

Update: Pledging of shares of a limited liability company in the UAE

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At present the Commercial Companies Law does not provide a mechanism for pledging the shares of a limited liability company in the UAE, and there is accordingly no official register on which to record the pledge of shares to perfect such security. In addition, one of the concerns about pledging the shares of a limited liability company is that a limited liability company does not have shares or shares certificates to be pledged. A partner's percentage of allocated ownership in a limited liability company is listed in a private registry maintained by the company and are typically referred to as quotas as opposed to shares. Such quotas are similar to shares, however no certificates of ownership are issued to the partners.

The proposed amendment to the Commercial Companies Law (the "Amendment Law") – which has been approved by the UAE Federal National Council and pending approval by the Federal Supreme Council – is expected to resolve this issue.

The Amendment Law

Article 79 of the Amendment Law states that:

1. "A partner may transfer or pledge its shares in the company to another party or to a third party. Such transfer or pledge shall be made in accordance with the terms of the Memorandum of Association of the company under an official document, in accordance with the provisions of this Law. Such transfer or pledge shall not be valid against the company or third parties until the date of its entry in the Commercial Register with the competent authority.
2. The company may not refuse to enter such transfer or pledge in such register unless the transfer or pledge violates the provisions of the Memorandum of Association or this Law."

The above provision of the Amendment Law would appear to indicate the following requirements for a valid pledge over shares in a limited liability company:

A pledge must be in accordance with the terms of the Memorandum of Association of the company

The Amendment Law appears to make it a requirement for limited liability companies to specifically authorise the pledging of shares by the partners in their Memorandum of Association (similar to provisions commonly included in the articles of free zone companies). What is not clear is whether the Memorandum of Association would have to contain such an express provision, or whether the lack of any prohibition would suffice. Assuming an express provision is required, to facilitate registration of the pledge with the competent authority, this new requirement would force most, if not all, limited liability companies in the UAE to amend their existing Memorandum of Association to incorporate provisions on the authority, requirements and procedures of pledging a partner's shares in favour of another party or a third party.

A pledge must be under an official document

Reference to "official document" suggests that an agreement in relation to a share pledge would need to

be executed before a competent authority (i.e. [notary public](#) in the UAE) prior to actual registration in the Commercial Register. This requirement would reflect the existing practice of the Dubai Economic Department and many of the free zone authorities in the Emirates.

A pledge must be made in accordance with the provisions of the Commercial Companies Law as amended by the Amendment Law

Under the proposed Amendment Law, in order to register a pledge over shares in a UAE limited liability company, a pledge should not violate any provision of the Commercial Companies Law or any UAE law. Parties to the share pledge must ensure that the pledge does not conflict with any statutory provision which would render the security void and unenforceable.

The pledge must be registered with a competent authority and its details entered in the Commercial Register

Article 79 intends to provide a solution to the historic problem regarding the absence of a formal register on which to record the share pledges. The proposed amendment presumes that the Commercial Register maintained by the competent authority (i.e. the relevant Economic Department) will accept and record share pledges in respect of shares/quotas of limited liability companies (as, for example, the Dubai Economic Department has been doing in recent times).

While the Amendment Law specifically mentions that a partner in a limited liability company may pledge its shares, Article 79 of the Amendment Law does not refer to any share certificate that should be presented with the competent authority to complete the pledging of the shares. At present the Dubai Economic Department does not require physical share certificates when filing a share pledge over a limited liability company, and it is likely this would be the approach taken by the other relevant authorities.

Enforceability of a Share Pledge

Article 81 of the Amendment Law provides a mechanism of enforcement against a partner's share in a limited liability company noting that a creditor may agree with the partner (debtor) and the company on the method and terms of sale (i.e. by way of private arrangement), otherwise, the subject shares shall be offered for sale at a public auction. Article 81 further states that the company may, within 15 days from the date on which the auction is awarded, recover the shares on the same terms as awarded at the auction (effectively giving the company a pre-emptive right).

It is interesting to note that Article 81 of the Amendment Law has not addressed the issue on the local ownership requirement and the restrictions that should be imposed on a share pledge (or any sale of shares following enforcement) to maintain the local ownership over a limited liability company.

Conclusion

The Amendment Law should bring to an end the prolonged uncertainties which have existed regarding the ability to take, and validity of taking, security over shares/quotas in limited liability companies. However as Article 79 intends to implement a new system which does not currently exist (outside of, arguably, Dubai), it will remain subject to implementation of formal procedures by each relevant Commercial Register, and of course the enactment of the Amendment Law.