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UNITED ARAB EMIRATES

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The United Arab Emirates (UAE) is a federation of seven emirates, all of which, with the exception of Dubai and Ras Al Khaimah, are part of a federal judicial system. The emirates of Dubai and Ras Al Khaimah have independent judicial systems. **38.01**

The UAE is a civil law system, statutes being the primary source of law. There is no doctrine of binding precedent, although judgments of the highest courts may be a useful guide as to how a court may react in cases with similar issues in dispute. Relatively recent federal legislation requires commercial disputes to be referred first to a reconciliation committee, appointed by the Ministry of Justice. The reconciliation committee attempts to facilitate a settlement, failing which the parties may proceed with filing an action in the courts. This procedure is not applicable in Dubai and Ras Al Khaimah.

This chapter does not address creation of security over receivables in Free Zones. Free Zones are not governed by UAE laws.

Meaning of Receivables

- 38.02** Federal Law No 18 of 1993 concerning commercial transactions (the Commercial Code) recognizes security interests in (i) certain types of real property, (ii) securities, (iii) chattels, and (iv) entire businesses (ie going concerns). Articles 164–177 of the Commercial Code address security interests in various types of chattels and Article 167 contemplates a pledge of commercial debts. This reference to ‘commercial debts’ is ordinarily interpreted to include receivables.

Purpose and Priority of Security

- 38.03** The purpose of taking security over receivables is to establish priority over other creditors in case of the pledgor’s insolvency.

Pursuant to Article 4 of UAE Federal Law No 8 of 1980 Regulating Labour Relations, as amended (the Labour Law), employee entitlements under the Labour Law create a lien over all assets of an employer. However, the priority of the employee’s lien is not uniformly applied by the UAE courts in practice. The Commercial Code recognizes the priority of certain creditors, including holders of chattel mortgages or liens (Article 711), a trustee in bankruptcy or any other person subrogated to the rights of an interested party who pays a debt of the estate from his own funds (Article 714), lessors to the extent of rent payments (Article 715), and the government for taxes due for the two years prior to the bankruptcy judgment (Article 716). The bankruptcy court has discretion to order that the first funds entering into the bankrupt’s estate be used to satisfy secured creditors with chattel mortgages (Article 717). Articles 718–720 of the Commercial Code address the rights of secured creditors with mortgages over real property.

While the Commercial Code recognizes that different classes of creditors may have differing rights and priorities with respect to the bankrupt’s assets, the Commercial Code grants considerable discretion to the bankruptcy court to resolve such competing priorities and provides little guidance to the court on the criteria to be applied in doing so. Moreover, there can be no guarantees that, in practice, insolvency and bankruptcy concepts would be applied such that a single court would assert jurisdiction to maximize the value of the assets of a bankrupt’s estate, evaluate creditor claims, and supervise an orderly distribution of assets. Instead, creditors who file claims, earlier (and are able to obtain attachment orders over the bankrupt’s assets) may well be in a stronger position than creditors who act later. The courts have not yet articulated clear rules regarding the establishment of first priority security interests that would be enforceable over competing claims of creditors (secured or unsecured).

Nature of Floating Charge

The Commercial Code creates a concept of pledge over movable property which is similar to a floating charge (Article 171). If a pledge is granted over 'replaceable objects' (eg, stocks, electronic goods), the pledge is recognized even if the pledged goods are replaced by similar goods. Even if the pledged property is not 'replaceable', a pledgor may substitute different property provided the pledge agreement so permits and provided the pledgee accepts such replacement. However, it is not clear whether Article 171 of the Commercial Code may be applied to a pledge of receivables. **38.04**

Nature of Security Assignment or Fixed Charge

At present, UAE laws recognize two principal forms of security interests over movable property: (i) a commercial pledge of goods and (ii) a business mortgage. **38.05**

Commercial Pledge. The Commercial Code contains a chapter pertaining to commercial pledges (Articles 164 to 177). A commercial pledge is defined as one created as collateral for repayment of a commercial loan. The Commercial Code requires a transfer of possession of the pledged goods either to the pledgee/bank or to a third party stakeholder. Further, such transfer could be actual (ie actual physical transfer) or constructive (eg transfer of possession of the instruments of title to the goods or hypothetical transfer of goods to a third party stakeholder). The transfer of possession in such a manner that the pledgor cannot deal with the property without the knowledge of the pledgee remains essential for a pledge to be recognized as such by the UAE courts. Accordingly, a mere acknowledgement by the pledgor to the effect that it holds the 'pledged goods' in trust for the pledgee would not satisfy this requirement.

Under Article 167 of the Commercial Code commercial debts (receivables) may be pledged by delivering the instrument confirming the debt to the pledgee. However, such pledge is not effective against the debtor (of the pledgor) unless the pledge is served upon such debtor or such debtor accepts it. The secured party's priority shall be determined from the firm date of the service on, or acceptance by, the debtor. **38.06**

In addition to provisions of the Commercial Code, the Civil Transactions Code enacted under Law No 5 of 1985 (the Civil Code), also contains provisions relating to pledges. Article 2 of the Commercial Code provides that, in the absence of commercial practice or custom, the provisions relating to civil matters shall apply. Even though most transactions relating to receivables will qualify as commercial transactions and fall within the ambit of the Commercial Code, there could be circumstances where the Civil Code is applicable. **38.07**

Article 1487 of the Civil Code provides that a pledge of movable assets shall not be effective against third parties unless it is recorded in writing on a fixed date and states the amount of the secured debt, the asset pledged, and the fact of the transfer of the possession of the pledged asset to the pledgee.

38.08 *Business Mortgages.* The Commercial Code permits the creation of a charge or 'mortgage' over a business and its assets in favour of banks and financial institutions.

With regard to the scope of a business mortgage, the Commercial Code provides that the 'business' comprises of all material and intellectual tangible and intangible property. Tangibles are defined as goods, stores, machinery, and tools whilst intangibles include client contacts, goodwill, trade name, intellectual property, and licence rights. Please note that the Commercial Code provides that if the details are not specified, only the trade name, client contacts, and goodwill are deemed to be mortgaged.

In Dubai, such mortgage may be registered only in favour of a bank licensed to do business in Dubai. A foreign bank may appoint a bank licensed in Dubai as its security agent and the security interest will be created by the mortgagor in favour of such security agent.

Any information about the existence of a commercial mortgage may be obtained only with consent of the mortgagor.

Security Over Bank Account

38.09 Security over a bank account may be created by the holder of the account executing a pledge over the account. Such pledge is contractual in nature only and there is no procedural mechanism pursuant to which the pledge can be notarized or registered with any authority in the UAE. Such pledge can only be created in favour of the bank in which the account is held. The pledgee bank would normally have priority over other creditors of the holder of the account in respect of the amounts in the pledged bank account. Further, the bank will have the right to offset any amounts owed by the borrower to the bank against the monies in the pledged account.

Pooling Arrangements

38.10 It is possible for various companies within one group to guarantee each other's obligations. However, each company would have to register a Commercial Pledge or a Business Mortgage over its own assets independently.

Capacity of Companies to Give Security

Any company properly licensed to do business in the UAE may grant security over its assets, including receivables. **38.11**

The company's objects should specify that the company is permitted to grant security over its assets and/or income. Alternatively, in most cases the power to grant security over the assets and/or income of the company is conferred on the manager/managing director of the company either under the memorandum of association or under a separate contract or power of attorney that is signed by all shareholders.

If the objects of the company do not provide for the grant of a security interest over its assets or there is no specific grant of power in this regard to the manager/managing director of the company, the shareholders may by a unanimous resolution approve the grant of such security and authorize person(s) to execute documents in this regard.

It would also be possible for the shareholders of a company to approve and ratify a security that has previously been granted by the company.

Authorization of Company Officers

The memorandum of association may authorize the manager or directors of the company to execute security documents on behalf of the company. Alternatively, powers of attorney may be executed by the company authorizing person(s) to execute the documents. All powers of attorney to be deemed by a UAE court as valid must be notarized and, if executed outside the UAE, must be notarized and authenticated by the ministry of foreign affairs (or its equivalent) in the jurisdiction where executed and by the nearest UAE Embassy and when brought into UAE must be authenticated by the UAE Ministry of Foreign Affairs, translated into Arabic by a legal translator, and authenticated by the UAE Ministry of Justice. **38.12**

Commercial Benefit

There is no specific requirement that commercial benefit to the company must be established to authorize the grant of a security interest over the company's assets and/or income. **38.13**

Registration Requirements

- 38.14** There is no requirement under the Commercial Code to have the Commercial Pledge notarized or registered with any authority in the UAE.

The Commercial Code requires that Business Mortgage must be executed before a notary public and registered in the Commercial Register. In Dubai, registration is effected in the Commercial Registration section of the Dubai Department of Economic Development. The registration procedure includes publication of notices in the Arabic press. Registration is granted for a period of five years, after which it may be renewed.

Enforcement

- 38.15** Security interests created in the form of commercial pledge or business mortgage may be enforced by the secured party (or through its security agent) through application to the court for sale of the pledged/mortgaged assets by public auction. A pledgee or mortgagee is not entitled to exercise self-help (regardless of any provision to the contrary in the mortgage agreement).

With regard to the enforcement of a commercial pledge, Article 172 of the Commercial Code provides that if the debtor fails to pay the debt secured by the pledge by the due date, the pledgee/creditor must give the debtor seven days' notice to pay whereafter the pledgee may apply to the court for leave to sell the property. The pledgee has priority over the sale proceeds. If the pledge agreement is in relation to several assets, the pledgee/creditor may specify which property must be sold, unless the pledge agreement provides otherwise.

Sale of the pledged goods is only permitted to the extent necessary to satisfy the subject debt. Any agreement granting the pledgee a right to acquire or sell the pledged goods without first proceeding to court and satisfying the aforesaid provisions is invalid.

- 38.16** As in the case of a commercial pledge, in the event of a default by the mortgagor under a business mortgage, a mortgagee may, after eight days' notice, apply to a court for sale of the mortgaged assets by public auction.

Further, Article 56 of the Commercial Code appears to give the lessor of premises where the mortgaged assets are located a lien over such items to the extent of the value of unpaid rent (subject to a maximum of two years' rent) which takes priority over a mortgagee's rights (although this is not expressly stated).

Court Protection

The bankruptcy provisions of the Commercial Code provide for the appointment **38.17**
by the court of a trustee in bankruptcy. After obtaining permission from the judge
supervising the bankrupt's estate, the trustee in bankruptcy may, at any time,
pay a debt secured by a chattel mortgage or a lien and return the objects of the
mortgage to the account of the group of creditors (Article 711).