

New UAE Commercial Companies Law and Related Regulatory Changes

On 25 March 2015, the new UAE Commercial Companies Law (UAE Federal Law No. 2 of 2015) was issued. The new law ("New CCL") was published in the Official Gazette on 31 March 2015 (issue number 577) and will come into force three months thereafter. It replaces the existing commercial companies law, UAE Federal Law No.8 of 1984.

This marks the culmination of six years of legislative process during which there has been much debate about which aspects of the existing companies legislation should change, particularly around foreign ownership restrictions. (We have not quite reached the end of the process as a number of areas of regulation are left open by the New CCL, to be determined by the Emirates Securities and Commodities Authority (the "SCA"), the Ministry of Economy or the Council of Ministers. The SCA has begun this process by announcing certain regulatory changes on 19 April 2015, although the details of the new regulations are still to be released.) In the end, the existing rules on foreign ownership have not yet been amended, but will reportedly be considered separately as part of an investment law to be issued later. While the basic framework of the UAE companies legislation remains unaltered, the New CCL does introduce a number of significant changes, especially in connection with fundraising, in particular via initial public offering. This memorandum summarises some of the key changes.

An initial general point to note is that, other than the rules relating to public subscriptions, and except where to do so contradicts a particular article of the New CCL, two articles state that (i) provisions relating to joint stock companies apply to Limited Liability Companies ("LLCs") too, and (ii) rules applicable to Public Joint Stock Companies ("PJSCs") also apply to Private Joint Stock Companies ("PrJSCs"). It is unclear exactly how these provisions will apply in practice, in particular to LLCs as a result of certain features that are not shared with joint stock companies.

It is also worth mentioning that the New CCL introduces the concept of a companies' registrar, that is required to maintain a trade name register. The register seems to be aimed at preventing unfair competition and ensuring consumer protection. This will be regulated further by rules to be issued by the Minister of Economy.

Fundraising: IPOs encouraged by lower float thresholds and bookbuilding

The existing rules require PJSCs to float at least 55%, which is a very high percentage compared to most other countries. While waivers could be, and were, obtained, the existence of this rule is thought to have deterred some companies from listing on the two UAE markets, the DFM and ADX (issuers could list lower percentages in the DIFC on Nasdaq Dubai, which is

subject to a different regulatory regime altogether). The New CCL reduces the proportion that must be floated to 30%, allowing founders to retain a majority (up to 70%) of their company (thus, extending the system which, under the existing rules, is specifically applicable to “local family-owned companies” to cover all PJSCs). The maximum proportion that can be floated has been decreased from 80% to 70%.

For the first time, public offers of subscription to shares are expressly prohibited without SCA consent. The New CCL prohibits (i) any company, other than a PJSC, from offering any securities for public subscription; and (ii) any person (anywhere in the world) from publishing any advertisements in the UAE that include an invitation for public subscription in securities prior to obtaining SCA approval. This prohibition is further emphasised by complementary changes to regulations approved by the SCA Board on 19 April 2015 (the “**SCA Regulatory Amendments**”).

A notable change introduced by the New CCL is shortening the maximum period for the public subscription to 30 business days, extendable by an additional 10 business days with the approval of the SCA, as compared to a maximum of 90 days extendable by an additional 30 days under the existing rules. The minimum period for the public subscription remains unchanged at 10 business days. The New CCL now permits the local underwriting of IPOs and rights issues and hands responsibility for certifying underwriters and regulating subscriptions by way of bookbuilding to the SCA. It is hoped that, together with the possibility of minority stake flotations, this recognition of the concepts of underwriting and bookbuilding will help to facilitate and encourage IPOs in the UAE. However, the New CCL does not expressly deal with IPOs through sell-downs by existing shareholders.

It is also worth mentioning that, under the New CCL, the founders’ committee, the company’s advisers and all parties involved in establishing the company (and their representatives) are jointly liable for the content of the IPO prospectus.

The New CCL includes specific provisions governing the conversion of a company from one form to another. Most importantly, in respect of conversion of any company into a PJSC, while the New CCL retains creditors objection rights and provides objecting shareholders with share redemption rights, this additional clarity is expected to boost and facilitate IPO processes. For a company to be able to convert into a PJSC (i) its entire share capital must have been paid up, (ii) it must have completed at least two fiscal years before conversion, (iii) it must have earned net distributable profits equal to an average of 10% of the share capital for two years prior to conversion, (iv) a special resolution to approve the conversion must have been issued, and (v) the company must comply with any additional conditions set out by the SCA Board.

Fundraising: facilitation of domestic bond issuances

As under the existing rules, only PJSCs or PrJSCs may issue bonds to the public, but the New CCL removes the requirement that their value must not, subject to certain exceptions, exceed

the company's capital. The New CCL envisages separate regulations governing bond issuances to be published by the SCA or the Central Bank.

Fundraising: issuances to strategic partners

The New CCL introduces the possibility that a company may issue shares to a "strategic partner" through a capital increase on terms approved by special resolution of the shareholders, without needing to comply with pre-emption rights, provided that (a) the strategic partner's business is similar or complementary to that of the company and provides it with a genuine benefit; and (b) the strategic partner has issued balance sheets for at least two years (except where the strategic partner is the federal government or a UAE local government). The SCA and the competent authority may oppose such issuance if the participation of such strategic partner is deemed contradictory to the applicable laws or regulations or detrimental to the public interest.

Purchase of existing shares to be resold to new investors

The New CCL permits a PJSC that has been in existence for at least 2 years to buy back up to 10% of its share capital for the purpose of reselling it. This must be done in accordance with procedures to be determined by the SCA. As treasury shares, the shares held by the company do not entitle it to voting or dividend rights.

Foreign ownership restrictions remain, for now

A draft of the new law that was considered in 2011 would effectively have permitted the UAE Federal Cabinet to exempt certain categories of company from the foreign ownership restrictions that currently limit foreigners' stakes in UAE companies to 49%. This was removed from the subsequent draft circulated in 2013 and remains out of the New CCL.

However, it is widely anticipated that the UAE's rules on foreign ownership will be relaxed in due course, through a separate new investment law currently being considered. We cannot expect 100% foreign ownership of all UAE companies to be permitted any time soon, but it is possible that the maximum foreign ownership for particular sectors will be increased above 49%.

Recognition of investment funds

The New CCL introduces the concept of a common investment company, whereby an investment fund can be incorporated with separate legal personality. More detailed regulation of such entities is to be introduced by the SCA.

Conversion of debt into equity to facilitate restructurings

The New CCL expressly permits the share capital of a company to be increased through the capitalization of the company's cash debts, pursuant to certain rules to be issued by the SCA. The New CCL explicitly provides that debts owed by the company to the Federal Government of the UAE, any of the Emirates, public authorities or establishments, or banks or finance companies constitute cash debts, but it is unclear whether this list is meant to be restrictive. In any event, this surely facilitates restructurings of UAE companies.

Sole founder companies to encourage Emirati entrepreneurship

The existing rules require an LLC to have a minimum of 2 shareholders and a PrJSC to have a minimum of 3 founders. The only corporate form available for sole traders or entrepreneurs was an unlimited liability sole partnership, which was not appealing from a risk and liability perspective.

The New CCL permits a single UAE person (whether an individual or a legal entity) to establish an LLC which it is hoped will encourage entrepreneurship among Emiratis. The New CCL also permits one legal entity to establish a PrJSC. (In practice, pending relaxation of foreign ownership restrictions, only UAE companies will be able to be sole shareholders of private joint stock companies for now.)

Pledges of LLC quotas to facilitate debt financing and the granting of security

Under the existing law, it was unclear whether quotas (shares) in LLCs could be pledged. The New CCL clearly permits LLC quotas to be pledged to other shareholders or to third parties. This will make it easier for UAE LLCs to raise debt financing, by giving lenders a strengthened security package.

The ability to pledge LLC quotas will also offer additional comfort to foreign 49% shareholders in their relationship with local 51% sponsors/nominee companies, as it is customary for foreign investors to lend their local sponsor/nominee the purchase price of their 51% interest, in return for security over the local partner's shares.

In the event where the creditor proceeds with the enforcement of its rights but fails to agree with the debtor and the LLC on the conditions and mechanics of sale of the pledged shares, such pledged shares shall be disposed of by public auction following a request to the competent court. The shareholders will have the right to buy back the shares from the winning bidder within 15 days of the public auction, on the same terms and conditions. The same rules apply in the event of bankruptcy of an LLC shareholder.

Simplification of LLC management

A number of changes have been made by the New CCL to make management of LLCs simpler and more efficient. These include the removal of the maximum (previously 5) number of managers, and restricting the managers from undertaking activities competing with those of the company or usurping the company's corporate opportunities. However, some uncertainty has been introduced by the new provision extending rules applicable to joint stock companies to LLCs too, as it is unclear exactly how this will apply in practice in all cases.

LLC general assembly meetings now require 15 days' notice (on first call), instead of 21, notice need no longer be given by registered letter, and shorter notice can be given if approved by all shareholders. There is a new quorum requirement of at least 75% of the share capital, which reduces to 50% upon the adjournment of an inquorate meeting. No quorum requirements apply on the third call of a general assembly meeting. Shareholders can now appoint a third party proxy to attend in their place, if the articles of association so permit, as opposed to limiting proxies to other (non-director) shareholders only under the existing rules.

Although previous drafts of the new law would have increased the maximum number of shareholders from 50 to 75, in the final draft the limit remains at 50.

Some simplifications of PJSC and PrJSC management

The minimum number of founders for a non-governmental PJSC has been reduced from 10 to 5. The minimum number of shareholders in a PrJSC has been reduced from 3 to 2 (with a possibility of establishing a sole founder PrJSC as highlighted above) and the maximum number of shareholders now set to be 200. It is worth noting that this maximum number of shareholders does not apply to PrJSCs with more than 200 shareholders as of the date of issuance of the New CCL, but no further increase in the number of shareholders in these PrJSCs is permitted (other than, as is the case with any PrJSC, pursuant to inheritance or a court order).

The minimum share capital for a PJSC has been increased from AED10m to AED30m and, for new PrJSCs, from AED2m to AED5m. The minimum share capital may be increased by a decision of the Cabinet acting on recommendations of the Chair of the SCA (with respect to PJSCs) or the Minister of Economy (with respect to PrJSCs).

Like LLCs, the notice period for general meetings has been reduced to 15 days (with the right of shareholders representing at least 95% of the company's capital to waive the notice period), with the distinction between ordinary and extraordinary general meetings abolished and replaced by the new concept of "special resolutions" which require the approval of at least 75% of the shares represented at a general meeting.

While the maximum number of directors of a PJSC has been reduced from 15 to 11 (with a requirement that the total number of directors must be an odd number), at least two thirds of

them must hold shares in the company. In addition, a majority of the board seats including the chairman must be UAE nationals.

The New CCL authorizes the shareholders, in the context of electing the directors of the company, either to cast all of their voting rights (which shall be equal to the number of shares they own in the company) to one candidate or to split them between various candidates.

Changes to share capital rules for PJSCs and PrJSCs

While the existing law provides that, in the case of initial subscription, shares may only be issued at nominal value, this requirement no longer appears in the New CCL thus suggesting that shares can now be issued at a premium to nominal value even in the case of initial subscriptions, as was already the case with respect to shares issued as a result of a capital increase. The premium shall be subject to SCA's consent, and the New CCL provides that the means of computing issuance premiums will be determined by a decision of the SCA Board.

The New CCL also creates the possibility of PJSCs issuing different classes of shares, although this would require further steps by the Cabinet, acting on recommendations of the Chair of the SCA. In addition, the New CCL introduces for the first time the concept of "authorised" share capital pursuant to which the general assembly can now grant the board of directors an upfront approval for future increases of the issued share capital up to the limit of authorised share capital (which must not exceed double the issued share capital). The SCA is expected to set out further rules and conditions governing these procedures. This will allow company boards more flexibility to act quickly to issue shares in reaction to market conditions.

On new issuances of shares, the New CCL permits shareholders to sell their pre-emption rights to other existing shareholders or to third parties for consideration, subject to further rules to be issued by the SCA regulating the transfer of the pre-emption rights.

These changes are accompanied by new provisions to be introduced through the SCA Regulatory Amendments that prohibit a subsidiary from being a shareholder in its parent company (and if a company that becomes a subsidiary of its new parent already held shares in the parent, it will be required to dispose of them within 12 months and will be unable to vote them in the meantime).

Enhanced Corporate Governance, directors' duties and shareholder protection

The New CCL introduces new requirements for accounting, corporate governance and auditing. These include obligations on all companies to keep accounting records for 5 years, to prepare those accounts in compliance with international accounting standards and (for PJSCs, PrJSCs and LLCs) to have their accounts audited annually.

Except with respect to banks, finance companies, investment companies, and exchange and financial intermediation companies, the New CCL mandates the Board of the SCA to issue

resolutions to regulate corporate governance for PJSCs and the Minister of Economy to issue resolutions to regulate corporate governance for PrJSCs that have more than 75 shareholders. New rules have also been added which expressly prohibit certain related-party transactions and insider trading.

The New CCL introduces a new offence of failure to keep accounting records to document the company's transactions, punishable by a fine of between AED50,000 and AED500,000.

The New CCL allows shareholders with at least 10% of the share capital to request an inspection of the company (by the Ministry of Economy or the SCA) in the event of material violations by board members or auditors in performing their obligations, but the details of such inspections remain to be determined by the SCA (for PJSCs) and the Ministry of Economy (for PrJSCs).

The New CCL introduces a new 'unfair prejudice' procedure whereby shareholders holding individually or together at least 5% can apply for remedies to the SCA (or the competent court, in case of rejection of the request or failure to act by the SCA) if the affairs of the company are deemed to be conducted to the detriment of any or all of the shareholders.

In addition to the changes introduced by the New CCL, the SCA Regulatory Amendments will prohibit companies from using amendments to articles of association to prevent trading in their shares prior to/during general meetings, transactions, trades or actions that may impact their capital. The SCA Regulatory Amendments will also clarify that the SCA (or in some cases the director general of the stock exchange) has the right to suspend trading in listed securities in exceptional circumstances, or where trading does not "serve the common good or violates the rights of shareholders" or for "other reasons". These changes will be implemented through amendments to the Regulations concerning Trading, Clearing, Settlement, Transfer of Ownership, and Custody of Securities.

New takeover regime: MTO at 50% and other M&A-related changes

Unlike the existing law, the New CCL contemplates a takeover regime for the shares of publicly listed companies through rules to be issued by the SCA. Violation of these rules may result in unwinding the takeover transaction and a fine not exceeding the acquisition consideration, or disqualifying the offending persons from serving in the boards of, or voting in, the acquired companies.

The SCA has begun the process of regulating takeovers by announcing that as part of the SCA Regulatory Amendments, shareholders that own 50% or more of a listed PJSC and wish to increase their stake shall be required to make a mandatory takeover offer for all remaining shares. The SCA Regulatory Amendments will also prohibit two independent PJSCs from owning more than 10% of the capital of each other. It remains unclear whether the 10% limit

applies to each of the two companies considered separately, or whether it is meant to set an upper limit on combined cross-ownership.

In addition, the statutory merger process remains as an available method of merging PJSCs in the UAE. However, the new rules in the New CCL no longer distinguish between merger by acquisition and merger of two companies into one new company. Instead, the New CCL allows companies to merge by contract specifying the method of conversion of the existing entity's (or entities') shares. However, the New CCL introduces a short-form merger procedure between a holding company and a fully-owned subsidiary, as well as between two or more fully-owned subsidiaries of the same holding company, where no merger contract is required.

Shareholders holding at least 20% of the share capital, or creditors, of either existing company can appeal against the proposed merger. Other than in the case of joint stock companies, the New CCL gives appraisal rights to shareholders who oppose the merger, pursuant to which such shareholders shall be entitled to a fair value of their shares as determined by agreement, by a committee constituted for this purpose by the competent authority, or by the courts.

The New CCL suggests that the SCA will issue regulations governing merger rules and procedures for PJSCs and the Minister of Economy will issue a resolution covering other companies.

Holding companies

Under the New CCL, an LLC, a PJSC, or a PrJSC can be incorporated for the sole purpose of holding a controlling interest in UAE or foreign subsidiaries. Holding companies must be identified as such in the name of the company and must file consolidated accounts but other practical requirements related to this new type of company are as yet unclear.

Free Zone companies

As under the existing rules, free zone companies do not need to comply with the New CCL, except to the extent they also operate 'onshore' within the UAE.

The drafting of the New CCL makes it clear that free zone companies may operate outside their free zone and 'onshore' in the UAE provided that their free zone's rules permit this and they are registered under the relevant Cabinet resolution (to be issued in due course).

Maintenance of Capital: new prohibition on financial assistance and on loans to directors

The New CCL, for the first time in UAE law, introduces a prohibition on financial assistance. This is a surprise given the recent trend in other countries to abolish such rules and because the proposal was criticised when it appeared in earlier drafts of the law.

The rule prohibits the company, and any of its affiliates, from providing financial assistance to any shareholder for the purpose of enabling the shareholder to own any shares, bonds or instruments issued by the company. (The Arabic text of the New CCL refers to “*sukuk*” but this should not be taken to be limited to *sukuk* in the sense of Shari’a-compliant bonds.) Prohibited financial assistance includes loans, gifts/donations, providing the company’s assets as collateral and providing a security or guarantee for the undertakings of another person. There is no “whitewash” procedure in the New CCL, whereby financial assistance is permitted if approved by shareholders and no *de minimis* exception: the New CCL merely contains an outright prohibition on financial assistance.

The New CCL also expressly prohibits loans by joint stock companies to their directors or their close family members, as well as to companies in which a director or his/her close family members own more than 20% of the share capital.

Compliance by existing companies

Existing companies need to amend their articles of association to comply with the New CCL within the next year, although this period may be extended for another year by decision of the Cabinet based upon the proposal of the Minister of Economy. If a company fails to make the necessary amendments to its articles, it shall be deemed to be dissolved.

Conclusion

The New CCL is only one of several significant legislative changes that have been eagerly awaited by the UAE business and professional community in recent years. The others are the bankruptcy law, the investment law and the competition law, which is in force but incapable of being enforced while final guidelines (e.g. on market share thresholds) remain pending.

It is hoped that the increased certainty the new laws will bring will facilitate efforts to diversify the UAE economy by encouraging increased entrepreneurship and foreign investment.

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