

A night-time photograph of the Dubai skyline, featuring several illuminated skyscrapers and a body of water in the foreground. The sky is dark blue, and the city lights are reflected on the water.

UAE insolvency

A new era or another false dawn?

A challenging economic environment and Covid-19 are behind a looming wave of contentious insolvency in the Middle East. The legislative framework in the UAE now provides the tools to creditors to face the challenge.

In 2018, NMC Healthcare had a market value of almost US\$11 billion – enough to earn it a place among the esteemed ranks of the FTSE 100, thanks to a 2012 listing on the London Stock Exchange. Less than two years later, the Middle Eastern hospital group had filed for insolvency after admitting it had understated its debt to the tune of US\$4 billion, amid allegations of fraud. The process has left the string of banks that have lent to NMC potentially nursing huge losses. (HFW is advising Abu Dhabi Commercial Bank on the matter, including in associated proceedings in the English and ADGM Courts.)

The hugely complex matter could be considered a turning point for what has in the past been seen as a challenging jurisdiction for contentious insolvency. Even as the UAE became the established regional capital for international business, it discouraged corporate collapses via a mix of state edict and a legal system that dealt harshly with debtors.

The UAE established a formal bankruptcy regime in 2016, when the Bankruptcy Law was passed. The law's coming into force was heralded as the start of a new era for insolvency in the Middle East. Taking its cues from international best practice, the new law helped modernise the system, assuage foreign investors and provide a more debtor-friendly path to constructive workouts. For the first time, distressed companies in the UAE had a legal framework to help them avoid bankruptcy and liquidation, via mechanisms such as consensual financial restructuring and composition procedures.

However, a combination of lack of familiarity and understanding of the legislative framework, businesses that tend to sweep problems under the carpet and a lack of bankruptcy experience amongst local practitioners, meant the shake-up had limited immediate impact.

But HFW Dubai-based insolvency partner Nick Braganza says that recent revisions to the legislation have created a bankruptcy law that is “more fit for purpose”. The expectation among insolvency practitioners is that this revised law – and the UAE insolvency process more generally – are now going to get a major workout.

The UAE has already seen a flurry of prominent corporate collapses over the past 18 months, with Covid-19 having caused unprecedented disruption and damage to trade and the commodities markets that play a key role in the regional economy. (HFW has been advising many players involved in these markets.)

More are likely to follow, with limited (but developing) corporate governance in the region, falling asset prices and Covid-induced turmoil giving more chance for sharp practice and soft balance sheets to come to light. As HFW insolvency partner Rick Brown says: “It’s like musical chairs: so long as the music’s playing, it’s all ok. But when the music stops – and

“...formal insolvency through the Courts is a last resort and you should look at other options.”

Covid caused that to happen with a number of businesses – suddenly it becomes very apparent there aren't enough chairs to go round.”

Quantuma restructuring veteran Andrew Hosking echoes the point, arguing that the commodities sectors are set for a wave of contentious insolvency, with trade finance creditors becoming far more wary after recent losses. “I see senior lenders having a degree of scepticism in the industry because of what has unravelled,” he says. The emergence in several collapses of ‘name lending’ – where banks lend to high-profile individuals or corporates on the basis of reputation without collateral – is likewise set to come under renewed focus in a market heavily based on personal connections.

Braganza argues that the corporate restructurings and bankruptcies seen so far are just the “tip of the spear”, predicting the region will see a “ripple effect” of failures over the next three-to-five years. He adds: “As things start getting more challenging, people will start investigating, which will lead to further insolvencies down the line.”

“You have options”

If it is accepted that the dam holding back big-ticket insolvency in the region is fast crumbling, creditors and counterparties face awkward choices in how to respond in what remains a largely untested jurisdiction for complex restructuring.

There are presently no provisions in the UAE Bankruptcy Law to deal with cross-border insolvencies. The courts in the DIFC and ADGM are perceived as more appealing fora, with common law procedures that are familiar to international players – even if getting the matter before those courts is not always straightforward. The DIFC's 2019 Insolvency Law incorporates cross-border provisions and benefits from a new “rehabilitation” procedure for DIFC companies that leaves directors in control while they seek to restructure debt with minimal court intervention. A number of NMC companies were passported into the ADGM to take advantage of the insolvency regime in that financial free zone. The consequent Administration Order issued by the ADGM Courts (and the associated moratorium on claims brought against NMC) has generally been broadly enforced in the other courts of the UAE.

There is an additional complication in that the UAE in 2020 amended the Bankruptcy Law to include the concept of an Emergency Financial Crisis (EFC), which can be used to suspend normal insolvency procedures. In January 2021, the UAE Cabinet declared an EFC occurred from 1 April 2020 until at least 31 July 2021, curtailing the ability of creditors to push companies into insolvency and introducing short-term uncertainty regarding the regime.

Recognising such difficulties, Braganza recommends creditors first exhaust other avenues. “Creditors sometimes fast-track insolvency processes in other jurisdictions. In the UAE, doing that often doesn't get you what you need – it doesn't get you paid,” he says. “So, formal insolvency through the Courts is a last resort and you should look at other options.”

Foremost among those options are payment order applications, allowing the court to order payments on obligations on an ex parte basis (without prior warning for the other side), which can then be enforced. “It's fast, quick, cheap and very creditor friendly,” notes Braganza. “We see a lot of banks looking to go down that route.”

Where irregularities are suspected and substantial foreign assets exist, the London courts remains a go-to destination for worldwide freezing orders, as NMC creditor Abu Dhabi Commercial Bank did in February, pursuing six executives and shareholders. “There's a

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trend for going to London to advance those actions,” says Braganza. But while effective with international assets, Braganza warns that English orders may not always be readily enforced locally – a contrast to judgments from the courts at the DIFC and ADGM.

With mismanagement and fraud often playing a part in insolvencies, Braganza says that creditors and counterparties should be alert to familiar warning signs of suspicious activity, such as general managers holding too many positions of authority in a business or a lack of audit rigour. “If there’s too much power in one person, then that’s a bad thing and you’ve got to make sure the audits are done properly and meticulously,” he says.

HFW’s Brown, meanwhile, stresses that “speed is key” in a potentially distressed situation. “You need to be ahead of the curve, to be doing that kind of rigorous credit risk analysis even if it results in awkward discussions. That way, you’ve got options,” he says. “You can take a passive role, you can be active yourself, you can look at where to place a company into insolvency to get the best result for you, you can club together with other creditors. Don’t just sit back and wait for it to come crashing down – you have options.”

If a wave of expected corporate failures is a symptom of the malaise in local business culture, treatment is ultimately expected to come in the shape of an overdue drive to beef up regulation, compliance and governance standards in the UAE. Following media reports of McKinsey advising the Saudi government on economic transformation and governance reform a few years ago, Braganza says that there has been a real focus among UAE companies over the past 12-18 months on “revamping” their compliance regimes.

If toughened governance is not enough to save local companies from failure, Braganza concludes that the new insolvency regime is a substantial improvement on which the UAE will likely build. “The processes are now there,” he says. “The focus now isn’t on winding up companies – it’s recovery. By having these Chapter 11-style processes in law, it’s very much the intention of government to save companies, rather than let them fold.”

The Takeaway

1. The Middle East is primed for a series of contentious insolvencies involving commodities players and other businesses in the region.
2. Early action and targeted remedies like payment orders will usually prove better options for creditors than pressing for insolvency.
3. The DIFC and ADGM courts provide a number of advantages in an insolvency process if jurisdiction can be established.

About HFW

HFW is a leading global law firm in the aerospace, commodities, construction, energy and resources, insurance, and shipping sectors. It has more than 600 lawyers, including 185 partners, based in offices across the Americas, Europe, the Middle East and Asia-Pacific.

The firm is one of the most active users of the DIFC Courts and has handled more than AED500 million worth of civil and commercial claims before the Courts since 2017, including financial services, shareholder and joint venture, real estate, employment and re/insurance disputes, fraud, insolvency and enforcement matters. HFW was recently **appointed to the DIFC Courts Users' Committee**, which helps ensure that the service provided is cost-effective, professional and fit-for-purpose.

HFW has been in the Middle East since 2006 and now has offices in Abu Dhabi, Dubai, Kuwait City and Riyadh, making it one of the largest practices of any international law firm in the region.

The firm prides itself on its deep industry expertise and its entrepreneurial, creative and collaborative culture.

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