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Creditors' Rights in the UAE

The recent announcement by the government of Dubai that it would be seeking a stand-still on debt repayments by Dubai World and its subsidiary Nakheel PJSC has sent shock waves around the globe and raises questions regarding the rights of creditors in the UAE. This Alert highlights some key features of UAE federal insolvency law which may be relevant to those who have dealings with debtors in the UAE.

It should be noted that this Alert deals with insolvency processes commenced in the UAE (excluding the Dubai International Financial Centre which has its own insolvency laws). It may be possible for creditors to petition foreign courts to exercise insolvency jurisdiction over those related entities within their jurisdiction. Ordinarily, a foreign court will only entertain insolvency jurisdiction over an entity if a sufficient nexus is established with that jurisdiction. This is commonly known as establishing COMI (Centre of Main Interest). Inevitably, jurisdictions have established different canons of construction in relation to COMI, and creditors will need to seek advice from insolvency lawyers in the relevant jurisdiction.

What are the insolvency laws in Dubai?

Federal Law No (18) of 1993 (the Commercial Code) and Federal Law No (8) of 1984 (the Commercial Companies Law) are the primary pieces of legislation governing insolvency in the UAE.

What constitutes bankruptcy under the insolvency laws?

The Commercial Code provides that any trader that is unable to pay its commercial debts when due by reason of its financial instability may be declared bankrupt.

Who is subject to the insolvency laws?

According to the Commercial Code only traders can be declared bankrupt. The Commercial Code definition of 'trader' is broad and includes:

1. Everyone who conducts commercial activities as his profession in his own name (provided such person has the required legal capacity to do so); and
2. Every company that undertakes a commercial activity or adopts one of the legal forms stipulated in the Commercial Companies Law.

The Commercial Code expressly excludes the following from the definition of trader: ministries of State, its departments, public authorities and establishments, public benefit authorities and establishments, associations and clubs and professionals who do not conduct commercial activities. This implies that such bodies are not subject to the insolvency regime set out in the Commercial Code, although their day-to-day commercial activities may nevertheless be subject to the Code. However, a commercial company in which the State has an interest will be treated as a trader and therefore be subject to the insolvency regime, unless the law provides otherwise.

There are certain categories of juridical bodies in the UAE that inhabit a grey area, operating as commercial concerns but without the characteristics of a company in the conventional sense. It is unclear how, if at all, the insolvency laws apply to such companies.

Who can commence bankruptcy proceedings?

An application can be made by:

- the trader itself;
- the public prosecutor;
- a court; or
- creditors, if they can satisfy the court that the trader has not paid a debt when it has fallen due. Where the debt is not yet payable, a petitioning creditor must demonstrate that the trader has no domicile in the UAE, has fled or closed or commenced dissolution of its business or has otherwise acted to the detriment of its creditors.

A trader is required to file for bankruptcy within 30 days of the date on which it ceases to pay its debts. Failure to do so is a criminal offence. A trader may be deemed unable to pay its debts if it adopts unusual or unlawful ways to pay debts.

Can a creditor sue the bankrupt business?

With the exception of holders of pledges and what the Commercial Code describes as "special liens" (the meaning of which is unclear), creditors cannot pursue remedies against a trader after bankruptcy is

declared. However, a creditor's rights will be revived if the bankruptcy proceedings end and the assets of the trader can only be sold following an order from a judge.

How are creditors ranked in insolvency?

The Commercial Code sets out the priority of creditors in a bankruptcy: Priority is given to payment of wages and salaries due to employees for the period of 30 days preceding the declaration of bankruptcy. Second in priority are certain preferred claims, including rent due on business premises and government taxes for the two year period preceding the bankruptcy judgment. It should be noted that the Commercial Code also states that public funds that are used to cover the cost of a bankruptcy can be reclaimed out of the first cash that enters the bankrupt estate 'with priority over all creditors'. In a liquidation, the expenses of the liquidation have priority over other debts. Then come 'preferred' creditors who hold rights over the assets pledged. Finally come the unsecured creditors.

Can a trader seek protection from its creditors?

There are two types of composition:

1. arrangements proposed by the trader before any adjudication proceedings in order to try to avoid bankruptcy (protective composition); and
2. arrangements initiated by a judge following a declaration of bankruptcy (judicial composition).

A trader, other than a joint venture company or a company that has entered into liquidation, may apply to the courts for protective composition where its business is disrupted such that it cannot pay its debts. To obtain such protection the trader must have traded continuously for one year and have complied with all applicable laws. Application must be made to the court within 20 days of the trader ceasing to pay its debts. A moratorium will be placed on any bankruptcy proceedings against the trader and the court may make orders to preserve its assets (including restrictions on enforcing security held by creditors) until a final determination is made on the application. Claims and actions to enforce judgments and awards

against the trader will be suspended. Generally, the court will only sanction a composition proposal which provides for at least 50 per cent of the trader's outstanding debts to be paid within three years from the ratification of the terms of the composition.

Judicial composition proceedings may be initiated by the court after a declaration of bankruptcy. A meeting of creditors who have had their debts accepted by the court is convened at which a report is submitted by the bankruptcy trustee setting out the trader's proposals for the composition and the bankruptcy trustee's opinion of the proposal. If a judicial composition is approved by the requisite majority of creditors, the court can make an order annulling the bankruptcy. Even if the composition is not approved, a creditors' committee will be formed and, if consented to by three quarters of creditors by number and value, the bankruptcy trustee may arrange the continuation of the trader's business for a period determined by the creditors. If consent is not forthcoming, the court may put the trader into liquidation if it appears that the remaining assets of the trader are insufficient to carry on its business effectively.

For a proposed composition to be implemented, it must be accepted by a majority of the creditors who vote in respect of the proposal, provided that at least two-thirds of the trader's debts are represented by the majority. It should be noted that the Commercial Code does not permit a creditor to vote in respect of its secured debts. Where the trader has issued debentures exceeding 20 per cent of its total debt, the plan must also be accepted by the general assembly of the debenture holders. In the case of judicial compositions, creditors who do not attend the meeting are deemed to have rejected the terms of the composition. However, in protective compositions non-voting creditors are disregarded in determining whether a majority has been achieved. Where the relevant threshold is achieved, all unsecured creditors (or creditors who have waived their rights to security) may be bound by the composition whether or not they submitted to the composition.

Can transactions be set aside in bankruptcy proceedings?

Pre-bankruptcy transactions with a trader that may be set aside in a bankruptcy include:

- gifts;
- repayment of debts before their due date;
- debts repaid with something other than that contracted for;
- providing security for pre-existing debts; and
- transactions that are detrimental to creditors and where the counterpart is deemed aware that the trader has ceased to pay its debts.

The Commercial Code provides that transactions entered into during a "suspect" period of up to two years prior to the declaration of bankruptcy may be at risk of being set aside. Creditors may seek to recover any monies or assets of a bankrupt trader which were the subject of such transactions.

Could the government be responsible for the debts of its controlled entities?

Normally, and according to Article 15 of the Dubai Law No. (3) of 2006 (the "Law") in the case of Dubai World, there is no direct liability. However, these limitations apply only as a matter of national law.

The UAE may be responsible for actions of its controlled entities under international law. Such actions therefore could give rise to potential claims under bilateral investment treaties concluded by the UAE with the home states of investors. Apart from offering protection against expropriation and unfair and inequitable treatment, such treaties also often contain the obligation on the state to "observe any other obligation it may have entered into with regards to investments in its territory". Such "umbrella clauses" allow parties to enforce contractual obligations, including payment obligations under a loan, as a treaty claim. Moreover, most of the treaties provide for international arbitration against the UAE itself before an independent international tribunal, including tribunals established under the auspices of the World Bank's International Centre for Settlement of Investment Disputes (ICSID).

Can creditors of the government have recourse to State assets?

Federal Law No (11) of 1992 (the Civil Procedures Code) prevents seizure of "public assets owned by the federal government or any of the Emirates".

Dubai Law No (10) of 2005 provides that proceedings may be brought against the government of Dubai and government entities before the courts of Dubai provided that the claimant has first given details of such claim to the Attorney General of Dubai and has entered into settlement negotiations for a period of two months. If the parties are unable to reach a mutually acceptable settlement at the end of the two months, the claimant is entitled to

commence proceedings. This law further provides that no debt or obligation of an establishment of the government may be recovered by way of an attachment on its properties or assets. These two laws, taken together, make it extremely difficult, if not impossible, for creditors of the government and related entities to have recourse to assets in the UAE. It should be noted that there is no clear guidance on what entities would constitute "government" for the purposes of the laws but it is likely that a UAE court would construe the laws to capture a wide category of entities that are controlled by the State.

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