



THE NEW UAE COMPANIES LAW

Client briefing note

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INTRODUCTION

On 1 April 2015, the UAE Government announced the issue of Federal Law No. 2 of 2015, a new companies commercial federal law (the **New Law**) comprising 378 articles which replaced the previous companies commercial law (No. 8 of 1984 as amended) (the **Old Law**) on 1 July 2015.

Unlike many UAE laws in the past, the New Law states its objectives, which include contributing to the development of the business climate and the UAE's commercial position, protecting the rights of shareholders and supporting foreign investment. The New Law does this by covering the relations of companies and government institutions and introducing changes which will affect certain structures used by foreign investors establishing businesses in the UAE. Companies excluded by resolution of the Federal Cabinet, companies operating in certain oil, gas or power sectors, companies fully owned by the Federal government or local governments, and companies fully owned by such entities, are excluded from the scope of the New Law.

The New Law will not be applicable to free zone companies, except where the laws/regulations of the relevant free zone permit the conduct of the company's activities outside of the free zone in the UAE (Article 5). Article 5 also states that there will be a Cabinet decree that will set out the conditions which should be followed in registering free zones companies in case these companies wish to operate onshore or outside the borders of the free zone in question but within the UAE.

MAIN CHANGES INTRODUCED BY NEW LAW

General Modernisation

A heavy criticism of the Old Law was that it was unclear in places and lacked legal certainty. The New Law has introduced defined terms such as "business day", "related parties", "diligent person" and "member of the board of directors" which bring clarity to the application and interpretation of the New Law.

Holding Companies

Limited liability companies and joint stock companies are now permitted to be established as holding companies in order to conduct business activities solely through their relevant subsidiaries (Article 266). The concept of a "holding company" was not recognised under the Old Law. In many other jurisdictions, setting up holding companies is now a common practice for large corporate groups to achieve tax and other benefits. The New Law increases the appeal of the UAE for large corporate groups considering an establishment or restructuring in the region.

Sole Founders

The New Law introduces the concept of a sole founder. Under Articles 71 and 255, an individual can now establish a private joint stock company ("**JSC**") or limited liability company ("**LLC**") - a move likely to make life easier for UAE entrepreneurs. It was previously not possible, other than in some free zones, to establish an LLC wholly-owned by one individual or entity. Allowing a sole shareholder to incorporate an LLC means sole shareholders may enjoy the benefit of limited liability in their businesses whilst exercising unilateral control. In light of section 2.4 below, this change will primarily benefit Emirati entrepreneurs and those from other GCC countries.

Companies Registrar

Chapter 3 of the New Law introduces for the first time the role of "Companies Registrar", to be appointed by the Minister and perform duties through the Companies Department at the Ministry. Though the extent of the roles and responsibilities of the Companies Registrar will not be known until detailed regulations are published by the Ministry of Economy, the Companies Registrar shall supervise the trade name register (to avoid double registration), hold company records and enable "concerned parties" to inspect the relevant company records (Article 33-38). The wording of Article 37, by referring to "concerned parties" being able to access company records, may suggest that the general public will be unable to access corporate records and information.

New Power to Pledge Shares

The Old Law did not address taking security by way of pledging the shares of a UAE LLC, and accordingly, to date, there has not been any official register on which to record the pledge of shares to perfect such security. The New Law introduces a new right for shareholders to grant security by way of a share pledge over shares in an LLC and possibly for securing shareholders' arrangements. This will be a welcome additional power when it comes to raising finance. In accordance with the New Law, a partner may transfer or pledge shares in the company to another partner or to a third party, provided the transaction is made pursuant to the terms of the company's Memorandum, by way of a legally binding document, notarised and registered in the commercial register of the department of economic development of the relevant emirate. It will be interesting to see how the authorities implement this provision, especially if a UAE national were to create security on its shares in favour of a foreign party.

Local Ownership

Contrary to widespread media speculation prior to the promulgation of the New Law, **the New Law retains its mandatory requirement of not less than 51% UAE national ownership for any company established in the UAE.** It in fact goes even further in its restriction of foreign ownership by invalidating any transfer of shares that would impact the national ownership rule, through Article 10. Whilst the Old Law recognised the ownership of the foreign investor to the value of his shares even in a situation where a company was declared null and void for breach of the foreign ownership requirement, the New Law now specifies that any shares subject to void transfer documents will end up by the force of law under the ownership of the national shareholders, in spite of any contrary agreement he may have signed.

Notwithstanding the above, the UAE government is considering relaxing the current restriction on foreign ownership in certain industry sectors under a new Foreign Direct Investment Law regime. At the UAE Annual Investment Meeting held in Dubai on 30 March 2015, His Excellency Sultan Al Mansoori, UAE Minister of Economy, reiterated the government's intention to enact a new law that would relax foreign ownership restrictions in certain, as yet unspecified, industry sectors. However, no timeline has been declared for the introduction of the proposed law.

It should be noted as well that there has been no change to the ability to set out in a company's memorandum of association, (Memorandum) that profits and losses can be shared in different proportions to the shareholdings.

Existing Companies to be Aware

There are a number of provisions in the New Law that existing UAE companies should be aware of. Some of these represent additional or changed compliance obligations and rights. Examples include:

- the obligation for all companies to keep accounting records at their relevant head offices for a minimum period of five years and to prepare audited accounts in accordance with international accounting practices and standards in order to give a clear and accurate view of the profits and losses of the company for greater accountability and transparency (Articles 26 and 27), which was not provided for in the Old Law;
- a requirement for the Memorandum to include up to date particulars of the company's head office and any branch offices (Article 42);
- a requirement that other than with the consent of the general assembly, a director/manager is not permitted to manage another competing company (including another company with similar objects) (Article 86);
- the need to specify in the Memorandum if the shareholders intend that a special resolution (rather than an ordinary resolution) of a general meeting is to be required in order to dismiss a manager (Article 85). Previously, if the Memorandum did not specify that a Manager could be dismissed, a unanimous vote was required;
- the duty for a director/manager to preserve the rights of a company and extend such care as a diligent person (Article 22) and any provision in a company's Memorandum exempting such person from personal liability is void (Article 24); and
- the quorum required to convene a general meeting, being 75% of shareholders to be present at the first attempt, 50% at the second attempt and no minimum requirement at the third attempt. This will be particularly relevant for minority shareholders as a quorum could be established at the second attempt without their attendance. Once the meeting is quorate, decisions require a simple majority of the shares **present or represented** unless the Memorandum requires a higher percentage.

Article 374 provides that existing companies to which New Law applies shall adjust their provisions according to the provisions of the New Law by no later than one year from its effective date, or else shall be deemed as dissolved in accordance with the provisions of the New Law. It should be noted however that certain provisions of the New Law require immediate compliance where some form of corporate action is taken for which the New Law imposes a specific requirement.

Public Joint Stock Companies

The New Law encourages financial markets and new IPO activity on UAE markets through the modification of some existing rules and the introduction of a number of new rules:

- IPOs are still allowed for a newly incorporated company with no track record.
- Under the New Law, founders can keep 70% of the company's equity, and float a minimum of 30% of their equity. Previous rules required companies to float at least 55% and were widely perceived as making IPOs in the UAE less attractive than in other jurisdictions. The retained equity (up to 70%) can now be offloaded at a later date at valuations that are higher than the initial valuations. This is more attractive for a company's founders and will encourage family owned companies to go public. However, it is important to note that once the company lists, any founder's holdings which have not sold down during the initial offering phase remain locked in for two years.
- Adding a premium to newly issued shares has now been permitted (Article 196).
- All public JSCs are now required to rotate the auditors every three years (Article 243).
- Underwriting has been given statutory recognition for the first time (Article 123), meaning that companies will also be able to use a book-building process to price shares. This was not permitted under previous regulations, which used the old nominal value as the only method to value shares. Under the new regime, pricing will be more closely aligned to the market rather than regulator-approved valuations.
- Though pre-emption rights can be sold under the New Law, companies must offer at least 20% of shares in an IPO to retail investors and 60% to qualified institutional investors. Additionally, the Emirates Investment Authority (the federal sovereign fund) has the right to subscribe to shares in any JSC undergoing an IPO, within the limit of 5% of the shares offered for subscription, provided that the value of such shares shall be paid prior to closing the subscription and the Securities & Commodities Authority is provided with evidence of such payment.
- Joint stock companies are prohibited from providing financial assistance to fund the acquisition of their own shares (in line with international market practice).

Conclusion

The changes are perhaps less wide-ranging than many would have expected to see after a long-awaited reform concerning the liberalisation of the foreign ownership requirement under the Old Law. There are nevertheless some significant changes brought by the New Law that impact existing UAE companies, notably regarding the pledging of shares, IPOs and JSCs,

Whilst Article 374 provides for a (potentially extendable) 12 month grace period for existing companies to "adjust their positions" to bring them in line with the New Law, companies should nonetheless be thinking now about how their Memorandums needs to be changed and should be aware that certain provisions of the New Law need to be complied with even where actions are taken during the grace period.

KEY CONTACTS

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