# TO THE RESCUE

The United Arab Emirates is overhauling its insolvency legislation to make it more debtor-friendly. Adrian Cohen and Melissa Coakley highlight the main changes

Over the past two years, the federal government of the United Arab Emirates (UAE) has been working on a widely publicised overhaul of its insolvency legislation. The reforms aim to de-stigmatise the scarcely used bankruptcy process, moving towards a more debtor-friendly rescue and rehabilitation regime. A significant move towards achieving a change in the wider public perception of financial difficulties arose last year, when the UAE government announced that criminal sanctions for dishonoured cheques would be abolished. Currently, the draft bankruptcy law is undergoing a consultation process. It is hoped that legislative implementation will occur within the next 18 months.

The draft bankruptcy law does not attempt to abandon the strong French law influence, which underpins UAE legislation, and instead seeks to build in modern French law concepts, along with elements of best practice derived from German, English and US insolvency legislation. Crucially, the cash flow test for insolvency has been refined, a balance sheet test has been introduced and the set-off regime has been codified. Debtors will also have the opportunity to raise debtor in possession (DIP)-style priority funding during a bankruptcy process. The existing protective composition and bankruptcy procedures prescribed within the current legislation have been expanded into the following processes: (i) a private, out-of-court, pre-bankruptcy procedure; (ii) a court-based, debtor-led composition process; and (iii) formal bankruptcy, which is itself comprised of a rescue procedure within bankruptcy or liquidation.

The new proposed law will apply to corporate entities and individuals trading for profit (such as lawyers and accountants) across the UAE, with certain key exceptions, such as governmental bodies, commercial banks, insurance companies and companies incorporated within free zones that have their own insolvency law, such as the Dubai International Finance Centre. The new law also prescribes a new insolvency regime applicable to individuals or 'civil debtors' not previously captured under federal bankruptcy law.

A crucial element of the proposed new regime is a move towards the heightened involvement of industry experts, or insolvency professionals potentially from private practice, within the bankruptcy processes themselves. The new law envisages the establishment of a Financial Reconstruction and Bankruptcy Commission, which will (among other duties) oversee the legislation and appoint accredited insolvency experts to assist the bankruptcy court with the various procedures.

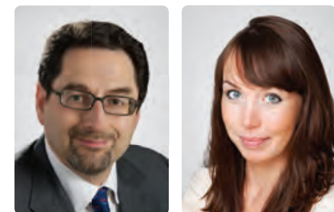
## What are the new insolvency procedures?

**Financial reorganisation procedure (FRP)** – an out-of-court, private conciliation process applicable to entities that have not yet formally entered the zone of insolvency. A mediator is appointed by the Bankruptcy Commission to oversee discussions between the debtor and its creditors. Experience from the French law equivalent *conciliation* dictates that the involvement of an official mediator can help break deadlock situations and avoid more formal court proceedings.

**Protective composition procedure (PCP)** – this follows the French *sauvegarde*, whereby a debtor proposes a compromise with its creditors outside of formal bankruptcy proceedings. Critically, the PCP includes a moratorium on creditor action (including enforcement of secured claims) and places the debtor under the control of an office holder appointed from the Commission's roll of experts. Other key tools of the PCP process include the ability to raise DIP finance, which may be secured on unsecured assets or take priority over existing security, and *ipso facto* provisions that prevent the invocation of insolvency-linked contractual termination provisions provided the debtor performs its executory obligations. The debtor is given time to file a plan, which is then voted on by creditors divided into secured and unsecured creditors or other such classes as may be required. Classes can be dispensed with when the size of the estate is below a certain threshold.

**Bankruptcy** – is split into two elements: (i) a rescue process within formal bankruptcy proceedings, which is procedurally similar to the PCP (including an automatic moratorium); and (ii) a formal liquidation procedure.

The new law will provide an excellent springboard for the development of a modern and robust insolvency framework in the UAE, but, ultimately, its success will depend on the support structures introduced to aid its practical application.



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