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Five Key Updates to the UAE Commercial Transactions Law and Implications for Financing Transactions

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For nearly 30 years, Federal Decree Law No. 18 of 1993 relating to the commercial transactions law (the "Old CTL") played a key role in regulating dealings between commercial counterparties in the United Arab Emirates (UAE). Its replacement, Federal Decree Law No. 50 of 2022 (the "Updated CTL"), came into force on 2 January 2023 with the stated aim of supporting and developing the UAE's business environment. Whilst many of the provisions of the Old CTL have been retained, there are a number of important additions and clarifications in the Updated CTL which will materially influence aspects of financing transactions. We explore below five of the key amendments and the implications for market participants.

Cap On (Conventional) Fallback Interest Rates and Compounding

Under the Old CTL, parties to a commercial loan were free to agree on the applicable rate of interest and, if the loan instrument did not expressly set out that rate, interest would instead be calculated based on the prevailing market rate of interest at the time of the transaction, subject to a cap of 12%. This provision has been retained under the Updated CTL, however, the cap has now been reduced to 9%. Whist this maximum amount has changed, it should be noted that this will not necessarily result in the relevant court selecting this reduced cap rate as the applicable fallback rate of interest. In Dubai, for example, Resolution No. 1 of 2021 issued by the General Assembly of the Dubai Court of Cassation, requires that onshore courts apply a rate of 5% per annum in the absence of a mutually agreed contractual rate.

In addition, Article 88 of the Updated CTL provides that a creditor may not claim compound interest. This is a helpful addition as previously the position was unclear with conflicting judgements reported in cases involving conventional loans. This restriction brings the Updated CTL in line with Article 121(4) of Federal Decree Law No. 14 of 2018 concerning the Central Bank and the Regulation of Financial Institutions and Activities (as amended, the "Banking Law"), which imposes a similar prohibition on compound interest.

Islamic Finance

In the UAE Ministry of Economy's media briefing introducing the Updated CTL, it was noted that one objective of the legislation was to further enhance the country's position as a market leader in Islamic finance. This initiative is reflected in new Part 6 of the Updated CTL, which regulates commercial transactions and contracts to which Islamic financial institutions are a party. Under Article 468(2) of the Updated CTL, an "Islamic financial institution" includes any institution whose articles or memorandum of association provide that it is conducting its business activities in compliance with the rules of Islamic *Shari'ah*. This is understood to include both Islamic subsidiaries and Islamic bank windows of conventional banks.

As well as entrenching a number of well-established *Shari'ah* principles into federal law (e.g. the general prohibitions on borrowing or lending in return for interest), Chapter 2 of Part 6 sets out a number of specific provisions relating to certain Islamic contracts and structures, including *Murabaha*, *Istisna'a*, *Ijarah* and *Salam*. In the context of an *Ijarah* structure, of particular note is Article 495(3), which prohibits recharging maintenance

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and insurance costs incurred by the lessor to the lessee by including such expenses as a component of the periodic rental payments made under the applicable lease. Any agreement contravening this restriction will be considered null and void. The practice of recharging maintenance and insurance expenses in this way is a common feature of *Ijarah* structures used in the market through a service agency construct, which notably is typically English law governed. Depending on the specific features of a proposed *Ijarah* financing, practitioners and stakeholders in the Islamic finance industry may need to consider this new provision and, in particular, whether any structural or documentary adjustments should be made to balance this restriction under the Updated CTL, the requirements of Islamic finance and commercial risk allocation between the parties.

Guarantees

The updated wording set out in Article 69(2) of the Updated CTL clarifies that, in addition to multiple guarantors having joint liability as between themselves for the repayment of the relevant debt obligation, the debtor will also be jointly liable with those guarantors. This change is understood to clarify that the principle of co-extensive liability applies to commercial guarantees such that a guarantor's liability is dependent on the existence and validity of the principal debtor's liability. This is similar to the position for civil transactions set out in Article 1080 of the Federal Law No. 5 of 1985 regarding the law of civil transactions (as amended, the "Civil Code").

Another important clarification relates to payment guarantees issued by financial institutions. Under the Updated CTL, an issuing bank may refrain from making a payment to a beneficiary under a payment guarantee where the proceeds of that payment are subject to an attachment order. This is similar to the position under the Old CTL, however, the revised wording adds emphasis to the right of the bank to withhold payment to a beneficiary under a guarantee instrument following court attachment, rather than the court's power to attach guarantee proceeds.

Adequacy of Security

Article 121(1) of the Banking Law introduced a requirement for licenced financial institutions to obtain sufficient guarantees and security for all types of facilities. Failure to do so will, under Article 121(2), prevent the relevant financial institution from bringing any application, action or plea before the relevant competent judicial authority or arbitral tribunal. Notably, the scope of this requirement under the Banking Law is limited only to natural clients and private sole proprietorships. Article 409 of the Updated CTL includes a comparable requirement but broadens the scope of application to all borrowers of commercial loans. As this will capture corporate lending, this is an important development and it remains to be seen how the UAE courts will interpret and enforce this requirement.

Statute of Limitations

Under the Updated CTL, absent any lawful excuse, claims as between merchants (being any party which conducts business regulated by the Updated CTL) are required to be brought no later than five years following the date on which the performance of the obligation fell due. This is a significant reduction from the 10 year limitation period set out in the Old CTL and extends the differential between the law and Article 473 of the Civil Code, which provides for a 15 year limitation period in respect of civil contractual claims.

Summary

The Updated CTL is an important legislative development in the UAE and forms part of a broader set of reforms which ensure that the UAE preserves its status as a key market for Islamic finance with a legal infrastructure which supports businesses and encourages investment. As outlined, a number of the changes are material in the context of financing transactions and it will be interesting to see how market practice and transaction documentation evolves to accommodate the new features of the Updated CTL.

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We continue to monitor developments in this area. If you have any questions regarding how any of these issues could apply to you, please contact:

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