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ALERT MEMORANDUM

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Abu Dhabi Global Market Brings Core Regulations Into Force

The 8 core regulations that will apply to companies operating within the Abu Dhabi Global Market (the ADGM), Abu Dhabi's financial free zone, have been enacted and brought into force. In addition, a further 17 supporting documents (Rules, Guidelines and an Order) have been published in connection with the regulations governing commercial licences and companies.

This, our third alert memorandum on the ADGM:

- explains some of the key features of three of the most important core regulations (Commercial Licensing Regulations, Companies Regulations and Insolvency Regulations);
- summarises the purpose of the 17 supporting Rules, Order and Guidelines; and
- gives an update on the continuing process to build the ADGM's legal and regulatory landscape.

Background and update

The ADGM was established as a financial free zone pursuant to Abu Dhabi Law No. 4 of 2013. Since then the ADGM has been working to build the regulatory infrastructure that will govern the free zone, consisting of an independent regulator, registrar and courts.

The ADGM Board launched a one-month public consultation process on the core regulations described below in January 2015. Cleary Gottlieb submitted a detailed response to that consultation and some of the recommendations we made have been taken on board in the final regulations.

The publication and bringing into force of the core regulations is the most important step so far in the development of the ADGM, but it is not the final step. For example, financial services legislation must still be drafted and consulted on. It is expected that the consultation papers in this area will be issued within the next month and the regulations enacted before the end of the year.

Overview of ADGM law and regulations

English common law applies in the free zone to govern matters such as contracts, torts, trusts, equitable remedies, unjust enrichment, damages, conflict of laws, security and personal property. Certain specified English statutes that modified or codified aspects of English common law, such as the Contracts (Rights of Third Parties) Act 1999 and the Partnership Act 1890, also apply, with some amendments. The rule against perpetuities has not been enacted and most trusts will be able to exist for an unlimited period.

The ADGM's approach is generally to follow the Hong Kong and Singapore method of applying English common law directly, rather than codifying it. This has been done through regulations that explain that English common law applies so far as it is applicable to the circumstances of the ADGM, subject to modifications required by those circumstances or specifically enacted by the ADGM. Subsequent changes made to the English common law by statute will not automatically take effect in the ADGM but would need to be expressly introduced by an ADGM enactment. These regulations also list the UK acts that will apply and explain any exceptions or amendments.

The consultation draft of the regulations suggested that decisions of the UK Supreme Court on equivalent UK legislation would be binding on the ADGM Courts, with decisions of the lower UK courts persuasive. These provisions have been removed from the final version of the Application of English Law Regulations and it is anticipated that the approach of the ADGM Courts to UK precedent judgments will be clarified separately at a later date.

Overview of Core Regulations

The core regulations that were enacted in March and brought into force on 14 June 2015 are:

1. Application of English Law Regulations
2. Companies Regulations
3. Commercial Licensing Regulations
4. Insolvency Regulations
5. Employment Regulations
6. Real Property Regulations
7. Interpretation Regulations
8. Strata Title Regulations

Of these, the Commercial Licensing Regulations and related Rules are central to understanding how to set up business in the ADGM. The key principles are explained below. The Companies Regulations and the Insolvency Regulations (both based on the equivalent UK rules) are also of particular interest and key features of these and related Rules are explained later in this alert. Being based on well-developed UK regimes, they offer a robust set of regulations in these areas within the ADGM.

Although the core regulations only came into force when they were published on 15 June 2015, they were all enacted in early March 2015, less than a month after the end of the public consultation period on the draft regulations. The final versions of the regulations differ from the consultation drafts only in a few, mainly minor respects. This indicates the desire (and ability) of the ADGM to move swiftly to introduce its regulatory regime and also that the responses submitted during the consultation process have not resulted in any significant deviations from the approach determined by the ADGM Board prior to the consultation period.

Commercial Licensing Regulations

These regulations describe the process to be followed to apply for and obtain a licence to carry out controlled activities in or from the ADGM.

The controlled activities are:

1. financial services;
2. legal services;
3. accountancy services;
4. insolvency practitioner services; and
5. any other economic activity, as described below.

A controlled activity is only carried on in the first four of the above categories if the activity is carried on from a permanent establishment maintained in the ADGM.

Any other economic activity, if carried on by way of business, is also considered a controlled activity if carried on (i) from a permanent establishment maintained in the ADGM or (ii) otherwise in or from the ADGM unless at the invitation of a person ordinarily resident or with a permanent establishment in the ADGM. The ADGM free zone area already contains hotels, restaurants and a hospital and the consultation paper issued in January expressly stated that it was envisaged that such activities would fall within the definition of controlled activities.

The Commercial Licensing Regulations set out the powers of the ADGM Board to make rules applying to licensed persons. These regulations also defined the powers of the Registrar to give guidance, to investigate licensed persons, to issue warning notices, to impose fines or to suspend (or to impose restrictions on) licences.

Rules adopted under the Commercial Licensing Regulations set forth additional requirements that must be satisfied by applicants seeking to obtain (or retain) a licence to carry on controlled activities, include maintaining premises in the ADGM free zone and maintaining a licence with relevant professional regulatory bodies.

Entities established by law or decree and their subsidiaries are exempt from the general prohibition on carrying on controlled activities.[1] There is also a 12 month exemption transition period for persons who were licensed by the Abu Dhabi Economic Development Department prior to the entry into force of the ADGM Founding Law (Abu Dhabi Law No. 4 of 2013).

Separate rules set out the standard scale of fines that can be imposed under the Commercial Licensing Regulations. The fines are on an 8-level scale, with the lowest fine (Level 1) being US$1,500 and the highest (Level 8) being US$50,000. There are also separate rules fixing the fees relating to controlled activity licence applications, variations and cancellations. Fees to apply for a new licence start at US$4,000 and there are additional fees payable depending on the business activities that the applicant wants the licence to cover. The permitted business activities are specified on the ADGM website.

[1] Commercial Licensing Regulations 2015 (Exemptions) Order 2015. Note that the Commercial Licensing Regulations 2015 (Exemptions) Order 2015 is described on its face as the Commercial Licensing Regulations 2015 (Exemptions) Rules 2015. This appears to be a mistake and the correct description is “Order” rather than “Rules”.

One aspect of the licensing regime that remains to be determined is the question of how an entity located in the ADGM will be able to operate "onshore" (in other words, in the rest of the Emirate of Abu Dhabi and the UAE generally). It may be necessary for ADGM entities to hold a separate licence to operate "onshore" and it is hoped that this question will be answered within the next few months.

Companies Regulations

The Companies Regulations follow the UK Companies Act 2006 very closely with some exceptions. A number of the differences are designed to address criticisms of the UK law. Others, such as the introduction of restricted scope companies and cell companies, are clearly intended to make the ADGM a desirable location for the types of institutions (particularly, in the initial stages of the ADGM's development, private banking, wealth and asset management firms) that Abu Dhabi hopes to attract to the new free zone.

The Companies Regulations adopt the main UK forms of company (private limited company and public limited company, as opposed to the various public and private joint stock companies, limited liability companies and other entities currently available in Abu Dhabi) and most of the regulations (comprising over 1,000 sections) will be recognisable to anyone familiar with the UK Companies Act. However, some of the key differences are listed below:

- Restricted Scope Companies
    - A new type of company has been introduced, to be used predominantly as a holding vehicle for professional investors and institutions.
    - The Restricted Scope Company (RSC) is a deregulated vehicle with less onerous disclosure and compliance requirements. For example, unless the Registrar expressly requires it, RSCs are not required to file their accounts and they are exempt from the requirement for audited accounts. Accounts of restricted scope companies will not be publicly disclosed by the Registrar.
    - However, the disclosure regime for RSCs in the final Regulations is slightly more transparent than as described in the consultation paper: whereas in the draft regulations, the right to inspect and require copies of the register of members did not apply to RSCs, the final Regulations permit any person to request to inspect or obtain a copy of an RSC's members register. The RSC can decline a request from a person who is not a member of the company but must obtain a court order to avoid revealing the register to a member (where it is not sought for a proper purpose).
    - Restricted companies must use the word "restricted" after their name.
    - One of the questions asked by the consultation paper was whether individuals or single family offices should also be permitted to establish RSCs, or whether they should only be available as subsidiaries of (i) groups that publicly file consolidated accounts or (ii) companies formed by decree. The final published version of the Companies Regulations does extend RSCs to individuals and family-owned companies. In fact, attracting family offices appears to be a key focus for the ADGM, although the ADGM makes clear that being in the ADGM is not a way to escape application of the UAE's international treaty obligations in

areas such as tax. Indeed, the Companies Regulations now contain an express obligation on the Registrar to assist the UAE in complying with its obligations under any international treaty or agreement to which the UAE is party.

- Cell Companies
  - The Companies Regulations also introduce a second innovation in corporate form, as compared to the UK system: protected cell companies and incorporated cell companies. These aspects of the Companies Regulations are based largely on Jersey law.
  - Although not a feature of UK company law, cell companies (or similar) are available in a number of (mainly "offshore") jurisdictions, such as Guernsey, Delaware, Jersey, the Cayman Islands, the British Virgin Islands, Bermuda and Qatar.
  - Cell companies are popular in the investment funds industry because they can be used to segregate portfolios into individual cells whose assets and liabilities are separate from each other and from those of the company itself. By treating each cell as a separate entity, it is intended that any claims by persons transacting with a particular cell can be brought only against the relevant cell and not against the other cells or the company itself. In the case of incorporated cell companies, this concept is strengthened by giving each cell separate legal identity as a separate company.

- Limited Liability Partnerships
  - One question that we raised in our response to the consultation papers was whether the ADGM would introduce limited liability partnerships (LLPs).
  - Although the Companies Regulations do not expressly envisage limited liability partnerships, we understand that the ADGM does intend to introduce them and a separate consultation process on this topic will be launched shortly.
  - Like the cell company, the introduction of LLPs appears to be specifically designed to attract funds to the ADGM.

- Share Capital
  - Unlike in the UK, shares in ADGM companies have no nominal/par value. This change was introduced primarily for simplicity and it is consistent with a trend among Commonwealth jurisdictions over the last 40 years to remove the requirement for par value.
  - This makes the concept of share premium redundant and thus obviates the need for share premium accounts.
  - Bearer shares and bearer warrants are not permitted in the ADGM.

- Continuance
  - Continuance provisions are included, based on the equivalent Jersey law, to enable companies to redomicile into the ADGM from another jurisdiction (or vice versa).
  - A non-ADGM company wishing to become an ADGM company must submit a number of documents to the Registrar, including a solvency statement.

  - There is no appeal right for foreign companies who object to refusal of continuance within the ADGM, and an ADGM company that is refused permission to re-domicile overseas has no right to appeal to the ADGM Courts. However, the members of an ADGM company do have the right to appeal to the ADGM Courts against a decision by the company to redomicile abroad.

- Directors' Duties / Conflicts of Interest
  - It has been argued that the UK rules on directors' conflicts of interest are confusing as the duty is to avoid a conflict, rather than a duty to take (or not take) certain actions when in a conflict scenario.
  - The Companies Regulations seek to avoid this uncertainty, by imposing a duty on directors not to act in relation to matters in respect of which they have an actual or potential conflict, unless the unconflicted directors or shareholders give their approval.

- Derivative Claims
  - In the UK, any shareholder, perhaps holding only one share in the company, can bring a derivative claim (a claim launched by a shareholder on behalf of the company against a director, e.g. for negligence or breach of duty).
  - To avoid ADGM companies being as vulnerable to activists as those in the UK, the Companies Regulations provide that only a member holding 5% or more of the company's shares (or representing members with an aggregate stake of that size, with their written consent) will be able to bring derivative actions.

- Schemes of Arrangement
  - Similar concerns have resulted in the removal of the need for a majority in number of shareholders to approve schemes of arrangement as required for schemes under the UK Companies Act.
  - A scheme is a court-sanctioned procedure used in restructurings and takeovers: with the approval of 75% by value (and, in the UK, over 50% in number) of creditors/shareholders, a restructuring or takeover scheme will (with court approval) become binding on all creditors/shareholders.
  - The "majority in number" requirement makes it possible for minority shareholders of UK companies to obtain disproportionate influence in the vote to approve the scheme, by splitting their shareholdings into many smaller units held by affiliates, thus requiring their and their affiliates' approval to satisfy the majority in number test.
  - Schemes of ADGM companies will be able to proceed with the approval of 75% of voting rights, regardless of whether a majority in number of shareholders (or creditors) voted in favour.

- Mergers and Divisions
  - The UK Companies Act contains provisions governing mergers (and divisions) of companies, based on EU law, but these rules are untested in the UK, where M&A activity universally takes the form of private share purchases or asset sales or public takeover offers (often through a scheme of arrangement as described above).

  - Although untested in the UK, the Companies Regulations adopt the same approach regarding mergers, but whereas in the UK a merger would involve the transfer of assets and liabilities from company A to company B and subsequent dissolution of company A, the Companies Regulations adopt the "universal succession" concept, whereby companies A and B are consolidated into one entity without the need to dissolve either of them.
  - This is one example of a situation where it remains to be seen exactly how the ADGM Courts will adopt – and adapt – UK court precedent where the ADGM Regulations and the equivalent UK legislation diverge.
  - Mergers under the Companies Regulations are not only open to public companies: a merger can be of any two companies, provided that one of them is ADGM-registered.
  - One key question posed by the consultation paper was whether, and when, an expert's report should be required in connection with a merger: (i) never; (ii) where shares in one company are exchanged for shares in another (i.e. a report on the share exchange ratio), which is the option that was proposed in the draft regulations; or (iii) also where the consideration is a form of property other than shares or cash. In line with the recommendation made in our response to the consultation paper, the final Regulations require an expert's report whenever there is non-cash consideration.

- Takeovers
  - The Companies Regulations do not contain equivalent provisions to Part 28 of the UK Companies Act, on takeovers.
  - It is proposed that takeovers will be dealt with in separate Takeover Regulations, to form part of a separate, future consultation.

- Financial Assistance
  - The Companies Regulations retain the concept of financial assistance, but the rules only apply to public companies.
  - With certain exceptions, it is unlawful for a public company or its subsidiary to give financial assistance for the purpose of a person acquiring shares in the public company, or for the public company to do so in connection with a person acquiring shares in its private holding company.
  - A public company can provide financial assistance if its net assets are not reduced or the assistance is provided out of distributable profits.

- Accounting standards
  - The "international accounting standards" in accordance with which companies' accounts must be prepared under the Companies Regulations are IAS, IFRS and related interpretations (SIC-IFRIC) and future standards issued or adopted by the IASB, save as otherwise determined by the ADGM Board.

- Model articles
  - The ADGM has released model articles of association for both public companies and private companies limited by shares or guarantee.

- Business names
  - Rules issued by the ADGM specify certain restrictions on the business names that can be used by persons carrying on business in the ADGM and the procedure to be followed by a person who objects to a company's registered name.
  - These rules also specify where and how companies' names, addresses and registered numbers must be displayed and disclosed.
  - For example, approval of the Registrar is required to be registered or carry on business in the ADGM under a name that includes any word from a list of over 70 sensitive words, mainly geographical terms such as "Abu Dhabi", "Emirates" or "National", words related to government or words connected with certain sectors, such as "Bank", "Fund" or "Trust".

- Auditors
  - Separate rules specify the criteria for the type of professional accountancy bodies of which a firm must be a member in order to qualify to be appointed as an auditor of an ADGM company and the requirements to be followed by the Registrar in respect of the register of auditors.

- Miscellaneous Rules
  - Other rules cover non-disclosure of directors' residential addresses, requirements for delivery of documents to the Registrar, fees and applications to amend the register.
  - The ADGM Registrar has also issued Guidelines covering the practicalities of companies' dealings with the Registrar.

Insolvency Regulations

The Insolvency Regulations also follow the UK insolvency laws but here the UK position is slightly more complicated than for company law: the UK Insolvency Act 1986 and Insolvency Rules 1986 are the starting point, but these are supplemented by other legislation and the UK Insolvency Rules 2015, which were designed to consolidate and modernise the UK's secondary legislation on insolvency and have been the subject of a consultation process in the UK in 2013 and 2014, but will not be in force until 2016.

The ADGM Insolvency Regulations follow the "rescue culture" approach that the UK has tried to implement, in particular through the adoption of administration as the main insolvency procedure. Some of the key features are explained below:

- Administration
  - An administrator can be appointed by the ADGM Courts, the holder of a qualifying charge, the company or its directors.
  - The administrator is required to act in the interests of the creditors as a whole and the administration procedure is designed to achieve the following purposes (in order of priority):
    - rescue the company as a going concern;
    - achieve a better result for creditors than a winding-up; or

    - realise property for the company's secured/preferential creditors.

- Creditor Compromise Procedures
    - One of the options that the administrator will have as an exit route from the administration procedure for the company is to implement a "Deed of Company Arrangement", a compromise arrangement with the company's creditors.
    - If the compromise arrangement is approved by a majority of the creditors, the resulting Deed of Company Arrangement will become binding on all creditors.
    - In this context, "majority" means that a simple majority of more than 50% (by value) of the creditors attending and voting at the meeting (or voting by correspondence) have approved the arrangement, provided that the approval does not count if more than 50% (by value) of creditors who are unconnected to the company vote against the arrangement.
    - The Deed of Company Arrangement is based on Australian rules and is included in the Insolvency Regulations instead of the UK "company voluntary arrangement" procedure.

- Administrative Receivership
    - By contrast to an administrator, who must have regard to the interests of the creditors as a whole, the primary concern of an administrative receiver (appointed by one secured creditor in respect of all or substantially all of the assets of the company) is to ensure that the appointing creditor has its debts repaid by selling the company's assets.
    - This is arguably not in keeping with the "rescue culture" approach, so the consultation paper asked whether secured creditors should benefit from this self-help remedy at all.
    - The final version of the Insolvency Regulations retains the possibility of a holder of a qualifying charge in respect of the whole or substantially the whole of the company's property appointing an administrative receiver. Despite a suggestion in the consultation paper to limit this right to secured creditors who obtain qualifying charges in connection with capital markets arrangements or project financings, the final Regulations give this right to all holders of qualifying qualifying charges, regardless of the circumstances in which the charge was created.

- Creditors' meetings
    - One interesting feature of the final version of the Insolvency Regulations is that the requirement for creditors' meetings can be satisfied through correspondence between the creditors and the administrator, administrative receiver or liquidator.

- Limited Disclosure
    - Where the administrator, administrative receiver or liquidator believes that disclosing a company's statement of affairs would prejudice the conduct of the relevant insolvency proceeding or lead to violence against any person, he can apply to the ADGM Courts for an order of limited disclosure.

- Floating Charges
  - A "floating charge" is a charge over all the assets (or all of a class of assets) of a company "from time to time" that, upon an event of default, crystallises into a fixed charge over all the assets at that point in time.
  - The consultation paper explains that the floating charge concept is not generally recognised in the UAE, but it will become part of ADGM law due to the adoption of English common law in the ADGM.
  - The Insolvency Regulations treat floating and fixed charges similarly, for example allowing a secured creditor to appoint an administrator if it holds security over the whole or substantially the whole of the company's assets (whether through a floating charge or a fixed charge).

- Netting and Financial Collateral Arrangements
  - The Insolvency Regulations contain netting-related provisions derived from the ISDA Model Netting Act and the UK's Financial Collateral Regulations that:
    - allow netting provisions to be enforced even if one party has become insolvent; and
    - allow a person to enforce against certain collateral arrangements entered into between parties even if the collateral provider has entered insolvency proceedings.

- Insolvency of Regulated Financial Institutions
  - The ADGM Insolvency Regulations do not deal specifically with insolvency of regulated financial institutions.
  - It is expected that draft regulations providing a specific insolvency regime for regulated financial institutions will be the subject of a separate consultation at a later date.

Should you have any questions about the new ADGM regulations or the Abu Dhabi Global Market generally, please get in touch with your regular contacts at the firm or, in the Abu Dhabi office, Gamal Abouali (gabouali@cgsh.com) or Chris Macbeth (cmacbeth@cgsh.com).

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