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Clarifications on pledges over commercial premises under UAE law

Monday, 10 October 2011 00:00 Habib Al Mulla & Co



There is some confusion among practitioners and even regulators with regards to a pledge over 'commercial premises' or 'businesses'. It is important to clarify how a pledge over commercial premises can be legally applied under UAE law from a definition perspective and under basic civil law concepts.

The *summa divisio* in the civil legal system and the UAE legal system in particular concerning pledges is between the possessory pledge and the non-possessory pledge.

Provisions relating to possessory pledges are found in Articles 164-177 of the UAE Commercial Transaction Code (CTC) where a commercial pledge is specifically defined as a possessory pledge, which only becomes enforceable on the borrower or a third party if possession (not to be confused with ownership) of the pledged asset is transferred to the lender or an agreed third party (Article 165).

A contrario, a non-possessory pledge entitles the borrower to maintain ownership and also management and control over the pledged assets.

COMMERCIAL PREMISES

So where does a pledge over 'commercial premises' under Articles 39-56 of the CTC fall?

Firstly, the term 'commercial premises' is the correct translation for the Arabic term contained in the CTC. It refers to an aggregation of tangible (movable) and intangible assets that are necessary for, and dedicated to, the performance of commercial activities (Article 39). The English term 'business' is, however, often used by practitioners in the UAE and, under the law, this is misleading. This term is not an accurate translation of the law and in broader terms arguably refers to an economic concept rather than a legal one.

Secondly, it is important to note that commercial premises do not have a legal personality and thus may not acquire rights or incur liabilities. These rights and liabilities are borne by the owner¹ of the premises whether this is an individual or a company.

Under the UAE legal system, a pledge over commercial premises is a non-possessory pledge that entitles its owner to secure liquidity and to retain, at the same time, management and control over the premises. The lender is secured by a written notarised pledge agreement registered in the Commercial Registry (Article 50).

If the pledge agreement does not specify the assets over which the pledge applies, the pledge shall be deemed to only cover the commercial name, the rights of the lease, the clientele and the goodwill (Article 49(2)).

To recap, pledges over commercial premises are non-possessory pledges and commercial premises have no legal personality in their own right.

A question arises here: would it be possible to have a pledge over a company, in the same way pledges are applied over commercial premises?

The answer is no, as this is legally impossible for the following reasons:

1. A distinction is made between the definition of a company and that of a commercial premises. A company is defined in Article 4 of the UAE Commercial Companies Law as follows: The company is a contract by which two or more persons undertake to participate in an economic project

The 2011 UAE section is contributed by Habib Al Mulla

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intended to make profits, by each providing a share of funds or effort to divide the profit or losses resulting from the project between them.

In the application of the preceding paragraph, the economic project shall include every commercial, financial, industrial, agricultural, real estate or any other type of economic activities. Thus a company is essentially a contract between two or more shareholders and not an aggregation of tangible and intangible assets belonging to a single owner (whether an individual or company) as commercial premises are.

2. A company has a legal personality and may acquire rights and incur liabilities. Commercial premises do not.
3. A company may own real estate assets that can be mortgaged, whereas commercial premises cannot own real estate assets, even if the owner of the commercial premises owns the real estate asset where the commercial premises is located and operates. As a result, in the event of the simultaneous sale of the commercial premises and the real estate asset to the same purchaser, there would be two distinct sale and purchase agreements.
4. A company can own commercial premises and shareholders may bring commercial premises as their contribution to the company, however the company cannot be qualified as a commercial premises.

CONCLUSION

In conclusion, a pledge (whether possessory or non-possessory) over a company is not legally possible under UAE law, however, taking security over the assets belonging to a company, such as its real-estate assets (mortgage), equipment (possessory pledge) etc is possible. This is further supported by Article 173 of the CTC that provides that a possessory pledge is permissible over several assets, meaning that different assets can be pledged through several pledge agreements. Since this article states that a lender may determine the asset that shall be sold (through public auction), this is distinct from a non-possessory pledge (under Articles 39-56 of the CTC) providing (under Article 49(2)) for a single pledge agreement over several tangible and intangible assets.

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Note

1. See Federal Supreme Court, judgment no 29/22 dated 13 February 2002; Dubai Supreme Court, judgment no 73, dated 15 October 1995.

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