



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.
2. All assessments must be submitted electronically in **Microsoft Word format**, using a standard A4 size page and an 11-point Arial font. This document has been set up with these parameters – **please do not change the document settings in any way. DO NOT** submit your assessment in PDF format as it will be returned to you unmarked.
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).
4. You must save this document using the following format: **[studentnumber.assessment7E]**. An example would be something along the following lines: 202021IFU-314.assessment7E. **Please also include the filename as a footer to each page of the assessment** (this has been pre-populated for you, merely replace the words “studentnumber” with the student number allocated to you). Do not include your name or any other identifying words in your file name. **Assessments that do not comply with this instruction will be returned to candidates unmarked.**
5. Before you will be allowed to upload / submit your assessment via the portal on the Foundation Certificate web pages, you will be required to confirm / certify that you are the person who completed the assessment and that the work submitted is your own, original work. Please see the part of the Course Handbook that deals with plagiarism and dishonesty in the submission of assessments. **Please note that copying and pasting from the Guidance Text into your answer is prohibited and constitutes plagiarism. You must write the answers to the questions in your own words.**
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]: 45 out of 50 – 90%. Very 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]: 7 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?

The key point of distinction is that each emirate has "its own land registration system", meaning that there is not a uniform registry to record security over real property that applies throughout the UAE/ or records securities for the whole of the UAE irrespective of the jurisdiction of the emirate where the property is located [Guidance Text par 5.1. page 8]. The result is that the procedures for registration is dependent on the laws of the specific emirate although the substantive law is similar to those of other emirates [Ibid]. This is because the UAE property laws apply to the ability to take a real security interest whereas the manner to effect this as a binding legal right is dependent on registration, which is governed by the individual emirate's procedural laws [Ibid].

In the UAE, mortgaged property may only be sold if the court has granted an order to this effect, but not necessarily an order that the debtor actually owes the debt due to the creditor, and the property will be sold by the court's execution division [Ibid]. The creditor has the right to sell the asset that is the subject of the security but "this right must be exercised through the Courts" [Ibid]. This means that both a court order and court involvement in enforcement of the security right is needed in the UAE [Ibid].

In the financial free zones, the enforcement of the security right does not necessarily require court intervention [Guidance Text par 5.2. page 9]. The creditor can take control of the secured asset and use it to recover the debt owed in various manners: sale (liquidation of the whole or part of the asset), lease (receiving a liquid income from the use of the property), and business (using the property for profit-making purposes) [Ibid]. The difference is thus that no court order or involvement is needed in this regard (as opposed to the position in the mainland UAE) – a court order only becomes applicable once "an order for forfeiture" is sought [Ibid].

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:

- (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) The court [Guidance Text paras 6.4.1.1. and 6.4.5.2. pages 13 and 24]
- (b) The court [Guidance Text paras 6.4.1.5. and 6.4.5.4. pages 17 and 27]
- (c) The creditors [Guidance Text paras 6.4.1.5. and 6.4.5.5. pages 18 and 28]
- (d) The trustee [Guidance Text paras 6.4.1.7. and 6.4.5.7. pages 19 and 29]

- (a) The Court.
- (b) The debtor’s unsecured creditors.
- (c) The Court.
- (d) The trustee.

2 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 debtor is the person who decides to apply to court to commence the preventative composition process (although as indicated above in question 2.2.(a), it is the court who ultimately decides whether the application should succeed or not) [Guidance Text par 6.4.1. page 13]. It is not an uncomplicated decision as the debtor has a duty to apply for bankruptcy proceedings in the event of insolvency, which duty is dissipated upon application for a preventative composition [Ibid]. The preventative composition is essentially a “debtor-led corporate rescue” mechanism, and the purpose is to develop a strategy to settle the debtor’s debts due to the creditors (with the assistance of an external professional called the composition trustee) and arguably aim to remain in business [Guidance Text par 6.4. page 12]. As such, the debtor’s circumstances need to be of such a nature that a settlement with creditors via a viable composition scheme is possible – this is also one of the features of the debtor’s proposal to court that is scrutinized by the court and court-appointed expert [Guidance Text par 6.4.1.1 page 13]. Also, an application to commence preventative composition made “in bad faith” may result in the liquidation of the debtor [Guidance Text par 6.4.6.1 page 30].

Different from the circumstances for the preventative composition (in the sense that there is no similar specific circumstances prescribed to force commencement of the preventative composition procedure other than the appeal of discharging the duty to apply for bankruptcy), the debtor must commence with bankruptcy proceedings where the debtor has failed to pay debts due and payable for “30 consecutive business days” [Guidance Text par 6.4.5.1. page 23]. The perusal of the debtor’s financial position by the expert, and later the trustee, will determine whether the debtor is eligible for “restructuring” (including sale “as a ‘going concern’”) or the “liquidation” of the assets of the debtor to pay the claims of creditors who proved same [Guidance Text paras 6.4.5.2, 6.4.5.4 and 6.4.6.1 pages 24, 26-27 and 31-32]. Based on the above it seems that, from the debtor’s perspective, the preventative composition would avoid the sale of the business (if applicable) or the loss of assets through liquidation,

but the ability to offer a viable composition scheme is dependent on the debtor's financial affairs at time of application [see above].

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?

Creditors are unable to force the initiation of preventative composition procedures on a debtor whereas bankruptcy proceedings may be commenced upon application to court by a creditor [Guidance Text paras 6.4.1 and 6.4.5.1 pages 13 and 23].

Threshold for creditors' claims?

1 mark

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

Commented [DB4]: 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.

The design of an overarching, holistic insolvency framework in the UAE was crisis-driven because the limitations of the court-based laws only applicable to commercial entrepreneurs became notable when the inability of the framework to deal with the commercial insolvency of a public-owned investment company in Dubai triggered potential national and international systemic risk [Guidance Text par 4.2.3. page 6]. In a nutshell, "the experience gave impetus to establishing a properly functioning insolvency regime" [Ibid]. The minimalistic and infrequently used 1993-regime was replaced by the 2016 "Bankruptcy Law", which also focused on commercial entities similar to its predecessor, the "Commercial Transactions Law" [Ibid]. The law was aligned with international best practices, is inclusive of "all aspects of the insolvency process" and was further developed in 2019 and 2020 [Ibid]. The framework of the Bankruptcy Law provides for "greater legal certainty" during debt-related dispute resolution than the 1993-regime [Guidance Text par 6.1. page 11].

The Bankruptcy law focuses substantively on UAE debtors in the commercial arena, whether corporate or natural, as opposed to "consumer" and "state-owned" corporate debtors but its application is more wide-spread [Guidance Text paras 4.2.3. and 6.1. pages 6, 10-11]. First, some debtors may choose to be bound to the Bankruptcy Law (it is thus voluntary as opposed to mandatory) – the option is available to corporations owned by the government ("established by federal or local government") and corporations not founded on the UAE Commercial Company Law [Guidance Text paras 6.1. and 6.4.1 pages 10, 11 and 12-13]. In the latter case, there may be legislation that specifically provides for the jurisdiction of the Bankruptcy Law over some corporations not founded on the UAE Commercial Company Law (this is then application with reference to the Bankruptcy Law and is a matter of law, not choice) [Guidance Text par 6.1. page 10]. Second, the Bankruptcy Law is a fallback framework: In the absence of a legislative framework to govern insolvency situations of free zone debtors (being "companies and establishments"), the Bankruptcy Law applies to these debtors [Guidance Text par 6.1. page 11] – with the exception of debtors in *financial* free areas of the ADGM and the DIFC as these areas have their own laws and thus there is no absence of governing provisions [see e.g. Guidance Text paras 4.2.4., 6.2. and 6.4.1. pages 7, 11 and 13]. Third, the Bankruptcy Law is the law that applies to: "all companies governed by the Commercial

Companies Law" (thus corporations subject to the general company laws of the UAE); "licensed civil companies of a professional character" (as an example, I assume this could be an incorporated/formally structured business of legal practitioners – see Guidance Text par 6.4.1. page 13); and "traders" (meaning individuals "engaged in commercial activities in a personal capacity": as an example, I assume this could be a one-man business or sole trader) [Guidance Text par 6.1. page 11]. In a nutshell, "the Bankruptcy Law is available essentially to all commercial entities and individuals carrying on commercial activities" [Guidance Text par 6.1. page 11].

As indicated above, the regime has been received by way of legislation and its application is governed either by the legislative provisions or the debtor's choice of law. However, even though the legislation puts the framework in place, the uptake through actual implementation thereof by way of reliance on its provisions by financially distressed debtors, has been slow [Guidance Text par 6.1. page 11].

Good comprehensive answer – 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.

Consideration of the application, making the order and appointing the trustee: The first manner in which the court is involved is during the application stage of bankruptcy proceedings: when the debtor or creditor(s) approach the court for an order to this effect [Guidance Text par 6.4.5.1. page 23]. During this stage, the court must review the application and ensure that the application contains the prescribed information, documents and security for costs as per sections 73, 74 and 76 of the Bankruptcy Law, failing which, the court has the discretion to deny the application outright [Guidance Text paras 6.4.5.1. and 6.4.5.2. page 24]. The court then has to consider the application by reviewing the information provided and soliciting more information (including from a court-appointed expert) to assist it with its determination [Guidance Text par 6.4.5.2. page 24]. After applying its mind in this regard, the application is accepted or rejected [Ibid]. Where the application is accepted, the trustee is appointed by the court [Guidance Text par 6.4.5.2. page 25]. The court has a choice of trustees from two pools of trustees (nominated or an expert of the Financial Restructuring Committee) and can decide on the number and type of trustee to be appointed [Ibid]. The court is thus involved in the appointment of the practitioner(s) who will ultimately effect the restructuring of the debtor [Guidance Text par 6.4.5.7. pages 29].

Creditors: The second manner in which the court is involved is during the determination of creditor involvement in the estate, meaning which creditors' claims are to be dealt with during the proceedings and which creditors' claims do not meet the requirements for inclusion [Guidance Text par 6.4.5.3. page 26]. The court reviews the trustee's determination of which creditors' claims should be accepted and whose claims should be rejected and considers it based on the reasoning that the trustee provides [Ibid]. Apart from generally overseeing the fair and reasoned inclusion of creditors, the court also hears contestations on inclusions or exclusions brought directly by the debtor or creditor(s) as based on the trustee's documented determination [Ibid]. Although the trustee drafts the list of creditors to be included, section 94 of the Bankruptcy Law determines that the court is the ultimate decision-maker when it comes to creditors listed for inclusion in the bankruptcy proceedings, which are logically those who will be affected by the restructuring process [Ibid]. They are also the ones who will be allowed to vote on whether the restructuring plan is acceptable [Guidance Text par 6.4.5.5. page 28].

Debtor: The third manner in which the court is involved is during the assessment of the debtor's entrepreneurial affairs by the trustee [Guidance Text par 6.4.5.4. pages 26-27]. The trustee

reports on the viability of a restructuring plan for the debtor and means to effect same as per section 96 of the Bankruptcy Law, which report is then submitted to the court for evaluation [Guidance Text par 6.4.5.4. page 27]. The court's involvement at this stage is aimed at ensuring that "the report takes account of all creditor claims", however, it also considers whether restructuring is indeed possible and whether the debtor will continue to trade (see section 98 of the Bankruptcy Law) [Ibid]. Although the trustee suggests restructuring and substantiates the recommendation in his/her/its report, it is the court who ultimately grants the permission for the bankruptcy proceedings to proceed as a restructuring of the debtor (see section 98 of the Bankruptcy Law) [Ibid]. The trustee is only allowed to draft a restructuring plan once the court instructs him/her/it to do so [Ibid].

Restructuring scheme: The fourth manner in which the court is actively involved in the restructuring process is the review of the restructuring plan drafted by the trustee [Ibid]. The court is thus the first point of evaluation – even before the creditors view the plan [Ibid]. The court assesses the plan based on its balanced consideration of "all parties' interests" and may reject this first draft if this is not the case (in which instances, the trustee has to amend the plan) (see section 103 of the Bankruptcy Law) [Ibid]. The court's involvement at this stage is to objectively assess the trustee's restructuring plan and, once the court is satisfied with the plan, the trustee is allowed to submit the plan to the creditors for their input [Ibid]. Once the creditors have voted in support of the plan, the court must finally approve the restructuring scheme before it can be implemented [Guidance Text par 6.4.5.6. page 28]. The final decision is based on the court's conviction that "all affected creditors will receive at least as much as the creditors would have received if the debtor's assets had been liquidated on the date of voting on the scheme" [Ibid]. The court has the ability to reject a plan, which may result in the ultimate liquidation of the debtor if the trustee does not manage to design an amended plan that meets the court's approval (see section 109 of the Bankruptcy Law) [Ibid].

Execution and conclusion: The court is lastly involved in overseeing the trustee's management of the plan – meaning that the trustee supervises the plan but provides the court with progress reports on a three-monthly basis (or, in the event of challenges, immediately) as per section 114 of the Bankruptcy Law [Guidance Text par 6.4.5.7. page 29]. In addition, a court order is needed "confirming the complete implementation of the scheme" before the restructuring can be deemed concluded [Guidance Text par 6.4.5.8. page 29].

These are the main stages where the court is considerably involved in the restructuring process. However, there are ad hoc instances where the court is also involved but these instances are not discussed in detail – they include: allowing secured creditors to benefit from assets that serve as security for debts [Guidance Text par 6.4.5.2. page 24]; interrupt the running of interest of debts [Guidance Text par 6.4.5.3. page 26]; provide orders ceasing or retracting unexecuted contracts [Ibid]; direct the steps that the trustee needs to take [eg Guidance Text par 6.4.5.4. page 27]; permit the debtor to incur financing debt [Guidance Text par 6.4.5.7. page 29]; confiscation of the debtor's assets [Guidance Text par 6.4.5.8. pages 29-30]; etc (see e.g ss 163-167, 181, 116 of the Bankruptcy Law as per the Guidance Text).

Comprehensive 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.

Appropriate. The UAE has no insolvency regulator or adjudicator to oversee trustees' administration of estates. The courts are the available alternative for creditors to protect their rights. Creditors are dependent on the trustee to consider their interests (whether during the

proving of claims, drafting of the report to establish the viability of restructuring and voting on the scheme). The trustee has law-based powers and duties, and has to balance numerous rights in the process (which may be collective as opposed to individual, e.g. grouped according to secured or unsecured creditors, voting rights, etc). Individual creditors have recourse to the courts in any event and the BL facilitates access to court by providing for court involvement in the legislative framework. For locus standi, a right needs to be “protectable” and in insolvency, there is often clashing *interests*, different rules “in” as opposed to “out” of insolvency that apply, and the merits of each case differs. The BL allows the court to consider interests (it can instruct the trustee to amend the plan “if it does not properly observe all parties’ interests”). The process of continuous involvement allows the court to deal with the matter holistically as it progresses (as the court is involved in numerous stages throughout the process) as opposed to an ad hoc basis if individual creditors were to approach it. Source: Guidance Text paragraphs 6.4.5.3 – 6.4.5.6 pages 26 – 28. BL – Bankruptcy Law.

Well-motivated answer – 1 mark.

However: 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 [DB5]: 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.

Steps 1, 2 and 3: The application is brought to court (1: application) and the court requests an expert to analyse and report on the debtor’s monetary situation (2: appointment of expert) [Guidance Text par 6.4.1.1 page 13]. The expert has 20 business days from date of appointment (when he received the directive from the court) to finalise his analysis [Ibid]. The

court then has 5 business days from date of receipt of the report to accept or reject the application (3: decide on application) based on whether the debtor is a good candidate for the process [Ibid]. The periods prescribed for appointment and consideration of the expert report thus affect the maximum time allowed.

Additional necessary step (noted as 4 but no time is expended here): I assume that there are also no disputes about the trustee selected by the court (4: appointment of trustee) [Guidance Text par 6.4.1.2 page 14]. This occurs on the date of acceptance of the application, so no time is expended here [Ibid].

Step 5: The next step(s) that affect the timelines are the notification periods that apply to the circulation of the notice of the court order for the preventative composition process affecting the debtor; and the grace period during which creditors must submit their claims. [Guidance Text par 6.4.1.3 page 16]. The trustee has 5 business days from date of appointment to distribute the notice and require creditors to submit their claims no later than 20 business days from "the date of publication" (5: request for, and submission of, claims) [Ibid]. The periods prescribed for publication of the notice and submission of claims thus affect the maximum time allowed.

Thus far, the process has taken (at most) 50 business days from the date on which the expert was instructed to review the debtor's affairs (and it seems that this appointment should ideally occur when the application is received by the court [see Guidance Text par 6.4.1.1 page 13]. Additional potential step – the time to inform the trustee of a debt that the debtor owes a creditor may be doubled by the court (thus run for an additional 20 days which is not applicable according to the facts) [Guidance Text par 6.4.1.3 page 16]. An application for extension may thus affect the time to complete the process.

Step 6: An additional 10 business days are added to the above as this is the time within which the trustee must draft the list of creditors who should be included in the composition (and note those who should not) (6: drafting of list of creditors and submission of same to court – see below) [Guidance Text par 6.4.1.3 page 16].

Step 7: The drafting of the preventative composition scheme takes place and must be presented to court no later than 65 business days (the set time period is 45 days but the court may grant an additional 20 business days although the facts note that no additional time is given) from when the trustee circulated the decision of the court to accept the debtor's application (7: drafting of scheme prior to submission to court) [Guidance Text par 6.4.1.4 page 17]. Thus, the drafting and presentation of the scheme to court is also subject to strict timelines but these timelines may be affected if the trustee indicates to the court that more time is needed and the court grants the request [Ibid]. One must, however, account for the slight parallel workings of the timelines pertaining to lodging of claims by creditors (dated from notification) and development of the scheme (also dated from notification but with seemingly slightly different times prescribed) [see Guidance Text paras 6.4.1.3 and 6.4.1.4 pages 16 and 17]. The drafting of the scheme and any additional time granted affects the length of the process.

Step 8: The first time that the court evaluates the scheme, it must provide its views on the scheme no later than 10 business days after the trustee provided the court with the first draft [Guidance Text par 6.4.1.5 page 17]. The trustee then has 5 business days to request creditors to meet in order to review the scheme (but creditors have, at least, 10 business days' notice as the creditors must review the plan at a meeting called for this purpose no later than 15 business days after the court told the trustee to convene the meeting (which the trustee had to do by way of invitation noted above)) [Guidance Text par 6.4.1.5 pages 17 and 18]. The time that the court takes to look at the scheme for the first time and the determination of a date for creditors to gather thus affects the timelines.

Step 9: The creditors review the scheme but as this is done at a meeting, the actual evaluation of, and voting on, the scheme does not affect the timelines [Guidance Text par 6.4.1.5 page 18].

Step 10: The next step is the second time the court reviews the scheme and this must be done after the creditors meeting but before 3 business days have lapsed [Guidance Text par 6.4.1.6 page 18]. The time that the trustee thus takes to get the scheme to court, affects the timelines

– but thereafter there is no specific time for the court to provide its views (after the trustee provided the court with the scheme as approved by the creditors) [Ibid]. The only requirement is that the second consideration and decision occurs “urgently” – hence, it is supposed to be fast [Ibid]. Thereafter, the trustee has 7 business days to “register” the acceptance of the scheme by the court and notify all affected thereof by way of publication [Guidance Text par 6.4.1.7 page 19].

Comprehensive answer – 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.

The VGK LLC shareholder (hereinafter “Bob”) has the right to apply for the liquidation of VGK LLC although this right is not exercisable until the end of July 2021 [Guidance Text par 6.4.5.1 page 23]. Alternatively, VGK LLC may apply for its own liquidation [Guidance Text par 6.4.5.1 page 24] which is probably where the owner is heading with the statement “liquidation is the only option available”. In addition, the fact that “restructuring would be impossible” places pressure on the court to order the liquidation of the LLC as this would be based on one of the scenarios under section 124 of the Bankruptcy Law (“restructuring procedures are inappropriate for the debtor”) [Guidance Text par 6.4.6.1 page 30]. Another ground is that the preventative composition scheme was not accepted by the creditors, and if the composition process comes to an end, this would also be a ground for the court to order the debtor to enter the liquidation procedure [Ibid]. Arguably, neither the court nor the trustee will need to complete the process to determine whether restructuring is a viable option for the debtor [Guidance Text paras 6.4.5.2 and 6.4.5.2 pages 24 and 26 et seq].

The person applying for bankruptcy (with the outcome of liquidation) is important because it plays a role in the appointment of the trustee – if the debtor bring the application, the debtor may name the trustee [Guidance Text par 6.4.5.1 page 24]. In the event that the creditor brings the application (eg a creditor who demanded payment and who was not paid within 30 business days such as the staff in this case) [Guidance Text par 6.4.5.1 page 23], the trustee would be someone “enrolled in the table of experts appointed by the Financial Restructuring Committee” [Guidance Text par 6.4.5.2 page 25]. None of the creditors may be appointed as trustee for VGK LLC [Ibid].

The basic process is as follows: The assets of the debtor are liquidated (thus, the development site (but see below) as there is no indication of other assets including liquid funds as the latter has been depleted) and the proceeds distributed to the creditors [Guidance Text par 6.4.6.1 page 31]. In order to know who the creditors are, creditors are required to prove their claims after the court order that the debtor be liquidated [Ibid]. Thus, the creditors, employees and Bob must prove their claims. Although Bob is only entitled to payment by 2024 (the facts read “payment for the site would be made by VGK LLC to the shareholder in full in 2024”), the effect of the liquidation order is that “[a]ll debts owed by the debtor fall due upon the order for bankruptcy” and this makes him a creditor for purposes of the debtor [Guidance Text par 6.4.6.1 page 31]. As this is a future debt, some changes to the amount may be made if interest and other accruals need to be taken into account due to the early repayment of the debt [Ibid]. However, the bankruptcy proceedings do not prevent Bob from selling the site on his own with the court’s permission as “the secured creditor’s rights are not substantially affected by any formal insolvency process; the secured creditor can generally enforce its rights notwithstanding the debtor’s insolvency” [Guidance Text paras 5.1 and 6.4.5.2 pages 9 and 24]. The court may include “conditions” in its execution order [Ibid]. Should the trustee proceed

with the sale, then Bob would in any event be entitled to receive the proceeds from the secured assets as a secured creditor [Guidance Text par 6.4.6.1 page 31]. However, the costs involved are different to what would have been the costs had a court order been granted for the sale and the sale dealt with by the court's execution department [Guidance Text par 5.1 page 8]. The trustee's costs will be paid first before the surplus is used to settle the debt owed to Bob [Guidance Text par 6.4.6.1 page 31]. It may also be more beneficial for Bob to sell the asset privately as the trustee has to sell the asset "by public auction, under the supervision of the Court" [Ibid]. I am not familiar with the correlation between private and public sales in the UAE, but in my jurisdiction, public sale prices are generally not high.

The other creditors, specifically the employees, would have to wait and see whether the proceeds of the site are sufficient to cover both the trustee costs and those of Bob, because only if there is anything left will they be entitled thereto (and from the facts, it does not seem as if there is any other assets unless one can assume that there are other restaurant sites that are owned by the debtor over and above the site mortgaged to Bob) [Ibid]. Should there be proceeds left or generated from the sale of other property of the debtor, the creditors are ranked as follows (only those specified in the facts are dealt with here: the court and the trustee will be remunerated (costs paid); and then the staff will be entitled to receive three month's wages (thus they will not be prioritised in respect of the fourth month that they were not paid according to the facts) [Guidance Text par 6.4.6.1 page 31]. As the company did not trade, the prioritisation of "costs incurred in supplying the debtor with goods and services following the commencement of the bankruptcy" is not relevant, as is debts due by natural persons such as maintenance [Guidance Text par 6.4.6.1 pages 31-32]. As there is likely not going to be any assets left after the liquidation, unpaid creditors will not be able to claim repayment from surplus ("remaining") assets of the debtor [Guidance Text par 6.4.6.1 page 32]. The bankruptcy procedure would end automatically after five years as the debtor is then deemed "rehabilitated" (this also applies to incorporated entities and differs from winding-up under DIFC law where the company ceases to exist) [Guidance Text par 6.4.6.1 page 32].

As a side note, it is also important that the bankruptcy order does not bring the contracts with the staff to an end but the trustee may request the court to "rescind ... employment contracts" [Guidance Text par 6.4.5.4 page 26] On the other hand, unpaid creditors in a contractual relationship where the debtor does not honour its contractual obligations may also approach the court to set the contract aside [Ibid]. In addition, the commencement of bankruptcy prohibits creditors from taking legal action against the debtor and the court may even order that "interest and other penalties for non-payment [be] suspended" [Guidance Text paras 6.4.5.2 and 6.4.6.1 pages 24 and 31]. Further, the debtor loses the ability to deal with its own assets and liabilities once the court orders that bankruptcy proceedings should start [Guidance Text par 6.4.5.2 page 24].

Comprehensive – although a very long – answer. 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?

As VGK Ltd is incorporated in the DIFC, the DIFC laws may be applied to it [Guidance Text par 6.4.7 page 33]. The creditors would have to approach the DIFC courts to have the subsidiary wound up in terms of DIFC law [Ibid]. As the initiation of liquidation proceedings is not voluntary, the creditors' winding-up process is not applicable as a directors' resolution is needed [Guidance Text paras 6.4.7 and 6.4.7.1 pages 33 and 34].

There are a number of avenues available for a creditor to show a basis and its standing to bring the application to the DIFC courts: The fact that the company is unable to pay its debts can be the foundation for the application to court but the creditor would have to provide evidence to this effect and the company should owe the creditor more than 2 000 US dollars for it to have standing to apply for the winding-up order [Guidance Text par 6.4.7.1 page 34 and 35]. Ideally, the creditor should request payment of the debt (which should exceed the amount stated above) and rely on the default of VGK Ltd (for more than three weeks) to base the application on [Guidance Text par 6.4.7.1 page 34]. As the creditors want to bring the application, it is irrelevant that the company, directors or the DIFC Authority can also apply for the winding-up of the company [Guidance Text par 6.4.7.1 pages 34 and 35].

An insolvency practitioner, called a liquidator, would be appointed to effect the winding-up of the company [Guidance Text par 6.4.7. page 35] (see also Guidance Text par 4.2.3 page 7 which notes that “[i]nsolvency practitioners in the DIFC are appointed, on application, by the DIFC Registrar of Companies” as liquidators need to be practitioner, but in respect of a specific company’s winding-up, the court order has to stipulate who the liquidator is and the liquidator may then remain as such or the liquidator can be formally selected at a creditor’s meeting (see Guidance Text par 6.4.7.1 page 35). This is the official that creditors must convince of the legitimacy of their claims by proving same (providing information and evidence thereof) [Guidance Text par 6.4.7.3 page 36]. The liquidator also investigates the legitimacy of the claims prior to including or excluding it for settlement during the winding-up process [Guidance Text par 6.4.7.3 page 37]. A creditor has recourse to the DIFC courts in the event that there is a disagreement on claims with the liquidator [Ibid].

Creditors are paid pro rata, meaning that they do not receive full payment but only a part of the debt owed in the event that the company’s liabilities exceed its assets [Guidance Text par 6.4.7.4 page 38]. Creditors are treated equally with some exceptions where the company is factually insolvent: the winding-up expenditure may be paid as a priority payment and employment debts are dealt with as priorities [Ibid]. The priority treatment is effected over unsecured creditors and those secured creditors who hold “security interest[s] over all or substantially all of the assets of the company” [Guidance Text par 6.4.7.3 page 38]. Creditors must prove their claims otherwise they run the risk of not receiving payment (the entity ceases to exist at conclusion of the winding-up proceedings – see Guidance Text par 6.4.7.5 page 39) – although some exceptions may be made for “a creditor who has not proved his or her debt by the time a dividend is paid [may] ... if there are funds” receive some payment [Guidance Text par 6.4.7.4 page 38].

Bibliography: INSOL International *Module 7E Guidance Text United Arab Emirates 2020/2021*
INSOL International: London (“Guidance Text”)

Comprehensive answer – 5 marks

*** End of Assessment ***