that the composition takes effect. The composition may include granting to the debtor periods of grace for payment of debts and waiver towards a debtor of a part of the debt. The creditors may demand that one or more guarantors be offered to guarantee the implementation of the conditions of the composition. All the effects of bankruptcy are removed with the pronouncement of the court decision to ratify the composition. However, this does not affect any criminal prosecution.

In the case of a company, proposals for a composition or arrangement are required to be drawn with the approval of a majority of partners in general and limited partnerships and with the approval of the extraordinary general meeting of shareholders in other types of companies. If an arrangement relates to a company that has issued debentures amounting to 20 per cent of its total debt, the arrangement shall not be allowed unless the conditions are approved by a general meeting of the debenture holders. In any event, approval is required if the arrangement contains conditions that are not in accordance with the conditions on the basis of which the debentures were issued.

If the bankruptcy proceedings of a company and the partners result in a composition or arrangement, each composition or arrangement is to be separate from

each other and the conditions thereof only apply to the creditors of the particular arrangement.

Union of creditors

The creditors are deemed to be in a 'state of union' by law if a judicial composition is not concluded. After the state of the union has been established, the judge supervising the bankrupt's estate is required to invite each creditor to deliberate on the affairs of the bankrupt's estate. The appointed trustee referred to at this stage of the bankruptcy proceedings as the 'trustee of the union of the creditors' is permitted to sell moveable property of the bankrupt. The sale of immovable property of the bankrupt is carried out under the supervision of the bankruptcy judge and in accordance with the UAE Civil Procedure Code (Federal Law No. 11 of 1992). The union trustee is not permitted to continue the business of the bankrupt until requisite approvals of the creditors and the bankruptcy judge are obtained.

If six months elapse from the date of establishment of the state of union without the work of liquidation having been completed, the trustee must submit a report to the judge supervising the bankrupt's estate on the state of the liquidation and the causes for the delay in completing it. Whenever the work of liquidation is complete, the union of trustee is required to submit a final account to the judge supervising the bankrupt's estate. The judge must invite the creditors to discuss the account and the bankrupt must also attend the meeting. The union is dissolved and the bankruptcy proceedings are deemed complete in law once the account has been approved.

Further, if the bankruptcy proceedings of a company end in union and an arrangement is reached with one or more of the general partners, the funds of the company may not be allocated to comply with the conditions of such an arrangement or to guarantee its execution. If an arrangement is reached with a company and bankruptcy proceedings of the partners end in union, the company remains in existence unless the basis for the arrangement was the surrender of the company's assets.

A company is not dissolved if the bankruptcy proceedings end in union. However, the court that pronounced the bankruptcy judgment may decide to dissolve the company if it is apparent that the assets remaining after the liquidation of the union are insufficient to carry on the business profitably.

It should be noted that after the state of union has ended, each creditor regains the right of enforcement against the debtor to obtain the remainder of his debt.

Closure of bankrupt's estate

If during the course of the bankruptcy proceedings, the proceedings are halted because of insufficiency of assets prior to ratification of a judicial composition or establishment of a state of union, the court may at its own discretion or in accordance with a report from the judge supervising the bankrupt's estate order that the bankrupt's estate be closed. In such instance, each creditor once again has the right to take steps and to initiate individual actions against the bankrupt.

ii *The Commercial Companies Law*

The Commercial Companies Law provides for the dissolution of a company in certain prescribed circumstances. This includes for instance where the losses to a company amount to half of its capital.

All debts of the company become due and owing upon the company's dissolution. If the company's assets are not sufficient to meet all of the debts, then the liquidator is required to make proportional payment of such debts, without prejudice to the rights of preferred creditors. Every debt arising from acts of liquidation are required to be paid out of the company's assets in priority over other debts.

The liquidator is required to complete his task in the time period specified in his deed of appointment. The liquidator is required to present to the partners or the general assembly of a company, a provisional account of the acts of liquidation every six months.

Upon termination of liquidation, the liquidator must present to the partners or the general assembly a final account of the acts of liquidation. Such acts end with the certification of the final accounts.

iii *Composition to prevent bankruptcy – restructuring*

Provisions for a composition to prevent the bankruptcy of a debtor are contained in the Commercial Code.

In terms of the Commercial Code, any trader whose financial affairs are so disturbed so as to lead to a suspension of payments may, within 20 days of such cessation, apply for a composition with his creditors. This option is available to a trader even if the trader has applied to be declared bankrupt. Generally, a composition with creditors may be granted to any company that meets the same conditions as those applicable to a trader. However, such a composition is not available to a company that is in liquidation.

An application for a composition with creditors can be accepted only from an applicant that has carried on business continuously for the year prior to the application and during this period has complied with applicable provisions pertaining to the Commercial Register and commercial books.

Accepting the application for a composition

If the court decides to accept the application for a composition, it orders the opening of proceedings. The court (which is required to be a court competent to declare bankruptcy) appoints one of its judges to supervise the composition, and one or more trustees for the composition. The debtor is required to deposit with the court cashier a determined sum as a bond to meet the expenses of the proceedings. The court must order the composition proceedings to be cancelled or stopped if the debtor fails to lodge the security within the appointed period. The proposed settlement cannot be less than 50 per cent of the debt and the period for payment must not be more than three years from the date of ratification of the arrangement.

Administration of assets

After the decision to open composition proceedings, the debtor continues to administer his assets under the supervision of the composition trustee and may carry out all

ordinary transactions required for his or its business affairs. All actions and enforcement proceedings against the debtor cease. Actions brought by the debtor and enforcement proceedings that he has initiated remain in effect with the intervention of the trustee.

Deliberations on composition proposals

After the debts owing to creditors have been verified under the procedure provided for in the Commercial Code for this purpose, a period is designated for the creditors meeting to deliberate on the composition proposals.

The composition may be concluded only with the approval of the requisite majority of the creditors and conditions provided for in the Commercial Code.

The composition agreement may include a condition that the debt be paid in full if the debtor becomes solvent within five years of the date of the composition occurring. The debtor is not deemed to have become solvent unless the value of his assets exceeds the debts incumbent on the debtor. The creditors may demand one or more guarantors to guarantee the fulfilment of the composition conditions.

Enforcement of composition

The composition becomes effective upon the issuing of a decision for its ratification. The Commercial Code sets forth the procedure for ratification of the composition.

III RECENT LEGAL DEVELOPMENTS

There have been no recent legislative developments or key cases in this jurisdiction relating to insolvency or restructuring. Given that there is little evidence of the laws relating to restructuring and insolvency having been tested in the UAE, it will be interesting to see how the UAE courts would approach any insolvency and restructuring actions.

IV SIGNIFICANT TRANSACTIONS, KEY DEVELOPMENTS AND MOST ACTIVE INDUSTRIES

As mentioned *supra*, there are limited means to gauge market trends with respect to restructuring procedures as generally little information is published or released with respect to businesses facing financial difficulties. One key industry in the UAE that has particularly been adversely impacted by the global and local economic conditions is the property and real estate market. Liquidity-related issues locally and overseas (overseas investors being a major contributing factor to the growth in this business area) have resulted in a low demand for real estate and a corresponding oversupply of real estate. While developers and sellers of real estate projects are said to be negotiating their respective positions and exposures, there is little that has taken place by way of the initiation of formal proceedings relating to restructurings or reported insolvencies of businesses operating in the property and real estate market.

V INTERNATIONAL

The UAE has not entered in to any international treaties specifically covering insolvency or restructuring. Neither the Commercial Code nor the Commercial Companies Law envisage as to how judicial assistance would be provided in the UAE to proceedings commenced in another jurisdiction.

VI FUTURE DEVELOPMENTS

While there is no apparent pending or anticipated legislation with respect to restructuring or insolvency in the UAE, new legislation with respect to same cannot be ruled out bearing in mind the subsisting business conditions in the UAE. For the same reason, instituting of formal proceedings by parties under the current legislation is also possible in the near future if economic and business conditions do not gain momentum.

BASHIR AHMED

Afridi & Angell

Bashir Ahmed is a partner of Afridi & Angell. He is based in Dubai, United Arab Emirates.

Mr Ahmed joined the firm in 1988 and specialises in banking, corporate and commercial, and maritime matters. In his banking practice, Mr Ahmed advises international and domestic banks on a wide range of matters including loan and credit facilities, syndications and regulatory matters and, for a period for 18 months, was seconded to the regional office of an international bank as counsel for its Middle East and South Asia operations.

Mr Ahmed advises clients on a broad range of subjects including joint ventures, mergers and acquisitions. In his project practice, Mr Ahmed has recently advised on a number of mining, refinery and smelter projects, as well as infrastructure projects. Mr Ahmed also regularly advises clients in cross-border, corporate and commercial, private equity, licensing and maritime issues.

Mr Ahmed obtained a BA in Jurisprudence from Oxford University in 1983 and received an LLM in 1986 from Punjab University Law College in Lahore, Pakistan. He is a member of the New York State Bar Association, the Lahore High Court Bar Association and the International Bar Association.

ALY SHAH

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Aly Shah works out of Afridi & Angell's Abu Dhabi office. Mr Shah, who has had over 14 years' experience in Pakistan, practises in the areas of corporate and commercial law, banking and finance, energy, oil and gas, joint ventures, mergers, acquisitions, privatisations and dispute resolution.

Mr Shah received a Bachelor of Laws degree in 1991 from the University of Buckingham and a Master of Laws in 1993 from the University of Buckingham. Mr Shah qualified as a Barrister at Law (Lincoln's Inn) in 1994.

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