

Commentary on the Saudi Arabian Bankruptcy Law

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Saudi Arabia Royal Decree No. M32/1350; Saudi Arabia Royal Decree No. M16/1416; Saudi Arabia Royal Decree No. M3/1437; Saudi Arabia Royal Decree No. M5/1439; Saudi Arabia Cabinet [Decision No. 129/1416](#); Saudi Arabia Cabinet [Decision No. 264/1439](#)

Relevant Companies

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Abstract

In its attempt to lower its dependence on oil, diversify its economy and attract foreign investments while encouraging the growth of small and medium enterprises (SMEs), the Kingdom of Saudi Arabia (KSA) is adopting set of new investor-friendly rules and regulations.

Analysis

In its most recent attempt to achieve that, a new Bankruptcy Law draft was approved pursuant to the Saudi Arabia Royal Decree No. M5/1439 dated 28/05/1439H (corresponding to 13/02/2018G) – through Saudi Arabia Cabinet [Decision No. 264/1439](#). Thereafter, the Bankruptcy Law was published in the official gazette (Um Al-Quraa) on 06/06/1439 H (corresponding to 21/02/2018G), edition No. 4712.

However, the said law will not officially enter into force until its Implementing Regulations are issued within a period of 180 days.

The Bankruptcy Law complies with the best international practices and was drafted after exhaustive

consultations, recommendations and reviews by international experts of the World Bank and the United Nations Commission on International Trade Law (UNCITRAL). Henceforth, the new Saudi Bankruptcy Law is inspired, to a large extent, from the laws of countries which are regarded by the World Bank and the International Monetary Fund (IMF) as having the best bankruptcy regimes (such as the United Kingdom, Germany, Singapore and the United States of America).

The Bankruptcy Law, which consists of 17 chapters and 231 articles, tries to find the perfect balance between the interests of investors and creditors and allows indebted corporations to maintain their operations while gradually settling their debts. This introduced process will encourage corporations to fulfil their obligations and reorganise their financials with the aim of retaining their business operations.

The Bankruptcy Law will give Saudi Arabia a legal infrastructure to deal efficiently with companies that get into financial difficulties, paving the way to achieving financial stability while simultaneously benefiting both creditors and debtors by (i) allowing them to enter into agreements to schedule the payment of the debt; (ii) reducing the costs and timeframe of the bankruptcy procedures; and lastly (iii) encouraging SMEs to further invest in the commercial market (article 5, Bankruptcy Law).

I. Scope of the Bankruptcy Law

According to article 4, the Bankruptcy Law will be applicable to:

- (a) any natural person practicing commercial, professional and/or profitable activities in the KSA;
- (b) all KSA registered companies (both commercial and professional) and any other businesses intending to generate profits on the Saudi territory; and
- (c) any natural and/or juristic foreign investor that owns assets, practices commercial, professional and/or profitable activities in Saudi Arabia through a KSA-licensed entity. The Law will be applicable solely to such assets located in the KSA.

The legislator enabled the Bankruptcy Law to cover any bankruptcy relating provisions by prohibiting any debtor to be liquidated by virtue of another law (including the Companies' Law) unless (i) its assets are sufficient to cover all of its liabilities; and (ii) the debtor was not in financial distress at such time. Failure to abide by the said provisions would render the directors of the debtor jointly responsible of any remaining debt (article 7, Bankruptcy Law).

In its attempt to be the sole regulation covering bankruptcy, and as per article 230 of the Bankruptcy Law, the Law effectively replaced the following:

- (a) The Law of Settlement against Bankruptcy issued pursuant to the Saudi Arabia Royal Decree No. M16/1416 dated 04/09/1416 H (corresponding to 24/01/1996) approved by Saudi Arabia Cabinet [Decision No. 129/1416](#);

(b) Article 103 to 137 of the Commercial Courts Laws issued pursuant to the Saudi Arabia Royal Decree No. M32/1350 dated 15/01/1350 H (corresponding to 01/06/1931G); and

(c) All provisions of any applied law or regulation that are inconsistent with the Bankruptcy Law shall consequently be void.

As per article 2 of the Bankruptcy Law, the said law covers the following areas:

(a) The Preventative Settlement (including Preventative Settlement for small debtors (as defined hereunder));

(b) The Financial Reorganisation/ Restructuring (including Financial Reorganisation/ Restructuring for small debtors);

(c) Liquidation (including liquidation for small debtors); and

(d) Administrative liquidation

II. Bankruptcy Committee

According to the provisions of the Bankruptcy Law, a specialised Bankruptcy Committee that reports directly to the Ministry of Commerce and Investment (MOCI) should be formed by a Cabinet Decision. This Committee will be led by a secretariat that carries out its agenda according to regulations and procedures set-out by the MOCI. However, it is worth noting that this Committee is considered as an independent administrative and financial legal body.

The Committee shall be responsible for (list not exhaustive):

(a) setting-up, organising and managing a bankruptcy register;

(b) preparing an inventory of bankruptcy experts and trustees, and issuing:

(i) their licenses; and

(ii) the Implementing Regulations governing the framework of their work.

(c) inspecting the relevant liquidation and all of the ongoing bankruptcy procedures;

(d) determining the minimum amount of debt that allows the creditors the right to request any liquidation procedure; and

(e) providing consulting services and training to companies.

III. Preventative Settlement

A Preventative Settlement is a procedure that allows the debtor to reach an agreement with its creditors to settle its debts while maintaining the management of its company. However, a Preventative Settlement may not be requested by a debtor that has already benefitted from such a settlement within the previous 12 months (article 13, Bankruptcy Law).

Debtors could ask the court, through a Settlement Request to proceed with the Preventative Settlement, subject to any of the following events occurring:

- (a) debtors are expecting financial distress that may prevent the continuity of their business operations;
- (b) debtors are undergoing financial distress; or
- (c) debtors are bankrupt.

(Collectively, the Preventative Settlement Beneficiaries).

Thereafter, the court will fix a hearing date (to occur within 40 days) and notify the debtor of the same. The settlement report will then be discussed and voted on by the concerned creditors.

Accordingly, the court will either decide to proceed with the Preventative Settlement or to deny it, subject to (list not exhaustive) (article 15, Bankruptcy Law):

- (a) upon its discretion, figuring that the likelihood of the debtor pertaining the operation of its business and settling its debt might occur within a reasonable period;
- (b) the debtor being bankrupt or in financial distress and is likely to incur additional financial indebtedness; or
- (c) if the Settlement Request is submitted in bad faith and/or incomplete without legitimate justification.

Moreover, the debtors may request the court to suspend any claims arising from the creditors in which they aim to declare the debtor's bankruptcy or any requests to execute on the debtor's assets (the Suspension of Claims). The Suspension of Claims applies to any claim directed towards the debtors, their assets or their guarantors. All similar claims made will be null and void. The said request remitted from the debtor must be accompanied by a report prepared by a bankruptcy licensed trustee in which the latter reflects his views on whether the concerned creditors will approve or decline such request. For the court to accept the Suspension of Claims request, the bankruptcy licensed trustee must state in the report that he expects the majority of the concerned creditors to approve to it.

In case the Suspension of Claims is approved by the court, the suspension period may not, in its total, exceed 180 days (article 18, Bankruptcy Law).

After validation, the court will certify the report and the debtor will be required to finalise the procedures of the Preventative Settlement.

It is worth noting that all contracts and agreements entered into prior to the Preventative Settlement period will remain active and applicable unless otherwise agreed between the parties (articles 22, 23, 24, Bankruptcy Law).

The Preventative Settlement terminates when either of the following conditions occurs (list not exhaustive):

- (a) if the debtor submits a request to the court stating that the Preventative Settlement has taken place and is fully accomplished;
- (b) if the court refuses to approve the grant of such Preventative Settlement; and
- (c) if the debtor submits a request to the court stating that he is no longer considered to be a Preventative Settlement Beneficiary.

IV. Financial Reorganisation/ Restructuring

As per article 2 of the Bankruptcy Law, the Financial Reorganisation is a procedure that allows the debtor to reach an agreement with its creditors by reorganising its financials under the supervision of a bankruptcy licensed trustee.

Article 17 of the Bankruptcy Law provides that any debtor classified as a Preventative Settlement Beneficiary may submit a Financial Reorganisation request to the competent court. Moreover, even the debtor's creditors may request the court for a Financial Reorganisation of their debtor. In that case, the debtor will be notified of such request within a period not exceeding five days to allow them to object on such request.

Article 42 of the Bankruptcy Law gives the debtor the option to object on the creditor's request, solely if:

- (a) the requirements of the Financial Reorganisation do not apply;
- (b) the concerned debt is ambivalent; and
- (c) the creditor is abusing its right of requesting such Financial Reorganisation.

Throughout the procedures of the Financial Reorganisation the debtors, its shareholders, managers and board members and its auditors are exempted from applying the provisions of the Companies' Law in

relation to the company's obligations whenever it loses 50% or more of its total capital (article 55, Bankruptcy Law).

The court will issue a Suspension of Claims until the Preventative Settlement request is either accepted or denied. The court's merits on whether to accept or deny approval of such Financial Reorganisation are similar to those of the Preventative Settlement.

Following the acceptance of the Financial Reorganisation process, the court will (i) appoint one of the bankruptcy licensed trustees who shall seek with due care and diligence the creditors' interests; and (ii) notify the creditors of the court's acceptance to start the Financial Reorganisation process, who shall have the right but not the obligation to submit their claims/requests within 90 days therefrom.

As of the declaration of the Financial Reorganisation, the bankruptcy licensed trustee will initiate the supervision of the debtor's activities to ensure the swift implementation of the Financial Reorganisation plan and to safeguard the necessary protection for the creditors' interests.

Furthermore, and contrary to its duties under the Preventative Settlement, the bankruptcy licensed trustee is allowed, after reviewing certain agreements/contracts entered into by the debtor (including lease agreements) and terminate them to protect the creditors' interest. The contracting party whose contract/agreement has been terminated has the right to request damages from the bankruptcy licenses trustee. Additionally, the bankruptcy licensed trustee can sub-lease any part of the properties leased by the debtor to third parties even if the lease agreement states otherwise (article 61(6), Bankruptcy Law).

Throughout the Financial Reorganisation, and as per article 70 of the Bankruptcy Law, the debtor shall receive the bankruptcy licensed trustee's approval if he wishes to undergo any of the following acts (list not exhaustive):

- (a) receive any financing;
- (b) settle any due debts;
- (c) undergo a new insurance agreement; or
- (d) issue or renew a guarantee.

Article 71 of the same law further prevents the debtor from performing any act outside the scope of the ordinary course of business subject to such action being considered null and void.

The conditions for termination of the Financial Reorganisation process are similar to those of the Preventative Settlement (article 87, Bankruptcy Law).

V. Liquidation Process

Liquidation is the act of selling the debtors' assets and distributing the proceeds collected therefrom to the creditors, all being through and under the supervision of the bankruptcy licensed trustee.

If the following conditions, as mentioned in article 92 of the Bankruptcy Law, are met, either the debtor, his creditors or any other competent authorities may request a liquidation to take place:

- (a) the debtor undergoing an actual financial distress or bankruptcy;
- (b) the debt being (i) due; and (ii) of certain value, cause and warranties (if any);
- (c) the value of the requested debt or the total amount of the creditors' debts must be above the threshold set out by the Committee; and
- (d) the creditors must prove that they have requested the debtor to settle the due debt within 28 days prior to submitting the liquidation request to the court.

The court's merits on whether to accept or deny approval of the Liquidation Process are similar to those of the Preventative Settlement and the Financial Reorganisation.

According to article 96 of the Bankruptcy Law, the relevant court may, at its sole discretion or upon the request of any concerned party, execute any preventative procedures.

Upon the commencement of the Liquidation Process, a bankruptcy licensed trustee will be appointed to carry-out the liquidation procedures and the debtor or the entity under liquidation will be prohibited to manage their business operations, and any action undertaken by the debtor during the said period will be null and void (article 100, Bankruptcy Law).

VI. Preventative Settlement and Financial Reorganisation for small debtors

Due to their similarity, we will tackle herein the provisions for both the preventative settlement and Financial Reorganisation for small debtors (as defined hereunder).

According to article 1 of the Bankruptcy Law, small debtors are debtors to whom the standards determined by the Committee and the General Authority of SMEs apply on. However, such standards aren't published yet.

Small debtors who are bankrupt or undergoing financial distress or expected to undergo financial distress that would leave them either indebted or bankrupt may apply for Preventative Settlement (or Financial Reorganisation) for small debtors.

Articles 127 and 142 highlight the rationale of this new legislation stating that the Bankruptcy Law grants special treatment to small debtors, by allowing them to undergo a Preventative Settlement and a Financial Reorganisation (respectively), to reach an agreement with their creditors and settle their debts

through eased procedures and low costs, all while keeping full operation of their SMEs.

The provisions set out above for the Preventative Settlement and Financial Reorganisation apply *mutatis mutandis* on the Preventative Settlement and Financial Reorganisation for small debtors.

VII. Administrative liquidation

According to articles 1 and 167 of the Bankruptcy Law, an administrative liquidation is the process of selling the liquidation assets that are not expected to cover the expenses of the liquidation (including small debtors' liquidation process).

Either the debtor or any other competent authority may demand the administrative liquidation, provided that the debtor (or small debtor) is distressed, bankrupt or his assets will not cover the expected expenses of the liquidation procedures (article 170, Bankruptcy Law).

The merits for the court accepting or refusing the grant of the administrative liquidation are similar to those stated in the preceding paragraph.

VIII. Financing

Following the commencement of any of the abovementioned bankruptcy procedures, the debtor may only secure guaranteed financing after obtaining the court's approval. After the commencement of any Liquidation Process, an unguaranteed financing may not be secured by debtors and small debtors without obtaining the court's prior approval. However, neither types of financing may be secured when the debtor and/or small debtor enter into administrative liquidation (article 182, Bankruptcy Law).

Throughout the Preventative Settlement and Financial Reorganising (applicable as well for small debtors), a debtor (or small debtor as applicable) may secure a guaranteed financing after requesting the court's approval, provided that such request must contain a report by an expert approving the same. Thereafter, the court will assess the merits of such request and decide whether to grant its approval, if it considers it essential for (i) the carrying on of the debtor's business operations; or (ii) protecting the debtor's assets during the relevant bankruptcy procedures (article 183, Bankruptcy Law).

IX. Ranking of Debts

The proceeds that are obtained from the Liquidation Process shall be distributed according to the following ranking order:

- (a) remunerations and expenses for the appointed bankruptcy licensed trustee and the experts and the cost of selling the debtor's assets;
- (b) secured debts;

- (c) secured financed debts;
- (d) an amount equivalent to 30 days salary for the debtor's employees;
- (e) alimony for the debtor's family as determined by the applicable laws or a court order;
- (f) necessary expenses to ensure the continuity of the debtor's business operations during the relevant liquidation procedures as specified in the Implementing Regulations requirements;
- (g) accrued wages of the debtors' employees;
- (h) unsecured debts; and
- (i) unsecured governmental official fees, membership fees and taxes in accordance with the Implementing Regulations requirements.

X. Penalties

According to article 200 of the Bankruptcy Law, any debtor (if a natural person), or debtor's director, board member, officer, etc. that has committed, prior to the commencement of any of the above mentioned bankruptcy procedures, any of the following acts (list not exhaustive), will be subject to (i) imprisonment not exceeding five years; (ii) fines not exceeding five million Saudi Arabian Riyals (SAR 5,000,000); and (iii) prohibition in owning shares and managing the operations of any profitable businesses (directly or indirectly) in the Kingdom:

- (a) misused the debtor's assets;
- (b) fraudulent use of the debtor's activity to embezzle its creditors;
- (c) executed deals free of charge or for an unfair return; or
- (d) settled the debtor's debts to specific creditor hindering other creditors.

XI. The effect and implications of the Bankruptcy Law on Saudi Arabia's market.

Although the first draft of the Bankruptcy Law was introduced in 2016, and had been under study for almost two years, the long consultations ended up the favour of both the investors and the creditors as the end product drafted by the legislator emulates those used in developed and industrial countries.

This move will be entertained by most economists, SMEs and start-ups as they will look forward to investing in the KSA knowing that there's a slight risk of losing their companies in case of bankruptcy.

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