

# Preventive Composition: an Important Tool for Both Creditors and Debtors in a Time of Financial Crisis

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Covid 19 placed significant strains on market participants in the state of Qatar, where most businesses and industries are facing a strong drop in revenues coupled with a rise in legal claims brought against them. Many businesses in the state found themselves at the onset of insolvency and resorted to a wind up/liquidation process to solve their financial distress. The knock-on effect of this procedure negatively affect both the debtors who are losing their good will and client base and the creditors who are left without any actual hope of recovering their debts.

Nevertheless, the Qatari legislative framework offers in article 792 of the Qatari Commercial law no 27 of 2006 (QCL) an alternative scheme allowing distressed debtors to avoid wind up and rescue their business through Preventive Composition. This scheme would allow the debtor to preserve its business and professional portfolio, a requisite in the Qatari competitive construction environment.

It is important to highlight that notwithstanding the benefits offered by the Preventive Composition mechanism to both the debtors and creditors, this mechanism remains largely untested in Qatar where the emerging trend is to solve corporate difficulties through wind up and liquidation.

This article addresses the Preventive Composition process, the requirements and conditions to applying for Preventive Composition, the creditors' meetings and reaching a creditor consensus.

## 1. ***What is Preventive Composition?***

Preventive composition is a mechanism that assists the trader acting in good faith to enter into a court-supervised settlement agreement with his unsecured creditors to prevent the adjudication of his bankruptcy by agreeing a debt relief and restructuring court-approved plan. The creditors often agree to this arrangement, not as an act of leniency towards their debtor, but because the bankruptcy proceedings are usually costly, lengthy and uncertain.

## 2. ***The Criteria to applying for Preventive Composition:***

Preventive composition is available to the debtor who:

- (1) is a trader. It is noteworthy that, save joint venture companies, all commercial companies including de facto companies may apply for Preventive Composition unless they are in state of liquidation.
- (2) is in financial difficulties and has ceased or is on the brink of ceasing payment of his commercial debts,
- (3) has not committed fraud or gross mistake in carrying out his business; and
- (4) has continuously carried out the business for at least a year prior to submitting the application for Preventive Composition.

The debtor may not submit another application for Preventive Composition, while fulfilling a previous composition agreement.

### **3. The application for Prevention Composition**

The debtor must make the application for Preventive Composition (the "Application") to the court within twenty days of the cessation of payment, irrespective of whether bankruptcy has been declared or not.

The Application must include the reasons for the debtor's financial difficulties, his plan to repay his debts, provided he shall repay not less than 50% thereof, and the following documents:

- A certificate from the Commercial Registry confirming that the debtor has complied with his commercial obligations in the year preceding the filing of the Application;
- A certificate from the Qatar Chamber of Commerce and Industry confirming that the debtor has continuously carried out business in the year preceding the Application.
- The debtor's financial books.
- Copies of the debtor's last balance sheet, and profit and loss accounts.
- A statement of the debtor's personal expenses in the year prior the filing of the Application;
- A statement of the debtor's assets.
- A list of the creditors and debtors.
- The debtor's acknowledgment that he has never been convicted of a financial crime.
- If the debtor is a corporate, a copy of the memorandum and articles of association duly attested by the Commercial Register, and a shareholders' resolution seeking the composition.

### **4. The Adjudication of the Application**

The court may decide to accept or reject the Application.

The court shall reject the application if the debtor:

- fails to submit the documents required to consider the Application;
- was previously convicted of a financial crime, unless he has been rehabilitated;
- has retired from commerce, closed his business or fled.

If the court decides against the Application, it may, *sua sponte*, declare the debtor bankrupt if it finds that the conditions required for the declaration of bankruptcy are satisfied.

If the court accepts the Application, it shall order the opening of the Preventive Composition proceedings. This includes appointing a supervising judge and a trustee. This will also include a stay on all claims and execution procedures against the debtor.

During the proceedings, the debtor shall continue running his business under the supervision of the trustee, which means that the business' name, goodwill, customer base and professional portfolio are preserved.

### **5. The Creditors' Meeting**

Within five days of the appointment of the trustee, the latter shall register the court's decision in the Commercial registry and publish a summary thereof with a meeting invitation to the creditors in two daily newspapers.

The trustee shall lodge a report on the financial position of the debtor, the reasons for his financial difficulties, his views on the settlement plan put forth by the debtor, and the names of the creditors who have the right to participate in the composition proceedings together with the amount of their respective debts.

The trustee shall read at the creditors meeting his report together with the debtor's payment plan.

Only ordinary unsecured creditors and secured creditors who forego their securities may vote in the meeting.

For the composition to be approved, a majority of creditors must vote in favour of the debtor's plan, provided that such majority represents at least two-thirds of the total debt by value after deducting the debts of the creditors who did not partake in voting.

Upon ratification, the settlement plan becomes binding on all creditors whose debts have arisen before the opening of the composition proceedings, even those who did not partake in the proceedings.

#### **6. *The Terms of the Preventive Composition***

The composition agreement may grant the debtor a grace period for payment, or release the latter of part of the debt.

Composition may be subject to payment of the full debt if at any time within a pre-determined period not exceeding five years from the date of ratifying the composition, the value of the debtor's assets exceeds the value of his debts by at least 25%.

Further, the creditors may request the debtor to secure one or more guarantors for the performance of the terms of the composition agreement.

#### **7. *Ratification of the composition***

After approving the debtor's settlement plan in the meeting of the creditors, the court allows creditors 7 days to voice any objections on the plan and decides whether to ratify the settlement plan. The court may also amend the terms of the settlement if it deems it fit.

#### **8. *Termination of the composition agreement***

The composition agreement may be terminated upon an application made to the court by a creditor if:

- the debtor fails to observe the terms of the composition agreement.
- the debtor relocates his business without any acceptable reason.
- If in case of the demise of the debtor, his heirs fail to observe the terms of the composition agreement.

Upon termination of the agreement, the creditors will not refund any monies received on account of the composition prior to such termination. Such termination shall not release the guarantors securing the implementation of the terms of the composition.

## Conclusion

In closing, we note that albeit the Qatar legal framework provides through the QCL for a mechanism to prevent wind up and bankruptcy through a court-supervised agreement with the creditors by way of preventive composition, this mechanism is not sufficient to keep pace with the speed of developments in the business environment. This realisation has fueled over the past few years a recent wave of insolvency law reforms in the adjacent countries where amendments focused on offering debtors greater opportunities for reorganisation, and ensuring fair treatment of creditors.

Therefore, Qatar must modernize its insolvency laws and adopt a more robust insolvency regime that offer greater restructuring tools for businesses facing financial distress and turnaround and rescue schemes.

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