

Comparative Analysis - Bankruptcy Laws in the United Arab Emirates and in the Kingdom of Saudi Arabia

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Saudi Arabia, United Arab Emirates

Related Legislation

Saudi Arabia Royal Decree No. M/05/2018; Saudi Arabia Royal Decree No. M2/1970; Saudi Arabia Royal Decree No. M16/1996; [Federal Law No. 9/2016](#); [Federal Law No. 2/2015](#); [Federal Law No. 18/1993](#); [Federal Law No. 3/1987](#)

Relevant Companies

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Abstract

As part of a string of legislative reforms in the Kingdom of Saudi Arabia (“KSA”), the Saudi Arabia Royal Decree No M/05/2018 dated 13/02/2018) (the “KSA Bankruptcy Law”) comes as a boost to the continued growth of the KSA economy and the increase of foreign direct investment. Before the issuance of the KSA Bankruptcy Law, the general insolvency framework in the KSA was mainly set out in the Saudi Arabia Royal Decree No M2/1970 dated 23/03/1970 (the “Law of Commercial Courts”) and in the Saudi Arabia Royal Decree No M16/1996 dated 25/01/1996 (the “Bankruptcy Preventative Settlement Law”).

Analysis

In the United Arab Emirates (“UAE”), insolvencies, reorganisations and financial restructurings are governed by UAE [Federal Law No. 9/2016](#) on Bankruptcy (the “UAE Bankruptcy Law”). The UAE

Bankruptcy Law contains the main legislation on proceedings relating to businesses and persons unable to meet their debts, and whose assets are not sufficient to cover liabilities.

The UAE and the KSA Bankruptcy Laws contain a myriad of similarities and differences with respect to several fundamental matters which we will outline below. Both laws have been drafted as part of efforts to attract foreign investment and to encourage private sector activity; they offer comprehensive guides to companies facing financial difficulties.

Scope of the Bankruptcy Laws

According to Article 2 of the UAE Bankruptcy Law, the provisions of the law apply to:

- companies subject to the provisions of Federal Law No. 2/2015 on Commercial Companies;
- companies owned in whole or in part by the federal or local government and whose incorporation documents subject them to the provisions of the UAE Bankruptcy Law;
- companies established in free zones that are not subject to bankruptcy-specific legislation issued by the free zone's authority;
- licensed civil companies of professional nature;
- and any person having the capacity of a merchant.

The UAE Bankruptcy Law does not apply to companies established and operating in Financial Free Zones which have their own bankruptcy legislation such as the Dubai International Financial Centre and the Abu Dhabi Global Market.

According to Article 4 of the KSA Bankruptcy Law, the provisions of the law apply to:

- Natural Persons performing commercial, professional or profit-seeking activities;
- Commercial and Professional Companies;
- regulated entities and other profit-seeking companies; and
- Non-Saudi natural or legal person investors with assets in the KSA carrying out commercial, professional or profit-seeking activities (only the assets of the investor that are in the KSA).

Insolvency Committees

Article 3 of the UAE Bankruptcy Law establishes the "*Financial Reorganisation Committee*". The Committee's responsibility is to oversee the management of the financial reorganisation procedures of the financial institutions licensed by the competent supervisory authorities, to approve the list of experts

concerning the affairs of financial reorganisation and bankruptcy, to determine a table of the fees of the appointed experts, to establish and organise a record for the persons against whom judicial decisions were issued, and to submit period reports to the Minister of Finance on its works.

Similarly, Article 9 of the KSA Bankruptcy Law establishes the “*Bankruptcy Committee*”. The Bankruptcy Committee’s responsibilities are similar to those of the Financial Reorganisation Committee in the UAE insofar as the Bankruptcy Committee is charged with overseeing organisation procedures and regulating bankruptcy experts. The Bankruptcy Committee has the responsibility of inspecting and verifying bankruptcy proceedings, managing administrative liquidation proceedings, licensing bankruptcy experts and trustees, and issuing rules governing the work of bankruptcy experts and trustees.

However, the KSA Bankruptcy Law provides a more exhaustive description of its bankruptcy-regulating committee’s responsibilities than the UAE Bankruptcy Law. The Bankruptcy Committee is responsible for determining the minimum debt value entitling the creditor to request the opening of any liquidation proceedings, for issuing the forms and documents related to the KSA Bankruptcy Law, for establishing, maintaining and managing the Bankruptcy Register, and also for determining the minimum debt value that entitles the creditor to request the opening of any liquidation proceedings. In addition, unlike the Financial Reorganisation Committee which is charged with reporting to the Minister of Finance, the Bankruptcy Committee is charged with raising recommendations to the Minister of Commerce and Investment and with making the necessary proposals for enhancing the implementation and development of the provisions of the law, thus granting it greater authority.

Preventive Procedures

Under the UAE bankruptcy law, debtors, creditors and regulatory authorities may apply to the Court for a preventive composition procedure, wherein a restructuring of the debtor’s liabilities will take place. In this case, a “*Preventative Composition of Bankruptcy Plan*” must be filed with the Court. A bankruptcy expert (or bankruptcy experts) will then be appointed by the Court to help the debtor with the restructuring process and to monitor them in their business dealings.

Article 13 of the KSA bankruptcy law provides similar preventive provisions insofar as it authorises debtors to submit preventive settlement requests to the courts either if they are bankrupt, if they are defaulting or if they are likely to suffer from financial turmoil which is feared would lead to defaulting.

In both countries, the scheme requires the approval of the concerned creditors. The approval of a majority of the unsecured creditors and of two-thirds by value of them must be obtained for the Court to be able to proceed with the matter. In the KSA, a settlement report must be voted on by the creditors before the preventive settlement procedures can be implemented (according to Article 16 of the KSA Bankruptcy Law). Both the UAE and the KSA have adopted measures that provide an assurance to creditors, by giving them a say in how the financial distress of a business should be dealt with.

The difference here between the UAE and KSA bankruptcy laws lies in restrictions of access to preventive settlement procedures for debtors. Article 15 of the UAE bankruptcy law provides that the Court will reject the application for preventive composition if the debtor is subject to procedures of preventive composition, restructuring, bankruptcy and liquidation of his assets. In contrast, Article 13 of the KSA Bankruptcy Law states that a debtor may not apply to open the preventive settlement procedure if they have previously been subjected to such a procedure within twelve months preceding the request to open the procedure.

This could point towards the stricter approach taken by the KSA in allowing debtors to resort to preventive settlement procedures but Article 6 of the UAE Bankruptcy Law stipulates that for the UAE Court to accept the application of preventive composition, the debtor should not be in a situation of cessation of payment of his due debt for a period exceeding thirty consecutive working days, as a result of a difficult financial position or in case of insolvency. The KSA Bankruptcy Law is silent on this matter.

Financial Restructuring

Following Articles 64 and 65 of the UAE Bankruptcy Law, the Courts reserve the right to change the Preventive Composition Plan into insolvency management plans if the “*Preventive Composition of Bankruptcy Plan*” is judged to be futile by the Courts due to an excessive level of indebtedness and a lack of improvement of the situation. This may be initiated at the Court’s will or at the request of an interested party. The shift may be requested by the Supervisors of Composition, and will strip the debtor of any authority they have in the management of their business. Such powers are taken over by the bankruptcy expert, who will recommend a restructuring plan to the Courts.

The terms of the restructuring plan require the same level of approval by the creditors, but they allow for a longer period of implementation than for preventive composition procedures. Alternatively, if the restructuring scheme is not deemed appropriate, or if there is proof of an intention from the debtor to evade their financial obligations, the Courts will order the liquidation of the business.

Similarly, Article 42 of the KSA Bankruptcy Law gives the debtor, the creditor or any competent authority the right to request a financial reorganisation of the distressed business if it is bankrupt, if it is defaulting or if it is likely to suffer from financial turmoil which is feared would lead to defaulting. Financial reorganisation is offered as an alternative to Preventive Composition procedures, and can be requested under the same circumstances. It should be noted that a request to open financial reorganisation proceedings may not be made if the debtor has been subject to this procedure within the twelve months prior to the request to open procedures. Government authorities, creditors and debtors are also authorised to request the liquidation of the debtor’s assets.

Article 44 of the KSA Bankruptcy Law gives the debtor the right to object to the financial restructuring procedure if there is a dispute or disagreement on the value of the debt, if the financial restructuring procedures are being used for purposes other than helping the business pay its debts, and if conditions

for opening proceedings are not applicable.

Liquidation Procedures

In order to initiate judicial bankruptcy in the UAE, the debtor is required to submit an application along with supporting documents before the Court. The Court will then decide whether to accept or reject the application on a prima facie basis. If the application is accepted by the Court, one or more trustees will be appointed. The trustee will either be one of the experts or any other individual deemed fit by the Court. The trustees are required to determine the bankruptcy procedure with which to proceed with, and must agree on the appointment of a controller. The Court can then order a liquidation of the debtor's assets and shall appoint a trustee to initiate such proceedings.

Under Article 92 of the KSA Bankruptcy Law, the debtor, the creditor or the Competent Authority may apply to the Court to open the liquidation proceeding for the debtor if the debtor is bankrupt or defaulting. The request of a creditor will only be accepted if the following conditions are met:

- the debt is of a fixed duration and the amount, cause and guarantees are determined;
- the amount of debt, or the total amount of debt of the applicants shall not be less than the amount determined by the Bankruptcy Committee;
- the debt to be paid is payable under an executive bond or ordinary paper; and
- the creditor shall prove that repayment from the debtor had been requested twenty-eight days prior to the date of registration of the application, and it has not been paid or the debt disputed in accordance with the Regulation.

In the KSA, the liquidation process also requires the appointment of a trustee, and the debtor shall cease to manage its activities immediately upon the appointment of a trustee according to Article 100 of the KSA Bankruptcy Law. Said trustee is required to carry-out the liquidation procedures, to conduct the sale of the bankruptcy assets which are authorised to be sold by the Courts (Articles 103-105), and may do so immediately upon the opening of the liquidation proceeding (Article 104).

Administrative Liquidation

“Administrative Liquidation” is defined as an action intended to sell bankruptcy assets with proceeds not expected to be sufficient to meet the expenses of the liquidation procedure or liquidation procedure for small debtors, under the management of the Bankruptcy Committee. The UAE Bankruptcy Law does not explicitly refer to any such procedure. In contrast, Chapter 9 of the KSA Bankruptcy Law sets out the conditions relating to opening an administrative liquidation. According to Article 168, both the debtor and the Competent Authority may request the opening of an administrative liquidation procedure if the debtor is bankrupt or defaulting and the assets are insufficient to meet the expenses of the liquidation procedure or liquidation procedure for small debtors. If such an application is issued, it will result in the

suspension of claims until the date of decision of the Court.

Article 170 states that the Court may refuse the application if: the application does not meet the regulatory requirements or is incomplete without an acceptable justification, if the Court deems it likely that the activity of the debtor will continue and settle the claims of the creditor within a reasonable period of time, if the request is made in bad faith involves abuse of the procedure and if the assets of the debtor are sufficient to meet the expenses of the liquidation procedure or the liquidation procedure for small debtors. If the application is rejected by the Court, the Court may order the opening of the appropriate bankruptcy procedure.

The Insolvency Regime in the UAE

A common frustration existed with regards to insolvencies in the UAE due to their time-consuming nature and their significantly low recovery rates, which in part stemmed from the outdated governance of insolvency under Volume 5 of UAE Federal Law No. 18/1993 on Commercial Transactions (the “**Commercial Transactions Law**”). The Commercial Transactions Law provided that it was an offence for a company to fail to petition for bankruptcy within thirty days of the date of suspension of the payment of its debts, and that criminal proceedings could be taken against the directors of a company for failing to initiate and apply for corporate bankruptcy.

The UAE Bankruptcy Law provides that a company is still required to initiate the bankruptcy process after thirty consecutive working days from it either being unable to pay its debts when they mature, or from being balance sheet insolvent. However, there is no longer any specific offence for failure to file for bankruptcy. In addition, it has been clarified that it is the shareholders’ responsibility to decide, by way of extraordinary resolution, whether to commence with a business restructuring or bankruptcy process.

Criminal Liability of Debtors

An essential aspect of the UAE Bankruptcy Law is this decriminalisation of what once constituted a “bankruptcy by default” offence. Under the country’s old rules, if a business owner, who was unable to pay their debts, failed to declare bankruptcy within 30 days of their inability to pay their debts, they had committed an offence of “bankruptcy by default”. This offence was punishable by fines and by imprisonment. The UAE Bankruptcy Law, by removing this offence, now states that any failure to declare bankruptcy could result in a disqualification order but no longer in imprisonment. The decriminalisation initiative has encouraged business owners to restructure their insolvent businesses instead of absconding and fleeing the country.

Under UAE [Federal Law No. 3/1987](#) (the “**UAE Penal Code**”), bounced cheques carry a risk of potential criminal liability. However, under the UAE Bankruptcy Law, proceedings for a debtor’s bounced cheques will be stayed during and until a Protective Composition of Bankruptcy Plan or a Financial Restructuring Plan is completed, if the cheque was written prior to the application for the plan. The receiver of the bounced cheque is treated in the same way as the debtor’s creditors and can obtain

similar settlements, thus giving the debtor a chance to rectify the criminal breach. The UAE's approach to how bounced cheques, related to insolvency rectification plans, should be managed has also encouraged business owners to undertake restructuring proceedings instead of fleeing the country.

In contrast with the UAE Bankruptcy Law, Chapter 13 of the KSA Bankruptcy Law on Penalties and Revocable Transactions makes no allusion to the partial or full decriminalisation of any failure to declare bankruptcy or for issuing any bounced cheques. A release of criminal liability in these respects strengthens the Kingdom's move towards more attractive bankruptcy regulations.

Small and Medium Enterprises

The UAE Bankruptcy Law has introduced several processes to assist businesses in financial distress. All these processes encourage small and medium enterprises to address their debt matters through restructuring mechanisms instead of fleeing the country to avoid them. Under the KSA Bankruptcy Law, a debtor that meets the criteria established by the Bankruptcy Committee in coordination with the Small and Medium Enterprises General Authority is considered a "small debtor". The KSA Bankruptcy Law makes explicit references to insolvency processes for Small and Medium Enterprises, and sets out Preventive Settlement, Financial Reorganisation and Liquidation procedures that apply to them. These procedures are similar to those that apply to debtors that are not considered small debtors.

On the whole, the UAE and the KSA Bankruptcy Laws set out provisions relating to insolvency frameworks that are similar to a certain extent. In both countries, the Bankruptcy Law significantly improves the old insolvency regime and gives companies experiencing financial difficulties a chance to repay their debts through clear procedures. However, until applications under the newly issued KSA Bankruptcy Laws are filed, the laws regulating the Kingdom's insolvency framework can only be analysed theoretically. We note that the Implementing Regulations of the KSA Bankruptcy Law have yet to be published and we expect these to become public within the third quarter of 2018. These Regulations may provide additional insight to determine how the KSA Bankruptcy Law will be implemented.

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