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July 2011

# Restructuring & insolvency law in the DIFC.

## The Dubai International Financial Centre ("DIFC")

The DIFC is a financial free zone in the Emirate of Dubai which was established in 2004. The DIFC is empowered to self-legislate in civil and commercial areas and its legislative system is based on English common law. The United Arab Emirates ("**UAE**") federal civil and commercial laws do not apply in the DIFC (although federal criminal, administrative and anti-money laundering laws do apply). The DIFC has its own common law judicial system, the DIFC Judicial Authority (known as the DIFC Courts). The DIFC Courts have exclusive jurisdiction over all civil and commercial disputes and are independent of the Dubai Courts and UAE Federal Courts.

## DIFC restructuring and insolvency procedures

This guide deals with the main restructuring and insolvency procedures applying to a company within the jurisdiction of the DIFC, namely:

> **Company voluntary arrangements** which provide for a restructuring plan which obtains sufficient creditor support to be imposed on dissenting creditors;

> **Receivership** which is an enforcement right granted to a secured creditor which typically results in the company's business being sold and the company itself going into liquidation; and

> **Liquidation** which results in the company ceasing trading and which involves a liquidator collecting in the company's assets and distributing the resulting realisations to the company's creditors so as to satisfy, as far as possible, the company's liabilities.

A table summarising these procedures is set out in the appendix to this guide.

There are no formal restructuring procedures in the DIFC (like Chapter 11 in the US) or any procedures whose primary objective is to rescue the company (like administration in the UK).

Insolvency law in the DIFC differs from insolvency law applicable in the rest of the UAE. Please click here for a summary of the procedures available in the UAE (other than DIFC).

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There are also bespoke insolvency protection regulations governing the formal reorganisation and restructuring of Dubai World and any of its direct or indirect subsidiaries set out in Decree No.57 of 2009 (as amended by Decree No.11 of 2011). These are based on a modified form of the DIFC insolvency regime. Please click here for a summary of Decree No.57.

This guide also considers the duties of directors where the company is in financial difficulties and the risk that certain transactions may be set aside in a subsequent insolvency procedure.

## The DIFC legislative framework

The DIFC Insolvency Law (DIFC Law No. 3 of 2009) (the "**Insolvency Law**") provides the framework for the restructuring and insolvency procedures described above. Broadly, these procedures apply to companies incorporated under the DIFC Companies Law (DIFC Law No. 2 of 2009) (the "**Companies Law**").

The Insolvency Law is supported by the DIFC Insolvency Regulations (the "**Insolvency Regulations**") which are enacted pursuant to Article 140 of the Companies Law and Article 93 of the Insolvency Law. There are also the DIFC Preferential Creditor Regulations which set out the category of preferential creditors and their rights in an insolvency process.

The Insolvency Law and the Insolvency Regulations are largely based on the insolvency regime in the United Kingdom.

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Modifications are made to the Insolvency Law and the Insolvency Regulations in respect of persons authorised by the Dubai Financial Services Authority (the independent regulator of financial and ancillary services conducted from the DIFC) and certain protected cell companies. There are also separate regulations for insurers. These are not dealt with in this guide.

## Company voluntary arrangements (CVAs)

**Commencement:** the Insolvency Law enables the directors of a company to propose a voluntary arrangement with its creditors.

**Terms of the CVA:** the terms of the company's proposed CVA are not restricted by the Insolvency Law, other than being unable to affect the rights of preferential or secured creditors without their consent (see below). The aim of a CVA is to enable the company to restructure its debts and may encompass, for example, debt write-offs or compromises, payments from future earnings and debt/equity conversions. The proposals must contain certain information prescribed by the Insolvency Regulations - e.g. the value of the assets and liabilities, the extent of any security, the proposed duration of the arrangement and an estimation of any distributions to creditors.

**Moratorium:** in limited circumstances and if instructed to do so, the nominee (see below) may apply to the DIFC Court for a moratorium which, if granted, will restrict the opening of insolvency proceedings against the company and the enforcement of any security. The main limitations are that the company will not be eligible for a moratorium if it is already subject to insolvency proceedings, it has incurred a liability under an agreement of US$20 million or more or it is party to a capital market arrangement. If a moratorium is obtained, there is no restriction as to its duration.

**Voting:** a CVA must be approved by a majority in excess of 75 per cent. in value of the creditors present in person or by proxy and voting on the resolution. This is similar to the test under English law, although the English law test has a further requirement – not found in the Insolvency Law – that at least 50 per cent. of the unconnected creditors must have voted in favour.

**Implementation:** prior to its approval, the directors must appoint a nominee to supervise the CVA's implementation (in practice, they will assist in the preparation of the proposal). After approval, the nominee (unless replaced by the DIFC Court) will become the supervisor to see through the implementation of the CVA. The nominee/supervisor must be a DIFC registered insolvency practitioner.

**Effect of approval:** a CVA approved by the requisite majority will be binding on all creditors including dissenting creditors, other than preferential and secured creditors who may only be bound if they consent.

"The CVA procedure cannot bind secured creditors without their consent."

**Challenge:** there is no right of challenge for a creditor once a CVA has been approved, although during its implementation a creditor may challenge the actions of the supervisor.

The use of the CVA procedure by large DIFC incorporated companies is likely to be limited given that the proposals cannot bind secured creditors without their consent and the moratorium is available only in limited circumstances. At present, there is no equivalent to the English scheme of arrangement which enables a company to affect the rights of secured creditors.

## Receivership

**Power to appoint:** if there is an instrument containing the power to do so (e.g. a security document), a creditor may appoint an office-holder to sell any part of the company's property and apply the proceeds in reduction of the creditor's debt.

**Types of receiver:** an office-holder so appointed will be a receiver, unless the property over which he is appointed consists of all or substantially all of the undertaking of the company in which case the office-holder will be an administrative receiver. In both cases, the office-holder must be a DIFC registered insolvency practitioner.

**Powers:** a receiver will only have those powers set out in the instrument. An administrative receiver, however, will also have those powers set out in Part 3 (see below) and Schedule 2 to the Insolvency Law. These include, for example, the power to take possession of the property, sell it, borrow money and grant security, bring or defend legal proceedings and generally to do anything necessary to wind up the company's affairs and distribute its assets. In practice, the security document would include the powers set out in

Schedule 2 so that a receiver will have broadly the same powers as an administrative receiver.

**Sale of secured property:** an administrative receiver (but not a receiver) has the power under Part 3 of the Insolvency Law to sell property which is subject to prior security, provided DIFC Court consent is obtained. The DIFC Court must be satisfied that the sale of the secured property free of the security would be likely to promote a more advantageous realisation and the proceeds of the sale will have to be used to discharge the sums secured by that security.

**Reporting obligations of an administrative receiver:** an administrative receiver must send creditors a report within 3 months of his appointment detailing the events leading to his appointment, any disposals or proposed disposals by him, the amount of principal and interest owing to the appointing secured creditor and the amount likely to be left over for the payment of other creditors. The report must be discussed at a meeting called by the administrative receiver within 14 days of his appointment. The unsecured creditors may decide to form a creditors' committee to assist the administrative receiver in his functions.

**Vacation of office:** the DIFC Court may remove the administrative receiver from office at any time. A receiver or administrative receiver may also resign on 7 days' notice given to the appointing secured creditor, the company and, if there is one, the creditors' committee.

## Winding-up

A company may be wound up voluntarily or by the DIFC Court (known as a compulsory winding-up). A company may be wound up voluntarily either as a members' voluntary liquidation ("**MVL**") or a creditors' voluntary liquidation ("**CVL**"). Winding-up – also known as liquidation - is a terminal procedure and its aim is to wind up the company's affairs. It allows contingent and future liabilities to be valued and settled and for the company's assets to be sold and realisations distributed to creditors and, in a MVL, members.

"A company may be wound up voluntarily or by the DIFC Court."

### Voluntary winding-up

**Commencement:** a voluntary liquidation may be commenced in accordance with circumstances provided for in the company's memorandum and articles of association, by the shareholders resolving that the company should be wound up voluntarily or by the shareholders resolving that the company cannot continue its business by reason of its liabilities. In a MVL and CVL, the winding-up is deemed to commence at the time of passing of the resolution.

**MVL:** a MVL is a procedure where the directors have sworn a statutory declaration of solvency. This is a declaration by the directors that they have made a full inquiry into the company's affairs and have formed the opinion that the company will be able to pay its debts in full within a period not exceeding 12 months from the date of commencement. The actual solvency of the company is not relevant and an insolvent company may be subject to the MVL procedure if a statutory declaration of solvency is sworn (e.g. where a company has the benefit of a parent guarantee), until such time as it is established that the declaration was incorrect. The declaration is a matter of opinion and not fact. In order to be valid in respect of a winding-up resolution the declaration of solvency must be sworn on the date of the resolution or not more than 5 weeks before that date. Directors who swear the declaration without having reasonable grounds for the opinion are liable to a fine of up to US$20,000. In practice, a MVL is likely to be used as part of a group reorganisation. The liquidator is chosen by the shareholders and, since the creditors will be paid in full, they are not involved in the process.

**CVL:** in a voluntary liquidation where the directors do not make a statutory declaration of solvency or during a MVL where the liquidator determines that the company will not be able to pay its debts in full within the period stated in the statutory declaration, the voluntary winding-up will be a CVL. The liquidator is chosen by the creditors.

**Effect:** on commencement of a voluntary liquidation, the company will cease to carry on its business unless it benefits the winding-up, although its corporate status and powers continue until dissolution. Any transfer of shares or alteration in the status of the company's members will be void without the sanction of the liquidator.

**Directors' powers:** the powers of directors cease on commencement of the voluntary winding-up. Their continuance may, however, be sanctioned by the company (i.e. the shareholders) or the liquidator in a MVL or by the liquidation committee or, if there is no such committee, the creditors in a CVL. It is, however, unusual for such sanction to be given as there should be little for the directors to do.

### Compulsory winding-up

**Commencement:** a company may be wound up by the DIFC Court if: (i) it resolves that it should be; (ii) it is unable to pay its debts; (iii) a DIFC Court ordered moratorium in relation to a CVA comes to an end and no voluntary arrangement has effect; (iv) the DIFC Court makes such an order pursuant to any provision of or under DIFC Law; or (v) the DIFC Court is of the opinion that it is just and equitable that the company should be wound up. An application may be commenced by the company, its directors or any creditor. If a winding-up order is made, the liquidation commences from that date and the DIFC Court will appoint a liquidator.

"A company is deemed unable to pay its debts based on a cash flow test of insolvency or a balance sheet test of insolvency."

**Inability to pay debts:** a company is deemed unable to pay its debts if it fails to pay a sum exceeding US$2,000 within 3 weeks of issue of a statutory demand of payment, if a judgment is returned unsatisfied or it is unable to pay its debts as they fall due (generally known as a "cash flow" test of insolvency). It will also be deemed unable to pay its debts if its current assets are less than its current liabilities, taking into account contingent and prospective liabilities (generally known as a "balance sheet" test of insolvency).

**Effect:** following a winding-up order, any transfer of property or shares or alteration in the status of the company's members will be void without the consent of the DIFC Court. Actions and proceedings are stayed and may not be continued or commenced without the court's consent.

**Winding-up in general**

**Liquidators and their powers:** extensive powers of liquidators are set out in Schedule 3 of the Insolvency Law, including the power to make compromises, bring or defend proceedings, carry on the business, sell the company's property, borrow money and grant security. A liquidator in a CVL or compulsory winding-up also has the power to disclaim onerous property (including unprofitable contracts). Liquidators also have powers to reverse certain transactions. This is dealt with further below.

**Expenses:** the expenses of the liquidation are payable out of the assets of the company in a particular order set out in the Insolvency Regulations. Such expenses include, for example, the costs of getting in and realising property, necessary disbursements, the liquidator's remuneration and tax on chargeable gains.

**Preferential creditors:** the DIFC Preferential Creditor Regulations provide for certain categories of preferential debt to have priority in a distribution of the company's assets in a liquidation. Such preferential debts are sums owed by the company in respect of: (i) contributions to an employee pension scheme or any end of service gratuities; (ii) remuneration for the period 4 months before the winding-up order or resolution (as appropriate); (iii) payments in lieu of notice; and (iv) accrued holiday entitlement.

**Ranking of creditors:** realisations are distributed in a particular order of priority. Realisations of unsecured assets will be used to meet first the liquidation expenses, then preferential creditors and finally unsecured creditors. Secured creditors will be paid out of the realisations of the secured assets, although preferential creditors are paid out of the realisations of security taken over all or substantially all of the company's assets (i.e. floating charges) where the unsecured assets are insufficient to meet such preferential claims. Once all creditor claims are settled the remaining funds, if any, are distributed to the members (e.g. in MVL).

"Secured creditors will be paid out of the realisations of the secured assets."

**Proofs of debt:** creditors must submit written claims of what they are owed (known as a proof of debt). The liquidator will either admit the claim – in full or in part – or reject it and in either case a creditor has 21 days in which to appeal the decision. Although secured creditors must provide details of their security interests, they will only receive a distribution in respect of any unsecured balance unless they surrender their security in which case they may prove for the whole of the debt.

**Duration:** there is no fixed time limit for a liquidation. If a voluntary liquidation continues for more than 1 year, then the liquidator must call a meeting of the members and, in a CVL, the creditors. It should be held at the end of the year and each subsequent year. The liquidator must account for his acts and dealings and the conduct of the winding-up during the preceding year. Once the company's affairs have been fully wound-up, the liquidator must call a meeting of the members and, in a CVL, the creditors. At that meeting, he must explain the winding-up and how property was disposed of and show a summary of his receipts and payments and a statement of how much unsecured creditors were paid. Similarly, in a compulsory winding-up the liquidator must send creditors a final account and return. At the end of 3 months from sending the final account and return, the company is dissolved.

## Directors' duties

### DIFC statutory duties of directors

DIFC law does not impose an all-embracing code of conduct on directors. The duties of directors of a DIFC-incorporate company are therefore derived from various laws including the Companies, Law, the Law of Obligations (DIFC Law No. 5 of 2005) (the "**Law of Obligations**") and the Insolvency Law. The company's constitution will also contain provisions which determine the ambit of the directors' powers.

"The duties of directors of a DIFC-incorporated company are derived from various laws."

Under the Law of Obligations, a director is a fiduciary of the company and owes an obligation of loyalty to the company. This duty of loyalty comprises several aspects namely a duty to act in good faith, a duty to avoid conflicts of interest, a duty of confidentiality and a duty to exercise care, skill and diligence and a duty not to use the company's property, information or opportunities for his own or anyone else's benefit. Additionally, under the Companies Law, a director must act honestly and lawfully with a view to the best interests of the company in exercising his powers and discharging his duties. These duties are owed to the company alone and not to individual shareholders or groups of shareholders or other members of the company's group.

The Insolvency Law regulates various kinds of misconduct by officers and former officers in relation to companies which are being wound up. For the purposes of this guide, we have focused on these provisions, as summarised below.

### Misapplication of property, breach of duty and fraud

The DIFC Court may, on the application of any aggrieved person, including a liquidator or administrative receiver, make an order against a director for the return or payment to the company of money or other property misapplied or retained by that director, an order requiring the director to compensate the company for any misfeasance or breach of duty, an order to contribute to the company's assets as the court thinks proper or an order requiring the director to do or not do any other act or thing.

The circumstances in which directors face the risk of such orders being made against them include where they have engaged in behaviour with the intent to defraud creditors, including:

> in the 12 months preceding the winding-up, concealing or removing company property or disposing of company property other than in the ordinary way of business;

- gifting or charging property, or concealing or removing company property since, or within 2 months before, the date of any unsatisfied judgment for the payment of money by the company;
- destroying or falsifying company books, papers, registers, books of account or documents;
- making material omissions in statements relating to the company's affairs;
- making false representations to creditors so as to obtain the consent of creditors to an agreement; or
- fraudulent trading (being an offence which extends to any persons who were knowingly parties to the carrying on of such fraudulent trading).

### Wrongful trading

Absent fraud, directors also face liability for what is known as "wrongful trading". This is where the company goes into insolvent liquidation and before the commencement of the winding-up, one or more of the directors knew or ought to have known that there was no reasonable prospect of avoiding going into insolvent liquidation.

Under English law, the directors have an express defence if they took every step possible to minimise potential loss to creditors, but this does not appear to be available under the Insolvency Law. It is unclear, therefore, to what extent liability for wrongful trading might be strict although this would be unusual in a common law system and bearing in mind the similarities generally with English insolvency law.

### Restriction on re-use of company names

Directors (including shadow directors) also face a fine of up to US$10,000 if the company goes into insolvent liquidation and they subsequently become directors of a company, or have a connection with such company, within the next 5 years whose name is a name by which the former liquidating company was known at any time in the period of 12 months before the liquidation or whose name is so similar to the name of the liquidating company as to suggest an association with that company. In addition to the fine, a person is personally responsible for all the relevant debts of a company if they are involved in the management of the company in contravention of the restriction on the re-use of company names.

"Directors may face liability for misapplication of property, breach of duty, fraud, wrongful trading and breach of the restriction on the re-use of company names."

## Transaction avoidance

When a company goes into receivership, administrative receivership, liquidation or provisional liquidation, the Insolvency Law empowers the relevant office-holder to challenge certain types of transactions which took place before commencement of the relevant proceeding.

### Transactions at an undervalue

An office-holder has power to challenge a transaction entered into at a ‘relevant time’ (see below) if the company received no consideration or the consideration received is significantly less than the consideration provided by the company, the value of each being measured in money or money’s worth (e.g. sale of assets at less than market value). However, a defence is available if the company entered into the transaction in good faith, for the purpose of carrying on its business and at the time it did so, there were reasonable grounds for believing that the transaction would benefit the company.

### Preferences

An office-holder may challenge a preference given by the company at a ‘relevant time’ (see below) which puts a creditor, surety or guarantor into a better position, in the event of the company going into insolvent liquidation, than it would otherwise have been in (e.g. early repayment of unsecured debt or granting security for pre-existing debt). In addition, the company must have been influenced by a desire to prefer. The requirement for a desire to prefer means that, for example, payments made to unconnected creditors exercising commercial pressure are unlikely to be preferences. However, the analysis would change where the repayment was made to a connected party since the desire to prefer is then presumed and the onus would be on the recipient of the alleged preference to rebut the presumption.

### Relevant time

A transaction at an undervalue or preference will only be voidable if it took place at a "relevant time". Unlike under English insolvency law, there is no need for the company to be insolvent at the time of the transaction or preference (or become so as a result). The transaction must have taken place within the following periods before the onset of insolvency

"Unlike under English insolvency law, there is no need for the company to be insolvent at the time of the transaction or preference (or become so as a result)."

> transactions at an undervalue: 2 years before the onset of insolvency;

> preferences: 6 months (if given to an unconnected party) or 2 years (if given to a connected party) before the onset of insolvency; and

> in either case, any time between the presentation of a petition for administrative receivership and the making of an administrative receivership order.

### Invalid security interests

A security interest over all or substantially all of a company’s property (i.e. a floating charge) is invalid if the security interest was created:

> in favour of a connected party within the 2 years before the onset of insolvency;

> with a year before the onset of insolvency and the company was at that time cash flow insolvent (or became so as a result);

> after the commencement of a CVA.

In each case, however, the security interest is valid to the extent of the value transferred to the company or the liabilities of the company released as a result of the transaction giving rise to the grant of the security interest.

# Appendix

## Summary of the DIFC insolvency and restructuring procedures

| | Company Voluntary Arrangement (CVA) | Receivership | Liquidation |
|---|---|---|---|
| **Who can initiate proceedings:** | Directors of the company | Any secured creditor | *Voluntary liquidation:* the company<br>*Compulsory liquidation:* the Court or the company |
| **Goal of proceedings:** | Goal is for company to make a restructuring arrangement with its creditors | Goal is for receiver to enforce security by selling secured property and applying the proceeds in reduction of the debt | Goal is to collect in assets, distribute proceeds and terminate existence of the company |
| **Conditions to initiate proceedings:** | Directors propose CVA to company and creditors | • Power to appoint receiver as set out in instrument appointing him (e.g. security document)<br>• Receiver is an administrative receiver ("**AR**") where secured creditor holds a security interest over all or substantially all of the undertaking of the company (i.e. a floating charge) | *Voluntary liquidation:*<br>• as provided for in company's Articles of Association or if company resolves to do so<br>• Members voluntary liquidation ("**MVL**") if solvent<br>• Creditors voluntary liquidation ("**CVL**") if insolvent<br>*Compulsory liquidation*:<br>• Court may liquidate company in certain circumstances, including where the company is unable to pay its debts |
| **Key issues:** | • Approval of company and its creditors required<br>• Creditor approval threshold: 75% or more in value of those present and voting<br>• CVA cannot affect rights of secured or preferential creditors (unless | • Receiver exercises powers in accordance with instrument<br>• AR has additional powers, including to take possession of and sell property, borrow money and grant security<br>• AR is the agent of | • Liquidator appointed by company (MVL), creditors (CVL) or the Court (compulsory liquidation)<br>• Creditors required to submit proof of debt and may (other than in MVL) appoint |

| | Company Voluntary Arrangement (CVA) | Receivership | Liquidation |
|---|---|---|---|
| | they agree)<br>• Insolvency practitioner appointed to supervise implementation of approved CVA | the company (unless and until it goes into liquidation) and has the power to act on behalf of the company | liquidation committee<br>• Preferential debts paid in priority. Other debts paid on pari passu basis<br>• Set off permitted of mutual credits and debts<br>• Court may take action against persons in certain circumstances (e.g. wrongful trading) |
| **Moratorium:** | • Court may grant moratorium in limited circumstances where company is eligible<br>• Company is not eligible if, for example, it is subject to an insolvency procedure or party to certain secured and/or capital markets arrangements | • Secured and unsecured creditors may claim against the company<br>• Where AR appointed, any existing receivers required to vacate office and no subsequent AR may be appointed | • Any disposition of the company's property, transfer of shares or attachment/ appropriation of assets void (unless approved by liquidator / Court)<br>• Liquidator may redeem secured creditor's security interest at agreed value |
| **Avoidance of Pre-insolvency transactions:** | N/A | • Transactions at an undervalue and preferences may be set aside if entered into/given at a relevant time<br>• If company is insolvent, a security interest in all or substantially all of the company's assets may be set aside if granted at a relevant time and no value transferred to the company | As for receivership |

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