Capacity? Check!

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 In commercial financing transactions, a formal legal opinion is usually sought by the lender to give them certainty on the legality of the financing transaction (and its related aspects which may include security being provided for the purposes of the financing) together with ensuring that the commercial intent is achieved. More often, a thorough view on the enforceability of the financing and security aspects of the transaction are sought, together with capacity and authority checks. This article considers particular issues relating to capacity and authority in the UAE.

Express versus implied powers

It is not uncommon in the UAE for directors or managers to be granted general powers under the company's memorandum and articles of association. Such powers are expressed in generic terms, referring to the power to 'do all acts and deeds for and on behalf of the company' or to 'manage the company and do all things necessary to achieve its objects'. While useful for the management of the day-to-day operations of the company, relying on such generic powers when borrowing money, granting security or providing a guarantee can be risky.

In general, the UAE courts will usually need to see explicit authority where the company has provided a

certain representative (be it a manager, director or otherwise) to do that specific act for and on behalf of the company. General management powers granted to the directors or managers in the articles of association are unlikely to be sufficient for the purposes of establishing the capacity of a company to enter into finance transactions.

Another important aspect of the capacity check in the UAE is the ability to rely on the authorisations granted as per the Arabic text of the constitutional documents of the company. In a situation where the English text may give the particular authority that is being sought, but the Arabic translation does not, then such authority should not be relied upon as at the time of enforcement the Arabic text will prevail.

Legal analysis

Certain relevant provisions of law applicable for lending and security creation transactions include:

1. Article 22 of the Federal Law No. 2 of 2015 on Commercial Companies ('Companies Law') states that a person who is authorised to manage a company must carry out all acts in accordance with the company's objectives and powers granted to that person in accordance with an authorisation issued by the company. Article 23 of the same law states that all acts carried out by an authorised person in the context of the ordinary management of the company is binding on the company (to the extent such person is authorised to represent the company and third parties have relied on this fact in dealing with the company).
   From the above, an authorised person's acts within the ordinary management of a company would be binding on the company if there are specific powers in the company's constitutional documents authorising one or more persons (e.g. directors, managers) to carry out all management activities. Article 929 of the Civil Transactions Law Federal Law No. 5 of 1985 ('Civil Transactions Law') also requires a special authorisation in relation to acts which do not fall within the 'management' or 'custody' activities of a company. Article 935 also specifies certain acts which would not be valid if not expressly mentioned in the relevant authorisation. The acts specified under Article 935 include lending and mortgages. Therefore, lending and mortgages must be expressly stated in the powers of the authorised signatory of the company in order to be able to legally enter into such transactions. It is also worth noting that scholars and courts in the region have, on several occasions, ruled that taking a loan, providing a guarantee or security is not an 'ordinary' act of a business and such acts require express authorisation in the company's documents.
2. The above position is supported by 154 of the Companies Law which states as follows:
   'The Board of Directors shall have all the required powers to do such acts as required for the object of the company, other than as reserved by this Law or the Articles of Association of the company to the General Assembly. However, the Board of Directors may not enter into loans for periods in excess of three years, sell or pledge the property of the company or the store, mortgage the company's movable and immovable properties, discharge the debtors of the company from their obligations, make compromise or agree on arbitration, unless such acts are authorised under the Articles of Association of the company or are within the object of the company by nature. In other than these two events, such acts require to issue a special decision by the General Assembly.

The importance of Arabic text

Article 1057 of the Civil Transactions Law states that a guarantee can be expressed as a guarantee (*kafalah*) or security (*damaan*). However, the courts in the region have time and again ruled that the provisions of the constitutional documents of a company providing a guarantee must expressly give the power to the authorised person of the company to enter into and execute a *kafalah*, in order to validate

the obligations of the guarantor company. It is worth noting that the Commercial Transactions Law (Law No. 18 of 1993) ('Commercial Law') refers to the term 'guarantees' as '*kafalah*' in the Arabic text. The Commercial Law is the specific law that applies to banking transactions. In the absence of specific provisions in the Commercial Law, the Civil Transactions Law would apply.

Further, the power of providing security generally (even if such power is stipulated in the constitutional documents of a company) is unlikely to cover the power to provide a guarantee for third party obligations. Guaranteeing third party obligations (such as guaranteeing the debt of subsidiaries) is defined in the Civil Transactions Law as 'a suretyship with the joining of the liability of a person called the surety (the guarantor) with the liability of the obligor (the principal debtor) in the performance of his obligations.' Therefore, guarantees are generally not a form of security as guarantees do not provide any priority or secured rights in relation to a guarantor's assets (unlike other types of security such as pledges and/or mortgages). Therefore, in the case of guarantees, it is important to look for the express powers of a company's authorised signatory(ies) and ensure the necessary powers are granted in the Arabic text.

Are there exceptions to the rule?

In a very recent case, the Dubai Court of Cassation applied the rule of the good faith principle with regards to the capacity of a company's representative to arbitrate. The respondents in the case brought an action to set aside an arbitral award on the grounds that the arbitration clause was void because the signatories to the agreement containing the arbitration clause lacked the capacity to agree to arbitration (arbitration requires a special authority under the Civil Transactions Law).

The Court of Cassation held that if the name of a particular company is included in the preamble of a contract without the name of its legal representative and the contract is signed or the signature is legible at the bottom, this establishes a legal presumption that whoever signed the contract was the company's legal representative and has the capacity to arbitrate on behalf of the company. The same presumption arises if an illegible signature appears at the bottom. In such cases, a challenge may not be entertained if the person who signed on its behalf did not have the capacity to agree to arbitration. This is to ensure the obligation of good faith is complied with in all business dealings, practices and procedures. Despite the positive outcome of the above ruling in favour of establishing capacity, this outcome is not guaranteed in future cases that may come before the UAE courts.

Conclusion

Interpreting constitutional documents and establishing capacity and authority can often be more complicated than one would expect.

"There's more to this than meets the eye" is the mantra that should always be followed when reviewing constitutional documents of a company.

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