

The Amendments Introduced by the UAE Commercial Companies Law of 2015 in Relation to Share Pledges and Executions Against Partners' Shares in Limited Liability Companies

Ali Bachrouch - Partner, Head of Corporate Structuring - Northern Emirates - Corporate Structuring
a.bachrouch@tamimi.com - Sharjah

Bashayer Al Obeidli
b.alobeidli@tamimi.com - Sharjah, UAE

February 2017

The legal position governing share pledges and execution against partners' shares in a limited liability company ("LLC") has stood as a very debatable topic during the application of the Former Law.

This article will focus on the legal amendments under the 2015 Law in relation to share pledges and execution against partners' shares in an LLC, with practical examples on its application in the Emirate of Sharjah. The first section of this article will tackle the share pledge concept, and the second section will focus on the execution against a partner's share in an LLC.

Share Pledge

This section will discuss the legal provisions governing share pledges, and will present the procedures for execution and registration of a share pledge agreement as per the practice in Sharjah.

1. Share Pledge Regulation under the 2015 Law

The principle of a pledge of shares is found at Article 79 of the 2015 Law, titled "Assignment or Pledge of the Share of a Partner in the Company". Article 79 provides that:

"1- A partner may assign or pledge its share in the company to another partner or to a third party. Such assignment 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 assignment 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 shall not reject the entry of such assignment or pledge in the register unless the transfer or pledge violates the provisions of the Memorandum of Association or this Law."

Article 79 is a substitute for Article 230 under the Former Law. Compared to Article 230, Article 79 differs from Article 230 in that Article 230 was dealing solely with the topic of the assignment of shares, whereas Article 79 addresses the pledge of shares as well and stipulates that the Partner may "assign or pledge its shares in the company". In doing so, Article 79 has resolved the debate which arose under the Former Law in relation to the possibility of pledging shares in an LLC. Article 79 is explicit in stating that shares can be pledged to another partner or a third party.

2. Share Pledge Procedures in Sharjah

The main procedure for executing and registering a share pledge agreement in Sharjah can be summarized as follows:

- Notarization of the Share Pledge Agreement:

The share pledge agreement ("Agreement") should be drafted in accordance with the terms of the Memorandum of Association of the relevant company and the provisions of the 2015 Law, and should be executed as an official document (i.e. notarized). In order to notarize the Agreement at a notary public, the parties (pledgor and pledgee) either personally or through an authorized Power of Attorney holder, must attend the Notary Public office to sign the Agreement before the notary. In the Emirate of Sharjah a fee of 0.4% (with a maximum fee of AED 10,000) of the monetary amount mentioned in the agreement must then be paid and the Agreement shall be notarized.

- Registration of the Share Pledge Agreement at Economic Development Department:

Upon completing the notarization process, either party may personally or through an authorized person visit the competent Economic Development Department in Sharjah (SEDD) with the notarized Agreement to apply for the registration of the share pledge in the commercial register. The application fee is AED 1500 in Sharjah, and the fee may differ from one emirate to another. The registration would then take place by entering the Agreement into the electronic register at the SEDD, and a letter certifying the entry is then handed to the applicant.

Execution Against a Pledged Share

As explained in section I above, the share in an LLC can be pledged in security for a debt. If the pledgor fails to pay the debt secured when due, the pledgee has the right to enforce the pledge. In this section we deal with the regulations governing the execution against a partner's share in an LLC and the execution procedures in practice.

1. Legal Provision Related to Execution under the 2015 Law

Article 20 of the 2015 Law states that:

"1- A creditor of a partner may not claim his right from the share of his debtor in the capital of the company, but he may claim his right from his debtor's portion of the profits. If the company is dissolved, the creditor may collect his right from the share of his debtor upon the liquidation of the company."

Article 20 of the 2015 Law mirrors Article 17 of the Former Law. Compared to Article 17, Article 20 has almost the same content but comes with some changes in the legal drafting, and provides that a creditor may not satisfy his debt directly from the shares of his creditor, but may do so from the profits that his debtor attains as per the debtor's shares.

However, Article 20 of the 2015 Law is under Chapter 2 which deals with the formation and management of companies in general, and the said article sets a general principle that must be followed in the case of any type of company, unless a special article provides differently for certain types of companies. In this regard, Article 81 of 2015 (under Title 3 on Limited Liability Companies) gives an additional right to the creditor of a partner in an LLC and provides that:

"If a partner's creditor commences the execution procedures against the share proceeds of its debtor, the creditor may agree with the debtor and the company to the method and the terms of the sale. Otherwise, the share shall be offered for sale at a public auction, upon a request submitted to the competent Court. One or more partners may recover the sold share at the same terms as awarded at the auction, within 15 days from the date on which the auction is awarded. These provisions shall apply in the event of

bankruptcy of a partner.”

Article 81 of the 2015 Law is titled “Execution against a Partner’s Share in the Company” and replaces Article 234 of the Former Law. Compared to Article 234, Article 81 differs in three main respects:

- Article 234 talked about the execution procedures that may be taken by the creditor against the “share”, whereas Article 81 clarifies that the action can be taken against the “share proceeds”.
- In respect of the sale of the shares at public auction, Article 234 provided that the “company” may recover the sold share at the same terms as awarded at the auction, but Article 81 is more accurate in stating that “one or more partners” (not the “company”) may directly recover the sold share at the same terms as awarded at the auction.
- Apart from the above two changes, Article (81) contained a content similar to Article (234); with some amendments in terms of the legal drafting of the article, specifically by adding that the offer for sale at public auction should be “upon a request submitted to the competent Court”.

It can be understood from the above mentioned regulations that the creditor of a partner in an LLC has an additional right represented by the execution against the share proceeds in general (in addition to the right to satisfy his debt from the profits of the share as provided for in Article 20).

2. Procedures Related to Execution against a Partner’s Share.

In order to proceed with execution, the first step is for the pledgee/creditor to commence execution proceedings against the proceeds (including the profits) of the pledged share. This step is in line with the terms of Article 20, which allows the pledge/creditor to first target the profit of the pledged share, before targeting the actual share.

Secondly, if the pledge/creditor is unable to satisfy the debit from the profit of the share, the pledge/creditor may then target the sale of the share. This is to be carried out by negotiating with the debtor and the company to reach an agreement on the method and terms of the sale of the share. If this negotiation is successful, the share is to be sold as per the aforesaid parties’ agreement, and the sum in exchange for it is to be used to satisfy the creditor’s debt.

Thirdly, if the parties fail to reach any agreement with regards to the sale of the share, the pledge/creditor must submit a request to the competent court seeking the sale of the share through a public auction. The partners in the company would have the right to participate in this auction, and where the share is sold to a third party, the partners may also recover the sold share within 15 days from the date on which the auction is awarded. The price that the share is sold for shall also be used here to satisfy the debt.

For the avoidance of doubt, it should be noted that:

- The creditor who is a pledgee (i.e. has a share pledge) shall have precedence, over both ordinary creditors and creditors subsequent to him in ranking, in satisfying his debt from the proceeds of the sale of the pledged share.
- Where the creditor participated in the auction and won, the court may accept the creditor’s request to adjust the amount that should be paid by the creditor as price against the amount of the debt which is outstanding to the debtor. This would result in the debtor paying the remaining amount of the price of the share (if any remains) after adjusting the amount of the debt from the price.

Conclusion

The 2015 Law has clearly resolved the legal debate regarding the possibility of pledging shares in an LLC by introducing express provisions in Article 79. However, the right to pledge shares has not been added to the provisions relating to Joint Liability Companies and Limited Partnerships (Simple Commandite

Companies). In addition, unlike the pledge of a sole establishment under the commercial transactions law, the 2015 Law does not limit the right to offer pledges to banks and financial institutions.