ALERT MEMORANDUM

The UAE Government Clarifies Rules Applicable to Private Joint Stock Companies

October 14, 2024

On July 30, 2024, the Ministry of Economy (the "**Ministry**") of the United Arab Emirates ("**UAE**") issued Ministerial Decision No. 137 of 2024 concerning the operation of the registrar of private joint stock companies ("**PrJSCs**") and regulations and governance applicable to such companies (the "**Decision**").[1]

The Decision sets out detailed steps and regulations concerning the incorporation, registration, management and governance of PrJSCs. The Decision implements the provisions of Federal Decree-Law No. 32 of 2021 on Commercial Companies (the "**CCL**") that are relevant to PrJSCs and that were delegated to the Ministry for further clarification.

This alert memorandum provides a high-level overview of the rules issued by the Decision. It does not purport to be an exhaustive summary of the Decision or the provisions of the CCL that apply to PrJSCs.

If you have any questions concerning this memorandum, please reach out to your regular firm contact or the following authors

ABU DHABI

Gamal Abouali
+971 2 412 1720
gabouali@cgsh.com

Mohamed Taha
+971 2 412 1741
mtaha@cgsh.com

Raghib Masrur
+971 2 412 1812
rmasrur@cgsh.com

Rawad Abou Jaoude
+971 2 412 1721
raboujaoude@cgsh.com

Omar Almansoori
+971 2 412 1748
oalmansoori@cgsh.com

[1] The Decision was published in the UAE Official Gazette No. 781 dated August 15, 2024, and entered into force on the same day.

I. Background

The PrJSC is a corporate form often used by privately held businesses in the UAE. The provisions specific to PrJSCs in the CCL are generally limited and the CCL instead refers to further regulations and guidelines to be issued by the Ministry. Other than provisions related to public subscription and the provisions specifically governing PrJSCs (e.g. in relation to minimum capital requirements and number of shareholders), the provisions of the CCL governing public joint stock companies are also generally applicable to PrJSCs.

The Decision provides valuable clarity on processes related to incorporation, management, operation and governance of PrJSCs in the UAE.

II. Scope

The Decision applies generally to PrJSCs in the UAE. However, PrJSCs operating in the financial services sector that are regulated by the Central Bank of the UAE, branches and representative offices of foreign companies, and free zone companies are exempt from the governance rules set out in the Decision.

III. Key Provisions

Filings

- **Electronic Platform**: In line with the provisions of the CCL, the Decision provides that the Commercial Registration and Agencies Department at the Ministry (the "**Registrar**") must establish an electronic portal through which all PrJSC-related filings shall be submitted, and which shall be linked to the commercial registers within each relevant competent authority. These filings include applications for incorporation and corporate documents related to PrJSCs, such as articles of association, resolutions, and annual financial statements.
- **Access to Corporate Information**: Pursuant to the Decision, interested parties may request information on a PrJSC from the Registrar, which may issue a certificate in response to such request. The Decision does not, however, define "interested parties" within this context, nor does it specify which details the Registrar may (or is required to) provide in such a certificate.

Board of Directors

- **Nomination Criteria**: The Decision provides that a PrJSC may, pursuant to its articles of association, set criteria for nominations to its board of directors (the "**Board**"), provided that such criteria are in line with the CCL and the Decision and also acceptable to the Ministry. The Decision also sets forth a list of eligibility requirements for Board nominations, which include, *inter alia*, that the nominee must be a natural person of legal age who has not been convicted of a criminal offense or a crime involving dishonesty or breach of trust (unless their good standing was reinstated). The nominee must also undertake to comply with the CCL, its implementing regulations and the articles of association of the PrJSC, and to exercise due care in the performance of his or her obligations. The Decision defines the "due care" standard as the care exercised by a natural person who has sufficient experience and exercises due diligence in performing his or her professional duties.
- **Removal**: In addition to the right of the general assembly of a PrJSC to dismiss any or all of the members of its Board pursuant to the CCL, the Decision further clarifies that Board members appointed by any shareholder that is a corporate or government entity may be removed and/or replaced by such shareholder at any time during the term of the Board, without requiring the approval of the general assembly.
- **Remuneration**: In line with the related provisions in the CCL, the Decision mandates that the remuneration of Board members must be calculated as a percentage of the net profits of the PrJSC for the relevant financial year. Furthermore, it specifies that the remuneration must not exceed 10% of the net profits for that year, after deducting

depreciation, amortization, and reserves. In addition, the Decision clarifies that Board members may be further remunerated (through fees, expense reimbursement, salaries or bonuses) for additional services performed over and above their regular duties as Board members. However, no remuneration shall be payable merely for attending Board meetings.

Exceptions to Rules on Priority Subscription Rights in Capital Increases

The CCL grants shareholders priority rights to subscribe for shares newly issued by a PrJSC, with certain exceptions, as outlined below. The Decision elaborates on the means for implementing these exceptions.

- **Strategic Partners**: The CCL provides that a PrJSC may admit, with no pre-emption right exercisable by the existing shareholders, a strategic partner whose contribution to the PrJSC results in the provision of technical, financial, operational or marketing support for the benefit of the PrJSC (a "**Strategic Partner**"). The Decision further details that a Strategic Partner may be a corporate or a government entity and must be independent from the PrJSC's group (including holding and subsidiary companies). The admission of a Strategic Partner as a shareholder of the PrJSC must be approved by special resolution of the general assembly, its stake in the PrJSC must not be less than 10% of the PrJSC's issued share capital, and the shares held by it shall be subject to a lock-up of at least one year. Pursuant to the CCL, the Ministry and the relevant competent authorities may veto the admission of a Strategic Partner if it is determined to be in violation of UAE law or against its public interest.
- **Conversion of Cash Debts into Equity**: The CCL allows a PrJSC to convert its cash debts into equity, with no pre-emption right exercisable by other shareholders in respect of the newly issued capital (a "**Conversion**"). The Decision provides that a PrJSC may only effect a Conversion if its issued capital has been fully depleted, and the relevant debts are cash debts (noting, in line with the CCL, that any debts due to the UAE government or government-related entities, banks or financial institutions shall be considered cash debts). The Board must submit a request for approval of a Conversion to the Ministry, and must also present the rationale for such Conversion to the general assembly of the PrJSC, which may approve the Conversion by special resolution (specifying therein the quantum of the converted debt and the increased share capital). Following approval by the general assembly, the Board must request the written approval of the holders of the debt that is to be converted and such approval must be submitted, along with certain other required documents, to the Registrar for registration of the issuance of the new shares.
- **Incentive Plans**: The CCL provides that a PrJSC may issue, free from pre-emption rights, shares to employees pursuant to an approved incentive plan (an "**Incentive Plan**"), provided that Board members do not participate in such Incentive Plan. Pursuant to the Decision, participation in an Incentive Plan shall be restricted to employees of the PrJSC (excluding its parent companies, holding company or subsidiaries), and shares issued pursuant to such Incentive Plan shall be considered treasury shares which shall have no voting rights until vested in the relevant employee. The Board must ensure that the rules of any Incentive Plan adopted by a PrJSC do not impose any restrictions on the voting rights of employees following the vesting of their shares.

Mergers and Acquisitions: The Decision specifies that a PrJSC that intends to merge with or acquire another company (pursuant to the statutory provisions of the CCL and the Decision) must comply with, *inter alia*, the provisions of Federal Decree-Law No. 36 of 2023 on the Regulation of Competition (in particular, its merger control provisions).

Treasury Shares: The Decision requires a PrJSC intending to purchase or sell treasury shares to establish a formal treasury share program to be approved by the general assembly. Such program shall have a maximum duration of five years, and shall furthermore be subject to the detailed procedural requirements set out in the Decision regarding filings, approvals, voting procedures, and timing.

Governance Rules

- **Delegation of Authority**: The Board of a PrJSC must establish written policies governing the delegation of authority to the PrJSC's representatives with respect to contractual and financial matters.
- **Whistleblowing**: The Board must also establish secure channels for reporting violations, with a direct channel to the general assembly.
- **Board Composition**: Pursuant to the Decision, diversity is a key factor in the selection of Board members. A PrJSC must ensure that its Board reflects a diverse range of skills, experiences, and backgrounds relevant to its industry. The Decision mandates that at least one third of the Board must be composed of independent members and a majority must be composed of non-executive members, with an emphasis on ensuring that such members effectively contribute to the PrJSC's decision-making and oversight. Furthermore, the Decision mandates appointing at least one female member to the Board.
- **Committees**: Pursuant to the Decision, the Board must establish a nomination and remuneration committee and an audit committee (the "**AC**") as permanent committees reporting directly to the Board (the "**Committees**"). Each Committee must be composed of no fewer than three members (the majority of whom shall be non-independent members)[2] and be chaired by an independent member. The chairman of the Board may not be a member of the Committees. The Board must appoint non-executive members on the Committees for duties that may result in conflicts of interest (e.g. reviewing financial statements or vetting related party transactions). Specifically, AC members must have relevant experience in financial and accounting matters, and at least one such member must have been previously employed in such sectors.
- **Internal Audit**: The Decision requires the Board of a PrJSC to establish an internal audit policy aimed at assessing the risk management procedures and legal compliance of the PrJSC. Such policy must be implemented by an independent internal audit department that reports directly to the Board.
- **Governance Report**: Pursuant to the Decision, the PrJSC must submit a governance report, signed by the chairman of the Board, to the Registrar prior to the annual general assembly meeting for the preceding financial year. The governance report must be distributed and made available to all shareholders of the PrJSC.

IV. Key Takeaways

- Overall, the Decision reflects the UAE's commitment to effecting digital transformation and administrative efficiency at the level of its local and federal government authorities.
- The governance rules in the Decision will also enhance transparency and accountability within UAE PrJSCs, and the UAE's legal and business framework generally, which further solidifies the UAE's position as a global business hub.

CLEARY GOTTLIEB

[2] It is unclear whether the intention is that a majority of the members be non-executive, as opposed to non-independent.