Legislation Watch: The New DIFC Insolvency Law

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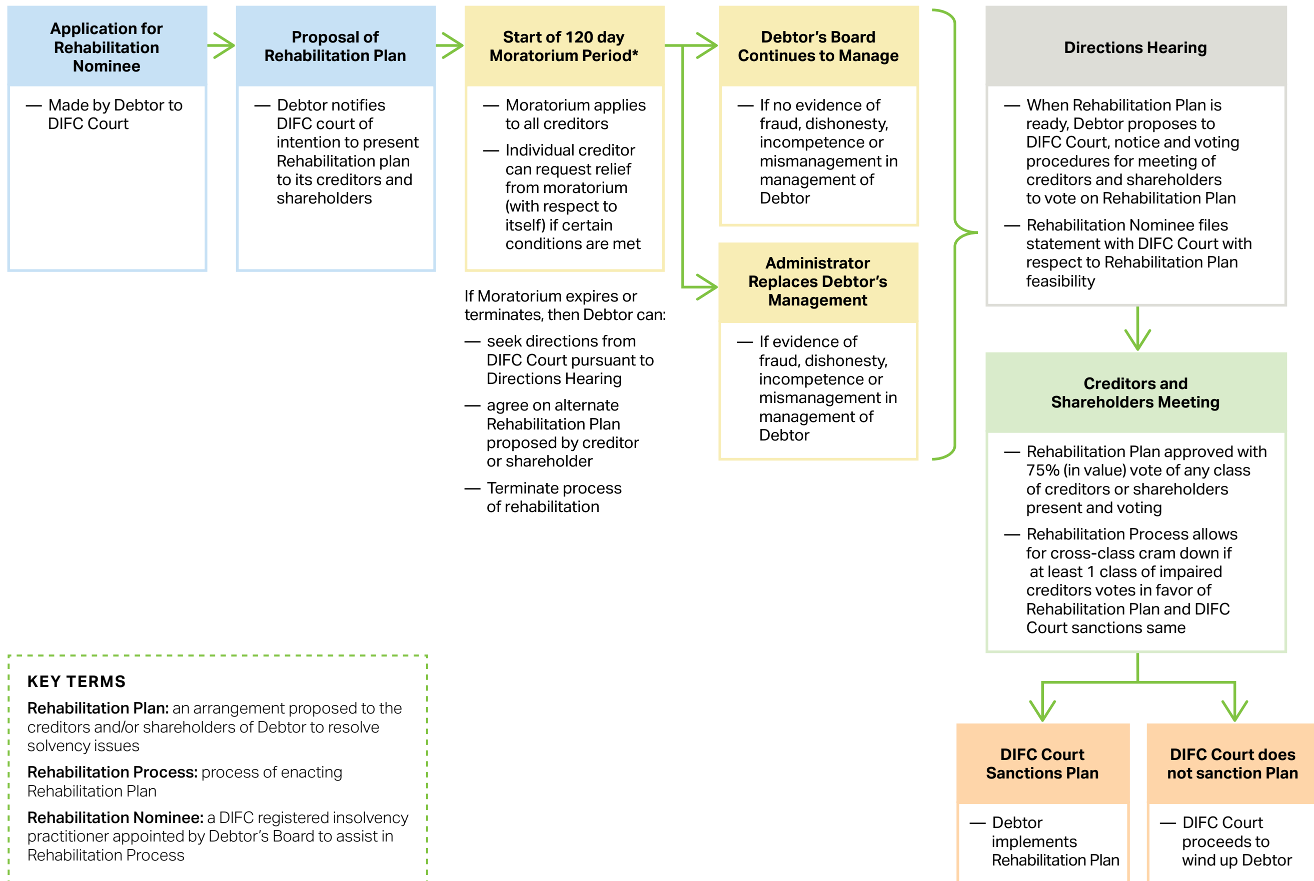
On 13 June 2019, the Dubai International Financial Centre brought into force a new insolvency law, the DIFC Law No. 1/2019, repealing the DIFC Law No.3/2009. The new DIFC law is the latest in a line of recent insolvency law related developments in the Gulf region.[1] These include bankruptcy law reform initiatives in Saudi Arabia, Oman, Bahrain[2] and 'onshore' UAE[3]. The Abu Dhabi Global Market also adopted its own set of insolvency regulations when it was established in 2015.

In addition to the drivers to reforms of the insolvency regimes in the GCC region more generally, the DIFC legal update was clearly accelerated by the well-publicized insolvency procedure of the failed Abraaj Group.

Unlike its predecessor regime, the new law provides for an administration process to be carried out, where there is evidence of mismanagement or fraud by the distressed corporate entity (like that seen in the case of the Abraaj Group). The new law seeks to balance "*the needs of all stakeholders in the context of distressed and bankruptcy related situations in DIFC, facilitating a more efficient and effective bankruptcy restructuring regime*"[4].

It also seeks to add an increased level of transparency and visibility to the likely outcome of insolvency proceedings undertaken in the DIFC. The new law has shifted the objective from punishing failing businesses by liquidating them to supporting the rehabilitation of businesses capable of being saved and maximizing their chances of returning to financial health.

Some of the major changes implemented by the new law, include introduction of a debtor in possession rehabilitation processes, streamlining the winding up procedure and facilitating better cross-border coordination in relation to insolvency proceedings. These are discussed in more detail below.



If a DIFC incorporated debtor is or is likely to become unable to pay its debts, and there is a reasonable likelihood of a successful Rehabilitation Plan being reached between the debtor on one hand and its creditors and shareholders on the other, then the debtor can apply to the DIFC Court for the rehabilitation process. The DIFC Court is a court established under the general laws of Dubai and is not a specialized court established pursuant to the provisions of the new law.

Step 1 – Rehabilitation Nominee And Rehabilitation Plan

— An application is made by the debtor to the DIFC Court to appoint one or more Rehabilitation Nominee(s).

— The debtor's board of directors may notify the DIFC Court that they intend to propose a Rehabilitation Plan to the debtor's creditors and shareholders.

— A 120-day Moratorium Period starts immediately from the date the debtor notifies the DIFC Court.

Step 2 – Moratorium Period

Creditors during Moratorium Period

— ***Scope:*** The Moratorium Period applies to all creditors (whether secured or unsecured) and extends to the debtor and all its assets, wherever they may be located.

— ***Restrictions on Creditors:*** During the Moratorium Period, the creditors are precluded from exercising any right of set off in respect of any obligation due from the debtor. Further, any contractual provisions relating to termination or modification thereof in the event of insolvency of the debtor cease to have effect during the Moratorium Period.

— ***Termination of the Moratorium Period:*** An individual creditor, after giving notice to the debtor, can apply to the DIFC Court for grant of relief from the Moratorium Period with respect to itself. The DIFC Court may grant relief to such creditor on such terms and conditions as the court finds equitable. In granting a relief, the DIFC Court will consider whether: (i) there is any imminent irreparable harm to the debtor in the absence of a moratorium in relation to that specific creditor; (ii) the creditor would suffer any significant loss which the debtor cannot compensate the creditor for; and (iii) the balance of harm to the creditor outweighs the interests of the debtor. A creditor can also request the DIFC Court to terminate the Moratorium Period with respect to all creditors for cause (including bad faith). In the latter case (i.e. termination of the Moratorium Period for cause), the DIFC Court can make such consequential orders as it deems fit including taking steps to wind up the debtor or appoint the Administrator.

Debtors during the Moratorium Period

— ***Management of the debtor:*** The debtor's board of directors will continue its management during the Moratorium Period unless there is evidence of fraud, dishonesty, incompetency or mismanagement.

— ***Appointment of the Administrator:*** If there is evidence of fraud, dishonesty, incompetence or mismanagement in the management of the debtor, the creditors can request the DIFC Court to appoint an Administrator to replace the debtor's management. (see detailed analysis of the powers and duties of the Administrator in the section entitled "The Administrator" below.)

Other considerations during the Moratorium Period

— ***Rescue Finance/DIP Finance:*** The DIFC Court can authorize the debtor to obtain additional secured or unsecured financing during the rehabilitation process, provided that the new financing (i) has priority over unsecured existing debt; (ii) is secured over previously unsecured property of the debtor; or (iii) is secured by a junior security interest on debtor's property which is already secured. The DIFC Court can also authorise the debtor to obtain new debt that is secured on a senior or *pari passu* security interest on property that is already secured if (i) the existing security holders are given adequate protections (i.e. an interest that is reasonably sufficient to protect holder of a security interest against diminution in the value of security); or (ii) the consent of the existing security holders is obtained.

— ***Pre-emption:*** The Moratorium Period will not render any undue debt due and payable. Also, any contrary provision in a contract, or in any applicable law shall be deemed unenforceable for the Moratorium Period. This encourages continued trade by the debtor during the Moratorium Period.

Expiration or Termination of the Moratorium Period

— ***Rights of the Debtor:*** If the Moratorium Period expires or terminates, the debtor may take any of the following steps: (i) seek directions in accordance with Step 3 below; (ii) agree to an alternative Rehabilitation Plan that may be proposed by any creditor or shareholder of the debtor; or (iii) apply to the DIFC Court to terminate the process of rehabilitation and wind up the debtor.

Step 3 – Directions Hearing

— ***Notice and Voting Procedures for the Rehabilitation Plan Meeting:*** Once the Rehabilitation Plan is ready for consideration, the debtor (or the Administrator, if appointed) will propose to the DIFC Court notification and voting procedures for a meeting of the creditors and shareholders to vote on the Rehabilitation Plan (the "**Rehabilitation Plan Meeting**"). Such notification and voting procedures essentially propose classification of the secured creditors, unsecured creditors and the shareholders for the purpose of voting in the Rehabilitation Plan Meeting. See Step 4 below regarding quorum and majorities requirements.

— ***Directions Hearing:*** The DIFC Court will hold a hearing where it may approve or amend the proposed classification and the voting procedures (the "**Directions Hearing**"). The notice for the Directions Hearing is to be sent in writing to all the creditors and the shareholders of debtor where they shall be given an opportunity to be heard. The creditors and the shareholders of the debtor may challenge the proposed classification of the creditors and the shareholders at the Directions Hearing. At the Directions Hearing, the DIFC Court may also extend the Moratorium Period if the creditors and shareholders require more time to consider the Rehabilitation Plan.

— ***Feasibility of the Rehabilitation Plan:*** At the Directions Hearing, the Rehabilitation Nominee (or the Administrator, if appointed) is required to file a statement with the DIFC Court that: (i) the Rehabilitation Plan has a reasonable prospect of being approved; (ii) the debtor is likely to have sufficient funds available to it during the Moratorium Period to enable it to carry on its businesses; and (iii) Rehabilitation Plan Meeting should be summoned to consider the proposed Rehabilitation Plan.

Step 4 – Rehabilitation Plan Meeting

— ***Notice of the Rehabilitation Plan Meeting:*** The Rehabilitation Plan Meeting takes place in accordance with the voting and notification procedures as agreed/directed by the DIFC Court in Step 3 above. The notice for the Rehabilitation Plan Meeting is to be sent in writing to all the creditors and shareholders of the debtor and should include a copy of the Rehabilitation Plan to be voted upon at the Rehabilitation Plan Meeting. The new law is silent on the quorum related requirements for the Rehabilitation Plan Meeting.

— ***Approval of the Rehabilitation Plan:*** The Rehabilitation Plan has to be approved by at least 75% in value (of claims agreed to by the debtor or Administrator or otherwise allowed by the DIFC Court) of any class of the creditors or shareholders present and voting. The procedure in the new law allows for cross-class cram down, if at least 1 class of impaired creditors votes in favour of the Rehabilitation Plan and the DIFC Court sanctions the Rehabilitation Plan (see Step 5). Unimpaired classes or creditors/shareholders are deemed to have accepted the Rehabilitation Plan and solicitation of votes from such class/creditor/shareholder is not required.

— ***Challenge to the Rehabilitation Plan:*** Following the vote of each class of creditors and shareholders on the Rehabilitation Plan, any member of the class can challenge the Rehabilitation Plan if they consider, amongst others, that the arrangement is prejudicial or the Rehabilitation Plan is not proposed in good faith.

Step 5 – Sanction Hearing

— ***Post Plan Hearing:*** The DIFC Court will hold a hearing to consider whether or not to sanction the Rehabilitation Plan.

— ***Sanction of the Rehabilitation Plan:*** The Rehabilitation Plan will be sanctioned by the DIFC Court if, amongst others, it finds that: (i) the Rehabilitation Plan complies with the applicable provisions of the new law (and is proposed in good faith), and that the arrangement is not unfairly prejudicial to each class of the creditors and shareholders (and the general body of the creditors taken as a whole); (ii) either (a) all classes of creditors and shareholders have voted to accept or are deemed to accept the Rehabilitation Plan; *or* (b) if a class of claims or interests is impaired under the Rehabilitation Plan, then at least one impaired class of creditors has voted to accept the Rehabilitation Plan; (iii) there has been no material violation of the notice and voting procedures approved by the DIFC Court at the Rehabilitation Plan Meeting; (iv) any class of creditors or shareholders of the debtor voting against the Rehabilitation Plan has received at least as much value as such class would have received in a winding up of the debtor; and (v) no holder of any claim or interest which is junior to the claims of any dissenting class will receive any property under the Rehabilitation Plan on account of such junior claim or interest before the dissenting creditors are paid in full.

— ***Binding Nature of the Rehabilitation Plan:*** Once sanctioned by the DIFC Court, the Rehabilitation Plan is binding on all persons within such class that have or could have a claim against or interest in the debtor before the date the DIFC Court sanctions the Rehabilitation Plan.

— ***No Sanction of the Rehabilitation Plan:*** If the Rehabilitation Plan is not sanctioned by the DIFC Court in the Post Plan Hearing, then the DIFC Court will immediately proceed to winding up the debtor.

Winding Up Procedure

Part 6 of the new law streamlines and modernises the existing rules and procedures for the winding up of companies. The procedures to be followed by a liquidator are clarified and the technical aspects of the liquidator's role (such as, for example, the contents of the final report a liquidator must produce when investigating the causes of a debtor's failure) are explained.

The Administrator

Appointment of the Administrator

One of the key aspects of the new law is the introduction of the provisions with respect to the appointment of an independent Administrator to oversee the insolvency proceedings of a debtor. The Administrator is a person who is registered as an insolvency practitioner under the new law.

Application for the appointment of the Administrator can be made by one or more creditors in cases where, during the rehabilitation process, there is evidence of fraud, dishonesty, incompetence or mismanagement. Notice of the application for the appointment of the Administrator must be given to all the creditors of the debtor.

An order for appointment of the Administrator will be made if the DIFC Court is of the view that the debtor is or is likely to become unable to pay its debts, and considers that the appointment of the Administrator is likely to facilitate the approval of the Rehabilitation Plan. The Administrator replaces the management of the debtor and will be given various powers to, amongst other things, investigate the wrong-doing, or propose a Rehabilitation Plan. During the period the court order is in force, all the affairs and property of the debtor are to be managed by the appointed Administrator.

Effect of the Order by the DIFC Court

Once the DIFC Court appoints an Administrator in relation to a debtor, any application with respect to the winding up of that debtor is dismissed and any receiver appointed in respect of all or substantially all of the undertakings of the debtor appointed with respect to such debtor is required to vacate office.

Powers and duties of the Administrator

The Administrator has extensive powers under the new law. Some of the Administrator's key powers include:

— to do all such things as may be necessary for the management of the affairs, business and property of the debtor;

— to remove any director of the debtor;

— to take possession of or collect property of the debtor;

— to sell or otherwise dispose of the property of the debtor;

— to raise or borrow money and grant security therefor over the property of the debtor; and

— to defend or bring any action or other proceeding.

While the Administrator has broad powers as discussed above, it is required to manage the debtor's affairs, business or property in accordance with the orders of the DIFC Court and the Rehabilitation Plan.

Removal of Administrator

As an additional layer of protection available against actions of the Administrator, the creditors and shareholders of the debtor can make an application to the DIFC Court on the ground that the Administrator is carrying on the affairs of the debtor in a manner that is prejudicial to all or some of the creditors or shareholders. The application can only be made by an aggrieved creditor/shareholder of the debtor.

The Administrator can be removed from office at any time by order of the DIFC Court. Further, the Administrator may, in certain scenarios, be required to vacate his office if he ceases to be qualified to act as an insolvency practitioner. When a person ceases to be an Administrator, he is released from his office with immediate effect and is accordingly discharged from all future liability in respect of his actions or omissions in relation to the administration of the debtor and his conduct as the Administrator.

Cross Border Insolvency Proceedings

The new law further assists in cross-border insolvency proceedings. Under the new law, if a foreign company is the subject of insolvency proceedings in the host country, then the court in such country can request that the DIFC Court assists it in gathering and remitting of assets that are maintained by the foreign company in the DIFC.

The new law also fully incorporates the UNCITRAL Model Law on cross border insolvency with certain modifications, which applies where:

— assistance is sought in the DIFC in connection with foreign proceedings;

— assistance is sought in a foreign country in relation to proceedings under the new law;

— foreign proceedings and proceedings under the new law take place concurrently; or

— the creditors or other interested persons in foreign countries are interested in commencing or participating in proceedings under the new law.

Conclusion

With the DIFC bringing its insolvency law more in line with international best practices, investors proposing to make investments in Dubai or the wider region may be more comfortable viewing the DIFC as an appropriate jurisdiction in (or through) which to structure their investments. Insolvency is still associated with business failure in Islamic countries[5] and it is hoped that the new law will allow for this stigma to subside and for the entrepreneurship to thrive.

Enacting the new DIFC insolvency law as a replacement to a relatively recent (2009) insolvency regime reinforces the DIFC's desire to keep up with the reforms in bankruptcy regimes in other neighbouring jurisdictions and enhances Dubai's image as a business-friendly jurisdiction. ■

1. See Polina Lyadnova, Fatema Al-Arayedh, Maha Alali, Lucinda Smart and Mohamed Taha, "Bankruptcy and Restructuring in the GCC: An Update on Recent Developments," *Emerging Markets Restructuring Journal Issue No. 9 – Summer 2019.*

2. See Buthaina Amin and David Billington, "Legislation Watch: Bahrain's New Bankruptcy Law," *Emerging Markets Restructuring Journal Issue No. 9 – Summer 2019.* Also see Asli Orbay (with inputs from David Billington and others), "Bahrain's bankruptcy law one year on: an untested revolution," *Debtwire* CEEMEA (https://events.debtwire.com/emerging-markets/bahrains-bankruptcy-law-one-year-on-an-untested-revolution).

3. See Lawale Ladapo and Mohamed Taha, "The New Bankruptcy Law of the UAE: Towards A More Business-Oriented Bankruptcy Regime," *Emerging Markets Restructuring Journal Issue No. 4 – Fall 2017.*

4. "*Dubai International Financial Centre Enacts New Insolvency Law*" – DIFC Press Release – 11 June 2019.

5. "*Why Have The Islamic Countries Failed To Develop Even With Resources Like Oil, While Countries With No Resources Like Switzerland Have Flourished?*" – Forbes Online – 8 January 2013.

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