

Liabilities of Directors under the UAE Bankruptcy Law

Ahmad Ayoub

April 2017

This article assesses the impact of the new UAE Bankruptcy Law on directors and managers of distressed companies. However, the assessment will significantly depend on the courts' application and the infrastructure necessary for an effective implementation. It is believed that although the new bankruptcy law puts bankruptcy under the supervision of the court, and to a certain extent promotes a 'rescue culture', it introduces onerous duties on company directors.

The General Aspects of the Law

The Bankruptcy Law introduces a number of detailed processes with expedited timelines to address financial distress. Primarily, these processes include:

- A framework for the restructuring of financial institutions (the details of the framework have not yet been provided);
- A rehabilitation process for solvent debtors facing financial difficulties – “the preventative composition”;
- A rehabilitation process for insolvent debtors – “the restructuring scheme”; and
- An insolvent liquidation process.

It may be argued that these processes are a positive change from the previous system, which did not provide many options to deal with financial distress and which failed to secure protected legal rights or information for creditors.

Under the new law, a court appointed official or insolvency trustee plays a central role in the aforementioned processes. Pursuant to the preventative composition option, the debtor continues to manage its business, under the supervision of the court appointed insolvency trustee. Comparably, within the restructuring regime, the management of the debtor or its business will essentially be undertaken by the court appointed trustee. In both cases, the law appears to favor a debtor friendly rescue culture, but practical challenges remain, such as the lack of experience available in the UAE to administer these judicial processes.

However, while the law favors a rescue culture by providing various alternatives to formal insolvency procedures, it imposes significant duties on directors.

Liabilities of Directors under the Law

Following the enactment of the new Bankruptcy Law, individuals, whether directors of a company or not, remain subject to the criminal liabilities imposed by Article 423 of Law No. 3 of 1987 promulgating the Penal Code for acts such as fraud, embezzlement and forgery. The principal statement regarding “directors' duties” is contained in Article 162(1) of Federal Law No. 2 of 2015 concerning Commercial Companies Law, which states that directors are liable towards the company, shareholders and third parties for all acts of fraud, abuse of authority, breach of the provisions of the Commercial Companies Law or the company's articles of association, and mismanagement.

Under Article 144 of the Bankruptcy Law, a competent court may obligate the directors and general managers, all or part of them, jointly or not, to pay all or part of the company's debts in cases where they are held responsible for the company's losses according to the Commercial Companies Law. This provision applies in cases where the company's funds are not sufficient to fulfill at least 20% of its debts.

Further to the aforesaid liabilities provided in the Commercial Companies Law, the Bankruptcy Law implements further penalties against directors and general managers. Article 198 of the Law states that directors and general managers shall be sentenced to a period not exceeding five years and shall be fined an amount not exceeding AED 1,000,000, if, after issuing a final resolution to initiate legal proceedings against the company, they commit any of the following:

- hide, damage or alter all or some of the company's records, with the intention of harming the creditors;
- embezzle or hide a part of the company's assets;
- acknowledge unpayable debts and, knowingly, either in writing, verbally, or in the budget, or through refraining from submitting papers or explanations in their possession, know the result of such refraining;
- obtain the preventive composition or restructure for the company through deception; and/or
- announce false information of the subscribed or paid up capital, or distribute fictitious profits or receive bonuses higher than the amount stipulated by law or in the memorandum or articles of association of the company.

The previous regime, under the Commercial Transactions Law, specified various scenarios where a debtor might become criminally liable for the offence of negligent insolvency, such as where the debtor fails to file for insolvency when its debts become significantly overdue. Even though the new Bankruptcy Law decriminalizes a number of these scenarios, it is still interrelated to the Commercial Transactions Law, which is evidenced in Article 68 of the Bankruptcy Law. Article 68 obliges a debtor company to submit a request for initiation of procedures to the court if it has stopped paying its debts at its maturity for over 30 consecutive working days, due to the instability of its financial position or if it has a negative asset position. If this scenario befalls the company, it is arguable that the company's failure to initiate formal procedures will constitute "mismanagement" on the part of the manager, and will therefore, constitute grounds for creditors to bring claims under Article 162(1) of the Commercial Companies Law.

Previously there was no recourse to directors liable for insolvency, as it was a criminal offence under the UAE Penal Code to draw a cheque on an account knowing that there are insufficient funds in the relevant account to meet the amount drawn. Under the new Bankruptcy Law, criminal actions filed for dishonored cheques are suspended if a preventative composition plan or a debt restructuring plan is initiated. In this event, the cheque holder/creditor becomes one of the unsecured creditors. This encourages distressed businesses to initiate composition plans and file for debt restructuring, rather than prompting managers to abscond and exit the UAE. However, the protection offered is only a suspension. This may still mean that directors are inclined to exit the UAE, due to the risk of imprisonment, and undertake any restructuring or bankruptcy from outside the UAE. The new law offers a slight reprieve, yet it remains to be seen whether managers will be personally liable for dishonored cheques following the suspension period, or whether this penalty is reserved only for directors.

Conclusion

While the new Bankruptcy Law significantly improves the old insolvency regime under the Commercial Transactions Law, for directors and managers it acts as a double edge sword. Whilst it does offer a safe harbor in some situations, in many cases it creates new potential exposures for liability. Like any new law, it will take time for all stakeholders to fully understand how the law will be implemented in practice, and until applications are filed, the practical effects of the Bankruptcy Law can only be analyzed theoretically.