CLEARY GOTTLIEB

ALERT MEMORANDUM

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New UAE Commercial Companies Law: Some Practical Observations for Equity Capital Markets Transactions

Background

As we have previously discussed in our alert memo dated April 21, 2015 (available here), the new UAE Commercial Companies Law (UAE Federal Law No. 2 of 2015) (the "New CCL") comes into force on July 1, 2015. 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 April 19, 2015. 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, many of which we expect to be relevant to capital raisings within the UAE. We have highlighted in this memo a non-exhaustive selection of practical points which are likely to be of significance when considering and executing equity deals under the New CCL.

It should be noted that a number of the provisions of the New CCL highlighted in this memo require further legislation or decisions from the SCA in order to be fully implemented, for example the certification process for underwriters under Article 123, and the provisions relating to the regulation of subscriptions for securities and book building in Article 129.

Requirements for Listing

Relaxation of public float requirements

The previous rules required public joint stock companies ("PJSCs") to float at least 55% of the existing issued share capital, 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

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floated to 30%, allowing founders to retain a majority of the issuer (thus, extending the system which, under the existing rules, is specifically applicable to "local family-owned companies" to cover all PJSCs)[1]. The 30% threshold is higher than that which is prescribed by the UK listing regime (25%), and lower than the FTSE requirements for indexation for an overseas issuer (50%).

The maximum proportion of an issuer's share capital that can be floated has been decreased from 80% to 70%. Whilst this ceiling is not likely to be relevant in the context of an IPO, it may be relevant when structuring certain follow-on transactions. In addition, depending on who the holders of the 30% (or greater) rump are (essentially the founders of the PJSC), this requirement may mean that, in practice, most UAE companies, in the view of the UK Financial Conduct Authority, (the "FCA") would have a "controlling shareholder" and so may fall within the controlling shareholder regime applicable under the UK listing rules[2] in the event they pursued a dual listing in London.

Foreign ownership restrictions remain

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 provision was not included in 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%.

SCA consent required for public offer

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[3]. In addition to providing its consent to the offering, the SCA is also charged with reviewing the IPO prospectus.

Board composition

[1] Potential issuers and underwriters should be aware that Article 279 of the New CCL also states that "a company proposing to be converted into a Public Joint Stock Company may sell by way of public subscription 30% maximum of its capital upon assessment". It is not clear whether this provision could be interpreted in a way that could potentially limit deal size on an IPO; guidance should be sought at an early stage in the transaction.

[2] Note such regime only applies to companies seeking a premium listing in London. Notwithstanding this, certain aspects of the regime, notably the relationship agreement between the issuer and the controlling shareholder, are often adopted voluntarily by issuers seeking a standard listing in London, and this practice is encouraged by the FCA.

[3] This prohibition is further emphasised by complementary changes to regulations approved by the SCA Board on 19 April 2015.

The board of the issuer can have a maximum of 11 directors. At least two thirds of the directors must be shareholders of the issuer, there must be an odd number of directors, and the majority of directors (including the chairman) must be UAE nationals. It should be noted that, for issuers which are also planning a premium listing in London, care must be taken when reconciling the New CCL requirement for a majority of UAE nationals with the requirement in the UK Corporate Governance Code for a majority of independent directors to be on the board.

The Offering Process

Recognition of underwriting and book building concepts

The New CCL now contemplates a legal framework for the local underwriting of IPOs and rights issues and hands responsibility for certifying underwriters and regulating subscriptions by way of book building to the SCA. It is hoped that, together with the possibility of minority stake flotations, a clearer legal framework for underwriting and book building will help to facilitate and encourage IPOs in the UAE. What this means in practice, and what parameters may be imposed on underwriters is not yet clear, as the certification process for underwriters under Article 123, and the provisions relating to the regulation of subscriptions for securities and book building in Article 129 both envisage that further legislation will be implemented.

It should also be noted that the New CCL does not expressly deal with IPOs that have a secondary component (i.e. sell-downs by existing shareholders), and further legislation or guidance from the SCA is therefore desirable on that point as well.

Subscription periods

The New CCL has shortened the maximum period for public subscriptions 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. Given a typical marketing timetable for an IPO, and issuers' and underwriters' desire for smooth execution of transactions, we would envisage subscription periods to be closer to the minimum period prescribed by the New CCL, which is consistent with a typical two week international book build on a European IPO.

Allocations

An interesting point is raised by Article 125 which envisages that, in the event of an oversubscription, shares may be "distributed to subscribers pro rata to their respective subscriptions or as determined in the prospectus". Given the way the allocation process is managed on an international book built transaction and the focus in the UK around best execution and allocation principles, underwriters will likely want to specify a greater level of flexibility around allocation within the prospectus in the event of an oversubscribed transaction.

Prospectus requirements

A prospectus must be published in Arabic and approved by the SCA in connection with an offering by a PJSC. We would also expect an "international" offering memorandum to be produced to Reg S/144A standards as appropriate. Care will likely need to be taken around ensuring the two documents are consistent and it will need to be clarified whether the international offering memorandum (which will likely be a much more detailed document) can be provided to local investors.

Forecasts in IPO prospectuses

Under SCA regulations, first time offerors are required to include forecasts of financial performance[4]. SCA guidance indicates that forecasts should cover estimated income items, estimated cash flow statements, and estimated financial statements, including an auditor's report. Basic assumptions upon which such forecasts and notes were based should be clearly set out. Offerors must apply to the Ministerial Cabinet for an exemption from this requirement. The general criteria, according to verbal guidance from the SCA is that the offeror must show a good enough reason as to why projections can be omitted. While exemptions can be requested, they are not always provided. While these requirements do not derive from (nor have they been amended by) the New CCL, such detailed forward looking disclosure requirements pose evident liability concerns for issuers and underwriters[5].

Pre-emption rights

The New CCL provides for pre-emption rights for existing shareholders, and it does not appear that such rights can be waived, although Article 197 expressly specifies that the rights can be sold in the market. The exact timetabling implications of this are not yet clear but it is likely to be of relevance to secondary/ follow on transactions undertaken by issuers. In terms of primary issuances, "founders" of the issuer are not permitted to participate in the book build.

Financial assistance

The New CCL introduces an outright prohibition on financial assistance. PJSCs (and their subsidiaries) may not provide financial assistance to any shareholder to enable such shareholder to hold any shares, bonds or other instruments issued by the issuer. There is no whitewash procedure available.

Experience in many other jurisdictions which have stringent financial assistance regimes teaches us that, in the context of equity (and debt) capital markets transactions, both the transaction structure and the underwriting documentation will need careful consideration in

[4] It should be noted that it is popular to seek a waiver of this requirement. Recent practice shows that the SCA has granted a waiver in at least two recent transactions where issuers did not included profit forecasts in offering documents. A waiver may be less likely to be granted with respect to newly founded companies without an established financial track record.

[5] Issuers that are considering a dual listing in London should be mindful of this requirement. Historically profit forecasts have not been included in offering documents largely due to the requirement for an accountants report on outstanding profit forecasts, which can be difficult to obtain.

order to confirm that fee and indemnity arrangements which are put into place in connection with the offering do not inadvertently contravene the financial assistance regime.

Liability Regime for Underwriters and Directors

Prospectus liability for advisers

Under the New CCL, the founders' committee, the issuer's advisers and all parties involved in establishing the issuer (and their representatives) are jointly liable for the content of the IPO prospectus. This is in contrast to the EU prospectus liability regime, which generally imposes liability on the issuer, its directors and any person who has otherwise directly taken responsibility for the prospectus. Under the New CCL, such liability could potentially extend to underwriters who need to consider the implications of this potential liability and any recourse they may have, for example under the indemnity provisions in the underwriting documentation.

Directors' liability

Under the New CCL all directors are liable towards the issuer, shareholders and third parties for acts of fraud, misuse of power, violation of the New CCL or the issuer's articles and "errors in management". It is not possible to limit the liability of directors by contract. Such regime extends to "absent directors" unless they can provide they were unaware of a decision that was taken.

Given the increasing focus on corporate governance in the IPO marketing process and the importance of independent directors (particularly if the issuer will either be subject to, or intends to voluntarily adhere to, the UK or a similar corporate governance code), it is likely that potential or newly appointed independent directors will want to take local law advice in order to understand what their potential liabilities in connection with their appointments may be, and take measures (i.e. D&O insurance or otherwise) to help protect themselves. Underwriters may wish to take this into account when planning IPO timetables that include the recruitment of new board members.

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Should you have any questions about the New CCL or international capital markets transactions, 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) or, in the London office, Simon Ovenden (sovenden@cgsh.com) or Paul Hodgson (phodgson@cgsh.com).

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