



Dubai
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CONSULTATION PAPER NO. 8

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**INSOLVENCY LAW
DIFC LAW NO [X]. OF 2018**

CONSULTATION PAPER NO. 8

PROPOSALS RELATING TO A NEW INSOLVENCY LAW AND REGULATIONS

Why are we issuing this paper?

1. The Dubai International Financial Centre Authority (“**DIFCA**”) proposes to replace its current Insolvency Law, DIFC Law No. 3 of 2009 (the “**Current Law**”) with a new law to update insolvency relationships in the DIFC. This Consultation Paper No.8 of 2018 (“**Consultation Paper**”) seeks public comments on the proposed new Insolvency Law (the “**Proposed Law**”).

Who should read this paper?

2. This Consultation Paper would be of interest to persons conducting or proposing to conduct business in the DIFC. In particular:
 - (a) companies;
 - (b) limited liability partnerships;
 - (c) officers and employees of Companies and limited liability partnerships, such as directors, company secretaries, compliance officers, partners and senior executive officers;
 - (d) shareholders and creditors of companies and limited liability partnerships;
 - (e) liquidators registered in the DIFC;
 - (f) legal advisors; and
 - (g) auditors undertaking company audits.

How to provide comments

3. All comments should be provided to the person specified below:

Jacques Visser
Chief Legal Officer
DIFC Authority
Level 14, The Gate, P. O. Box 74777
Dubai, United Arab Emirates
or e-mailed to: consultation@difc.ae

4. You may choose to identify the organisation you represent in your comments.
5. DIFCA reserves the right to publish, on its website or elsewhere, any comments you

provide, unless you expressly request otherwise at the time the comments are made.

What happens next?

6. The deadline for providing comments on the proposals in this Consultation Paper is 17 October 2018.
7. Once we receive your comments, we will consider if any further refinements are required to the Proposed Law. Once DIFCA considers the Proposed Law to be in a suitable form, it will be enacted as a new DIFC law to come into force on a date specified and published.
8. The Proposed Law is in draft form only. You should not act on it until the Proposed Law is formally enacted. We will issue a notice on our website when this happens.

Defined terms

9. Defined terms are identified throughout this paper by the capitalisation of the initial letter of a word or of each word in a phrase and are defined in the Proposed Law. Unless the context otherwise requires, where capitalisation of the initial letter is not used, the expression has its natural meaning.

Background

10. The DIFCA has proposed to amend and enhance the current insolvency law regime (found in the Current Law) and the Insolvency Regulations (the "**Current Regulations**") to bring that regime in line with international best practice. In doing so, we have taken into account specific factors relating to the DIFC and the need to provide efficient and viable insolvency and restructuring tools to both debtors and creditors doing business in or from the DIFC.
11. The proposal to replace the Current Law and the Current Regulations with the Proposed Law and the Proposed Regulations stems from a comprehensive review of the Current Law and the Current Regulations. In undertaking that review, we have considered international best practice and comparable models in other jurisdictions, focusing specifically on the United Kingdom (upon which the current regime is substantially premised) and Singapore.
12. We have also considered the standards set by international standard setting bodies, such as the World Bank and the International Association of Restructuring, Insolvency and Bankruptcy Professionals, so far as they are relevant to the DIFC or have an impact on companies based in the DIFC. The Proposed Law and the Proposed Regulations seek to modernise the current regime and to enhance its operation by introducing an additional option to compliment the existing options already available, namely company voluntary arrangements, receivership, and winding up. The additional process is a rehabilitation process, which allows a debtor to seek to effect a compromise with their relevant creditors, it is subject to the supervision of the DIFC Courts.

Key Changes proposed

13. The Proposed Law and the Proposed Regulations contain significant enhancements and refinements to the current regime to provide an additional option for dealing with distressed DIFC companies. The amendments also include a more modernised approach to insolvency procedures. The key aspects of the proposals include:
- (a) a new debtor in possession rehabilitation procedure supervised by the Court – see paragraphs 14 - 19;
 - (b) a new administration process accessible via rehabilitation where there is evidence of mismanagement or misconduct – see paragraphs 20 - 21;
 - (c) enhancing the rules governing voluntary winding up procedures – see paragraph 22;
 - (d) enhancing the rules governing compulsory winding up procedures – see paragraph 23;
 - (e) including more detail on the wrongful trading provisions and the re-use of company names, and adding an offence of misconduct in the course of winding up – see paragraph 24;
 - (f) incorporating the UNCITRAL Model Law on cross border insolvency proceedings (with certain modifications for application in the DIFC) into DIFC law – see paragraphs 25 - 26;
 - (g) enhancing the provisions relating to the enforcement of financial collateral – see paragraph 27; and
 - (h) miscellaneous enhancements – see paragraph 28.

The new rehabilitation procedure

14. The Current Law, in Part 2, already contains a procedure (the company voluntary arrangement or "**CVA**") whereby a debtor may seek to compromise its debts with its creditors. However, the CVA procedure is limited in a number of respects. In particular, the debtor and its creditors may only approve a compromise proposal which affects the rights of a preferential creditor or a secured creditor to enforce its rights or its security with the consent of the creditor concerned.¹
15. Under the Proposed Law, a new rehabilitation procedure is introduced which provides a more sophisticated procedure whereby creditors are divided into separate classes (including secured and preferential creditors) for the purposes of voting. All creditors may be bound by the plan if at least one class of creditors votes in favour of the rehabilitation by a three quarters majority in value, provided that the Court subsequently sanctions the plan. Creditors or shareholders that are unimpaired under the rehabilitation plan will be automatically deemed to have accepted the plan. In this respect the rehabilitation procedure may act as a useful mechanism to cram down dissenting minorities.

¹ See Article 10(3) of the Proposed Law.

16. The debtor will also benefit from an automatic moratorium which will apply from the date that the company notifies the Court that it intends to submit a rehabilitation plan² and, unless the Court orders otherwise, the moratorium will apply for 120 days from the date of the notification.³ A creditor may apply to seek specific relief from the effects of the moratorium or apply to terminate the moratorium.⁴ There is also the ability for a creditor to promote an alternative creditor plan.⁵ In addition to this protection, there are also provisions allowing the debtor's contractual arrangements to continue, upon certain conditions being met.⁶
17. The debtor may select one or more rehabilitation nominees who must be approved by the Court⁷ (and who must be registered insolvency practitioners⁸) they must prepare a report for the Court stating whether the rehabilitation plan has a reasonable prospect of being approved by the creditors and implemented, and that the company is likely to have sufficient funds available to enable it to carry on its business during the moratorium.⁹ However, the day to day management of the debtor will remain with the directors of the debtor, except in certain cases (see below).¹⁰
18. The Court shall have a number of roles in relation to this procedure. It shall be required, before the rehabilitation plan can be sent to creditors and/or shareholders, to consider the nominee's report, the classification of creditors for voting purposes, and the procedures for holding meetings of those classes of creditors.¹¹ If the requisite majorities of creditors duly approve the rehabilitation plan, the Court will then sanction the rehabilitation plan provided that the plan is fair and that there have been no breaches of the Proposed Law or any procedural irregularities.¹² A cross class cram down mechanism is also available, so that the Court can sanction the Rehabilitation Plan where there is at least one impaired creditor group that approves the Rehabilitation Plan. There are a number of creditor safeguards in this respect, in particular no creditor should be worse off than in a liquidation and the treatment in respect of any dissenting class should adhere to the absolute priority rule, namely that no junior creditor gets paid before the senior dissenting creditors are paid.¹³ Creditors also have the opportunity to challenge the Rehabilitation Plan.¹⁴
19. The Court may also authorise the debtor to obtain new debt (secured or unsecured) which has priority over existing unsecured debt, is secured over previously unsecured property, or is secured by a junior security interest on already-secured property. If such debt cannot be

² See Article 15 of the Proposed Law.

³ See Article 16 of the Proposed Law.

⁴ See Article 19 of the Proposed Law.

⁵ See Article 23 of the Proposed Law.

⁶ See Article 18 of the Proposed Law.

⁷ See Article 20 of the Proposed Law.

⁸ See Article 21 of the Proposed Law.

⁹ See Article 24(2) of the Proposed Law.

¹⁰ See Article 22 of the Proposed Law.

¹¹ See Article 24 of the Proposed Law.

¹² See Article 27 of the Proposed Law.

¹³ See Article 27 of the Proposed Law.

¹⁴ See Article 26 of the Proposed Law.

obtained, the Court can also authorise the obtaining of new debt that is secured by a senior or pari passu security interest on property that is already secured, but only if the existing security holders have adequate protections against any potential devaluation of the secured asset(s), or if the existing security holders consent.¹⁵ In this respect existing secured creditors are protected, whilst the debtor has potentially greater access to rescue funding.

Q1. Do you agree with our proposal to introduce a further restructuring mechanism with the Proposed Law?

Q2. Do you think that the proposed rehabilitation procedure adequately balances the interests of the debtor whilst providing adequate safeguards for creditors? In particular, please provide any comments on the introduction (a) a cram down mechanism; (b) a moratorium;

(c) a nominee supervising the procedure; and (d) priority financing.

The new administration procedure accessible via rehabilitation only

20. Once a Rehabilitation Procedure has commenced and where there is evidence of dishonesty or mismanagement or where a person has committed one of the offences set out in the Proposed Law, creditors may apply to the Court for the appointment of an insolvency practitioner as an administrator of the debtor. The administrator displaces management and manages the company, he may also appoint new management.¹⁶ The Court will appoint an administrator if the debtor is or is likely to become unable to pay its debts. The administrator will have a limited role and be required by the Court to seek to achieve either:

- (a) a successful Company Voluntary Arrangements;
- (b) a rehabilitation plan;
- (c) a scheme of arrangement under the Companies Law, or
- (d) simply to investigate any wrongdoing by the debtor and/or its management.¹⁷

21. The administrator will take over the management of the debtor in order to carry out the specific purpose for which they were appointed, and will remain in office until the purpose is achieved or they are discharged by the creditors.¹⁸ This includes using investigatory powers and anti-avoidance provisions previously only available to liquidators such as wrongful trading and fraudulent trading.

¹⁵ See Article 31 of the Proposed Law.

¹⁶ See Article 32 of the Proposed Law.

¹⁷ See Article 32 of the Proposed Law.

¹⁸ See Articles 37 and 38 of the Proposed Law.

- Q3.** Do you have any concerns regarding the introduction of a new rehabilitation procedure that displaces management in this way?
- Q4.** Do you agree that only creditors should apply for the appointment of an administrator and that it should be accessible only within the context of the rehabilitation procedure?
- Q5.** Do you agree that the administrator should be an insolvency practitioner?
- Q6.** Do you agree with the specific purposes of the administrator being limited to restructuring or investigation?
- Q7.** Do you agree that the role should be limited, in particular that the administrator will not require any powers to continue to trade independently of the process? It should be noted

that in other regimes where administrators have the ability to continue trading the majority of such instances are in the context of trading companies.

Voluntary winding up procedures

22. The Proposed Law and Proposed Regulations seek to more closely adhere to international best practice, with particular reference to modernisation changes made in other jurisdictions since the date of the Current Law. The proposed changes include:
- (a) simplifying the language for the commencement of the voluntary winding up process;¹⁹
 - (b) abolishing the requirement for a liquidator to call certain mandatory meetings of creditors or shareholders, such as on the conclusion of the winding up;²⁰
 - (c) simplifying the process of nominating and appointing a liquidator on a creditors' voluntary winding up;²¹
 - (d) providing a mechanism by which a liquidator can disclaim onerous property;²²
 - (e) clarifying the duties of the liquidator upon the completion of the winding up;²³ and
 - (f) providing a mechanism by which a liquidator may be removed or may resign.²⁴

- Q8.** Do you consider that these changes will improve the efficiencies and reduce costs in the voluntary liquidation procedure?

¹⁹ See Article 26(c) of the Current Law and Article 54 of the Proposed Law.

²⁰ See Articles 35 and 44 of the Current Law and Articles 63 and 74 of the Proposed Law.

²¹ See Article 68 of the Proposed Law.

²² See Article 71 of the Proposed Law.

²³ See Articles 63 and 74 of the Proposed Law.

²⁴ See Article 80 of the Proposed Law.

Q9. Are there any other changes which you consider would improve how such liquidations are currently administered?

Compulsory winding up procedures

23. The Proposed Law and Proposed Regulations seek to more closely adhere to international best practice, with a particular focus on reflecting the practice in the United Kingdom. The proposed changes include:
- (a) expanding on the duty of a liquidator to investigate the affairs of an insolvent company and report to the Court if they see fit;²⁵
 - (b) modernising and streamlining the process for appointing a liquidation committee, its roles and duties, and voting procedures;²⁶
 - (c) clarifying and expanding the actions a liquidator should take in respect of any assets belonging to / owned by an insolvent company located at properties that were previously leased by the insolvent company, and the rights of former landlords in respect of such property;²⁷
 - (d) clarifying the duties of the liquidator upon the completion of the winding up;²⁸
 - (e) clarifying and expanding on the process for disclaiming onerous property;²⁹
 - (f) clarifying the process for dissolving a company;³⁰ and
 - (g) providing a mechanism by which a liquidator may be removed or may resign.³¹

Q10. Do you consider that these changes will improve the efficiencies, and reduce costs in the compulsory liquidation procedure?

Q11. Are there any other changes which you consider would improve how such liquidations are currently administered?

Insolvency offences

24. Under the Current Law, there are a number of offences designed to prevent the dispersal of the assets of a debtor and/or misconduct on the part of the directors and management of the debtor to the detriment of the debtor's creditors. As such, the Proposed Law seeks to expand on these offences in line with international best practice, with particular reference to offences which are currently contained in the United Kingdom Insolvency Law. However, in

²⁵ See Article 89 of the Proposed Law.

²⁶ See Article 92 of the Proposed Law and Sections 5.37 – 5.41 of the Proposed Regulations.

²⁷ See Article 94 of the Proposed Law.

²⁸ See Article 95 of the Proposed Law.

²⁹ See Article 100 of the Proposed Law and Section 5.50 of the Proposed Regulations.

³⁰ See Article 105 of the Proposed Law.

³¹ See Article 106 of the Proposed Law.

addition, the Proposed Law also contains certain defences to the offences in order to ensure the fair application of justice. The proposed changes include:

- (a) the addition of a defence of taking every step to minimise loss to creditors from the offence of wrongful trading;³²
- (b) the addition of an offence of misconduct in the course of a winding up, where a past or present director of a debtor has not effectively co-operated with the liquidator (together with certain defences);³³ and
- (c) the addition of exceptions to the restriction on the re-use of a name of a company that has gone into insolvent liquidation.³⁴

Q12. Do you think these additions adequately balance responsible management with appropriate levels of sanction for inappropriate or poor management?

Q13. Are there any further changes which you think may encourage responsible behaviour, particularly in periods of distress and the period directly before formal procedures are commenced?

Does the corporate governance framework in the DIFC relating to companies approaching insolvency, provide the right combination of high standards and low burdens? If not, how can it be improved? In particular, do you think that for larger more complex entities there should be stronger corporate governance rules and transparency, for example an annual confirmation statement that they have complied with their duties? Do you think shareholders should take a more active role in the stewardship of entities and monitor risks?

UNCITRAL Model Law on cross border insolvency

- 25. The purpose of the UNCITRAL Model Law is to provide an effective mechanism for dealing with cases of cross-border insolvency, and to encourage cooperation and coordination between different jurisdictions. It seeks to ensure that insolvency officials from one jurisdiction are recognised in other states, and ensure that other states provide the necessary cooperation to facilitate the insolvency process in the principal jurisdiction.
- 26. The Proposed Law will enhance the provisions of the Current Law that deal with assisting foreign insolvency proceedings by incorporating the UNCITRAL Model Law on cross border insolvency (with certain modifications for application in the DIFC) into the law of the DIFC.³⁵

³² See Article 113 of the Proposed Law.

³³ See Article 114 of the Proposed Law.

³⁴ See Article 116 and Section 9 of the Proposed Regulations.

³⁵ See Article 117 and Schedule 4 of the Proposed Law.

Q14. Do you think the DIFC should adopt the Model Law in this way?

Q15. Do you think that it will improve how Courts in the DIFC operate on cross border cases?

Financial collateral

27. The Proposed Regulations seek to clarify the effect of insolvency on financial collateral arrangements. As such, the proposed changes include:

- (a) a deletion of the definition of what financial collateral is for the purposes of the Proposed Regulations – this has been replaced by a definition which cross-refers to the financial collateral regulations issued pursuant to article 44 of the Security Law (DIFC Law No. 8 of 2005);³⁶
- (b) a section stating that certain provisions of the Proposed Law and Proposed Regulations do not apply to relevant financial collateral arrangements on a winding up of a debtor (for example, a moratorium under Section 3 of the Proposed Regulations would not apply to security interests created or arising out of a financial collateral arrangement);³⁷ and
- (c) a provision clarifying the circumstances where a financial collateral arrangement (or similar arrangement) will be enforceable and binding on third parties if such circumstance occurred on the day of, but after the moment of the commencement of, a winding up or rehabilitation procedure in respect of a debtor.³⁸

Q16. Do you agree that these clarifications make the position on financial collateral arrangements and the effect of the Insolvency Law on those kinds of arrangement more understandable?

Q17. Do you think any further changes are required to clarify how the proposed law and regulations operate in relation to these arrangements?

Miscellaneous enhancements

28. We have also made a significant number of other changes to ensure that the Proposed Law and Proposed Regulations promote an efficient and effective insolvency and restructuring regime in the DIFC. These include:

- (a) the creation of bonding arrangements for insolvency practitioners;

³⁶ See Sections 7.2.1 and 7.2.2 of the Current Regulations and Section 1.1.2 of the Proposed Regulations.

³⁷ See Sections 7.2.3 and 7.2.4 of the Proposed Regulations.

³⁸ See Section 7.2.5 of the Proposed Regulations.

- (b) the creation of further sanctions for failure to comply with certain obligations imposed by the Proposed Law;³⁹
- (c) expanding on the information required to be included in a statement of affairs produced by a liquidator in a creditors' voluntary winding up;⁴⁰
- (d) allowing for the possibility of remote attendance at meetings and the use of websites to give notices;⁴¹
- (e) updating the rules and processes relating to a creditors' committee in respect of a receivership;⁴² and
- (f) modernising the language used in the Proposed Law and the Proposed Regulations (including consistencies with the changes to the Companies Law).

Q18. Do you agree with the proposed amendments, regarding the introduction of a bonding system for insolvency practitioners? In particular do you think that it will:

- (a) provide stakeholders with greater confidence in the work undertaken by insolvency practitioners;

- (b) provide an effective mechanism to promote responsible behaviour;
- (c) facilitate the compensation of and ability to investigate cases where insolvency practitioners have acted either dishonestly or fraudulently. In this regard, does it achieve the right balance between cost effective and workable requirements (in terms of putting the bonding arrangements in place and reporting and monitoring requirements; and
- (d) serve as a useful addition to existing professional indemnity requirements.

Q19 Do you think these practical changes will improve the operation of the Proposed Law and Regulations?

Q20. Do you have any other suggestions regarding how the law might be modernised and made more efficient and cost effective?

³⁹ See Articles 63(3), 64(4), 131(2) and Schedule 5 of the Proposed Law.

⁴⁰ See Articles 65 and 68 of the Proposed Law and Annex 3 of the Proposed Regulations.

⁴¹ See Articles 139 and 140 of the Proposed Law.

⁴² See Annex 2 of the Proposed Regulations.

Legislative Proposal

29. This legislative proposal contains the following:
- (a) the Proposed Law (at Annex A);
 - (b) the Current Law (at Annex B);
 - (c) a comparison of the Current Law and the Proposed Law (at Annex C);
 - (d) the Proposed Regulations (at Annex D);
 - (e) the Current Regulations (at Annex E);
 - (f) a comparison of the Current Regulations and the Proposed Regulations (at Annex F);
 - (g) roadmap of the proposed changes to the Law (at Annex G); and
 - (h) roadmap of the proposed changes to the Regulations (at Annex H)
 - (i) a table of comments to provide your views and comments on the consultation paper (at Annex I).