Asset Security in the United Arab Emirates

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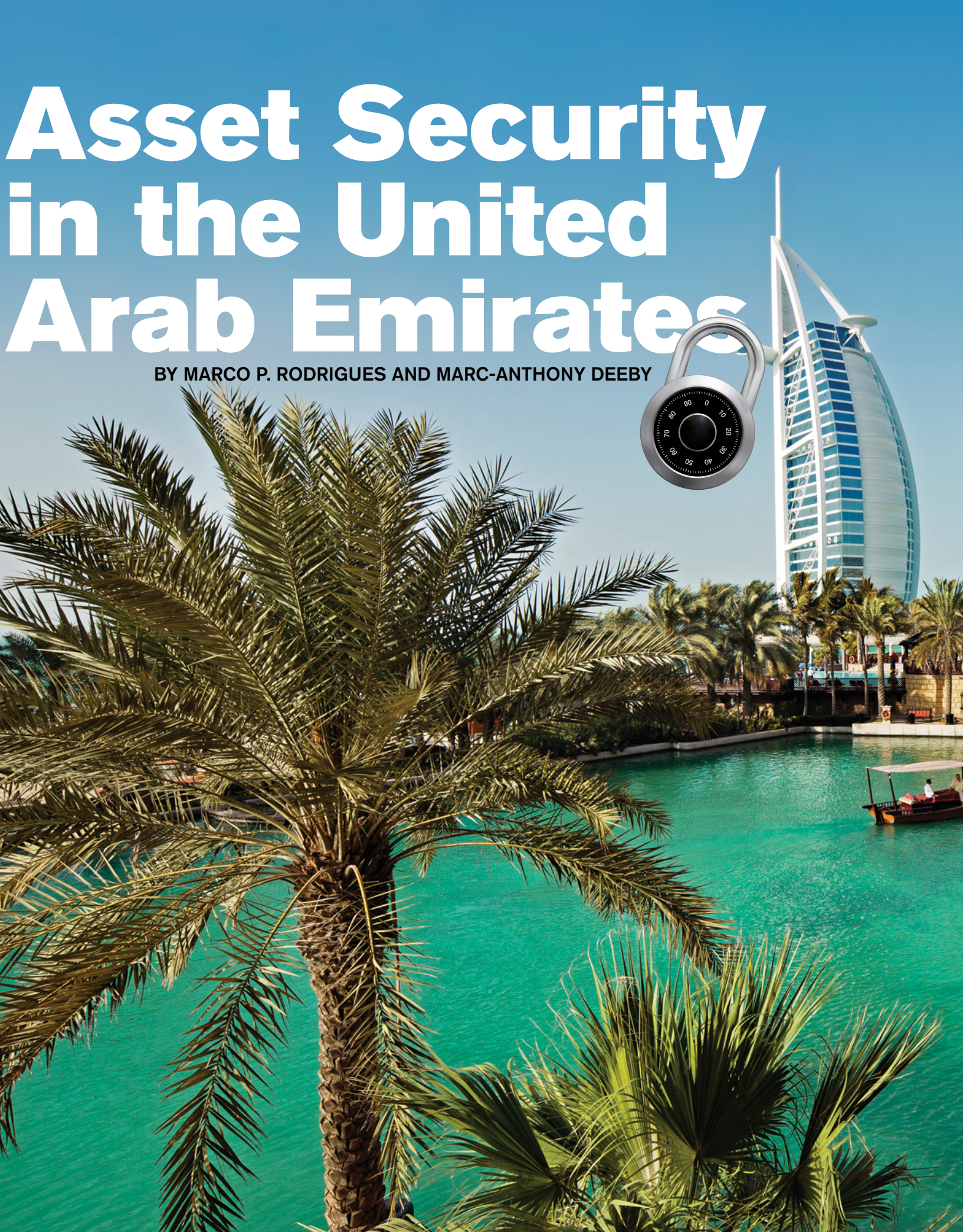

The United Arab Emirates[1] is a young country. U.A.E. laws relating to secured lending remain largely untested. Taking effective asset security in the U.A.E. is, therefore, not a straightforward process. This article highlights certain key issues that secured lenders should be mindful of when executing transactions in the U.A.E.

The United Arab Emirates (the "U.A.E.") is a relatively young country, having only existed in its current form for 40 years. Prior to obtaining its independence in 1971, the U.A.E. was known as the Trucial States and was a British protectorate. Despite its strong historical ties to Britain, the U.A.E. decided not to adopt a common law legal system. Instead, and very much in line with most other neighboring Arabic and Levantine countries, the U.A.E. adopted a civil law legal system which is broadly based on the French legal system. Unsurprisingly, U.A.E. laws relating to secured lending differ quite significantly from the laws of more mature, and common law, jurisdictions, such as the U.S.

U.A.E. laws relating to secured lending remain largely untested before the U.A.E. courts as there has, to date, never been a large-scale corporate insolvency in the U.A.E. (outside of a governmental decree[2]). This factor, combined with the relative youth of the U.A.E., explains, at least in part, why some areas of U.A.E. law relating to secured lending are so archaic.

U.A.E. law does not cater to certain legal structures customarily used in today's sophisticated international financing transactions. Whilst, over the years, a relatively homogenous commercial practice has developed in the U.A.E. amongst the legal community to address some of these lacunae, it is yet to be seen whether these practices would, in fact, withstand the scrutiny of the U.A.E. courts.

Taking effective asset security in the U.A.E. is not an entirely straightforward process. Accordingly, lenders should be prudent when structuring transactions that have a nexus to the U.A.E. It is crucial to appoint U.A.E. counsel who are civil law-trained, privy to the numerous pitfalls associated with secured lending in the U.A.E. and, more importantly, can guide a lender through the process safely. The aim of this article is to draw attention to certain key high-level issues that secured lenders are confronted with regularly when executing transactions in the U.A.E.

Centralized Registry

Save for certain specific categories of assets (e.g. aircraft and vessels), there is no mandatory, centralized and freely searchable security registry in the U.A.E. that is comparable to the filing system established under UCC-Article 9 in the U.S. As such, lenders are currently unable to file a security interest or other analogous rights against an obligor and/or its assets in the U.A.E. Of equal importance, lenders are also precluded from conducting routine lien searches in the U.A.E. These searches represent an essential tool for lenders and their credit committees. They allow lenders to assess the robustness of a projected security package and highlight existing filings that could potentially impair the priority and ranking that such lenders expect to achieve. Lenders have no choice but to rely exclusively on the good faith of the representations made by an obligor under the transaction documents. This uncertainty is obviously less than ideal.

Notarization Process

In an attempt to circumvent the absence of a security filing system, a practice has developed in the U.A.E. whereby material security documents are tendered to a notary, who is an independent and "quasi-judicial" third party, for notarization. The rationale behind this practice is that notarization effectively "crystalizes" the date of execution of the tendered document. This enhances the ability of a secured lender to successfully defend and prove its priority and ranking before the U.A.E. courts as it is the date of notarization that should, at least in theory, determine the priority and ranking of such lender in an enforcement scenario.

The notarization process in the U.A.E. is cumbersome and costly. By way of example, security documents must be translated into Arabic[3] , so advance planning is key. Depending on the type of security document, additional formalities may be required by the notary or the law itself, such as prior notification in the local newspapers of the intention to take security. Note that such formalities may also vary from one U.A.E. notary to another. Hence, it is important to select the transaction notary wisely, to the greatest extent possible, and endeavor to build a good working relationship with that same person.

Given the pivotal role of the notary in the U.A.E., particularly in the context of financing transactions, his powers are quite broad compared to that of a notary public in the U.S. By way of example, as a condition precedent to the notarization of a security document, it is not unusual for a U.A.E. notary to request copies for review of ancillary transaction documents containing sensitive information, such as a negotiated credit agreement. U.A.E. notaries have also been known to "suggest" amendments to such ancillary documents from time to time, some of which are substantive. These amendments tend to be non-negotiable and failure to integrate them can hold-up a closing or, worse yet, bring a transaction to a complete halt. Best practice is to engage with the notary as soon as possible at the outset of a transaction to avoid unnecessary surprises and delays.

Security Overview

As a general rule, security is available in the U.A.E. only by way of a pledge (i.e. actual possessory security) on an asset-by-asset basis. There is no equivalent in the U.A.E. to a blanket lien allowing a lender to obtain a security interest in all present and after-acquired personal property of an obligor. U.A.E. law does however recognize "business mortgages". This instrument was originally designed to allow lenders to obtain a security interest in all of the assets dedicated to the "business" of an obligor (other than real property). Whilst the actual scope of the business mortgage remains broadly untested, it is widely accepted that this instrument is use-

ful only to obtain a security interest in equipment and machinery which have been specifically earmarked.[4] It is also not currently possible under U.A.E. law to take a valid security interest in after-acquired assets. This presents obvious challenges to obtaining a meaningful security interest in certain categories of assets, namely receivables and inventory.

U.A.E. law does not recognize the concept of "trust" as understood in common law jurisdictions. This creates significant hurdles when structuring a security package in the context of a syndicated lending transaction. The entity holding U.A.E. security for, and on behalf of, a syndicate of lenders will need to be carefully appointed to ensure that the whole structure does not implode. Some have wrongly argued that the holder of such security acts merely as an agent of the syndicate of lenders. While U.A.E. law does in fact set out a very basic agency regime, the existing provisions of the law and, more fundamentally, the civil law concept of agency itself, were not tailored to accommodate changes in the composition of the syndicate of lenders after closing. U.A.E. counsel will be able to help mitigate these risks by ensuring that certain steps are followed.

What The Future Holds....

There is currently a wind of change blowing in the U.A.E. With major overhauls of, among others, the insolvency and companies laws announced for this year, it is widely anticipated that, as a logical next step, a major upgrade of the secured lending laws will follow shortly. The hope is that the revised laws will address and improve the areas discussed above. These changes would be welcomed by financial institutions and the legal community alike, as they are expected to align U.A.E. law to that of more mature jurisdictions and other major financial hubs around the world and thus induce and simplify international investment into the U.A.E. TSL

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1. Unless otherwise specifically set out in this article, all references herein are to onshore U.A.E. laws only. The U.A.E. contains within its borders numerous "offshore" jurisdictions (i.e. free zones), such as the Dubai International Financial Centre (the "DIFC") and the Jebel Ali Free Zone Authority. Most of these freezones have their own independent and bespoke legal framework.
2. In November 2009, the Government of the Emirate of Dubai (U.A.E.) announced that the debt of Dubai World and its subsidiaries would undergo a significant restructuring. To facilitate this restructuring and ensure that its processes are compatible with international best practices, Decree No. 57 of 2009 was enacted and became effective on 13 December 2009. Building on the existing DIFC insolvency regime, this decree established the legal framework governing any restructuring of Dubai World and its subsidiaries going forward.
3. The Arabic version of a security document governed by U.A.E. law (and indeed most other documents governed by U.A.E. law) always prevails.
4. Certain intellectual property rights can also be validly charged thereunder.

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