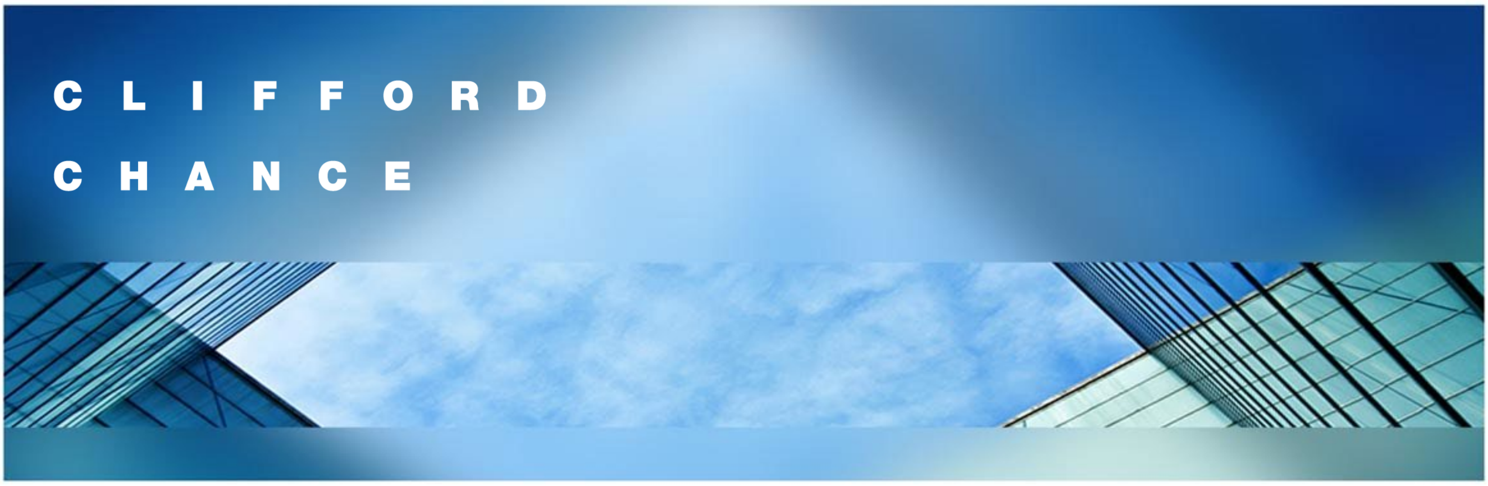

THE UAE'S NEW BANKRUPTCY LAW: KEY IMPACTS ON RESTRUCTURINGS

On 1 May 2024, Federal Law Decree 51/2023 on Financial Restructuring and Bankruptcy (the "**2024 Bankruptcy Law**") came into force and replaced the previous 2016 bankruptcy law (the "**2016 Bankruptcy Law**").

Whilst the 2016 Bankruptcy Law provided a powerful framework for debtors to restructure their financial liabilities under the protection of a Court moratorium, it is hoped that the 2024 Bankruptcy Law will provide greater consistency for stakeholders with the introduction of a new specialist bankruptcy unit and bankruptcy court.

It is clear that the development of a consistent and comprehensive insolvency regime remains a high priority for the UAE's legislative bodies as the region looks to continue to compete to attract investment from around the globe.

This client alert considers a number of the key changes introduced under the 2024 Bankruptcy Law and the associated Executive Regulations introduced on 1 October 2024, whilst drawing on a number of practical challenges we have encountered from our experience working on the UAE's first debt for equity swap under the under the 2016 Bankruptcy Law.

Key issues

- Executive Regulations to the 2024 Bankruptcy Law introduced on 1 October 2024
- Significant changes introduced to Bankruptcy and Restructuring procedures in the UAE
- The (now repealed) 2016 Bankruptcy Law saw two large international restructuring complete earlier this year (the JBF Group and the KBBO Group)
- The region now awaits the first major restructuring under the 2024 Bankruptcy Law

Five key changes introduced under the 2024 Bankruptcy Law

1. Introduction of a new "Bankruptcy Court" and "Bankruptcy Administration"

Arguably the most substantial amendment is the proposed introduction of a new Bankruptcy Court to oversee and determine bankruptcy related matters, including the initiation and ratification of bankruptcy proceedings. The introduction of a specialist court is a significant departure from the previous position, which saw judges with a range of different backgrounds and fields of expertise (such as employment and family disputes) allocated complex international restructuring mandates.

The Bankruptcy Court will be supported by a new "Bankruptcy Administration" headed by a Court of Appeal judge. This specialist division shall provide administrative assistance to the Bankruptcy Court in ensuring that applications are filed correctly and notifications and meetings are distributed and held compliantly.

The harmonisation and centralisation of bankruptcy specialists is a welcome step to promote consistency and develop a breadth of experience amongst the judicial bench. This appears to be a clear signal of intent from the legislative bodies that the UAE is committed to building a trusted and consistent bankruptcy framework that can provide confidence to both debtors and investors seeking certainty and alignment with international insolvency regimes.

2. Changes to voting thresholds

The 2016 Bankruptcy Law had a very simple threshold for creditor approval: a majority in number of approved creditors representing two-thirds by value of the debt. However, this threshold provided logistical difficulties for companies seeking creditor approval as it afforded a handful of trade creditors with small debt claims a disproportionate veto over a restructuring plan that had the approval of the overwhelming majority of creditors by value. In some cases, debtors struggled to encourage its numerous trade creditors to even engage on a complex restructuring proposal.

In line with reforms to other restructuring tools in other jurisdictions (for example the UK Part 26A restructuring plan), the 2024 Bankruptcy Law has removed the requirement for a majority in number of creditors to approve the relevant proposal. Creditor approval can now be obtained with the consent of two-thirds (by value) of the debts represented at the meeting. A quorum threshold has also been introduced to ensure that the creditors are fairly represented – although the quorum is also calculated by reference to value (a simple majority), so we wouldn't expect this to present large quantities of small trade creditors claims with a veto right.

It is also envisaged that creditors will now vote according to their "classification" which suggests separate voting classes for secured and unsecured creditors. It remains to be seen whether the Court will approve further division within those classes (as would be the case in a UK Part 26A Restructuring Plan) to reflect differential treatment of secured creditors under a restructuring proposal.

3. Introduction of new "company cram-down" tool

The restructuring landscape across many jurisdictions in Europe has been transformed by the introduction of the notorious "cross-class cram down" tool, inspired by the US Bankruptcy Code (see for example the UK Part 26A restructuring plan). The policy objective behind the cross class cram down is to ensure that a single group of creditors does not have a disproportionate veto of the implementation of a restructuring, where that restructuring is approved by an "in the money" group of creditors and the restructuring ensures that the dissenting class is no worse off under the restructuring than the "relevant alternative" (often a liquidation of the debtor(s)).

The changes introduced by the 2024 Bankruptcy Law are arguably even more radical. The Bankruptcy Court can now ratify a restructuring plan where not a single creditor has approved the proposal, in effect creating the possibility of a "company" cram down on its creditors. This power is caveated with the safeguards we would expect to see on ensuring that creditors are no worse off under the restructuring than they would be in a liquidation. Nevertheless, this new provision has the potential to become an incredibly powerful tool for debtors in restructuring negotiations.

4. A Broadening of the scope of the Trustee's powers

The 2024 Bankruptcy Law directly confers on the Trustee all the powers that the directors of the debtor exercise. This is an important development as, in our experience, it is common for debtors who have entered into bankruptcy processes in the region to lack a functioning board of directors. Under the 2016 Bankruptcy Law, this resulted in Court applications to seek authorisation for the Trustee to sign documentation on behalf of the debtor, causing unnecessary procedural delays to implementation of the restructuring.

The incorporation of this legislative authority directly into the 2024 Bankruptcy Law should reduce the administrative burden associated with the existing tools and provide greater certainty and efficiency for all stakeholders.

5. Requirement for shareholder approval to Restructuring Plan

An unexpected (and potentially unwelcome) development is the introduction of an express requirement for shareholder approval for any restructuring plan proposed to creditors. Restructurings are often associated with the disenfranchisement of shareholder interests to reflect the statutory order of priority on a liquidation. Whilst shareholders may be aligned with the implementation of a restructuring to delever the business, it is not uncommon for creditor and shareholder views to diverge, which can often lead to a conflict in the position of the debtor and the shareholder. Most other jurisdictions (including the UK) do not require shareholder consent and indeed explicitly legislate for the possibility of implementing a restructuring without shareholder approval.

It remains to be seen how the UAE Courts will deal with a restructuring that does not have the consent of a shareholder and whether this distorts the balance of consensual negotiations: perhaps a Judge may interpret the expanded powers of the Trustee more broadly – including, in some instances, references to the Trustee approving certain actions on behalf of the general assembly.

Two provisions that haven't changed

1. Shareholder approval for entry into bankruptcy

The 2016 Bankruptcy Law contained a consent right for shareholders to approve the company's decision to enter into bankruptcy proceedings, which prevented company directors acting independently from their shareholders, even if the directors considered bankruptcy to be in the best interests of creditors. Many other jurisdictions allow (and in some cases, oblige) directors to file for insolvency independently of shareholders if it is considered to be in the best interest of creditors.

As shareholders are often disincentivised to approve the entry into bankruptcy proceedings (given their respective position in the distributions waterfall) we were expecting to see an amendment to this provision, which didn't align with the directors' obligations to file in certain circumstances. However, whilst the 2024 Bankruptcy Law did not remove this consent right, it instead relaxed the obligations on directors to file for bankruptcy which is perhaps a good indicator of the legislative intentions behind the amendment.

2. **Binding secured creditors**

Amendments were made to the 2016 Bankruptcy Law in 2019 to enable secured creditors to vote on, and ultimately be bound by, a restructuring plan that is approved by the requisite majority. This had previously been a lacuna that afforded individual secured creditors with disproportionate leverage in negotiations over any proposed restructuring.

The 2024 Bankruptcy Law retains the ability to bind dissenting creditors subject to certain safeguards to ensure the replacement security offered under the restructuring is of equivalent value. This is arguably similar to - and can likely be satisfied by - the requirement to ensure that creditors are no worse off under the terms of the restructuring plan than they would be in a liquidation.

Need to know: Q&A

Question: what are the tools and processes available under the 2024 Bankruptcy Law?

Answer: a debtor may apply to initiate (i) preventive settlement; (ii) restructuring; or (iii) liquidation proceedings.

Question: what are the financial thresholds for creditors to initiate bankruptcy proceedings?

A: the Executive Regulations have raised the threshold for a creditor's indebtedness to AED 1,000,000 (from AED 100,000). Higher thresholds apply for regulated entities.

Question: which entities does the 2024 Bankruptcy Law apply to?

A: the 2024 Bankruptcy Law will apply to most onshore entities. It will also apply to entities incorporated in free zones, wholly or partially government owned entities and entities licenced by the Central Bank, except to the extent that such entities are stated to be subject to separate restructuring tools or bankruptcy procedures. In the free zones, the exclusion would include, most notably, entities incorporated in the DIFC or the ADGM, which each have their own insolvency laws.

Question: how long is the statutory moratorium that accompanies a restructuring plan?

A: the moratorium now lasts from initiation of proceedings until ratification (under the 2016 Bankruptcy Law the moratorium could only last for a maximum of 14 months).

Question: will a Trustee be appointed to oversee the restructuring processes?

A: a Trustee will be appointed by the Court to oversee restructuring or liquidation proceedings. The directors will continue to manage a debtor's business under preventive settlement.

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