



SUMMATIVE (FORMAL) ASSESSMENT: MODULE 7E

UNITED ARAB EMIRATES

This is the **summative (formal) assessment** for **Module 7E** of this course and must be submitted by all candidates who **selected this module as one of their elective modules**.

The mark awarded for this assessment will determine your final mark for Module 7E. In order to pass this module, you need to obtain a mark of 50% or more for this assessment.

INSTRUCTIONS FOR COMPLETION AND SUBMISSION OF ASSESSMENT

Please read the following instructions very carefully before submitting / uploading your assessment on the Foundation Certificate web pages.

1. You must use this document for the answering of the assessment for this module. The answers to each question must be completed using this document with the answers populated under each question.
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3. No limit has been set for the length of your answers to the questions. However, please be guided by the mark allocation for each question. More often than not, one fact / statement will earn one mark (unless it is obvious from the question that this is not the case).
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6. The final submission date for this assessment is **31 July 2021**. The assessment submission portal will close at **23:00 (11 pm) BST (GMT +1) on 31 July 2021**. No submissions can be made after the portal has closed and no further uploading of documents will be allowed, no matter the circumstances.
7. Prior to being populated with your answers, this assessment consists of **8 pages**.

ANSWER ALL THE QUESTIONS

Commented [DB1]: 46 out of 50 – 92%. Well Done!

QUESTION 1 (multiple-choice questions) [10 marks in total]

Commented [DB2]: 9 out of 10

Questions 1.1. – 1.10. are multiple-choice questions designed to assess your ability to think critically about the subject. Please read each question carefully before reading the answer options. Be aware that some questions may seem to have more than one right answer, but you are to look for the one that makes the most sense and is the most correct. When you have a clear idea of the question, find your answer and **mark your selection on the answer sheet by highlighting the relevant paragraph in yellow**. Select only **ONE** answer. Candidates who select more than one answer will receive no mark for that specific question.

Question 1.1

The **most significant barrier**, historically, to the development of a culture of distressed business rescue in the UAE has been:

- (a) **The failure of the responsible authorities to enact laws which would encourage a business rescue culture.**
- (b) The low rate of business failure in the UAE.
- (c) The owners of failed businesses are liable as a matter of criminal law for the failure of their business.
- (d) **There could be criminal law consequences for business owners arising from the security agreements which a business might have with its creditors.**

Question 1.2

What is the **principal difference** between the “mainland” UAE Bankruptcy Law and the insolvency laws of the two financial centres (the DIFC and the ADGM)?

- (a) The insolvency laws of the financial centres govern the insolvency of financial service businesses only, while the Bankruptcy Law governs the insolvency all other businesses.
- (b) The insolvency laws of the financial centres have no application and cannot be enforced in the UAE “mainland” (that is, outside of the financial centres), while the Bankruptcy Law is the only applicable law governing insolvency in the UAE “mainland”.
- (c) **The Bankruptcy Law drew on the experiences of a number of jurisdictions, while the insolvency laws of the financial centres are based on the insolvency laws of one other country.**
- (d) The Bankruptcy Law incorporates substantial elements of Islamic law, while the insolvency laws of the financial centres are based on the common law.

Question 1.3

Which statement **correctly describes** the relationship between the Courts of the DIFC and the Courts elsewhere in the UAE?

- (a) The judgments and orders of the Courts of the DIFC are not enforceable outside of the DIFC.

(b) The judgments and orders of the Courts of the DIFC are enforceable elsewhere in Dubai only through the Dubai Courts.

(c) The judgments and orders of the Courts of the DIFC are enforceable elsewhere in Dubai only after recognition for enforcement by the Joint Judicial Committee.

(d) The judgments and orders of the Courts of the DIFC are not capable of enforcement outside of Dubai.

Question 1.4

As regards security in Mainland UAE a secured creditor's rights, both in relation to real and personal property security, are not substantially affected by any formal insolvency process; the secured creditor can generally enforce its rights notwithstanding the debtor's insolvency. Is this statement **True or False**?

(a) True.

(b) False.

Question 1.5

Which statement is **correct** in relation to the operation of security interests for both real and personal property in the DIFC?

(a) The law regulating security interests in land and personal property in the DIFC is based on Australian law.

(b) A mortgagee of land in the DIFC requires a court order to allow it to repossess land subject to a mortgage.

(c) The regulating security interests in land and personal property in the DIFC is based on English common law.

(d) There are separate registers in which security interests in both land and personal property in the DIFC can be registered.

Question 1.6

Which of the following statements is **incorrect** in relation to creditor rights following the Court's decision to commence preventive composition under the UAE Bankruptcy Law up until the approval of the scheme?

(a) All legal claims and proceedings and any judicial enforcement procedures against the debtor are suspended, unless otherwise decided by the Court.

(b) The commencement of preventive composition procedures will also suspend any criminal proceedings brought in relation to a dishonoured cheque, including against the signatory of the cheque.

(c) Creditors may not bring or pursue claims against persons jointly liable with the debtor or any guarantors of the debtor's debts.

(d) Secured creditors may enforce their securities provided they have obtained Court permission to do so.

Question 1.7

Which of the following **is not** a consequence or possible outcome of the commencement of Preventive Composition?

- (a) Interest on debts owed by the debtor stops accruing on the date of commencement of Preventive Composition.
- (b) The debtor can borrow further money during the period of preventive composition, with the Court's permission.
- (c) The debtor is not allowed to change its ownership in any way.
- (d) The Court can order the rescission of effective contract to which the debtor is a party.

Question 1.8

Which of the following **is not** a basis for an application to the Court for the commencement of bankruptcy proceedings under the UAE Bankruptcy Law?

- (a) If a secured creditor, having security over all or substantially all of the assets of a debtor, takes steps to enforce its security.
- (b) If a creditor (or a group of creditors) has given notice to a debtor requiring the debtor to pay a debt of AED 100,000, and the debtor has failed to discharge the debt within 30 business days of that notification.
- (c) Following the annulment or rescission of Preventive Composition by the Court.
- (d) If a debtor is in default of its payment obligations for 30 consecutive business days.

Question 1.9

Rehabilitation is a new DIFC insolvency procedure introduced by the 2019 law, which allows companies unable to pay their debts but able to reach agreement with its shareholders and creditors to agree to a plan referred to as a Rehabilitation Plan to achieve a court sanctioned plan that binds creditors. In regard to the rehabilitation procedure, which of the following statements is **incorrect**?

- (a) In order to initiate the rehabilitation process the company is required to make an application to court submitting the rehabilitation plan and nominating the proposed rehabilitation nominee.
- (b) A moratorium comes into effect for an initial 180 days, preventing creditors from commencing or continuing legal action against the company.
- (c) The moratorium disappplies contractual provisions that would otherwise enable a contract to be terminated upon insolvency.
- (d) Any creditor materially prejudiced by the moratorium may apply to court seeking the disapplication of the moratorium in relation to a particular contract.

Question 1.10

Which of the following statements is **not** correct?

- (a) The DIFC Courts will enforce judgments and arbitration awards from other countries in accordance with the Riyadh Convention (Riyadh Arab Agreement for Judicial Co-operation).
- (b) The DIFC Courts will enforce judgments and awards from other countries if there is a memorandum of understanding with the Courts of that country which enable the DIFC Courts to do so.
- (c) The DIFC Courts will enforce arbitration awards from other countries in accordance with the New York Convention for the Recognition and Enforcement of Foreign Arbitration Awards.
- (d) The DIFC Courts will enforce judgments and arbitration awards from other countries, even if the debtor has no presence of any type in the DIFC.

QUESTION 2 (direct questions) [10 marks]

Commented [DB3]: 8 out of 10

Question 2.1 [maximum 2 marks]

What is the key point of distinction regarding the registration of real property interests, including mortgages, in the different emirates of the UAE? What is the key difference between the sale of mortgaged real property following a debtor default if that real property is in a financial free zone or if the real property is in "mainland" UAE?

UAE law makes general provisions for granting of mortgages in relation to real property and land. However, each Emirate maintains its own land registration system. The registration and enforcement of mortgages can be subject to slightly different laws and procedures in each emirate, although at its core the law is similar. In addition, there are also various types of financing structure emanating from Islamic finance. These are musataha (long term right to use), ijara (form of leasing) Murabaha (instalment sale) whereby the person who would normally be seen as the debtor in conventional financing scenario acquires a lesser interest in the asset, while the ownership interest is taken by the financier.

The key difference vis-à-vis debtor default amidst "mainland" UAE and financial free zone is the intervention of courts.

In "mainland" UAE while the law provides for the right of a mortgagee to sell the mortgaged property following the debtors default this right must be exercised through the courts. There have been a number of cases, in several of the Emirates, which have sought to determine whether the mortgagee must first obtain judgement for the mortgage debt before proceeding with sale. The general approach though tends to be that a mortgagee can petition the court for an order for sale without first obtaining judgement for the debt. Once an order for sale is obtained, the Court's execution department will conduct the sale of the mortgaged property.

In financial free zone the stipulations of real property are governed by DIFC Law No 10 of 2018 (the DIFC Real Property Law) The DIFC real property law provides for a system of registration of interests in land adopting the Torrens system from Australia, whereby registration in the land registry, including mortgages and other charges, is

the exclusive method of determining interests in land and the rights arising therefrom. In the event of non-payment or other default by a debtor, a creditor holding a mortgage over the debtor's land can enter possession of the land by providing 60 days' notice to relevant parties and without the need for a court order. The creditor can sell the whole or part of the land, receive rents and profits from the land and apply the proceeds of sale in payment of the mortgage debt. A mortgage creditor may also apply to the DIFC court for an order for forfeiture.

2 marks

Question 2.2 [maximum 4 marks]

Preventive Composition and Restructuring are both insolvency processes that an entity can adopt under the UAE Bankruptcy Law. They share a number of similarities regarding the entry into and conduct of each of the respective processes. While the processes are different, various "actors" assume similar roles in each process. For all of the processes, which actor is responsible for each of the following:

Commented [DB4]: The answer required was brief!

- (a) A decision on any application to commence an insolvency process;
- (b) A primary determination as to whether a debtor's proposal should be adopted;
- (c) Confirmation of the primary determination as to whether a debtor's proposal should be adopted;
- (d) For supervising the implementation of the insolvency process by the debtor.

(a) Preventive Composition, under Article 6, is a court supervised mechanism and only a debtor can apply to the court for the appointment of a composition trustee by the Court. As the application is made by the debtor to the court, the decision-making actor in this is naturally, the court, which commences the insolvency process. However, the court in-turn appoints an expert to prepare a report which should include whether the applicant debtor fulfills the criterion. Once the court accepts the application pre or post expert report the insolvency process commences.

Restructuring on the other hand can be initiated both by debtor and a creditor. A creditor can initiate if the debtor has not paid debt of AED 100,000 within 30 days of creditors notice to pay (article 69). A debtor can initiate if it is in default and for debtors subject to control of "competent controlling body" a notice of 15 days has been given to such body. Again, Court is the final arbiter of initiation of restructuring and in turn appoints an expert to assess financial condition of the debtor.

(b) In Preventive Composition, a primary determination whether debtor's proposal should be adopted is by the Creditors. At commencement, the Court appoints a trustee on a certain fee, who is a non-conflicted natural or legal person. The trustee in turn prepares inventory of assets, validates claims, lists creditors, seeks information, may seek additional finance, take assistance from experts and supervisors and request court for any other matter including rescinding contracts. Thereafter, the trustee submits scheme to the court with mandatory information like financial position, means of debt settlement, debt-for-equity exchange and time period of scheme. In case court consents with trustee submitted scheme, a meeting of creditors is called wherein creditors whose debts have been admitted

vote and if it is accepted by two-thirds the scheme is considered as if a primary determination for adoption has been made.

Preliminary determination is a two-step process under restructuring. The role of trustee takes center stage as trustee has to submit a report addressing the possibility of restructuring the debtor's business along with debtor's commitment to continue the business and sell the business as a going concern (article 96). Though, trustee does most of the bulwark, prepares scheme in 3 months (article 103) with appropriate consent of the court the primary determination in restructuring too is by the creditors (article 104) whose debts have been admitted by a vote of two-thirds.

- (c) The confirmation of the primary determination in Preventive Composition as well as Restructuring is undertaken by the court.
- (d) The trustee is responsible for supervising the implementation of the scheme in Preventive Composition. The trustee is required to monitor progress, bring out failures, if any, in implementation, and report to Court every three months. If any amendment is required to scheme the trustee requires court approval and all creditors who voted need to be notified.
- (e) In Restructuring too, the trustee is responsible for supervising and implementation of the scheme, monitor any failure and report to court every three months. Again, if any amendment is required to scheme the trustee requires court approval and all creditors who voted need to be notified.

Long answer when a brief answer would have sufficed. 4 marks.

Question 2.3 [maximum 2 marks]

Under the UAE Bankruptcy Law, for a debtor, what is the key difference between the circumstances which could give rise to an application to commence Preventive Composition or an application to commence Bankruptcy (whether leading to Restructuring or Liquidation)?

The key difference, for a debtor, is that debtor can seek Preventive Composition as an option whereas Restructuring is alternate to liquidation. Also, Preventive Composition is a specific legal provision for debtor led corporate rescue. The purpose is to assist the debtor to reach settlements with his creditors under a preventive composition scheme, under the supervision of court and by assistance of a composition trustee appointed according to provisions of the section of bankruptcy law.

Preventive Composition pre-empts and terminates what would otherwise be the debtor's obligation to apply to initiate bankruptcy proceedings. Also, if the debtor is subject to the control of a competent controlling body, the debtor may apply for preventive composition if the debtor has given controlling body days' notice (as specified) of the application.

In case of Bankruptcy a debtor is required to initiate bankruptcy procedure if the debtor is in default of its payment obligations for 30 consecutive business days.

The main practical benefit for a debtor to enter into a "preventive composition" is that, if the debtor has a plan to restructure the business, the preventive composition maximises the debtor's ability to have that plan carried into effect.

2 marks

Question 2.4 [maximum 2 marks]

What is the key difference for a creditor regarding the commencement of Preventive Composition or Bankruptcy of a debtor?

Commented [DB5]: You misread the question

The key difference for a creditor is the time frame. In case of a scheme under Preventive Composition the scheme may be no more than three years from the date of approval, although the period can be extended for a similar term with the consent of a majority of the creditors holding two-thirds of the debt remaining unpaid.

In case of Bankruptcy (restructuring) the scheme must have a time-frame for implementation of not more than five years which can be extended by upto three years with the consent of a majority of the creditors holding two-thirds of the debt.

However, in case preventive composition and bankruptcy are not viable the process may head towards liquidation and proceeds from sale of assets are to be distributed to creditors. In case of sale of asset with security interest the proceeds are to be paid to secured creditor less the trustees cost of sale.

0 marks.

Under the UAE Bankruptcy Law, a creditor has no right to compel a debtor to enter Preventive Composition, but a creditor, or group of creditors collectively, who are owed more than AED 100,000 (USD 27,229), may also apply to the Court to initiate bankruptcy procedures if the creditor has given notice to the debtor requiring the debtor to settle the debt and the debtor has failed to discharge the debt within 30 business days of any such notification.

QUESTION 3 (essay-type questions) [15 marks in total]

Commented [DB6]: 14 out of 15

Question 3.1 [maximum 5 marks]

Briefly explain the historical background to the introduction of the Bankruptcy Law. Describe which entities the Bankruptcy Law applies to and how it has been received and applied in the UAE.

Federal Decree Law (No 9) relating to bankruptcy brought the first major change in the bankruptcy laws of UAE. Before 2016, the UAE insolvency law was rudimentary. There were provisions in Law No 18 of 1993 relating to commercial transactions governing bankruptcy of traders which provided a mechanism for insolvency, through courts, of those engaged in commerce. However, this was rarely used.

The shortcoming in the law came to fore when Dubai World, an investment company of Dubai Government, was on verge of default in 2009. Thus, Law No 9 came into effect in 2016 which repealed provisions of the commercial transaction law and put in place a consolidated insolvency regime for commercial but not consumer insolvencies in UAE. Furthermore, in 2019, the adoption of Federal Decree (Law No 19) of 2019 (Personal Bankruptcy Law) put in place a consolidated insolvency regime for debtors who did not fall within the ambit of the Bankruptcy Law i.e. consumers too.

Both the bankruptcy law and the personal bankruptcy law provide for several court supervised processes including preventive compositions for commercial companies and financial settlement proceedings for individuals. In case of Bankruptcy, it is restructuring for commercial debtors and liquidation for both commercial and non-commercial debtors. Furthermore, the bankruptcy law creates a financial restructuring committee, appointed by Minister of Finance, with a degree of supervisory control over insolvency practice and procedure in the UAE. However, despite the introduction of laws there have only been a handful of insolvency processes conducted under these laws.

The aforesaid describes the evolution of insolvency law in the UAE Mainland i.e., outside of the financial free zones, Financial Free Zones are important pillar of UAE economy and financial services contribute a hefty chunk to UAE GDP. The two financial free zones are DIFC and ADGM.

In the DIFC the Insolvency Law DIFC Law No 1 of 2019 and the associated regulations are modelled on and adopt a number of provisions of the United Kingdom Insolvency Act of 1986. It differs from the UK law because of inclusion of insolvency procedure referred to as Rehabilitation. The formal insolvency processes provided for in DIFC are Rehabilitations, Administrations, Receiverships, Administrative Receiverships and Winding Ups. Except for Rehabilitation all other processes require the shareholders and management of a company facing financial difficulty to surrender control to insolvency practitioner. The DIFC courts play a central role in insolvency process, alongside the role played by insolvency practitioners, who can be appointed as Rehabilitation Nominees, administrators, receivers, and liquidators. Again, there have not been many insolvencies in the DIFC. It cannot be said that there is a substantial and coherent body of DIFC specific law governing the insolvencies in the DIFC.

In the ADGM, the Insolvency Regulation 2015 and further amendments too are based on UK Insolvency Act 1986, and possibly adopt more of the United Kingdom legislation as compared to DIFC.

In the Mainland UAE in addition to the obligations that insolvency practitioners have to the respective courts in relation to any appointment, experts appointed by the courts are approved by the Financial Restructuring Committee. Insolvency practitioners in DIFC are appointed by DIFC registrar of companies and insolvency practitioners in ADGM are appointed by ADGM Registration Authority under ADGM Commercial Licensing Rules.

Bankruptcy law in Mainland UAE applies to:

- All companies governed by the Commercial Companies Law
- Any companies established under any other legislation who by law or voluntarily have submitted to the provisions of the bankruptcy law
- Free zone companies not governed by other insolvency procedures
- Any person who is a trader i.e. engaged in commercial activities in personal capacity and
- Licensed civil companies of a professional character

In summary, law is applicable to all commercial entities and individuals except for state owned companies unless they have opted into the application of the law.

Bankruptcy in DIFC is applicable to

- Companies and commercial entities in DIFC

- Branches of foreign companies in DIFC

Though, parallel judicial systems exist, the orders of all three i.e., Mainland UAE courts, the DIFC courts and the ADGM courts are capable of recognition and enforcement by the courts of DIFC & ADGM, mainland Dubai and mainland Abu Dhabi respectively without any re-examination of substance of the order or the merits of the case. Creative use of jurisdictions has led to creation of Joint Judicial Committee by Dubai Decree No 19 of 2016 with jurisdiction to resolve conflicts of jurisdiction.

Your answer could have been more succinct. **5 marks**

Question 3.2 [maximum 8 marks]

If a debtor company seeks to enter bankruptcy, describe the ways in which the Court is required to be actively engaged in the Restructuring in Bankruptcy Process (assume that a restructuring is possible, that there are no unusual features to the bankruptcy, there are no secured creditors and there has been no criminal conduct by any person involved in the debtor). Your answer should provide references to the legislation.

The Court plays an important part and is actively engaged in the Restructuring in Bankruptcy Process; virtually every step of the process either requires courts' affirmation in one form or another. The bankruptcy procedure is preceded by an application to the Court by either the debtor (article 73) or a creditor.

On application, the Court is required to appoint an expert from the panel of experts to assess the financial conditions of the debtor (article 77). The Court may reject any application if the specified information is not provided (article 79). The Court can require a person to provide further information (article 80), it can allow other parties to the proceedings, and it can make interim orders (article 81). The expert is required to report on debtors' financial condition and to give an opinion on the possibility of the debtor successfully restructuring. The Court is required to decide within 5 business days, either of application or of the expert report as applicable (article 78). If the Court is satisfied that the necessary conditions have been met, an order will be made whereby the bankruptcy procedure commences.

On commencement, a moratorium of sorts starts for a period of 10 months extendable by 4 months (article 162) though the secured creditors may enforce their securities provided they have obtained Court permission to do so. The Court is required to determine any such creditors application within 10 days after satisfying itself that there is no collusion between debtor and creditor.

The Court after accepting application of commencement needs to appoint a maximum of three trustees, who are non-conflicted and not barred by law (article 84), either of debtor's choice or from table of experts, who can be a legal or natural person. Any creditor may object against appointed trustee and the Court must pronounce a decision on objection within five business days (article 82).

On trustee's request for assistance the Court grants permission for any appointment including that of an expert. Also, the Court may substitute the trustee or an expert even on its own volition. The Court may also appoint one or more supervisors (article 87), who will essentially be the representatives of the creditors. The Court should also pass on all the information in its possession to the trustee (article 88).

The trustee is to prepare a list of creditors and lodge with the Court and advertise (article 93). Any debtor or creditor may object to the list (article 124) and Court must determine the application within 10 business days; a decision that can be appealed. The Court may also admit debt on interim basis and finally determine the list of creditors.

At the request of trustee, the Court may suspend interest and other penalties for non-payment (article 163). In case debtor fails to perform its obligations of a contract, the other party may request recession (article 164), including a landlord for a lease (article 166). The Court may at the request of the trustee, rescind contracts (article 165), leases (article 166) and employment contracts (article 167).

Once the trustee submits its report (article 96) the Court is required to review the report to confirm that it considers all the claims of creditors and direct the trustee to call meeting of creditors. The Court should direct the trustee to prepare a restructuring scheme (article 99) barring situations where Court thinks that liquidation is appropriate.

The trustee is thereafter required to prepare the scheme and submit to Court (article 103). The Court reviews and if required asks trustee to vary the scheme. Thereafter, the Court asks trustee to convene a meeting of creditors to review the scheme (article 104). The Court may also direct the formation of committee representing classes of creditors.

In case a creditor proposes some modification to scheme the Court may direct further meetings to consider the same (article 105). The Court may also allow creditors whose debt has been admitted on an interim basis to vote on scheme. If the scheme is approved by creditors, the trustee is required to put the scheme before the Court and the Court has to either accept or reject the scheme. The Court has to make final determination in case any dissenting creditor objects to the scheme passed (article 108). However, the Court must be satisfied that all affected creditors will receive at least as much as the creditors would have received if the debtors' assets had been liquidated on the date of voting of scheme. In addition, the Court may not approve a scheme that affects priority of any secured creditor rights. The Court may order acceleration of payment dates of long-term debt if that would be in the interest of the scheme. If Court rejects the scheme it is returned to trustee for amendment and return within 10 business days or for initiating bankruptcy and liquidation (article 109).

If the scheme is approved the trustee submits regular monitoring report to the Court and at least once every three months (article 114). The Court approval is required for any amendment to scheme after notifying all creditors who voted for scheme and any other creditor that Court deems necessary (article 114). In addition, the Court may declare certain assets not to be sold for a period of time without Court's approval if they are essential to debtors' business (article 112) and it may allow debtor to raise new finance to be secured against unencumbered assets (article 181). Moreover, the Court may compel a creditor to accept an alternate security if the Court finds it of equal value to the existing security and it would not prejudice the creditor to accept the alternative (article 111). Finally, when restructuring is completed on discharge of obligations provided for in the scheme the Court is to make an order confirming the complete implementation of the scheme which is to be advertised (article 115).

Good, if long, answer. 8 marks

Question 3.3 [maximum 2 marks]

In any insolvency system that involves the forced compromising of individual creditor claims, the requirement for court involvement is to ensure that the rights of all parties, including individual creditors, are being protected. The UAE Bankruptcy Law requires a high degree of Court involvement. Briefly describe (100-150 words) whether you consider that the level of Court involvement in approving a restructuring to be appropriate. Provide reasons for your answer.

The Court involvement in approving a restructuring in context of creditors' claims is appropriate as it ensures the process is fair.

- Secured creditors may enforce securities only with permission of the Court. The Court in such a scenario satisfies itself that there is no collusion between creditor and the debtor. Also, if making an order in relation to property subject to several security interests it determines the priority.
- The Court is amenable to hearing an appeal vis-à-vis appointment of trustee from a creditor as well as appoint supervisors if required. Thus, open to creditor concerns.
- Claims of creditors, including those whose debts have not yet fallen due are accumulated and listed. The creditor can object to list in seven days to the Court. The Court may admit the debt on an interim basis too. Thus, acting in larger interest of creditors.
- The Court may allow rescission of contract if debtor fails to perform its obligations. A landlord can seek from Court termination of lease in default and creditors may seek to exercise set-off rights. Herein, the court ensures that the creditors don't suffer due to debtor's bankruptcy.
- On receipt of trustee's report on possibility of restructuring the Court reviews the report to check that it considers all creditor claims.
- The proposed restructuring scheme is to be approved by debtors' creditors in a meeting by two-thirds thus ensuring that majority creditors point of view is respected. The trustee and debtor have to explain the scheme to the creditors. The Court is amenable to amendments proposed by creditors and grant extra time for the same. To have a level playing field of creditors, secured creditors are allowed to vote on scheme only if they have surrendered security interest.
- Even after approval of scheme a dissenting creditor has a right to object to the scheme and Court has to make a determination on the same.
- The Court satisfies itself that the creditors will receive as much as the creditors would have received on liquidation of debtor's assets on the date of voting on the scheme.
- The Court will not approve a scheme that upends the priority of secured creditors.

Thus overall, the intervention of Court is to ensure that creditors get just and fair treatment.

Long answer for 2 marks, but well-motivated! **1 mark.**

The level of Court involvement in restructuring is excessive. Ultimately, the question of whether a debtor-entity should engage in a restructuring should be a matter for the entity's creditors. However, even for a restructuring which all of the creditors support, the process of assessing the viability of restructuring requires an initial report to the Court by the expert, the submission of a restructuring scheme to the Court by the trustee before a creditors' meeting, and a final approval after that meeting by the Court. There is inevitably cost to that process, the funds for which would be better used in paying creditors.

QUESTION 4 (fact-based application-type question) [15 marks in total]

Commented [DB7]: 15 out of 15

VGK LLC operates a restaurant chain in various locations in Dubai. It was a thriving and successful business but had to cease operations temporarily due to the effects of COVID-19. It has exhausted all available funds and has no cash to pay creditors. VGK LLC owns a restaurant site which is under development, but the development is not expected to be completed for seven months. The site had been purchased by one of VGK LLC's shareholders and was transferred to VGK LLC on the basis that payment for the site would be made by VGK LLC to the shareholder in full in 2024. In the meantime, the shareholder holds a mortgage over the property for the unpaid purchase price.

Answer the questions that follow:**Question 4.1 [maximum 5 marks]**

The process of Preventive Composition requires adherence to a number of time-frames. Briefly outline the necessary steps and 10 specific steps that will determine the maximum time taken between making an application (the first step) and the registration of the scheme following final approval (the tenth and final step before its implementation).

Assume that: an expert's report is required by the Court; there are no disputes about whether a creditor is accepted or not; there are no amendments to the proposed scheme by the Court; the scheme is accepted by the creditors without the requirement for any adjournment of the creditors' meeting; the scheme is approved by the Court following the meeting; and there are no other extensions.

Below are the specific steps. Days and cumulative days should be read as business days.

Step No.	Details of Step	Days	Cum. Days
1	Appointment of expert and receipt of report	20	20
2	Court to decide on Preventive Composition application	5	25
3	Court to notify trustee	1	26
4	Publish a summary of decision in 2 newspapers; 1 Arabic & 1 English. Invite creditors to submit claim	5	31
-	Creditor may object within 5 days of publication		36
-	Court to determine objection within 5 days		41
5	Prepare a list of claimants (creditors) within 20 days of publication of decision	20	51
6	Lodge the list of creditors with court (no extension is sought)	10	61
-	No disputes by creditors and thus no Court determination on same		
7	Preventive Composition Scheme to be submitted to Court within 45 days of publication of decision (without extensions)		76
8	Court to review draft that it takes into account interest of all parties	10	86
9	Issue invitation by public advertisement as well as other means to debtor's creditors	5	91
10	Meeting of creditors for approval	15	106
11	Trustee to put draft scheme before court	3	109
12	Court to accept the plan	5	114
13	Trustee to register the Courts decision confirming approval in Government corporate register and publish a summary	7	121

Innovative manner of answering the question. 5 marks

Question 4.2 [maximum 5 marks]

VGK LLC's creditors rejected the proposed Preventive Composition scheme after a process of nearly four months. During that time, creditors, including staff, were not paid. The owners consider that without creditor support, restructuring would be impossible and liquidation is the only option available. With specific reference to the facts described above, describe the process that would be followed as part of any liquidation and, in particular, considering who could be appointed as trustee.

It is assumed the Federal Decree Law 21 of 2020 which is intended to provide relief to debtors from the provisions of Bankruptcy Law from 1st April 2020 to 31st July 2021, if VGK LLC's financial condition is caused by downturn triggered by global Covid pandemic, is not applicable to the liquidation.

The Court is required to appoint a trustee to undertake the liquidation, although it can order that any expert or trustee previously appointed in relation to any other procedure should continue in office. Thus, for the sake of continuity it is possible that Court may appoint either the trustee of Preventive Composition or the expert of Preventive Composition though it retains its rights to appoint anyone else.

The trustee has to give a notice within 3 business days of its appointment and state that VGK LLC is subject to bankruptcy order. Creditors are thereafter required to make their claims with the trustee within 10 business days. All debts including future and foreign currency denominated fall due. The court may suspend interest and other penalties for non-payment. A party may apply to Court for rescission of contract in case VGK LLC defaults in its contractual obligations.

The trustee will liquidate all of VGK LLC's property by public auction, wherein related parties are ineligible to purchase, over a period of six months, which may be extended by two months in public interest, or in interest of creditors. The proceeds of sale of assets subject to security interest are to be applied in payment of debts owed to secured creditor, less the trustee's cost of sale. Subject to court approval the trustee must pay claims in priority as provided by law which is:

- Payment of Court's cost and the trustee's cost
- Unpaid salary and wages up to a maximum period of three months
- Amounts due to Governmental bodies.
- Costs incurred in supplying the debtor with goods and services following the commencement of bankruptcy.

Following the liquidation of VGK LLC's assets the court must make an order confirming the conclusion of liquidation procedure including the final list of creditors and amount remaining unpaid. The decision needs to be advertised and the trustee is to return all documents to debtor following completion of liquidation. Following completion, the creditors may enforce any debt remaining unpaid against any remaining assets of the VGK LLC's.

It is possible that some of the creditors would remain unpaid post liquidation. We are aware that one of the sites had been purchased by a shareholder of VGK LLC and was leased to the company. However, it is not clear from the question whether the shareholder is substantial/majority shareholder (akin to director) or someone just holding one share. Basis the status of shareholder the court has to thus decide:

- If the assets of VGK LLC insufficient to pay 20% of company debt – the Court may require directors to pay

- Directors may also be required to pay if in the period of two years before bankruptcy commencement date any person acted in a way which was unduly risky, undertook transactions for insufficient consideration or paid debts of creditors in preference to other creditors. The last two may be relevant vis-à-vis the shareholder who had mortgage over VGK LLC property. The court will also have to determine whether as a quid-pro-quo the creditor (shareholder) voted on Preventive composition.
- Finally, any dispositions by VGK LLC in the period of two years before the commencement date are void unless the Court approves the transaction in public interest or if the transaction was entered into on the basis of another party's good faith.

Good answer although it could have been shorter! 5 marks

Question 4.3 [maximum 5 marks]

VGK LLC incorporated and registered a fully-owned subsidiary company in the DIFC to operate a restaurant in the DIFC, The subsidiary is called VGK Limited and it is incorporated as a DIFC company. VGK Limited is also unable to pay its debts. What actions can VGK Limited's creditors take if they wish to see VGK Limited liquidated in the DIFC? In particular, who can take such actions and what steps would have to be taken? If the VGK was to be wound up, who would be responsible for it and what process would be adopted for addressing creditor claims in the winding up?

Commented [DB8]: Read the question! Creditors' voluntary is not initiated by creditors but by the members!

VGK Limited's creditors have two options to get VGK Limited liquidated in DIFC:

1. Creditors Voluntary Winding-up
2. Compulsory winding-up pursuant to the orders of the Court

Creditors Voluntary Winding-up: The winding-up is deemed to commence at the time of passing of a resolution to wind-up VGK Limited. The power of directors ceases on appointment of liquidator although appointment does not occur immediately. The liquidator will be a person nominated by the creditors and in its absence a person nominated by VGK Limited. The creditors may also appoint liquidation committee to exercise functions under DIFC Insolvency law.

Compulsory winding-up: The court has jurisdiction to order winding up if the company has passed a resolution to that effect, if it is unable to pay its debts, if a moratorium under company voluntary arrangement has ended without arrangement or if the court thinks it is just and equitable. If an order for winding-up is made by Court, it must appoint a liquidator. The liquidator so appointed may choose to continue or summon a meeting of creditors and contributories to appoint a new liquidator. If the choice of creditors and contributories differ, the choice of creditors prevail.

As mentioned in the question VGK is unable to pay its debts thus an application to the Court for winding up can be made by the creditors or even by the DIFC authority. A creditor with a debt of at least US\$ 2,000 may apply to the Court for an order of winding-up.

The liquidator in either of the scenarios will wind-up VGK Limited, call for claims, prove and rank claims, gather, realise and distribute the company's assets. The liquidator may carry on the business for beneficial winding-up, conduct litigation and enter contracts in the name of company, sell property, disclaim onerous property, and do all acts necessary for winding-up and distribution of assets.

The creditors wishing to recover a debt in liquidation must submit a claim for the amount in writing to liquidator and provide supporting information. The liquidator may require the creditor to provide additional information. If the debt cannot be ascertained the liquidator may estimate its quantum. A proof of debt may consider any set-off, including as per Netting Law, which exists, and may take into account accrued interest up to the date of the commencement of winding-up. A creditor may also prove for future debt and debt denominated in foreign currency. A secured creditor may only prove for the balance owing, or which estimated would be owing following realisation of security interest.

The liquidator may either accept or reject the creditors claim. In case the creditors claim is rejected, the creditor may appeal against the decision within 21 days of receiving notice of that decision to the Court. A member of company or another creditor may also appeal against any such decision of the liquidator.

Whenever liquidator has sufficient funds, he or she may declare a dividend and distribute amongst VGK's creditors after retaining funds for costs and claims which liquidators believe will still be lodged. A creditor who has not proved his debt till the time of dividend payment, is entitled to the dividend he or she has failed to receive previously, called equalising dividend.

All debts of insolvent company rank equally unless they are preferential debts. Preferential creditor claims are paid in priority to unsecured creditors as well as secured claims. Preferential claims usually pertain to amounts owed by VGK Limited to employees or to their benefit.

In case VGK has sufficient assets to pay all creditors in full for the claims as at winding-up commencement date it must pay interest on all such claims that are interest bearing. The remaining assets are paid to shareholders and contributories of the company. The liquidator may by notice to the creditors declare a final distribution without regard to the claim of any person who has not yet proved their claim in the winding-up; the Court may on application by any person, postpone the date of final dividend.

There are no specific provisions governing contracts which have not been fully performed upon the commencement of a winding up. The value of such claims as between the company and the other party to the contract falls to be determined by the general law of liability.

The liquidator may take various actions to challenge transactions entered into by the company and seek recovery of assets which VGK was deprived of in the period prior to the commencement of winding-up. Liquidator may pursue action against past/present officers of company if they conducted affairs with the intention of defrauding the creditors. The liquidator may apply to Court requiring certain persons i.e., officers, directors, managers, contributories to repay, restore, account for company property, to compensate for misfeasance, falsification, fraud, false representation, or breach of duty and contribute to VGK's assets. A director is personally liable too if director knew beforehand that there was no reasonable prospect of company avoiding insolvent liquidation. In addition to requirement of the law such action will bolster the liquidation estate to pay out the creditors.

The liquidator must report to the creditors at various times during the winding up as to the state of affairs of the company. If a liquidation committee has been appointed the liquidator may determine when further meetings of committee will take place.

Very long answer for 5 marks, but in the end well answered. **5 marks.**

*** End of Assessment ***