UAE new Commercial Companies Law: Developments relevant to financial institutions

by Arina Gidwani - a.gidwani@tamimi.com - Dubai International Financial Centre
Renata Rai - -

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UAE Federal Law No. 2 of 2015 (“New Law”) governing commercial companies in the UAE was recently enacted, being published in the Federal Gazette dated 31 March 2015.

I. Introduction

The New Law will become effective on 1 July 2015 (“Effective Date”) and will replace UAE Federal Law No. 8 of 1984 (“Existing Law”). The New Law’s provisions as regards company structure and governance have been well documented. Developments relevant to financing transactions have received less attention but include provisions on: (i) corporate power and authority; (ii) regulation of Islamic banks; (iii) lending to board members; (iv) requirements in respect of directors interested in transactions; (v) financial assistance; (vi) pledges of shares in limited liability companies (“LLCs”); (vii) related party transactions; and (viii) application of provisions relating to public joint stock companies (“PJSCs”) to LLCs. This article covers some of the key developments relevant to financing transactions.

II. Power & Authority

Capacity and authority are problematic under the Existing Law because there is no statutory provision bestowing core powers upon a company. It is therefore usual for financial institutions to require resolutions of the shareholders of a company to approve a transaction, where the requisite powers are not explicitly granted in the constitutional documents. Many had hoped that the New Law would introduce a default level of corporate powers, but this has not materialised. Instead the New Law has a focus on implied powers and refers to an authorized individual acting in a “usual manner” and “within the usual limits”. This change in focus is unlikely to yield any lighter requirement in terms of establishing corporate capacity in financing transactions. Article 49, which applies to Joint Liability Companies, but its provisions could be applied by analogy as a guide to what would be considered ‘usual’, specifically notes that securing third party obligations and mortgaging of the company’s assets would be outside usual management. This is expressed to be the case even if the manager was authorised to sell property under the company’s Memorandum of Association. It would therefore seem that capacity and powers cannot be implied and a detailed review of constitutional documents will continue to be required, with shareholder resolutions obtained where necessary.

III. Pledge of Shares in LLCs

The New Law has enhanced the framework for financing UAE companies, as regards taking security over shares (or quota) in LLCs. Article 79 of the New Law allows for the transfer or pledge of a partner’s share in a company to an existing partner or a third party. Such a transfer or pledge must be executed in accordance with the company’s Memorandum of Association before a notary public and registered with the commercial register of the relevant emirate. The Dubai Economic Department has been accepting and registering pledges of LLC shares over the past 2 years. While the New Law clarifies the position on the pledging of shares in an LLC, it remains subject to implementation by the Economic Departments of the other emirates.

LLCs should anticipate that lenders may now require a pledge of shares as part of their security package and lenders will need to be mindful that emirates besides Dubai may require some time before the procedure for registration is clearly established. Lenders and borrowers alike would be wise to review existing powers of attorney and authorisations to ensure that they cover entry into and registration of share pledges.

IV. Financial Assistance

Financial assistance is generally seen as a company providing direct or indirect assistance to a person who is or becomes a shareholder, in connection with their acquisition of shares in the company. The Existing Law was silent on this subject. The New Law restricts a company and any of its subsidiaries from providing financial aid to any shareholder for the purchase of any shares, bond or Sukuk issued by the company. Financial assistance is widely defined under Article 222 and includes providing (i) loans; (ii) gifts or donations; (iii) the assets of the company as security; and (iv) a security or guarantee of the obligations of another person.

In many other jurisdictions where equivalent restrictions on financial assistance exist, the legislation typically prescribes a process to override the restriction in certain circumstances. The New Law, however, does not contemplate such a process, meaning that, on the face of it, the prohibition is absolute. This could be problematic for companies at the time of a share acquisition, as no security for, or guarantee in respect of, any financing could be granted by the target company or its subsidiaries (which is a common requirement in financings connected with share acquisitions).

There may be an argument that Article 222 does not apply to LLCs, as LLCs do not have shares and cannot issue bonds or sukuks. Similarly, the New Law is unclear on whether future transactions, for example those which refinance funding provided in connection with a share acquisition, would be subject to the Article 222 restriction. There will no doubt be further analysis and developments in respect of this provision of the New Law.

V. Related Party Transactions

The New Law also introduces the concept of related party transactions. Related parties are defined by the New Law as (i) companies in which a director, chairman, senior executive manager or employee holds at least 30% of the share capital and (ii) subsidiary, associated and sister companies. Article 152 prohibits a person from utilizing information they possess due to their membership or occupation to achieve any interest for themselves or a third party as a result of dealing in securities and any other transactions. While this is similar to restrictions on insider trading in western jurisdictions, the ambit of this article appears broader, as “other transactions” are not defined.

Securities are defined by the New Law as: (i) shares issued by joint stock companies; (ii) derivatives and investment units as approved by the UAE Securities & Commodities Authority (“SCA”); (iii) bonds, Sukuk and bills issued by the Federal Government or the Local Governments or by the public authorities or establishments in the State; (iv) bonds, Sukuk or any debt tools issued by companies in accordance with such regulation issued by the UAE Central Bank (“Central Bank”) and the SCA; and (v) any other local or foreign securities acceptable to the Central Bank and the SCA.

Additionally, related party transactions that exceed 5% of the company’s share capital require board and shareholder approval. The New Law also states that such transactions shall be evaluated by an assessor approved by the SCA (though there is no information on who may be the assessor or how they are appointed). Given the overlapping relationships and prevalence of multiple family businesses and corporate appointments in the UAE, this will likely be a significant point for companies to take into consideration and develop systems to show segregation of interests and independent decision making.

VI. Loans to Directors

The New Law introduces restrictions on loans, guarantees and securities to directors of PJSCs. Article 153 provides that a PJSC “may not provide any loans to any director, execute guarantees or provide any securities in connection with any loans” granted to a director. Furthermore, a loan granted to a director’s spouse, child or relative up to the second degree will be deemed to be granted to a director.

In addition, Article 153 also states that loans may not be granted to companies where a director, director’s spouse, child or relative holds over 20% of the share capital of such company. Any agreement in contravention of this article is stated as being invalid and auditors will be expected to report upon the extent of this kind of transaction and the company’s compliance with Article 153.

This article is of particular interest to banks because, unlike the Existing Law, the New Law does not have an express carve out from this prohibition as regards loans made by banks to their directors. On the face of it, there is therefore a mismatch between the New Law and the provisions of Union Law No. 10 of 1980, which permits banks to lend money to their directors in certain circumstances. We anticipate that there will be further developments in relation to the interaction between these two laws.

Article 368 sets out the penalties for (i) directors who violate Article 153 by obtaining loans, guarantees or securities for themselves or relatives up to the second degree and (ii) the senior officers (including chairmen, directors, executive officers and general managers) who authorize the provision of such loans, guarantees or securities. Under Article 368 the penalty is imprisonment of no more than three months and/or a fine of between AED 100,000 and AED 500,000

VII. Application of Joint Stock Company Provisions

Articles 84 and 104 of the New Law are of particular significance. Article 84 states that the provisions that apply to directors of joint stock companies apply equally to the managers of LLCs. Additionally, Article 104 provides that the provisions of the New Law applicable to joint stock companies apply equally to LLCs. Accordingly, amongst other things, Articles 152 and 153 (discussed above) would appear, on a strict interpretation of the New Law, to apply to managers of LLCs and LLCs. In addition, the limitations under article 154 (which prohibit certain actions by the board without express power in the company’s articles or a special resolution of the General Assembly) would also, on the face of the New Law, apply. The effect of these articles is a significant change for LLCs and their managers and they would be well advised to ensure they review and understand their obligations under the New Law.

VIII. Compliance

The New Law instructs existing companies to comply with its provisions by one year from the Effective Date (“Grace Period”), noting that the Grace Period may be extended. Notwithstanding other specific penalties prescribed under the New Law, Article 374 states that if a company fails to make the necessary changes in order to comply with the New Law, the company shall be dissolved in accordance with the provisions of the New Law. Article 374 does not distinguish between significant and technical breaches of the New Law and this will likely be a point for further consideration and perhaps secondary legislation.