The turnaround plan

DWF's Umera Ali and Leanie van de Merwe talks about the key elements of restructuring under UAE laws: protecting creditors' and investors' rights.

The financial landscape in the Middle East has drastically changed since the economic downturn in 2008. Even though the region was not as badly impacted as rest of the world, the companies operating in the Middle East have had a rude awakening in terms of their financial viability. These companies have seen significant financial strain and tightening of liquidity in the market, prompting them to reconsider the way in which they do business. Financing has not been as readily available and has come with a lot more scrutiny than in the pre-downturn era. Since the economic crisis, several companies have declared bankruptcy and others, such as Dubai World and certain of its units, have restructured their business operations. Realising the need for more comprehensive and modern legislation dealing with these issues, the United Arab Emirates (the "UAE") has updated its existing bankruptcy and insolvency laws.

The new regulatory regime focuses more on ensuring continuation of operations of a business, rather than winding-up or liquidation of business. The changes in

the law allow for judicially administrated restructuring (similar, but not identical to the Chapter 11 bankruptcy regime in the United States of America). However, consensual restructuring between the financial stakeholders of an entity remains the most favourable and effective way of restructuring debt.

This article discusses the key elements of the restructuring process and provides some insight into the case of Drydocks World ("Drydocks"), a company that is now relying on restructuring to reorganise its USD2.2.b debt.

UAE BANKRUPTCY LAWS & RESTRUCTURING

The UAE's first bankruptcy law was set out in the Federal Commercial Code Law No. 18 of 1993. However, that law did not fully deal with certain essential issues; such as, placing a moratorium on debts, which would allow a company to reorganise its business operations to keep trading. Therefore, in order to ensure that the country's laws were aligned with the needs of a dynamic and ever-growing business environment, the UAE issued the Federal Bankruptcy Law No. 9 of 2016 (the "UAE Bankruptcy Law"), which came into force on 29 December 2016. This law applies to all companies established under the UAE's Commercial Companies Law No. 2 of 2015 and state-owned entities. It does not apply to companies established in free zones that have their own bankruptcy and insolvency laws, such as companies established in the Dubai International Financial Centre ("DIFC") and the Abu Dhabi Global Market.

The UAE Bankruptcy Law provides a variety of options to companies in financial distress to consider before filing for bankruptcy; for example, it places more focus on restructuring proceedings than its predecessor legislation and makes specific provision for a consensual restructuring process, whereby a financial restructuring committee (the "Financial Restructuring Committee") (this is not a creditor's committee but an administrative committee set up under the legislation) is appointed to oversee the management of the restructuring process. The role of the Regulatory Restructuring Committee is discussed further below.

The DIFC has its own comprehensive bankruptcy and insolvency laws: the Insolvency Law No. 3 of 2009 ("DIFC Insolvency Law") that is supplemented by the DIFC Insolvency Regulations ("DIFC Regulations", together with DIFC Insolvency Law are referred to as "DIFC Insolvency Legislation"). The DIFC Insolvency Legislation provides a legal framework for the reorganisation and liquidation of financially distressed companies falling within its jurisdiction. It sets out procedures for voluntary and involuntary winding-up of a company's business. Notably, it also provides for company voluntary arrangements, whereby the directors of a company may make a proposal to the company and its creditors for a scheme of arrangement of its affairs, in other words, reorganisation or restructuring of its business affairs.

Financial restructuring helps to stabilise the business that is in economic trouble so that the company can continue to operate and offer stability for the company, its creditors and other stakeholders in an entity.

THE RESTRUCTURING PROCESS

The key elements of any restructuring process are as follows:

1. Setting up of a steering committee;
2. Negotiating a standstill agreement; and
3. Restructuring of the company's business activities.

These elements are discussed in further detail below.

1.1 Setting up of a steering committee

The steering committee is set up to represent the interests of all the various creditors and stakeholders of a company in bankruptcy proceedings. Although the role of the steering committee will differ from case to case, its role typically will be to collate reliable financial information about the company; to decide on whether or not the company is to be liquidated; and/or to facilitate discussions between the debtor company and its creditors in order to come up with a plan or agreement regarding the way in which the company is to be restructured. It is, therefore, important to set up a steering committee at the early stages of the restructuring process, because this will assist the negotiation process. Steering committees are usually made up of the different creditors and/or investors of the company. The steering committee may also decide to engage the services of other professionals, such as accountants and lawyers, to assist them in their task.

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1.2 Negotiating a standstill agreement

A standstill agreement, also typically referred to as a "freeze" of the rights of the creditors, is a temporary agreement entered into between a company which is facing financial difficulties and its creditors whereby the creditors agree to refrain from enforcing their debts against the company for a set period of time. This is to allow a period of financial stability whilst the company and its creditors focus their attention on agreeing a feasible restructuring plan in order for the company to continue trading. This period also enables the creditors of the company to obtain full disclosure of information about the company to assist them in negotiating their position with regards to their investments or credit. The steering committee can also assist in the process of agreeing a standstill agreement between the debtor company and its creditors.

1.3 Restructuring of the company's business activities

Restructuring refers to the process, whereby a financially distressed company reaches consensus with its creditors to reorganises the company's liabilities with the purpose of turning it into a viable business again. This process typically involves implementing cost-cutting measures such as selling assets or divisions of the company, or refinancing the company's existing debts.

Under the UAE Bankruptcy Law, where a company is capable of being rescued by a restructuring process, the company may apply to the courts for formal restructuring of its financial affairs after it has filed an application for insolvency with the courts. This law also provides for the establishment of a Financial Restructuring Committee. The role of the Financial Restructuring Committee is primarily to supervise and manage the restructuring process outside of the scope of the court and to facilitate discussions between the company and its creditors with a view towards reaching a consensual agreement. However, unlike in a stakeholders restructuring committee, members of the Financial Restructuring Committee are not stakeholders of an entity undergoing restructuring. The Financial Restructuring Committee is also permitted to appoint experts to assist it in carrying out its functions. The Financial Restructuring Committee was officially established pursuant to the UAE Cabinet Resolution No. 4 of 2018 on the formation of the Committee

of Financial Restructuring and had its first official meeting earlier this year where it discussed and adopted its work plan and formed committees to assist it in fulfilling its responsibilities.

Like the UAE Bankruptcy Law, the DIFC Insolvency Law makes provision for a process called a voluntary arrangement, whereby a company and its creditors can agree a restructuring scheme. In addition, the DIFC Insolvency Law provides that steps may be taken to obtain a moratorium for the benefit of the creditors when there is a proposal for a voluntary arrangement. According to the DIFC Regulations, the effect of the moratorium is, inter alia, that no petition for winding up of the (eligible) company may be presented during this time and that no other proceedings, or execution of other legal proceedings may be commenced or continued against the company.

It is important to mention that the restructuring law, where there is no standstill agreement between the creditors, will not prevent creditors taking action in another jurisdiction or enforcing their rights over assets not protected by the relevant bankruptcy regime.

THE CASE OF DRYDOCKS

Drydocks, a UAE ship repair company that is part of the state-owned Dubai World conglomerate, started its first restructuring in 2012 after it became clear that Drydocks was having trouble meeting its financial obligations with respect to a USD2.2.b loan taken out to expand its operations in South East Asia.

At the time, Drydocks relied on Decree 57 – a special decree that was introduced in 2009 by the Dubai government to deal with claims against Dubai World and its subsidiaries in the wake of the global financial crisis. Decree 57 permitted Drydocks to implement restructuring proposals without the need to get approval from all of its creditors. This step allowed Drydocks to continue its operations while the restructuring took place without negatively affecting the business.

Recently, it appears that creditors have given their full support for a new restructuring plan whereby DP World, a ports operator, will take 100 per cent control of Drydocks in exchange for a cash investment of USD225m. A six-member steering committee, comprising of hedge fund investors and banks are representing the creditors of Drydocks. If, however, Drydocks is unable to get 100 per cent support from its creditors, it will have to initiate proceedings under Decree 57 again in order to get the restructuring deal through.

CONCLUDING REMARKS

The new legislative restructuring regime provides greater flexibility to companies operating in the UAE's dynamic environment to resolve financial difficulties they may encounter in a pragmatic and sensible way. It may relieve companies in distress from immediate liquidation and gives investors/creditors the ability to have financial and operational visibility into the debtor company and gives some control as to how that debtor company might improve its fortunes, with the ultimate objective of protecting some, if not all, of their investment/credit.

As for the distressed company, using the restructuring regime, means that the axe will not fall as quickly and it will be given breathing space to work around the financial troubles it has faced. This is good for the company, its staff, its customers and its investors.

The ideal outcome, therefore, is for creditors and investors to agree a restructuring scheme whereby the company's business is turned around and creditors and investors are given the opportunity to recover their investments.

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Text by:
1. UMERA ALI, *partner, DWF Middle East*
2. LEANIE VAN DE MERWE, *associate, DWF Middle East*