

Overview of the New Saudi Arabia Bankruptcy Law

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The new bankruptcy laws in the Kingdom of Saudi Arabia represent a significant departure from the antiquated solvency rules of the past. These new laws may attract additional foreign investment from the West. This discussion summarizes the new laws, compares the new laws to U.S. bankruptcy laws, and considers some recent, and interesting, bankruptcy cases currently working through the court system in the Kingdom of Saudi Arabia.

INTRODUCTION

In 2016, King Salman bin Abdulaziz Al Saud and the Chairman of the Counsel of Economic and Development Affairs, Crown Prince Mohammad bin Salman, issued a vision and blueprint, called *Vision 2030*, for the future of the Kingdom of Saudi Arabia (“KSA”) reflecting a set of long-term goals and expectations.

The vision is based on three pillars:

1. Reestablishing the KSA as the heart of the Arab and Islamic worlds
2. Transforming the KSA into a global investment powerhouse
3. Transforming the KSA into a global hub connecting the three continents of Asia, Europe, and Africa

The KSA also formed the National Transformation Program (“NTP”) to seek alternative economic interests to oil production and exportation. The five-year NTP seeks public sector and fiscal reforms, economic diversification, enhanced business environments, and social reforms. The objectives of the NTP are divided into the following eight themes:

1. Transform health care
2. Improve living standards and safety
3. Ensure sustainability of vital resources

4. Social empowerment and nonprofit sector development
5. Achieve governmental operational excellence
6. Labor market accessibility and attractiveness
7. Contribute in enabling the private sector
8. Develop the tourism and national heritage sectors¹

The seventh theme is the most significant with regard to establishing alternative economic interests to oil production and exportation. The objective of the seventh theme is to facilitate business activity, develop the digital economy, and adapt rules and regulations to attract foreign direct investments, and empower small to medium business enterprises.

An important element to increasing private sector activity, foreign or domestic, is to facilitate procedures for exiting businesses. As such, the KSA launched a new law outlining bankruptcy procedures for 2018 and beyond.²

For the first time in its history, the KSA issued a comprehensive set of bankruptcy laws by virtue of Royal Decree No. M/50 dated 28/05/1439H (corresponding to 14/02/2018G) (hereafter referred to as the “Bankruptcy Law”). These new laws, developed

under the auspices of *Vision 2030* and the NTP, were intended to encourage both foreign and domestic investment, and simplify the legal and business framework of KSA.

The Saudi Arabian Ministry of Commerce and Investment (“MOCI”) benchmarked the Bankruptcy Law to existing Chapter 11 laws in the United States. This new law contains 17 chapters and over 200 sections.

While the KSA was researching and drafting this new Bankruptcy Law, the Commercial Law Development Program (“CLDP”) of the Office of General Counsel for the U.S. Department of Commerce regularly visited the KSA for consultations regarding insolvency law.³

These advisers met with lawyers from the MOCI and the Gulf Cooperation Council (“GCC”) Secretariat to devise new insolvency laws for the KSA and all GCC countries. The GCC countries include (1) Kuwait, (2) Oman, (3) Saudi Arabia, (4) United Arab Emirates, (5) Qatar, and (6) Bahrain.

Specifically, the CLDP encouraged the GCC countries to decriminalize insolvency and establish specialized courts to handle bankruptcy and insolvency matters. Such amendments to precedent bankruptcy and insolvency laws would provide necessary protection for domestic entrepreneurs and foreign companies operating in the gulf region.

Since the enforcement of the Bankruptcy Law, the CLDP has partnered with the various authorities in the KSA, including the MOCI and the Bankruptcy Commission, to educate business and legal professionals on the new established procedures.

On April 29, 2019, the CLDP supported the MOCI and the Bankruptcy Commission in the launch of the KSA Bankruptcy Law at the First Bankruptcy Conference. This conference included approximately 800 lawyers, judges, and accountants from across the KSA.⁴

In addition, on July 22, 2019, the CLDP conducted judicial capacity building programming at the U.S. Bankruptcy Court in the Southern District of New York for a 15-member delegation from Kuwait and Saudi Arabia. Participating individuals visited federal and New York state courts to witness live commercial proceedings and to learn best practice in adjudicating complex commercial transactions such as bankruptcy.

The delegation also interviewed stakeholders in commercial disputes, such as (1) U.S. bankruptcy judges, (2) lawyers for bankruptcy litigants, (3) U.S. bankruptcy trustees, and (4) claims agents.⁵



Many observers believe that the Bankruptcy Law will ease tensions with Western governments, investors, and financial institutions subsequent to the murder of journalist Jamal Khashoggi, as highlighted in the excerpt below.

A frequent critic of the KSA government and specifically Prince Mohammad bin Salman, Jamal Khashoggi was murdered at the Saudi consulate in Istanbul on October 2, 2018. Khashoggi was a prominent Saudi journalist and served as an advisor to the royal family for many years. In 2017, he fell from favor, exiled himself to the United States, and began writing critically of the KSA for *The Washington Post*.

As of this writing, there is debate over who is responsible for Khashoggi’s death. KSA officials claim he was killed by a “rogue” group of agents sent to return Khashoggi to Saudi Arabia. Turkish officials claim the agents acted on orders of the KSA government. Recently, a United Nations special report concluded Khashoggi was “the victim of a deliberate, premeditated execution, an extrajudicial killing for which the state of Saudi Arabia is responsible.”⁶

OBJECTIVES OF BANKRUPTCY LAW

The KSA has long lacked any significant guidance in the areas of bankruptcy and insolvency (limited exceptions are noted below).

According to article 5 of the Bankruptcy Law, the new bankruptcy procedures aim to achieve the following:

1. Enable the bankrupt debtor or the distressed debtor or the debtor expected to suffer from financial difficulties to benefit from bankruptcy procedures in order to

restructure its financial position, maintain its activities with an aim to contribute to the economy and support it

2. Consider the creditor's rights and to ensure a fair treatment among the creditors
3. Maximize the value of bankruptcy assets, ensure a controlled sale of such assets, and a fair distribution of the sale proceeds to the creditors upon liquidation
4. Reduce procedural costs and time frame, and increase the efficiency thereof especially in restructuring of the position of the small debtors or the sale of the bankruptcy assets and the distribution of the sale proceeds among the same in a fair manner within a specified time frame
5. Undertake administrative liquidation of the debtor where the assets are not expected to cover the costs of the liquidation procedure of small debtors' liquidation procedure

The primary objectives of the Bankruptcy Law are to implement legal process and procedures in the areas of preventative settlement, financial reorganization, and liquidation. The belief is that the new laws will ease the difficulties of distressed debtors by simplifying the restructuring process. Finally, and perhaps most importantly, the hope is the Bankruptcy Law will encourage additional business investment in KSA.

SCOPE AND TOPICS OF THE BANKRUPTCY LAW

According to article 4 of the Bankruptcy Law, provision of the law will apply to the following:

1. A natural person practicing a commercial activity or a professional activity or any activity with an aim to generate profits in the KSA
2. Commercial, professional and civil companies, regulated entities, as well as other entities or establishments with an aim to realize profits, registered in the KSA
3. Non-Saudi investors, whether natural or corporate persons, holding assets or practicing a commercial activity or a professional activity or any activity with an aim to generate profits through a licensed entity in the KSA (the Bankruptcy Law shall only apply to the investor assets located in the KSA)

In addition, while the Bankruptcy Law applies to regulated industries (telecom, banks, insurance), the law allows other regulated entities (e.g., Saudi Arabian Monetary Agency and Capital Market Authority) to issue their own rules and regulations related to bankruptcy and insolvency.

DEFINING INSOLVENCY AND BANKRUPTCY

The Bankruptcy Law defines both "insolvent" and "bankrupt." Insolvent is defined in the Bankruptcy Law as a debtor who fails to discharge a debt on its due date. This definition differs from the U.S. standard definition of insolvent as an inability to pay debts as they become due.

So, the logical question is: What happens if a debtor in the KSA chooses not to pay a debt? Does this make the debtor insolvent?

Bankrupt is defined in the Bankruptcy Law as a debtor without assets. This also differs from the commonly held definition of bankrupt. For instance, does a debtor with \$1 worth of assets constitute a bankrupt debtor?

The language contained in the Bankruptcy Law provides some clarity with regard to those important definitions, but the aforementioned questions remain. The financial community will have to wait to see how the KSA courts address these issues in the coming years.

HIERARCHY OF DEBTS

The KSA, for the first time in history, established an order of priority for creditor claims. Like U.S. bankruptcy laws, the expenses for the appointed trustees and experts and costs associated with selling the assets will have priority over other creditor claims.

Other debts are ranked as follows:

1. Secured debts
2. Secured financed debts as per Article 184 of the Bankruptcy Law and any other secured financed debts determined by the implementing regulations
3. An amount equivalent to 30 days salary for the debtor's employees
4. Alimony for the debtor's family as determined by the applicable laws or a court order
5. Necessary expenses to ensure the continuity of the debtor's business operations during the relevant liquidation procedures in accordance with the implementing regulations requirements

6. Accrued wages of the debtor's employees
7. Unsecured debts
8. Unsecured governmental official fees, membership fees and taxes in accordance with the implementing regulations requirements

PUNISHMENT FOR VIOLATIONS

Penalties for violations of the Bankruptcy Law can be severe. The potential penalties include the following:

1. Imprisonment for a term of up to five years and/or a fine up to five million Saudi Riyals (approximately 1.3 million U.S. dollars)
2. Restrictions on owning or operating a profitable business in the KSA

PRE-EXISTING LEGISLATION

The Bankruptcy Law will replace nearly 100 years of preexisting law as follows:

1. The Law of Settlement Against Bankruptcy issues pursuant to the Royal Decree No. M/16 dated 04/09/1416H (corresponding to 24/01/1996G)
2. Chapter 10 of the Commercial Courts Laws issued pursuant to the Royal Decree No. 32 dated 15/01/1350H (corresponding to 01/06/1931G)
3. All provisions of any applied laws or regulations that are inconstant with the Bankruptcy Law shall be voided

These previous laws lacked (1) detail regarding debtor eligibility for bankruptcy procedures, (2) an automatic stay of creditor claims during bankruptcy proceedings, (3) the option of debtor financing to properly reorganize a business operation, (4) protection for creditors' rights, and (5) clarification regarding a hierarchy of creditor claims.

PREVIOUS BANKRUPTCY INSOLVENCY ISSUES IN THE KSA

Prior to the Bankruptcy Law, debtors, creditors, investors, and business professionals faced uncer-



tainty in the KSA bankruptcy arena. Historically, courts have been highly reluctant to declare a debtor bankrupt—even after protracted collection efforts. This process lengthens the bankruptcy proceedings and complicates the KSA business environment for creditors.

From the debtor perspective, the KSA landscape was not much better. There was little protection for insolvent debtors with viable businesses. Liquidation and/or cash infusions were generally the first resort. The new laws better consider restructuring and reorganization as viable options if there is a belief that these efforts will benefit the creditors in the long term.

Other long-standing issues included the following:⁷

1. Disorderly collection of debts resulting in some creditors being paid but others missing out entirely
2. Little scope for workouts with the result that creditors and debtors may both be disadvantaged
3. Reduced prospects of survival of a viable business experiencing a temporary hiccup
4. Lack of or no information on whether a proposed counterparty was insolvent
5. A number of lawsuits resulting from a multiplicity of legal claims
6. Debtors attempting to defeat creditor's claims by concealing assets or disposing of them prior to insolvency at less than fair value or for no value at all

BANKRUPTCY PROCEDURES

The first step in the new bankruptcy environment is the establishment of a specialized committee (“Committee”) to oversee all KSA bankruptcy matters and report directly to the MOCI. The Committee is directed to establish a bankruptcy register,⁸ issue licenses for bankruptcy experts and trustees,⁹ implement regulations governing the framework of the licensed bankruptcy procedures, coordinate liquidation procedures, and inspect all ongoing bankruptcy procedures.

The three main procedures established by the Bankruptcy Law are (1) preventative settlement, (2) financial restructuring, and (3) liquidation.

Preventative Settlement

The preventative settlement procedures aim to facilitate an agreement between the debtor and its creditors to settle its debts where the debtor maintains the right to manage its activities.

Debtors may request a preventative settlement if any of the following criteria are met:

1. The debtor is experiencing financial distress that may cause the discontinuation of the business or insolvency.
2. The debtor is insolvent.
3. The debtor is bankrupt.

Upon submission of the preventative settlement request, the debtor may receive a suspension of further claims for up to 180 days while still maintaining management authority of the company. The settlement report is prepared and voted on by the relevant debtors and creditors.

Once these steps are completed, the debtor is required to finalize the procedures outlined in the settlement request (with oversight of the licensed bankruptcy trustee) and register the settlement petition with the bankruptcy register. Finally, the debtor should ensure its complete participation in the business’s contractual obligations once the preventative settlement proceedings are enforced.

Al-Shehili Engineering Industries Co. Ltd.— Preventative Settlement

In February of 2019, Al-Shehili Engineering Industries Co. Ltd. (“Al-Shehili”), filed for preventative settlement and a suspension of further claims under the new Bankruptcy Law. Al-Shehili produces refrigerators, mechanical pumps, concrete mixers, and other similar machinery and equipment.

In the bankruptcy proceedings, the court began by conducting an analysis of the Al-Shehili financial position and operating history as of December 31, 2018.

The court noted the following factors as important in its analysis of Al-Shehili:

1. The historical level of assets, liabilities, expenses, and revenue during/as of the latest 12-month period ending December 31, 2018
2. The number of employees and their respective salaries, wages, and benefits
3. Previous actions undertaken by creditors
4. The outlook or projections of the company

After completing its due diligence process, the court determined that the bankruptcy proceedings should be opened for Al-Shehili. The court acknowledged two pieces of evidence as sufficient in order to approve the initiation of the bankruptcy proceedings:

1. Improved financial projections based on the reasonable probability that Al-Shehili would win two military manufacturing contracts
2. Assurance from an independent bankruptcy trustee that the majority of creditors would approve the Al-Shehili settlement proposal

The court also granted a stay on creditors’ claims for the earlier of 90 days or the court’s final approval of the proposed preventative settlement plan. In this circumstance, the court appeared to rule in favor of the preservation of jobs and operational autonomy of Al-Shehili.

Financial Reorganization

Debtors, creditors, and regulators of the debtor may all request a financial restructuring under the supervision of a restructuring officer. Generally, this process allows debtors and creditors to work together for an agreed-upon reorganization—assuming the creditors holding two-thirds of the debt are able to agree.

Under the financial reorganization, claims against the debtor are halted until such time as:

1. the date of the request is rejected,
2. the request is approved by the court, or
3. the earlier termination of the financial reorganization without approval of the court.

If the court approves the plan, it will appoint the trustee who will supervise the execution of the reorganization plan. The trustee is given broad powers to avoid contracts¹⁰ under certain circumstances

(like U.S. law). Any approved plans apply to all creditors.

Saudi Indian Company for Cooperative Insurance—Financial Reorganization

In April 2019, the Saudi Indian Company for Cooperative Insurance (“Wafa Insurance”) appealed to the court for permission to initiate financial reorganization proceedings in order to avoid liquidation and protect shareholders’ interests. Wafa Insurance sells health, automotive, and other insurance products throughout the KSA.

As with the previously discussed Al-Shehili case, the court began with an analysis of the financial condition of Wafa Insurance. With the exception of fiscal year (“FY”) 2016, Wafa Insurance generated annual losses from FY 2011 through FY 2018.

In addition, after examination of the cash flow statements of Wafa Insurance, the court designated it as insolvent. As defined by the Bankruptcy Law, a debtor becomes insolvent upon failure to discharge a debt on its payment due date.

Wafa Insurance management submitted a financial restructuring proposal to the court that included provisions for raising capital to effectively reorganize. The Saudi Arabian Monetary Authority, the central bank of the KSA, confirmed the bankruptcy financing plan proposed by Wafa Insurance was feasible, and the court granted the request to initiate the financial reorganization proceedings.

Following the approval, pursuant with the Bankruptcy Law, the court appointed a trustee or financial reorganization officer. The major responsibilities of the financial reorganization officer are to ensure fairness of the procedure and implementation of the reorganization.

Finally, the court enacted a temporary stay on all creditor claims, provided Wafa Insurance with 150 days to submit a final reorganization proposal, and established a bar date for all creditors to officially file a proof of claim in order to receive restitution.

Liquidation

The liquidation procedure is conducted under the management of the liquidation officeholder, aiming to account for creditors’ claims, oversee the sale of bankruptcy assets, and distribute the sale proceeds to the creditors.

Debtors, creditors, and regulators of the debtor may all request a liquidation (considered a “last resort” provision) in the Bankruptcy Law under any of the following conditions:

1. Debtor is insolvent or bankrupt

2. Debtor believes the entity’s assets are not sufficient to cover the liquidation
3. Creditor proves the debt due is for a definite amount

As with the financial reorganization, the court will appoint a trustee to liquidate the assets based on priority claims and wind up the company (if necessary). The Bankruptcy Law provides guidance, although the standards are currently undefined, for the liquidation of small debtors. The goal is greater speed and lower costs for liquidation.

Alternatively, if the proceeds from the sale of bankruptcy assets are not expected to cover the expenses of the liquidation procedure, the liquidation process will be managed by the Bankruptcy Commission in a procedure known as an “administrative liquidation.”

Shalaal Wadi Banna Food Service Establishment—Liquidation

In June 2019, Shalaal Wadi Banna Food Service Establishment (“Shalaal Wadi Banna”) brought a case before the court seeking the authority to liquidate. Shalaal Wadi Banna has operated in the restaurant and food catering industry for over a decade.

When Shalaal Wadi Banna brought its case for liquidation before the court, (1) expenses incurred exceeded annual revenue generated, (2) liabilities were in excess of assets, (3) operations had ceased, and (4) creditors filed a total of 23 recovery lawsuits in attempt to receive restitution for \$4.8 million of alleged outstanding debts.

As of June 2019, on its balance sheet, Shalaal Wadi Banna held five vehicles and a moderate amount of cash.

The court approved the application for liquidation noting that Shalaal Wadi Banna (1) provided appropriate notice of the hearing to creditors and (2) was compliant with the Bankruptcy Law’s filings and insolvency requirements.

Notably, the court was unwilling to designate a private bankruptcy trustee to Shalaal Wadi Banna due to its lack of capital to adequately cover administrative expenses attributable to the liquidation proceedings. As such, the court appointed the Bankruptcy Commission to conduct the administrative liquidation procedures.

OUTSTANDING BANKRUPTCY CASES IN THE KSA

One of the first large tests of the KSA Bankruptcy Law is the case of Ahmad Hamad Alghosaibi and

Brothers (“AHAB”). The Saudi business defaulted on approximately \$22 billion in loans in 2009 (allegedly precipitated by the Great Recession) to a consortium of international and regional financial institutions including HSBC PLC, Standard Chartered PLC, Citi, Deutsche Bank AG, and BNP Paribas, leading to accusations of fraud and impropriety.

According to a Cayman Islands court, AHAB and its partner, Maan al-Sanea, fraudulently borrowed money to repay interest due on previous loans in Ponzi fashion. The Cayman Island court dismissed the AHAB claim that Sanea defrauded the family business of billions of dollars in unpaid debts.

Instead, the court ruled that AHAB knowingly entered into the Ponzi scheme that fraudulently obtained approximately \$126 billion in loans from more than 100 international banks. The business partners defaulted on the loan obligations at the beginning of the financial crisis.

The Gosaibi family directed blame to Sanea with accusations of fraud, theft, and forgery. Sanea married into the Gosaibi family in the 1980s and soon controlled the operations of AHAB’s financial services division. Sanea fraudulently borrowed money through a practice known as “name lending” in which a financial institution extends unsecured credit based only on the borrower’s reputation, not their financial condition.

Sanea was subsequently arrested by Saudi police and the KSA courts appointed a liquidator to sell the assets of his company, Saad Group. A commercial court in Dammam, Saudi Arabia, approved an application for financial reorganization filed by Maan al-Sanea and the Saad Group in February 2019.

In addition to appealing the Cayman Islands court verdict, AHAB petitioned the KSA court to use protective settlement procedures contained within the new Bankruptcy Law to assist with dividing up assets to repay \$6 billion in debts. The application was rejected by the court in Dammam because it lacked required details.

AHAB subsequently filed a petition for financial restructuring, which was initially denied. After another appeal, Saudi Arabia’s Dammam Commercial Court accepted a filing by AHAB to have its decade-long creditor dispute resolved under the Bankruptcy Law in May 2019. The court is now expected to appoint a bankruptcy trustee charged with collecting and assessing creditors’ claims against AHAB.

The KSA banks, either partly or wholly owned by the Saudi government, previously acquired hundreds of millions of dollars of the company assets

that were not shared with the other creditors. These issues will test the strength and will of the KSA courts and bankruptcy trustees to claw back these preferential asset transfers.

CONCLUSION

The KSA new bankruptcy laws are relatively unproven and will need to be tested in the court systems, but that need not diminish the significance of the laws. The bankruptcy laws in the United States have been tweaked, changed, and challenged for hundreds of years and are still far from perfect.

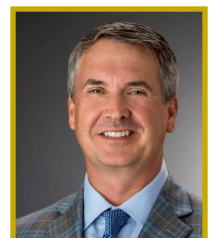
What these laws are expected to do is provide a more stable legal footing for addition foreign investment in the Kingdom of Saudi Arabia—and that was likely the primary purpose in the first place.

Notes:

1. *National Transformation Program: Delivery Plan 2018-2020*, Kingdom of Saudi Arabia, 2016.
2. Ibid.
3. <http://cldp.doc.gov/programs/cldp-in-action/details/1253>
4. <http://cldp.doc.gov/programs/cldp-in-action/details/2142>
5. <http://cldp.doc.gov/programs/cldp-in-action/details/2193>
6. Summarized from *Jamal Khashoggi: All You Need to Know about Saudi Journalist’s Death*, *BBC News*, <https://www.bbc.com/news/world-europe-45812399>
7. <https://www.tamini.com/law-update-articles/the-new-saudi-arabian-bankruptcy-law/>
8. The Bankruptcy Register is open to public view and will contain contents to be determined by the Committee.
9. Must be a member of the Saudi Organization for Certified Public Accountants or a legally licensed lawyer.
10. Fraudulent conveyances/transfers (transactions intended to defraud or harm creditors) are prohibited by the Bankruptcy Law. In such instances, the court may order the recovery of debtor’s assets and/or the payment of compensation.



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