



# PURSUING **NON-PERFORMING LOANS**

A KEY ISSUE CHECKLIST FOR FINANCIAL INSTITUTIONS

*With liquidity again becoming a serious concern in the region, we are witnessing a sharp uptick in the number of instructions from regional and international lenders relating to (i) regional borrowers failing to repay a loan; and (ii) the resultant need to accelerate the relevant loan and pursue enforcement proceedings against the borrower and their corporate and personal guarantors (many of whom have absconded in an attempt to avoid liability).*

There are a number of significant issues to be considered prior to acceleration, which fires the starting gun on debt recovery proceedings. In practice, such a move can be value destructive and (among other things) trigger cross-accelerations, so as a lender you need to be sure that you are ready for what happens next.

To assist in dealing effectively with default scenarios, set out below are what we regard as the principal issues which should always be considered at the outset. We have assumed in drafting this guide that all consensual restructuring tools have been exhausted or are not feasible.

## ISSUE 1

### CHECK THE GOVERNING LAW AND JURISDICTION CLAUSE IN THE LOAN/GUARANTEE AGREEMENT

- In terms of civil action, an important question to consider before doing anything is whether you have any flexibility as to where the borrower/guarantor can be sued. For example, a clause which provides for disputes to be resolved exclusively by one court, or in arbitration, may restrict your ability to sue the borrower/guarantor in other forums (although legal advice should be sought on this point as, for example, the “onshore” courts in the UAE tend not to uphold exclusive court clauses).
- In the event that there is no governing law and jurisdiction clause, you will have to consider (among other things) which would be the most advantageous jurisdiction in which to commence proceedings against the borrower/guarantor, and ascertain whether those courts are likely to accept jurisdiction over such a claim. In the UAE, for example, if a defaulting borrower or a guarantor is located in the jurisdiction and/or has assets here, then a UAE court would accept jurisdiction over any claim in the absence of a jurisdiction clause specifically conferring jurisdiction upon it.
- Of course if you have obtained a guarantee cheque, presenting that cheque for payment and pursuing criminal proceedings if it is dishonoured remains a forceful first option. This can be a critical action if there is a risk that the borrower/guarantor will abscond.

“*Acceleration can be value destructive. As a lender, you need to be sure that you are ready for what happens next.*”

## ISSUE 2

### CONSIDER ENFORCEMENT ISSUES BEFORE STARTING PROCEEDINGS

- A final judgment/arbitral award is only of value if you are ultimately going to be able to enforce it (or build sufficient pressure to reach a financial settlement with the borrower/guarantor). Before commencing proceedings, careful consideration needs to be given to whether any resulting judgment/award in your favour is likely to be enforceable in the jurisdiction in which the borrower/guarantor has assets. For example, if the loan/guarantee agreement contains an exclusive court clause, then one point that needs to be checked before proceedings are started is whether there is a mutual enforcement treaty in place between the country in which the claim will be commenced, and the country in which enforcement will be sought. In some countries, such as the UAE, direct enforcement of foreign court judgments in the “onshore” civil courts is generally not possible in the absence of a mutual enforcement treaty, although it may still be possible to enforce such foreign judgments against UAE-based borrowers/guarantors via the “conduit jurisdiction” of the courts of the Dubai International Financial Centre (**DIFC**).

## ISSUE 3

### COMPLY WITH ANY PRE-DISPUTE CONTRACTUAL STEPS

- It is critically important to check the loan/guarantee agreement carefully and to fulfil any pre-dispute procedure that is contractually mandated. A typical pre-dispute obligation for a lender in a loan default scenario is to serve a formal written demand letter on a borrower/guarantor which requests payment of the outstanding debt within a specified period of time. A failure by a lender to follow any contractual pre-dispute procedure would present a borrower/guarantor with a straightforward defence to any claim, and could ultimately result in the claim’s failure.
- In particular, it is important to carefully consider, and put in place, a viable plan for effecting service of notices and proceedings on the borrower. This is even more important where service needs to take place in another jurisdiction.

## ISSUE 4

### CONSIDER APPLICATIONS FOR URGENT INTERIM RELIEF TO PRESERVE THE STATUS QUO

- If there is a risk of a borrower/guarantor dissipating their assets in order to frustrate any adverse final judgment or award, it may be possible to obtain appropriate interim relief in order to safeguard the potential assets against which you may wish to enforce.
- Assuming the borrower/guarantor has assets in the UAE (or other onshore middle east jurisdictions), it is possible to apply to the “onshore” courts for a precautionary attachment over certain types of asset (such as real property, moveables, cash in a bank account and a company’s trade license). If you do not have a clear picture of the borrower’s/guarantor’s asset position (either in the UAE or elsewhere) serious consideration should be given to appointing a professional asset tracing agent. In the UAE, however, even if you do not know a borrower’s/guarantor’s asset position, in the event a court grants a precautionary attachment order, the court will, at your request, write directly to up to 5 local banks, in addition to relevant government agencies (such as the Land Department and the Road and Transport Authority) to try and identify assets on your behalf. There is also the possibility of obtaining a travel ban against individual borrowers/guarantors, though this has become more difficult in recent years.
- In addition, and assuming they have jurisdiction to hear such an application, the common law courts of the UAE’s two financial freezones, the DIFC and Abu Dhabi Global Market (**ADGM**), have the power to grant a much wider range of interim orders, such as worldwide freezing orders and asset disclosure orders.

## ISSUE 5

### CONSIDER ABILITY TO OBTAIN A JUDGMENT QUICKLY

- In common law jurisdictions such as the DIFC and ADGM, lenders can often obtain judgment in default if a borrower/guarantor fails to take part in the proceedings. Moreover, it is possible for lenders to apply for “immediate judgment” in the event that the defendant borrower/guarantor has no meaningful defence to the claim (which is frequently the case in loan default scenarios). The advantage of these procedures is that lenders may be able to obtain a final and binding judgment against the borrower/guarantor in a matter of a few weeks or months. By contrast, immediate judgment and default judgment are not recognised concepts in the civil law courts of the UAE or the wider Middle East.

## ISSUE 6

### CONSIDER POSSIBLE INSOLVENCY PROCEEDINGS

- There is currently a considerable interest in the new Federal Bankruptcy Law, which applies to individuals carrying on a business, as well as to most UAE onshore companies and those incorporated in freezones other than the DIFC and the ADGM.
- The provisions of the Federal Bankruptcy Law allow for the use of court protected compromises with creditors where the majority of unsecured creditors can agree to such an approach. The law also contains strong penalties for directors who are reckless or who have engaged in prohibited activities.
- Lenders may consider, where there are satisfactory assets that have not been identified for attachment, that initiating a bankruptcy process may be the appropriate action in respect of a clearly insolvent borrower. However, the new law is relatively untested and it will take time before there is any certainty as to how the UAE courts will approach and interpret the legislation.

## ISSUE 7

### CONSIDER INTERESTS OF OTHER LENDERS AND POSSIBILITY OF OBLIGATION TO SHARE RECOVERIES

- There may be provisions in club and syndicated facilities which would require you to approach other lenders to join any debt recovery proceedings. If there is a contractual requirement to do this and you fail to do so, there is a risk that you may ultimately be forced to share recoveries. This remains relevant even if you have a mixture of bilateral and club/syndicated facilities with the relevant borrower, as there may still be scope for argument as to whether any proceeds recovered should be attributable to one facility or another.

## ISSUE 8

### CONSIDER ALTERNATIVE FUNDING ARRANGEMENTS

- Most debt recovery actions, particularly where there is a cross-border element, are going to encounter difficulties along the way, and often put lenders to irrecoverable costs. Increasingly, lenders are examining alternative ways of offsetting some of the risk and cost associated with addressing their bad debt portfolios by:
  - partnering with specialist litigation funders, who will generally underwrite the entirety of the costs of pursuing borrowers/guarantors on a “success fee” basis (i.e. they will take a negotiated proportion of any recoveries made); or
  - selling bad debts into the secondary debt market, where such sales can achieve a recovery against debts which have been written down or written off.
- Depending on the circumstances, serious consideration should be given to these options, which in appropriate cases can bring about significant cost savings, and help you make the best of a bad situation. We have established contacts with litigation funders and funds active in the secondary debt market, if this would assist.

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