

On 15 March 2017 a significant new law, Law No 20 of 2016 Regarding the Pledge of Movables as Security for a Debt ("Pledge Law"), came into force in the United Arab Emirates (UAE). The new law is poised to substantially alter and create certainty in commercial lending practices in the UAE. It provides protections against the multiple pledges of assets to different lenders by borrowers, and is designed to encourage the adoption of more prudent lending practices by lenders in a market long dominated by "name" and family-based lending in place of contemporary best-practice risk analysis.

The advent of the Pledge Law is part of a recent flood of commercial legislation in the UAE which has included the introduction of a new national Commercial Companies Law and Bankruptcy Law. Unlike those laws, however, which had been anticipated for the better part of a decade, the Pledge Law was introduced with little notice or fanfare. Given the scope and potential effect of the law, its sudden and unheralded arrival was something of a surprise to practitioners and the financial community alike.

Overview of Existing Law

Historically in the UAE, security for lending has been supported, generally on a non-institutional basis, by possessory liens. These remain valid under the Pledge Law and, in fact, appear to remain capable of registration under the new law. The Pledge Law recognises these, but is almost entirely limited in its application to non-possessory pledges over assets in support of lending or other secured transactions.

Non-possessory pledges are not new to the UAE. The Commercial Transactions Law of the United Arab Emirates [Federal Law No. 18 of 1993] provides for non-possessory liens over a number of different types of physical and intangible assets. For moveable assets, the Commercial Transactions Law provides for business or commercial mortgages, which can only be granted to financial institutions, but also for commercial pledges (also known as chattel mortgages) for other than institutional lending contexts.

In order to be effective under the old law, business mortgages needed to include very specific wording as to what assets were charged, uncertainly being a grounds for voiding the charge; had to be executed before a notary public and, accordingly, be written in the Arabic language or parallel translation; and required registration with a Commercial Register to be established by each of the seven Emirates. Only Abu Dhabi and Dubai actually established such registers and, requiring physical attendance, they are notoriously difficult to search for prior liens or even to access at all. It was also a requirement that notice of the charge had to be given by publication in at least one Arabic-language newspaper two weeks prior to registration being effected.

In addition, the existing law did not provide for a system for determining priority amongst pledges. Other than a single provision of the UAE Civil Code [Federal Law No. 5 of 1985, as amended], which provides that, with respect to the assignment of "rights" (which has been interpreted as including the right to receivables, for example), where there are several assignments of one right, only the first assignment will be enforceable. Priority of security was not specifically addressed in UAE law.

Enforcement was also somewhat problematic under the previous system, heavily dependent upon courts throughout the process from notice to realisation, and with no self-help remedies generally available to a creditor. The Pledge Law has been designed to rectify some of these deficiencies.

What Is New?

Somewhat confusingly, the Pledge Law ignores business mortgages and pledges granted under the Commercial Transactions Law, and does not amend or suspend any aspect of it or the UAE Civil Code in any material respect. As these aspects of the law are not repealed, presumably debtors and creditors can create and take security under the old law. However, the Pledge Law is ground breaking in many ways:

- **Creation of a Register of Charges:** The heart of the new law is the creation of a registry for the registration of charges upon moveable and other stipulated assets, similar to the registries established under the US Uniform Commercial Code or under the personal property security laws applicable in numerous Canadian provinces, Australia, New Zealand and many other jurisdictions. The Register has yet to be established, however the Pledge Law states that it will be an electronic registry, presumably searchable, and that it is to be created by a Cabinet Resolution and, hence, probably administered federally at a national level. At present, there is a great deal of second guessing as to what information will be available on the Register and to what extent it will be publically available. The Pledge Law suggests that public access may be limited by the terms of the pledge agreement itself.
- **Collateral Subject to Pledge:** A wide range of assets can be pledged as collateral security under the Pledge Law, including trade payables, bank deposits, bonds and similar financial instruments, equipment and other tangible commercial assets, goods on consignment, raw materials or work in progress, agricultural products and any other assets stipulated as capable of pledge by law.

- **Pledge Free from Possession:** The Pledge Law affirms the right of parties to pledge their assets without the transfer of title to the pledgee or a third party, subject to due registration. It also allows pledgees holding a possessory lien the right to register under the new law, subject to certain conditions.
- **Form of Pledge:** Commercial or business pledges under the Commercial Transactions Law were required to be executed before a notary public. The fact that the new register is to be electronic renders that requirement unlikely, although it is unclear. There are, however, some form requirements which must be adhered to for the pledge to be valid, including:
 - Pledge contract must be in writing in a form consistent with Executive Regulations, which are to be promulgated.
 - Pledgor must have the capacity to enter into the pledge in respect of the pledged property.
 - Assets subject to pledge must be described in general or specific terms consistent with commercial practice relevant to the pledged property itself.
 - Importantly, in a first for the UAE, the pledge must contain a statement as to whether or not there are prior liens on the same asset, a move to bar the practice of creating multiple assignments or pledges of the same assets, a not uncommon occurrence.
 - Pledgee must actually pay the monies stipulated in the pledge agreement.
- **Pledge of Future Property:** In a significant departure in the UAE, after-acquired property may be included in a pledge. Whether the rights against this type of asset will be enforced by the courts in the manner of rights granted under floating charges (a concept not previously recognised under UAE law), remains to be seen.
- **Priority:** As with many international jurisdictions, first in time in registration grants priority to a creditor in a pledged asset as against third parties.
- **Priority as to Proceeds:** The priority of a registered interest extends to priority over the proceeds of disposition of a pledged asset.
- **Changes in Enforcement:** As noted above, the enforcement of security granted under existing law, which required it to be undertaken through the local courts, is lengthy, with the increased expense which that entails. The new law sets out a variety of self-help remedies, including seizure and sale, dependent upon the character of the asset in question.

Conclusion

The Pledge Law is a step in the right direction and, in the context of the wave of wider legislative commercial reform in the UAE, can only be regarded as positive. It is a move toward greater transparency in commercial life in the Emirates and should be welcomed as such. However, the devil is, as they say, in the details and there is work to be done in terms of the creation of the Register, in setting out what information it contains, to whom it is open for scrutiny and similar implementation matters. Further, it is not clear as to how the UAE Courts will adapt to their new and somewhat reduced role under the new law.

Contact

Douglas G. Smith

Partner, Dubai

T +971 4 447 8737

E douglas.smith@squirepb.com