Bills of Exchange and Promissory Notes – UAE legal position

Mamoon Khan - Partner - Banking and Finance / Turnaround, Restructuring and Insolvency
m.khan@tamimi.com - Dubai International Financial Centre

Dena ElKhatib
d.elkhatib@tamimi.com

Background

Commercial papers such as promissory notes and bills of exchange due to their universal nature are globally regulated by the 1930 Geneva Convention providing a Uniform Law on Bills of Exchange and Promissory Notes ("Geneva Convention"). Although the UAE has not formally ratified the Geneva Convention, the relevant provisions relating to promissory notes and bills of exchange covered under Federal Law No 18 of 1993 ("Commercial Code") are substantially similar to the provisions of the Geneva Convention relating to such commercial instruments.

Distinction between promissory notes and bills of exchange

The Commercial Code distinguishes between these instruments in that the bills of exchange reflect an unconditional payment arrangement between drawee, drawer and the beneficiary of such bills of exchange (i.e. a cheque or bankers draft). On the contrary, a promissory note is a bilateral arrangement between a promissor and beneficiary. Be that as it may, the provisions of the Commercial Code relating to negotiation, endorsements and avalisation are common among such instruments and are discussed further below.

Endorsement

Bills of exchange and promissory notes can also be endorsed and assigned by the beneficiary in favour of a third party. A valid endorsement under the Commercial Code means a transfer of title of the rights of a beneficiary to a third party (i.e. the endorsee). The procedure for endorsements of such instruments require the endorser to either execute the endorsement by stating that the payment shall be made to the order of the new beneficiary or by appending an allonge (a document setting out the terms of the endorsement) signed by the endorser. Such endorsement would constitute a guarantee by the endorser of the payment by the issuer or drawee under such instrument. It is important to note that all endorsements must be unconditional and any condition attached to the endorsed instrument shall be deemed null and void under the Commercial Code.

Avalisation

UAE law recognises 'avalisation' in connection with bills of exchange and promissory notes and such avalisation is envisaged under the Commercial Code as a 'precautionary guarantee'. A precautionary guarantee is an additional third party undertaking separate from the undertaking of the issuer (in case of promissory notes) or an acceptor (in case of bills of exchange), whereby the precautionary guarantor (which is usually a bank or financial institution) shall be liable in the same manner as the issuer or the acceptor. The details of the 'aval' or precautionary guarantee shall be written on the bills of exchange or the promissory note itself or on an 'allonge' appended to such instrument clearly indicating a precautionary guarantee. Further, the instrument being avalized is required to be signed by the precautionary guarantor.

Interest on bills of exchange and promissory notes

It is common to see interest provisions applicable to the amounts payable under promissory notes and bills of exchange and such interest on the face amount is calculated as an aggregate of a benchmark rate (i.e. EIBOR or LIBOR) and specific margin or profit (in percentage form). Although such practice in relation to time bills is common, it may be contrary to the provisions of UAE law as the Commercial Code restricts the application of interest on a bill of exchange or promissory note unless such instrument is payable at sight.

Enforcement

In the event of a non-acceptance of bills of exchange at the date of maturity the Commercial Code allows the beneficiary recourse against the drawer, endorser as well as the precautionary guarantor (if avalized). Under the Commercial Code the issuer of a promissory note has the same obligations as the acceptor of bills of exchange. As the above provision has been widely contemplated, in case of multiple endorsements, the Commercial Code allows the ultimate beneficiary to enforce such endorsed instrument against all the endorsers up to the ultimate endorser. The Commercial Code also prescribes certain limitation periods in relation to such instruments which vary between six (6) months to three (3) years depending on the nature of the action.

Conclusion

As bills of exchange and promissory notes are commonly used in the UAE for general trading activities, documentary credit transactions, as well as structured trade finance as legally enforceable payment instruments with the flexibility of endorsements and assignments. Therefore, it is useful to consider the UAE law issues highlighted in the article above in structuring trade or trade finance transactions which include such commercial papers and instruments.