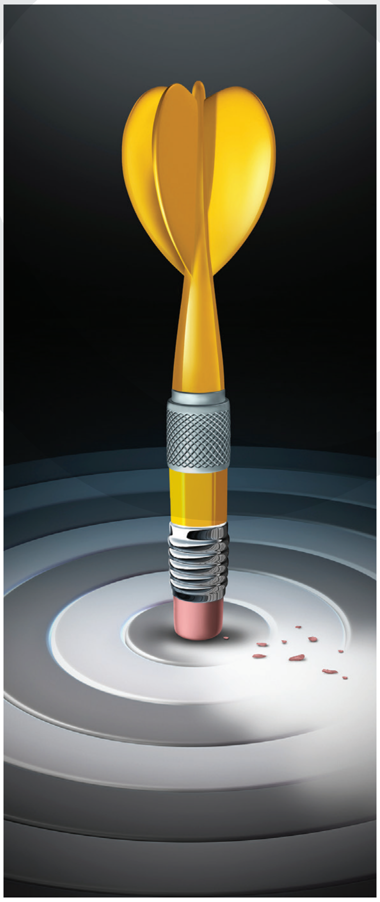
New law, massive impact

The new Insolvency Law aims to balance the needs of all stakeholders in the context of insolvency-related situations in the DIFC, to facilitate a more efficient and effective restructuring regime.



On June 13, 2019, the much anticipated DIFC Insolvency Law No. 1 of 2019 and associated DIFC Insolvency Regulations 2019 (collectively the "2019 DIFC Insolvency Law"), came into full force and effect, replacing the DIFC Insolvency Law No. 3 of 2009.

By way of context, the 2019 DIFC Insolvency Law applies only to entities registered and operating within the DIFC.

The 2019 DIFC Insolvency Law aims to balance the needs of all stakeholders in the context of insolvency related situations in DIFC, and in doing so facilitate a more efficient and effective restructuring regime.

Key changes introduced by the 2019 DIFC Insolvency Law include:

» the introduction of a debtor in possession procedure known as rehabilitation;

» the introduction of a procedure that allows the management of a company to be replaced by a court appointed administrator where there has been mismanagement of the company; and

» the incorporation of the UNCITRAL Model Law on Cross-Border Insolvency.

The purpose of this client alert is to provide a high-level overview of the changes mentioned above.

DEBTOR IN POSSESSION BANKRUPTCY REGIME

The 2019 DIFC Insolvency Law introduces a debtor in possession regime which the law refers to as 'rehabilitation'. A distressed company is eligible to apply for a rehabilitation plan where such company is, or is likely to become, unable to pay its debts, and there is a reasonable likelihood of successful rehabilitation, i.e. such company will eventually become capable of paying its debts. The approval mechanism for such plan is more particularly set out below.

A company's rehabilitation plan has to be submitted to the DIFC insolvency court, and to its creditors for consideration. In assessing the rehabilitation plan, the DIFC insolvency court will categorise the distressed company's creditors into different classes in order to vote on the plan. The 2019 DIFC Insolvency Law does not stipulate how creditors will be split into different classes and ultimately categorised, as such our presumption is that the DIFC insolvency court will determine the same.

Typically, a rehabilitation plan requires the approval of 75 per cent of creditors in each class of creditors in order for the DIFC insolvency court to approve such a plan, albeit the DIFC insolvency court can effectively bypass this requirement and approve the rehabilitation plan where:

» 75 per cent (in value) of one class of creditors affected by the rehabilitation plan approves it;

» the DIFC insolvency court considers that the rehabilitation plan is not unfairly prejudicial to each class of creditors and shareholders and the company's general body of creditors taken as a whole; and

» no junior creditor gets paid before senior creditors, with such ranking being determined in accordance with DIFC law and applicable contractual arrangements.

Once a rehabilitation plan has been submitted and accepted by the DIFC insolvency court, an automatic moratorium for a period of 120 days (the "Moratorium") will apply and such Moratorium will apply to all creditors, both secured and unsecured. A distressed company in rehabilitation will also benefit from certain protections against the termination of contracts, i.e. irrespective of a creditor's right to terminate, such right will be typically stayed during the period of the Moratorium. In addition, the DIFC insolvency court is able to sanction new financing during the rehabilitation process, whilst ensuring that existing creditors are protected.

During the implementation of a rehabilitation plan, the directors of the distressed company will be permitted to manage the company's affairs unless there is evidence that the such officers or management were involved in fraud or mismanagement of the company, in these cases, the management of the distressed company could be taken over by a court-appointed administrator, the process for which is further discussed below.

The creditors and shareholders of a distressed company have the right to challenge a rehabilitation plan and request for specific relief. In granting such relief, the DIFC insolvency court will consider whether:

» there will be irreparable harm to the distressed company;
» the creditor requesting relief would suffer significant loss; and
» the balance of harm to the creditor outweighs the interest of the distressed company.

The DIFC insolvency court can terminate any Moratorium upon the request of a creditor of the distressed company if there is evidence of bad faith on the part of the distressed company during such Moratorium.

DIFC INSOLVENCY COURT-APPOINTED ADMINISTRATOR

If a rehabilitation process has commenced and there is evidence of fraud or mismanagement within the distressed company, the creditors may apply to the DIFC insolvency court for the appointment of an insolvency practitioner as the administrator. Such administrator will replace the distressed company's management, and will be given various powers in order to:

» investigate any wrong-doing by the distressed company and/or its management;
» facilitate a company voluntary arrangement; or
» propose a rehabilitation plan or a scheme of arrangement under the DIFC companies law.

INCORPORATION OF UNCITRAL MODEL LAW ON CROSS-BORDER INSOLVENCY ("MODEL LAW")

The Model Law is designed to assist states to equip their insolvency laws with a modern legal framework to more effectively address cross-border insolvency proceedings concerning debtors experiencing severe financial distress or insolvency. The Model Law focuses on authorising and encouraging co-operation and coordination between jurisdictions, rather than attempting the unification of substantive insolvency law, and respects the differences among national procedural laws. For the purposes of the Model Law, a cross-border insolvency is one where the insolvent debtor has assets in more than one state or where some of the creditors of the debtor are not from the state where the insolvency proceeding is taking place. Consequently, the 2019 DIFC Insolvency Law incorporates the Model Law on cross-border insolvency proceedings with certain modifications to its application in DIFC.

IMPACT

The changes introduced by the 2019 DIFC Insolvency Law are welcome additions which actively promote shareholder and creditor protection, further balancing the needs of all stakeholders in the context of distressed and bankruptcy related situations in the DIFC. The 2019 DIFC Insolvency Law facilitates a more efficient and effective bankruptcy restructuring regime. Furthermore, the 2019 DIFC Insolvency Law has introduced certain concepts, in particular provisions to bind creditors across classes and contractual termination protections that are significantly advanced in respect of other insolvency regimes around the world, for example such provisions are only just being considered in respect of proposed reforms to insolvency law in the United Kingdom.

The introduction of the 2019 DIFC Insolvency Law further demonstrates the DIFC as a leading global financial centre with market leading laws.

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