

Introduction

The number of confirmed cases of COVID-19 in the United Arab Emirates (UAE) has risen rapidly, prompting local authorities to put in place stricter containment measures, including a full lockdown which commenced on 4 April 2020. Outside of businesses in vital sectors, all other businesses were directed to apply a work from home policy or to close down. Although certain restrictions have recently been eased, and while the government has rolled out a number of [initiatives](#) to support businesses in difficulty, it is generally anticipated that many companies will face financial difficulties as a result of the COVID-19 business disruption.

Unlike some jurisdictions, such as Australia, the Czech Republic, France and Poland, the UAE has not amended its bankruptcy laws nor enacted new laws which materially impact them. The obligations of companies arising out of the bankruptcy laws continue to apply. Although the measures announced and implemented offer some financial relief to companies in difficulty, some companies may still technically be in “cessation of payments” or be unable to pay their debts as they fall due and, as such, fall within the scope of the bankruptcy laws. In addition, various decrees issued at the federal and Emirate levels have created a general prohibition against enforcement action in civil cases (presumably under orders issued prior to 22 March 2020), which have had the effect of suspending certain rights of creditors.

Now more than ever, it is important for businesses to be aware of the legal requirements applicable in this case and the personal liability that managers may face in the event that they do not comply with their obligations under local laws.

Legislation

- In 2016, the UAE issued Federal Law No.9 of 2016 on Bankruptcy (the Bankruptcy Law), changing the legal framework with a better focus on restructuring and protection of debtors and employees.
- The main changes brought by the Bankruptcy Law are the following:
 - Removal of civil sanctions for debtors
 - Bankruptcy by default is no longer a criminal offence (failure to file within the prescribed timeline is not a criminal offense, but other penalties apply)
 - Introduction of a debtor-friendly scheme with allowance for the realization of assets in the normal course (versus a fire sale)

Obligations Under the Bankruptcy Law

As a result of the current COVID-19 pandemic, it is anticipated that a large number of companies will either become financially distressed or be the counterparties to a distressed business.

Companies in distress may seek protection from the competent courts, which may put in place a moratorium on all the debts due for a certain period of time. Two schemes are available under the Bankruptcy Law: the protective composition, which is a debtor-led, court-driven process, designed to facilitate the rescue of a business which is in financial difficulty, but not yet insolvent and aims at facilitating a settlement with the creditors, and the rehabilitation scheme, which is also a court-supervised process and is where a court determines that a company is worth saving as a going concern, but in which the debtor does not retain control of the management.

In both cases, the Bankruptcy Law imposes a strict timeline which must be complied with by the debtor/managers of the business.

COVID-19

As of the date of this article, it is still mandatory for onshore insolvent companies to file for bankruptcy where a company has failed to pay its debts as they fall due for a period of 30 days. No measures have been announced in connection with the suspension of the UAE bankruptcy regime. However, in respect of one of the UAE’s financial free zones, the Dubai International Financial Centre (DIFC), Presidential Directive no. 4 of 2020 was issued on 21 April 2020 suspending the wrongful trading obligations of DIFC established companies under the DIFC Insolvency Law (more particularly articles 113 and 115) from the date of its issuance to and including 31 July 2020. The DIFC has stated that the wrongful trading suspension was designed to ease the pressure on the directors of DIFC companies at risk of being held personally liable for continuing to trade in the current circumstances. Article 15 (2) of the Directive states that the suspension was intended to “ensure that directors of DIFC companies in the current uncertain environment are able to take decisions to continue to trade, incur new credit and make decisions which may otherwise cause directors concern about the potential for personal liability under the wrongful trading regime set out in Articles 113 and 115 of the Insolvency Law”.

From a practical perspective, most courts are operating as usual, but remotely in an attempt not to disrupt the judicial system while still addressing the COVID-19 health concerns.

Composition and Rehabilitation Schemes

Preventive Composition	
Test/Trigger	Approvals
<ul style="list-style-type: none"> Available to companies facing financial difficulties but not on cessation of payments Test: technically insolvent under either one of the two insolvency tests (cash flow or balance sheet test), but has not ceased to pay due debts for a period of more than 30 consecutive days Modelled on the French "<i>procédure de sauvegarde</i>" i.e. safeguard procedure 	<ul style="list-style-type: none"> Must be approved by 2/3 of creditors Who can apply: only the debtor Court must approve the composition scheme
Characteristics	Process/ Timeline
<ul style="list-style-type: none"> Debtor led application, i.e. debtor retains control of the management Purpose: rescue a debtor in difficulty – assist the debtor to reach a settlement with its creditors Quick, strict timeline under the Bankruptcy Law Moratorium on debt payments from the date the application is made with the court Criminal sanctions for bounced cheques suspended during the composition procedure Court supervised process Trustee has a supervisory role 	<ul style="list-style-type: none"> Composition scheme to include a timetable for implementation which shall not exceed three years from the date of the scheme ratification by the court

Rehabilitation Scheme	
Test/Trigger	Approvals
<ul style="list-style-type: none"> Company in cessation of payment i.e. already insolvent Default of payment for more than 30 days Test: Cash flow and balance sheet test Business capable of rescue 	<ul style="list-style-type: none"> Must be approved by 2/3 of creditors Who can apply: <ul style="list-style-type: none"> Debtor One or more creditors, i.e. any one creditor or group of creditors holding at least AED100,000 in debts and having given a written notice demanding payment and failure to pay within 30 days or Regulators Public prosecutor Court must approve the restructuring scheme
Characteristics	Process/ Timeline
<ul style="list-style-type: none"> Creditor led application or debtor led application Moratorium on debt payments from the date the application is made with the court Court supervised process Trustee has management control over the debtor Criminal sanctions for bounced cheques suspended during the rescue procedure Long term rescue/rehabilitation procedure Purpose: give the debtor a chance to restructure its business and implement a restructuring plan within a period of five to eight years 	<ul style="list-style-type: none"> Mandatory bankruptcy filing or filing for protection within 30 days Applicant must deposit cash or provide a bank guarantee for an amount of maximum AED20,000 to cover the expenses of the procedure Trustee appointed by the court Debtor must confirm its ability and willingness to continue with the business Restructuring plan to be rolled over within a period of five to eight years

Timeline Summarised

	Action	Timeline
1.	Application for composition/rehabilitation scheme to court	Within 30 days of cessation of payment (for the rehabilitation scheme)
2.	Court-appointed expert prepares a report on the debtor's financial position	Within 20 days of expert's appointment
3.	Court accepts the application and initiates the composition/rehabilitation proceedings	Within five days of receipt of expert's report
4.	Court appoints a trustee	No later than the day following the opening of the proceedings
5.	Trustee makes an inventory of debtor's assets and publishes a decision in a newspaper inviting creditors to file their claims (for 20 days) and in addition notifies the creditors whose addresses are known	Within five days of trustee's appointment
6.	Trustee provides a list of final creditors to the court	Within 10 days of expiry of the period for the creditors to file their claims
7.	Trustee publishes the list of debts stating the amounts accepted from each debt in two daily local widespread gazettes in English and Arabic	Within three days of step 6
8.	Debtor prepares with the trustee a composition/rehabilitation plan to include mentions of article 40 or article 102 (as applicable) of the Bankruptcy Law of which the implementation period of the plan and submits it to court for ratification	Within 45 days of the date of publication
10.	Trustee convenes a meeting of creditor for creditors to vote on and approve the composition/rehabilitation scheme by newspaper publication	Upon request of the court
11.	Court approves or rejects the composition/rehabilitation scheme	Promptly upon verifying that all the requirements have been met

Directors' Duties When Insolvent or at Risk of Being Insolvent

Directors are under a general duty to promote the success of the company as a whole, to act in good faith, honestly and exercise care and diligence in the performance of their duties. In addition, actions of directors must be undertaken in accordance with the company's objectives and the powers specifically granted to them by the company. Failure to act in accordance with such duties may result in civil and criminal liability.

The directors of a company facing serious financial difficulties (but not yet insolvent) must apply to the competent court to avail protection under the composition scheme, which involves the appointment of a trustee to carry out specific rescue measures and assist in negotiations with the main creditors. However, if a company has been unable to pay its debts as they fall due for a period of more than 30 days, the directors must file for bankruptcy.

Presently, the UAE courts are able to receive such applications so directors are not prevented from carrying out this key obligation.

Penalties

Penalties include fines up to AED1 million and prison time (between one and five years). In certain circumstances, the manager or debtor may be banned from practicing any commercial activity or playing any managerial role in a company or an establishment for a period of up to five years.

The Bankruptcy Law contains an exhaustive list of actions/inactions which may give rise to liability. All have an element of gross negligence, bad faith, fraud, deceit or relate to a breach of statutory duty.

Below are some examples of the actions that could expose managers/directors to liability:

- Concealing or destroying records of the company with the intention of harming creditors
- Stealing or hiding the company's monies
- Acknowledging unpayable debts
- Fraudulently entering into a scheme of composition or restructuring
- Submitting false documents with respect to the paid and subscribed capital
- Distributing dividends in contravention with the law or articles of association of the company
- Failure to maintain commercial records sufficient to reflect the actual financial position of the company
- Concealing money from the creditor
- Paying one creditor or granting advantages to one creditor at the detriment of others
- Selling assets below market value with the intent to avoid or delay the opening of insolvency proceedings
- Undertaking commitments which cannot be fulfilled in view of the company's situation

It should be noted that objecting to a decision may be a valid defence under the Bankruptcy Law.

Practical Tips

- If the company faces financial difficulties that are likely to lead to insolvency, the directors should apply to court for protection under the composition scheme.
- While directors should however be cautious not to file for bankruptcy to avoid obligations of payment, where a company has failed to meet its debts as due for a period of 30 days, they must commence bankruptcy proceedings.
- Appointing several directors can reduce the risk of liability, as the decision making and, thus, the liability does not rest on one person.
- Directors should not take any action that may put a creditor in a preferential position.
- Directors should not make commitments which cannot be fulfilled.

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