Another year of growth and progress…

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Whilst 2020 was a year of unprecedent events – mostly for all the wrong reasons – the continued growth of arbitration and associated forms of dispute resolution in the Middle East has been a welcome and positive development, writes King & Spalding.

The latest DIFC-LCIA annual report, published in November 2020 to coincide with Dubai Arbitration Week (itself now a firm fixture on the global arbitration circuit), confirms as much. There was an 18 per cent increase in cases in 2019 and the value of claims doubled from USD600 million to USD1.25 billion. According to the DIFC-LCIA, the figures for 2020, once tallied, will beat this. News from Abu Dhabi shows the same positive growth, with the ICC announcing the opening of a case management office in the ADGM in 2021 – its fifth such global office – to handle its increasing case load. No mean feat in a year where parties and arbitration institutes had to rise to the logistical and technological challenges of virtual working.

To support arbitration management, the DIFC Courts – which has a supervisory role over arbitrations seated within its jurisdiction – launched a new Arbitration Working Group, comprising an advisory team of arbitration professionals, bodies, centres, educational institutions, and industry-related organisations, tasked with reinforcing and sharing developments and best-practices. An updated version of the DIFC-LCIA Rules also came into effect on 1 January 2021 to ensure that procedures keep pace with users' expectations. Parties in the region should therefore have every confidence that their experience arbitrating in the UAE. will be as good as, if not better than, any of the competing centres in the world.

In this article, we reflect on the key drivers for the continued and successful growth of dispute resolution in the region and what we expect to see in 2021.

Construction & Infrastructure

The construction industry continues to be one of the cornerstones of economic development in the UAE and wider GCC. The UAE market has been driven in recent years by infrastructure projects to accommodate Expo 2020. There has been significant infrastructure investment in Saudi Arabia in accordance with the Kingdom's "Saudi Vision 2030". Notably a number of mega projects in Saudi Arabia are not linked to the oil industry, including NEOM, The Red Sea Project as well as significant transport infrastructure such as the Riyadh Metro. Overall it is estimated that Saudi Arabia was the main contributor to growth in construction activity in 2020. Across the GCC, the total value of construction projects in 2020 was estimated to be in excess of USD2.3 trillion.

While there has undoubtedly been a marked increase in construction and infrastructure investment, recent years have also featured significant turbulence within the construction sector with many in the industry questioning the sustainability of the current delivery model which is marked by lowest price competitive tendering, inequitable risk allocation, low margins and a culture of late payments. Such problems have driven some of the largest overseas contractors to exit the Middle East market in recent years and 2020 was also notable for the apparent collapse of Arabtec. A key trend seen with many disputes in the Middle East is the failure to properly administer the contract from the start of a project, a lack of collaboration between the parties with the culture of late payments often leading to disputes across the entire supply chain of a project. These tensions have led to an appreciable increase in the volume of construction disputes in the region through 2020. As has been the case for a number of years, parties are more readily referring such disputes to arbitration in preference to local courts.

The impact of the COVID-19 pandemic and the resulting pressure on government budgets is likely to see this trend continue in 2021. The impact of the pandemic and the resulting disruption to projects and the construction sector generally led to a substantial number of claims in 2020 many of which remain in a pre-dispute phase as the relevant project continues. It can be expected a sizable portion will crystallise into formal disputes through 2021 with a further increase in references to arbitration.

Energy

With nearly half of the world's oil and gas reserves in the Middle East, the energy sector plays a significant role in the economic development of the region. In addition to oil and gas, demand for energy (particularly alternative sources such as renewables) continues to grow. With more energy-related projects coming online, however, it is not surprising that the nature and scope of the disputes relating to these projects also expands. So too the chosen forum for those disputes.

To that end, 2020 continued to see many construction-related disputes arise in the energy sector – particularly those arising from large EPC projects related to oil & gas facilities, the construction of powerplants and other power-related projects such as waste-to-energy, and petrochemicals facilities. These disputes continue to be multi-faceted, multi-party and high value, with the EPC contractor often caught in related disputes both up and down the contractual-chain and with the supply-chain. In addition, the continued pressure created by the low oil price environment over the last few years has impacted a number of energy projects, with the resultant disputes proceeding to arbitration in 2020. In the oil and gas sector, these include (i) disputes between joint venture partners, often related to the non-payment of cash calls or to approvals for work programmes and budgets ("WP&B"), with one of the JV parties intent on minimising or avoiding its payment obligations given cash flow constraints; (ii) disputes between the joint venture and host government under the relevant concession agreement, again relating to payment disputes or WP&B/ development plans; and (iii) various supply chain disputes, such as those with drilling or well-services contractors.

Looking forward to 2021, the impact of the COVID-19 pandemic coupled with a continued low oil price environment is having an obvious follow-on effect on energy projects in the region. With many companies throughout the energy sector suffering from the impact of the pandemic, and the supply chain in particular facing significant disruption, force majeure and other related claims are inevitable. Although some of these claims have already resulted in the commencement of formal disputes, many more will still be in the pre-dispute phase. The expectation is that numerous of these will head to formal dispute in 2021 – whether arbitration or through the regional courts. Elsewhere, the push towards de-carbonisation has meant that energy companies continue to look to diversify into clean energy, with some long-term assets in the Middle East no longer economically viable. Disputes may arise as, for example, oil and gas companies look for ways to exit their existing assets, either at the end of life of the relevant concession agreement or through M&A.

Traditionally, the energy sector in the Middle East has favoured ICC or LCIA arbitration clauses in most long-term concession or joint venture agreements, or high value EPC contracts with international parties. However, that trend is slowly changing, particularly with regional and Asian counterparties and in supply-chain contracts where many of the parties are now using regional arbitration centres such as the DIFC-LCIA and ADGM-ICC as their preferred choice. This trend is expected to continue.

Commercial & Financial Services

The past year saw no shortages of scandal, from the well-publicized allegations of fraud and financial misappropriation among the likes of Abraaj, Emirates REIT, Finablr and NMC. Layered on top of this, as 2020 progressed, was the economic fall-out from the COVID-19 pandemic. Insolvencies and restructurings were frequent the world-over and the story was no different for entities registered in the DIFC and ADGM, as well as onshore.

In the case of NMC, whose parent company listed on the London stock exchange went into administration, the handling of its UAE subsidiaries, in equally precarious financial positions, gave rise to a novel approach. The onshore entities were converted to ADGM entities immediately prior to administration orders being granted in respect of them by the ADGM Courts, despite the solvency prerequisites existing in law for such conversions. The main purpose was to ensure alignment with the ongoing administration of the parent company in the UK. This demonstrated the increasingly international mindset that is now applied to dispute resolution in the Middle East, reflecting the interconnected nature of cross-border commerce.

With financial and economic woes came defaults in commercial transactions throughout 2020. In the rush to crystallise claims before the shutters fell on moratoriums, court proceedings and arbitrations were commenced swifter than might otherwise have been the case. As world economies emerge from the pandemic through the course of 2021 there will continue to be winners and losers. Where there are losers there will continue to be defaults on contractual obligations, with payment defaults being the most common. With the ever-present risk of insolvencies and restructurings, it will remain the case that parties with deep enough pockets will face no alternative but to issue claims without delay, in the hope that those that shout the loudest will stand the best chance of getting paid.

Text by:

Patrick McPherson, partner, King & Spalding LLP

Randall Walker, partner, King & Spalding LLP

Ben Williams, partner, King & Spalding LLP