Restructuring and insolvency: Directors Duties

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Becoming a director gives status and a direct impact on the strategy and success of a business. But at times when businesses face financial difficulties, directors are often faced with the challenge of balancing their obligations to shareholders, creditors and other stakeholders, while diligently performing their duties and keeping in mind potential personal liability.

Directors in the region will typically be under a general duty to:

1. dedicate sufficient time for the fulfilment of responsibilities;
2. ensure they are well informed about the company's business, its policies and the issues it faces;
3. act independently and avoid conflicts of interest;
4. act with honesty and integrity taking into account the interests of the company and its shareholders and to comply with the provisions of the laws, resolutions and regulations in force and the Company's constitutional documents; and
5. work for the benefit of the company with the care of a person who has adequate experience and the commitment required for his work.

But what changes in the context of insolvency: are there different considerations? As a starting point a heightened level of awareness and care is required in a potential insolvency situation. In certain jurisdictions like the United Kingdom, a director's duty can effectively switch to be owed to the creditors of the relevant company as opposed to the shareholders. This is also the case in the UAE common law jurisdictions of the Dubai International Financial Centre and Abu Dhabi Global Markets. While this is not necessarily the case in the Middle East, directors must be aware of their obligations when potentially trading while insolvent and what steps should be taken to protect themselves and the company.

Relevant considerations include:

1. identifying the trigger for insolvency under the relevant law and applying this to the particular factual position of the company. This is not always easy, as tests can range from payment defaults to balance sheet tests, often overlaid by mixed market practices. Additional complexity often exists where, for example, payment defaults exist however there are ongoing discussions with creditors for restructuring;
2. understanding who the obligations apply to. By way of example the UAE Bankruptcy Law places obligations on 'managers' being a much wider group than directors only'
3. seeking independent legal advice, separate from the company;
4. operating the business in a clear and transparent manner, ensuring all dealings are at arm's length and entered into in good faith for consideration. In particular transactions which give preference to any creditor, or harm creditors, should be avoided; and
5. corporate governance and record keeping is key, from documenting all decisions and rationale for the same through to obtaining shareholder directions for the continuance of the business. This can include, in some cases, recording dissenting members.

The need to consider these issues is amplified by the potential liability that can sit with directors. Looking at the region:

1. **UAE**: The Bankruptcy Law in the UAE contains various provisions directors need to be aware of, not least of which is potential personal liability where the company's assets are not sufficient to pay at least 20 per cent of the company's debts. The law also has various provisions which can give rise to criminal and civil liability on directors, including where transactions are undertaken to hide assets, dispose of assets at undervalue or which generally harms creditors.
2. **DIFC**: Directors' duties are set out in DIFC Law No.5 of 2018, the Companies Law (see Articles 69 to Article 75(1) and Article 75(2)). These include the duty to exercise reasonable care, skill and diligence, and to avoid conflicts of interest. DIFC Law No.1 of 2019, the Insolvency Law, allows directors to propose that a company be placed into a voluntary arrangement and/or rehabilitation, and they may also take steps to obtain a moratorium. Under rehabilitation the directors are authorised to continue managing a company but continue to be responsible and liable for any actions taken in their capacity as directors. In the event of fraud, dishonesty, incompetence, mismanagement etc. the DIFC Court may appoint an Administrator to manage a company. Where a company is ordered to be wound up by the Court, or passes a Resolution for Voluntary Winding Up, or an Administrator is appointed then directors may face liability pursuant to Article 115 of the Insolvency Law, for example in relation to false statements made to creditors, fraudulent trading, wrongful trading or misconduct. Remedies for a breach of directors' duties are set out at Article 115 and include an order to repay or restore assets to the company, an order to compensate the company or make a contribution to the company's assets. A director who makes a statutory declaration of solvency without reasonable grounds, in a voluntary arrangement, may face a fine of up to US$20,000 (see schedule 5 of the Insolvency Law).
3. **ADGM**: The ADGM Insolvency Regulations 2020, as amended, contain a number of protections for assets in liquidation and administration, set out at Part 4. Chapter 1 of that Part contains contraventions by directors and others, and directors should be aware of the prohibitions on fraud in anticipation of winding-up or insolvent administration; transactions in fraud of creditors; misconduct in the course of winding-up or insolvent administration; falsification of the company's books; material omissions from a statement relating to the company's affairs; false representations to creditors; fraudulent trading; and wrongful trading. The remedies for these wrongs range from fines (between US$ 150 and US$ 50,000 as set out in Schedule 9, Contraventions, to the Regulations and the ADGM Schedule of Contraventions), to orders compelling directors to make personal contributions to the company's assets or pay damages, and/or disqualification as a director (Chapter 9, Part 10, ADGM Companies Regulations 2020 as amended).
4. **BAHRAIN**: The Insolvency Law imposes criminal liability with the specific penalty of imprisonment and/or a fine on a natural person (which could extend to a director) who, amongst other things, intentionally conceals all or some assets or overestimates the same with intent to commence insolvency proceedings; neglects to mention a creditor in the list of creditors and/or overestimates debts. Without prejudice to the liability of a natural person, the above-mentioned liability also extends to the legal/juristic person if any of the acts set out above are committed in its name, for its account or for its interest and are caused by an act, omission, consent, concealment or gross negligence of any member of the board of directors. Directors also have duties under the Commercial Companies Law and the Corporate Governance Code 2018, a breach of which may give rise to civil and criminal liability for directors.
5. **EGYPT**: In the event that a bankrupt company is unable to pay at least 20 per cent of its debts, the court may, upon the request of the bankruptcy judge, oblige the board members to be personally – jointly or severally – liable to pay all or part of the company's debts. Nevertheless, this liability may be limited or refuted if the board members/managers are able to evidence that they exerted all their best endeavours to operate and manage the company. The best endeavours question is typically tested on the basis of the efforts a prudent person having such expertise would have exerted. Further, the Bankruptcy Law has a number of provisions giving rise to criminal liability of the directors of bankrupt joint stock companies and limited liability companies in case of bankruptcy for fraud or for negligence.
6. **JORDAN**: Pursuant to the Insolvency Law, any person who was administratively responsible for the

management of a juristic person, shall be liable to a penalty of imprisonment for a period not exceeding three years, and an obligation to return the funds to the account of the creditors if any of the following acts or omissions are committed: (i) concealing any funds included in the insolvency liabilities; (ii) overestimating the value of the funds included in the insolvency liabilities, with the intention of circumventing the same in the current agreement with the creditors; (iii) fabricating a fictitious creditor, exaggerating the amount of a creditor's debt, or including the name of a creditor whose debt arose out of an unlawful reason in the list of creditors with the intent to involve him in the creditors' negotiations or vote on a reorganisation plan; (iv) intentionally refraining from providing the information required by the court or the insolvency agent, or provided false information to the same; (v) intentionally removing any of the debts or creditors from the lists and statements; (vi) entered into an agreement with a creditor with the intent of granting him or another creditor advantages in exchange for voting in favour of the debtor or harming the rest of the creditors; and (vii) disbursing any funds after declaring insolvency with the aim of concealing these funds or excluding them from the proceeds of insolvency.

7. **KSA**: The Bankruptcy Law in the Kingdom of Saudi Arabia contains several provisions directors should be mindful of. For example, Article 7(2) of the Bankruptcy Law provides that in case a debtor is voluntarily liquidated and its assets are not sufficient to cover all the debts and it is insolvent, the board of directors or managers shall be jointly liable for any outstanding debts. Furthermore, directors may have criminal liability for acts committed in violation of the Bankruptcy Law prior to or following the commencement of bankruptcy proceedings. Acts which may incur such liability, include, among other things, executing transactions without or for unfair consideration, and paying debts due to any creditor in such a manner which is prejudicial to the rights of other creditors etc.
8. **KUWAIT**: The Bankruptcy Law in Kuwait contains various provisions directors need to be aware of not least of which is that the Bankruptcy Law increases the debtor's penalty from three years to five years and a fine or one of these two penalties in the event of concealing the books or misappropriating part of the company's money. The chairman and members of the company's board of directors, its directors, the auditors of its accounts, and those in charge of liquidating shall be punished with imprisonment for a period not exceeding five years, and a fine not exceeding one hundred thousand Kuwaiti Dinars or either of these two penalties, if after the issuance of a final decision to open the bankruptcy procedures, they concealed the company's books or embezzled any of the bankrupt company's money.
9. **OMAN**: The Bankruptcy law in Oman provides that if the company's assets are not sufficient to meet at least 20 per cent of its debts, the court may order the members of the board of directors to pay off the outstanding debt of the bankrupt company unless they can show that they had acted with due diligence in managing the company's affairs. The law also contains provisions that give rise to civil and criminal liability for directors, particularly in circumstances where the financial position of the company has been misrepresented or where there has been action to prejudice creditors. Directors can also be held criminally liable for their actions under the Penal Code of Oman.
10. **Qatar**: There are various provisions within Qatar's Commercial Law which place personal liability (including imprisonment) for fraudulent bankruptcy (where a trader conceals debts) or negligent bankruptcy (where a trader is unable to pay his debts due to serious negligence on his part, including preferring certain creditors and failing to maintain adequate records). In respect of the Qatar Financial Centre, there is potential personal liability (in the form of contribution orders) for a range of activities conducted by a person, including wrongful trading, fraudulent trading and false representations to creditors.

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