

# Perspectives on the New CCL - What do lenders need to know?

When the new UAE Commercial Companies Law (Federal Law No. 2 of 2015) (the New CCL) enters into force on 1 July 2015, it will introduce a number of concepts and amendments to the existing law which are likely to have a significant impact on loan documents and lending practices in the UAE.

**This note sets out the key changes introduced by the New CCL which we anticipate will be of particular importance to lenders and our initial views on their likely impact. Please refer to our recent briefing "Perspectives on the New UAE Commercial Companies Law – What do you need to know?" for a comprehensive analysis of the New CCL, an overview of the changes to Federal Law No. 8 of 1984 (as amended) (the Current CCL) and further commentary on the wider amendments.**

## Key points for lenders

Some key points arising from the New CCL in the context of loan documents and lending practices in the UAE are as follows:

- No relaxation of foreign ownership restrictions at present.
- Changes relevant to limited liability companies (LLCs), including:
  - A helpful new mechanism for taking security over shares in LLCs.
  - Expansion of existing provisions relating to attachment of shares.
  - New procedures for general assembly meetings and passing of shareholder resolutions.
- Changes relevant to joint stock companies (JSCs), including:
  - An unexpected restriction on the authority of a board of directors of a joint stock company (JSC) to enter into mortgages of both moveable and immoveable property without express authorisation in the articles of the company or a shareholders resolution.
  - New provisions relating to increase in share capital and purchase of assets during first fiscal year.
  - Further developments in the framework for maintenance of capital, including new provisions relating to financial assistance and director loans.
  - New procedures for shareholder unfair prejudice claims.
  - New provisions relating to corporate governance, including related party transactions and corporate benefit.
  - New procedures for general meetings and resolutions.
- The New CCL expressly states that provisions concerning JSCs will apply to LLCs unless otherwise provided.
- A requirement for mandatory amendment of constitutional documents.
- No change to existing practices for company searches.

## No relaxation of foreign ownership thresholds (Article 10)

Much of the commentary around the New CCL has been focused on the retention of the requirement for UAE companies to be owned at least 51% by UAE nationals. In addition, the New CCL grants the Cabinet the right, upon the recommendation of the Minister of Economy, to limit certain sectors to UAE nationals only.

At the Annual Investment Meeting held in Dubai on 30 March 2015 the Minister of Economy reiterated the Government's intention to enact a new Foreign Direct Investment Law that would allow increased foreign ownership in certain (but as yet unspecified) sectors outside free zones. According to recent press articles, the law will be designed to encourage innovation and technology transfer. It will likely require companies that are granted higher foreign ownership rights to provide support or expertise to sectors identified by the Government as strategically important. To date, no timeline has been published for the introduction of the new Foreign Direct Investment Law.

## Changes relevant to Limited Liability Companies

The legal framework relating to LLCs remains largely unchanged. However, the New CCL does include some amendments aimed at making LLCs simpler to manage and more attractive to investors. Set out below are some areas relating to LLCs under the New CCL that we anticipate will be of particular interest to lenders.



### Mortgage over shares in an LLC

**Robin Abraham**

"The explicit provision for the creation and registration of a mortgage over shares in an LLC is a positive clarification of what was an uncertain issue. The amendment will lead to the more common utilisation of LLCs as vehicles in secured lending structures, rather than more costly and burdensome private joint stock companies. It will also give banks a further cost-effective route for taking a registered security interest, which is to be welcomed.

While challenges will likely remain in relation to the procedure for taking and enforcing a mortgage over shares in an LLC, the framework for the registration of mortgages with the registrar will provide additional comfort to the market."

## Mortgage over shares in an LLC (Article 79)

Whilst the Current CCL specifically provides for a pledge to be taken over shares in a JSC, there is nothing expressly permitting security to be taken over the interest a shareholder holds in an LLC. The issue arises from the fact that the interest a shareholder has in an LLC is more akin to a partnership interest, a part share in an undivided whole. This has traditionally caused problems for lenders attempting to utilise LLCs as vehicles in secured lending structures.

A mortgage over shares in an LLC is now specifically provided for in the New CCL and the law allows for this type of security to be registered. This introduces some additional certainty with regard to the utilisation of LLCs in financing structures and the ability to grant security over interests in these entities rather than using the more burdensome private JSCs. We note that recent English translations of the New CCL have used the word "mortgage" as opposed to "pledge". There is no difference between these two terms in the original Arabic, which uses the word "رهن". In this note we have used the word "mortgage" to reflect the current versions of the translation.

What is not yet certain is how easy the new provisions will be to apply in practice. There are still no share certificates, no numbered or registered shares, and no identifiable "part" of the shares as a whole that is attributable to any shareholder in an LLC which, together, raise a number of practical challenges in terms of traditional methods of security creation.

Article 79 provides that such mortgages must be taken in accordance with the terms of the memorandum of association of the company under an official notarised



### Impact of New CCL and retention of foreign ownership thresholds

**James McCarthy**

"Although the New CCL contains a number of new concepts and offers increased flexibility in some areas, the underlying framework of the Current CCL remains intact and many of the anticipated developments, in particular the relaxation of the foreign ownership thresholds, have not yet materialised. We still however, expect a Foreign Direct Investment law to be issued at some point in the future. The New CCL also contains a few problematic provisions, most notably the blanket application of provisions relevant to JSCs to LLCs and it remains to be seen how borrowers, lenders and other market participants will adapt to this."

document. It is unclear at this stage what such terms may include given, for example, that formal registration requirements are yet to be issued. We understand, for example, that the Dubai Economic Department (DED) will treat requests for registration of a mortgage over the shares of an LLC in a similar manner to requests for registration of a commercial mortgage. Accordingly, a dual language document will be required which should be pre-approved by the DED and officially translated and notarised prior to being registered. Procedures for taking such a mortgage will need to be determined and practices are likely to vary between the different Emirates.

In addition, pre-emption rights on a transfer of shares in favour of the existing partners (which cannot be waived in advance) have been retained and it is therefore difficult to envisage how this will work in the context of enforcement, other than in relation to attachment as set out in Article 81.

### Attachment of shares (Article 81)

The New CCL expands on existing provisions relating to the attachment of shares in an LLC. In the event that a creditor proceeds with the enforcement of its rights but fails to agree with the debtor and the LLC on the conditions and mechanics of sale of the shares, such shares shall be sold by public auction following a request to the competent court. The shareholders will have the right to buy back the shares from the winning bidder within 15 days of the public auction, on the same terms and conditions. The same rules apply in the event of bankruptcy of a shareholder. This clarification will assist with the enforcement of share mortgages over LLC shares, where enforcement occurs by way of attachment.

### General assembly and shareholders resolutions (Part 3, Chapter 3)

A new requirement for partners representing at least 75% of the share capital to be present at a general assembly meeting for it to be quorate has been included (previously, it was 50%). The meeting invitation can now be sent by registered letter or as set out in the memorandum of association. The timeframe for dispatch of the invitation has been reduced from 21 days to 15 days. Resolutions must be passed by the majority of shareholders present or represented at the meeting voting in favour, or such higher number as specified in the memorandum of association. The threshold specified in the New CCL appears to be a majority in number which, as many LLCs have two shareholders, will imply unanimity in circumstances where both shareholders attend and increase the possibility of deadlocks. This could also give rise to unusual results in other circumstances (e.g. two minority shareholders could outvote a majority shareholder) and we anticipate that many LLCs will take the opportunity to specify an additional threshold in the memorandum of association (e.g. partners representing a majority of the shares in attendance).

### Corporate governance

There is no significant change to the governance regime applicable to LLCs. However, it is worth noting that:

- (Article 86) New non compete provision prohibiting a director (without the consent of the general assembly) from holding a management position at a competitor or conducting any competing business for his or her own account.
- (Article 84) The provisions that apply to the directors of JSCs continue to apply to the managers of LLCs.
- (Article 104) There is a new requirement that, unless otherwise provided by the New CCL, the provisions concerning JSCs will apply to LLCs. It is unclear how this provision is intended to apply in practice. See [Application of provisions applying to JSCs to LLCs](#) below for further commentary.



**Article 154 and  
Article 104**

**Peter Avery**

"The introduction of Article 154 in the New CCL may require both JSCs and LLCs to review their constitutional documents to ensure that they are able to carry out secured financings without having to undertake the burden of seeking the approval of a general assembly or a partner resolution. The general application of provisions relating to JSCs to LLCs under Article 104 will likely create some uncertainty, at least until a general practitioner view is taken on how this Article should be applied in practice."

## Joint Stock Companies

There have been some substantive changes to the framework applicable to JSCs. The New CCL introduces a modified process for the valuation of shares in kind (Articles 118-120, 194). It also appears to provide a degree of flexibility for the Cabinet to permit different classes of shares, including preference shares, although it remains to be seen how this will be implemented (Article 206).

New provisions permitting the issuance of new shares to a "strategic partner" without pre-emption rights have also been introduced (Articles 223, 224) which, taken with the potential for different classes of shares, may now offer new fund raising opportunities – although we have some reservations that the current definition of "strategic partner" for these purposes is perhaps unnecessarily narrow and further secondary legislation is required.

Other relevant points are as follows:

- **Purchase of assets during the first fiscal year (Article 142):** Directors must notify the Securities and Commodities Authority (SCA) if the company purchases assets, companies or establishments with a total value greater than 20% of its share capital during its first fiscal year. The SCA has the power to assess such acquisitions and this is likely to have timing implications for many transactions. We interpret this to mean that the SCA may require an additional valuation exercise to be carried out.
- **Restrictions on the powers of the board (Article 154):**
  - The Current CCL provides that (amongst other things) the board of directors of a JSC may not sell the company's real estate properties or its places of business, nor mortgage such properties unless authorised by the articles of association or a resolution of the general assembly of the company. The New CCL appears to expand this restriction providing that the board of directors may also not mortgage "movable and immovable property" of the company unless authorised by the articles or a special resolution.
  - As many existing companies will not have the necessary authorisation in their articles, this will make it more burdensome for companies to provide this type of security to their lenders and will affect existing practices for corporate authorities on ordinary course financing transactions, unless companies are prepared (and permitted) to amend their articles to allow the directors to grant such security. This may need to be taken into account when companies are looking to amend their articles over the next year, to bring their constitutional documents into line with the New CCL.
- **Board resolutions (Article 157(2)):**
  - The Current CCL is silent in relation to the ability of the board of a JSC to pass written resolutions. Generally, unless written resolutions are expressly permitted in the articles, written resolutions are not permissible for unlisted JSCs and are only permissible for listed JSCs in accordance with the criteria set out in the SCA Corporate Governance Resolution (Ministerial Resolution No. 518 of 2009).
  - The New CCL expressly contemplates that the board of directors may issue some Resolutions by circulation, in accordance with such conditions and procedures as resolved by the SCA in this respect. As such, this appears to clarify the current position as opposed to amending it further.
- **Shareholder unfair prejudice claims (Article 164):** The New CCL includes a new procedure for an application to be filed by one or more shareholders holding at least 5% of the shares of the company to the SCA where such shareholder considers that the affairs of the company have been or are going to be conducted to the detriment of all or any of the shareholders. Application may be made to the court if the SCA rejects the application or does not review it within 30 days. Ultimately, the court may annul or require the taking of any act that is the subject of the application.
- **Corporate governance**

For JSCs there are a number of new provisions relating to corporate governance that may impact on financing transactions:

  - *Corporate governance framework to be published (Article 6):* The New CCL anticipates new resolutions to establish the general framework regulating corporate governance in connection with private JSCs where the number of shareholders exceeds 75. The Board of Directors of the SCA will issue the governance resolutions in relation to

public JSCs (although current corporate governance regulations will continue to apply). The board of directors of a company or, as applicable, its managers shall be responsible for the application of the rules and the criteria of the corporate governance regime.

- *Related party transactions (Article 152)*: There is a new general prohibition on related parties of a JSC utilising the information in their possession for the purpose of a personal interest or the interest of a third party. A JSC may not enter into transactions with related parties (the chairman, directors, senior executive management and employees of the company and such companies in which any of such persons holds at least 30% of their share capital and subsidiary, associated or sister companies) having a value exceeding 5% of the share capital of the JSC without the consent of the board of directors and the General Assembly of the company in excess of that percentage. The New CCL prescribes that such transactions shall be assessed by an assessor approved by SCA.
- *Corporate benefit test (Article 170)*: Any board resolution of a JSC shall be invalid if it is passed in contravention of



**Corporate benefit (Article 170)**

**Mohamed Hamra-Krouha**

"The codification of the corporate benefit requirement is likely to require enhanced due diligence by lenders to check consistency of the relevant resolutions with their borrower's or security provider's objects and constitutional documents. The existing good practice (in drafting resolutions) of having the directors discuss, explain and confirm how a specific transaction benefits the company is likely to be extended. Due care will be required for upstream guarantees in the context of financings raised by a parent or grand-parent entity, in particular if the parent and subsidiary share directors."

the New CCL or the memorandum or articles of association of the JSC, or for or against a certain class of shareholder or to bring a special benefit to a related party without consideration of the interests of the JSC. Under the New CCL, proceedings for annulment are time-barred after 60 days from the date of the challenged resolution.

Article 170 is expressed to be "*without prejudice to the rights of a bona fide third party*", inferring that any "*bona fide*" third party can be confident in their dealings with directors in that, by purporting to act on the company's behalf, the directors are binding the company to any contractual arrangement. It is important to note in this context that the exact meaning of the term "*bona fide*" under UAE law is unclear, although it is likely to import a requirement that the third party seeking to rely on the provision is itself acting in good faith in its dealings with the company. It remains to be seen how widely this provision will be interpreted in practice by the UAE courts but, for example, in certain jurisdictions if a lender receiving security had the means and the duty to ascertain that the granting of security was an ultra vires act of the company (i.e. by having the requisite access to the constitutional documents and reviewing such constitutional documents), being put on notice of the ultra vires act would prevent a lender from being viewed as a bona fide third party should it seek to rely on similar protections.

- **General meetings and resolutions (Article 172 and 173)**: The notice period for general meetings has been reduced from 21 days to 15 days and a shortened notice period is permitted if shareholders representing 95% of the share capital of the company agree. We query how useful this provision is likely to be in practice given the requirement for SCA approval and publication of notice in two Arabic daily newspapers. A shortened notice period for reconvened meetings has also been introduced. The distinction between ordinary general meetings and extraordinary general meetings is abolished and substituted with the concept of a "special resolution" (a resolution approved by at least 75% of the shares represented at a general assembly). A special resolution is required to pass certain significant matters, including amendment of the articles of association.

- **Increase in share capital (Article 195, 225):** The share capital of the company may be increased by an issue of new shares, capitalising the statutory reserve or converting any bonds or sukuk issued by the company into shares. The New CCL expressly permits companies to increase their share capital on a non pre-emptive basis through the conversion of debt into equity in accordance with procedures to be issued by SCA, a practice which was not previously permitted under the Current CCL in express terms. This development could provide greater clarity in dealing with debt restructuring scenarios.

- **Maintenance of capital**

The New CCL introduces the concept of and prohibits financial assistance for the first time. Although anticipated, its inclusion is surprising given the wider retreat from these prohibitions in certain other jurisdictions. The New CCL also widens the prohibition on loans to directors of JSCs to include their family members, and the exemption for banks and credit companies has been removed.

- *Financial assistance prohibition (Article 222):* JSCs may not provide financial assistance to any shareholder to enable such shareholder to hold any shares, bonds or sukuk issued by the company. The prohibition is broad and includes providing loans, gifts or donations, assets of the company as security and a security or guarantee of the obligations of another person. It is important to note that there is no statutory "whitewash" regime of the type seen in other jurisdictions.
- *Prohibition on loans to directors (Article 153):* The New CCL widens the prohibition on loans to directors. JSCs may not make loans to their directors, a director's spouse, children and any other relative to the second degree. The exemption for banks and credit companies has been removed and will no longer apply.



### Increase in share capital (Article 195, 225)

Antony Single

"A dynamic economy such as the UAE needs flexibility to allow parties to achieve their commercial intent; this change provides welcome clarity and a more sophisticated option in restructurings"



### Financial assistance without "whitewash" regime

Debbie Walker

"The broad restriction on providing financial assistance without any "whitewash" regime will impact the ability of borrowers to raise debt for acquisition purposes. The restriction will prevent security being granted in favour of financiers over the assets of the target company and will prevent the target company from guaranteeing the acquisition debt, practices which are both common in other jurisdictions. Security will instead be limited to the shares which are the subject of the acquisition and any other unrelated assets of the borrower."

## General

There are a number of general changes introduced by the New CCL which are relevant to lenders and their clients.

## Application of provisions applying to JSCs to LLCs (Article 104)

There is a new requirement that unless otherwise provided by the New CCL, the provisions concerning JSCs apply to LLCs. It remains unclear how this will be interpreted and some potential questions which are likely to arise in practice for lending transactions are as follows:

- whether the maintenance of capital regime (financial assistance and director loans) will apply to LLCs (Articles 222 and 153)
- whether the corporate benefit test will apply (Article 170)
- whether boards of directors of LLCs will be prohibited from undertaking certain acts unless authorised by the articles of association or a resolution of the general assembly of the company, in the same way as boards of directors of JSCs. Such acts include entering into arbitration agreements, entering into loans which are in excess of three years and taking mortgages over moveable or immoveable property (Article 154)

- whether the requirements for directors to notify the SCA if the company purchases assets, companies or establishments with a total value greater than 20% of its share capital during its first fiscal year and seek shareholder approval for certain related party transactions will be relevant to LLCs (in our view this is unlikely to be the intent but the requirements apply on a literal interpretation) (Article 142).

### **Mandatory amendment of constitutional documents (Article 374)**

The new Article 374 sets out a one year period from implementation of the Current CCL for existing companies to comply with the provisions of the New CCL (currently by 1 July 2016). Failure to do so may result in the dissolution of the company. Although the majority of amendments required to constitutional documents will likely be minor (for example, reflecting notice periods), amendments may include significant matters such as revisions to:

- (in the case of a public JSC) the share capital if it is below the new minimum threshold of AED30 million (Articles 193, 194)
- (in the case of a public or private JSC) the size of the board if it deviates from the new requirements (Article 143)
- (in the case of an LLC) the quorum requirement for the general assembly if it is below 75% (Article 96).

Existing companies will be reviewing their constitutional documents and will need to consider what amendments may be required to comply with the New CCL. Lenders will want to ensure that their borrower clients have complied with Article 374 by amending their constitutional documents as required and that they are comfortable with any changes that have been made. Logistically this could be a difficult and lengthy task.

Legal advisers acting for lenders have traditionally carried out a detailed review of the constitutional documents for each company party to a transaction in order to establish that that company has power to enter into the transaction and the directors and other signatories have authority to enter into the relevant documents. Key points to check from a lender's perspective going forwards are therefore likely to include a number of new points introduced by the New CCL, for example, new quorum requirements and whether the board of directors are expressly authorised by the articles of a company enter into mortgages of moveable and immoveable property (and the other types of arrangement restricted by Article 154, including entering into loans in excess of three years and arbitration agreements).

It remains to be seen whether the Ministry of Economy or Emirate company registration departments will be implementing a new standard form of articles reflecting the New CCL or whether parties will be approaching these entities on a case by case basis with individually tailored amendments.

### **No change to current practice for company searches (Part 1, Chapter 3)**

The New CCL introduces the concept of a company registrar. The role of the company registrar appears limited and falls short of the public companies registers familiar in other jurisdictions: it is confined to supervising the Trade Names Register and keeping certain company documents. Further activities of the company registrar may be set out in a regulation to be issued by the Minister of Economy in coordination with the competent authorities in the individual Emirates. Only "concerned parties" may request the registrar to issue the particulars as set out in the records kept by the company registrar. We therefore do not expect public access to the company registrar's records at this stage, and this will not, as was initially hoped, assist with the lender's company searches in relation to the borrower and any other companies giving a guarantee or taking security over assets as part of the transaction.

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