

Briefing Series on the Draft UAE Commercial Companies Law

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Issue No. 3 — Key Changes for Joint Stock Companies

This is the third briefing in Latham & Watkins' five-part *Briefing Series on the Draft UAE Commercial Companies Law* (the Draft CCL). The Draft CCL introduces some significant changes to Federal Law No.8 of 1984 Concerning Commercial Companies (the Existing CCL), which will be repealed in its entirety when the Draft CCL comes into force. The purpose of this *Briefing Series* is to highlight the key changes expected to be introduced by the Draft CCL.

The topics in our five-part briefing series are:

- Issue No. 1 — key changes applicable to most forms of companies
- Issue No. 2 — key changes for limited liability companies (LLCs)
- **This Issue, No. 3 — key changes for joint stock companies (JSCs)**
- Issue No. 4 — key changes relating to mergers
- Issue No. 5 — key changes relating to penalties

The key changes to the Existing CCL contained in the Draft CCL applicable to JSCs¹ are:

- **Directors.** The Draft CCL provides that (i) the Federal government or the government of any Emirate may, if it holds more than 10 percent share capital, appoint its representative(s) to the board of directors of a JSC pro-rata to such percentage (Art. 152); (ii) a majority of the board of a JSC may be non-UAE nationals if non-UAE nationals are authorised to hold more than 49 percent of the share capital of the company (Art. 155) and (iii) the chairman of the board may be a non-UAE national (Art. 147). In addition, the Securities and Commodities Authority (the SCA), shall issue a resolution to determine the mechanism of voting at general assemblies to elect directors (Art. 150). It is not obvious why the Federal government or the government of any Emirate should have preferential rights to appoint directors of JSCs, or why the SCA should need to issue a resolution on the mechanism of voting at general assemblies to elect directors of JSCs. The change to the existing requirement for JSCs to have a majority of UAE national

directors and a UAE national as the chairman is an improvement from a corporate governance perspective, increasing the pool of available directors and chairmen.

- **Share capital rules.** The Draft CCL increases the minimum share capital for a PrJSC from AED 2 million to AED 5 million (Art. 260) and for a PJSC from AED 10 million to AED 30 million (Art. 197). In addition, the Draft CCL permits a JSC to have authorised share capital of up to two times the company's initial share capital and permits JSCs to determine authorised share capital in their articles of association (Art. 197). The directors may increase the issued share capital of a JSC up to the limit of the authorised share capital approved by the general assembly (Art. 198). Allowing JSCs to have authorised and issued share capital makes it easier for JSCs to issue new share capital and is consistent with share capital laws in many other jurisdictions.
- **Valuing non-cash consideration.** The Draft CCL maintains that founders may provide non-cash consideration for their shares in a JSC provided that the non-cash consideration is assessed by a financial consultant approved by the SCA at the cost of the shareholder providing the consideration (Art 122.2). The SCA may object to the assessment and appoint another assessor (Art. 122.5). This change should make the valuation of non-cash consideration for shares in JSCs more efficient so long as the SCA does not object to the financial consultant's valuation.
- **Insider trading.** The Draft CCL introduces a restriction on the related parties² and personnel of a JSC from utilising any information arising from their relationship to the company to engage in a transaction in the securities of the company (Art 156). The restriction extends to having an indirect interest in another party engaging in transactions to influence the value of securities (Art. 156). UAE Federal Law No. 4 of 2000 Concerning the Emirates Securities and Commodities Authority (the ESCA Law) prohibits trading in listed PJSCs only on the basis of unpublicised or undisclosed information. It

is curious that Article 156 does not restrict only the use of unpublicised or undisclosed information as per the ESCA Law.

- **Related party transactions.** The Draft CCL prohibits JSCs from engaging in substantial transactions (defined as transactions exceeding the lesser of five percent of share capital or AED 10 million) with related parties³ (Art. 156). The introduction of a “related party transactions” rule is a sensible change, although the lack of specificity around the thresholds may make this rule difficult to apply in practice.
- **Unfair prejudice.** The Draft CCL provides that one or more shareholders holding at least five percent of the shares of a JSC may file a complaint with the SCA, or in the event the SCA rejects the application, resort to a court, with an allegation that the affairs of the company are or have been conducted to the detriment of the interests of any of the shareholders, or that the company intends to do or omit to do any act that may cause damage to a shareholder (Art. 168.1). The SCA may issue a relevant resolution at its discretion, or alternately, seek a court order and the court is required to hear the suit as a matter of urgency and granted the authority to issue a judgment to annul an act or to require an omitted act (Art. 168.4). This provision increases the rights of minority shareholders. It will be very interesting to see how the SCA and the courts interpret and apply this provision.
- **Financial assistance.** The Draft CCL prohibits a JSC or any of its subsidiaries from providing “financial aid” to a shareholder to enable the shareholder to hold any shares, bonds or deeds issued by the company (Art. 226). “Financial aid” is defined to include providing: (i) loans; (ii) gifts or donations; (iii) assets of the company as security; and (iv) security or guarantee of the obligations of another person (Article 226). As drafted, this provision lacks practical exceptions such as a *de minimus* exception or an exception permitting a company to provide “financial aid” with express shareholder approval, which operate in many other jurisdictions.
- **Issuing shares at discounts/premiums.** The Draft CCL eliminates the restrictions in the Existing CCL on JSC issuing shares at a discount or a premium. In the Existing CCL, shares may only be issued at nominal value in the case of the initial subscription and at nominal value or a premium in the case of a capital increase (Art. 153 and 203). This change provides JSCs with more flexibility in the pricing of and issuance of shares.
- **Part payment for shares.** The Draft CCL maintains that shares in a JSC may be issued by payment of at least 25 percent of their nominal value. However, the period for payment of the balance of the value of the shares is reduced from five years to three years from the date of registration of the company, and the option for the company to extend the period pursuant to its articles of association has been removed (Art. 211).
- **Strategic partners.** The Draft CCL provides a right for JSCs to make a non-pre-emptive share issuance to a strategic partner subject to certain conditions (Arts. 153 and 203). A “strategic partner” is defined as a partner whose contribution to the company provides technical, operational or marketing support for the benefit of the company (Art. 1). Furthermore, the strategic partner is required to have activities that are similar or supplementary to the activity of the company and have issued two years of financial statements (Art. 228.1). The additional conditions relating to such an issue are: (i) a presentation by the board of directors to the general assembly of the benefits from the entry of the strategic partner; and (ii) a special resolution approved by shareholders holding at least 75 percent of the votes represented at the general assembly (Art. 227). The board of directors must offer the new shares to the strategic partner within three months of the special resolution and such shares must be subscribed within 30 days of the offer (Art. 228.1). In addition, the SCA will issue a resolution determining the conditions and procedures of entry of the strategic partner as a shareholder and retains the right to reject a contribution by a strategic partner if it contravenes regulations or adversely affects the public interest (Art. 228.3). These new provisions appear quite cumbersome. It would be preferable for JSCs to have the right to disapply pre-emptive rights through a special resolution of the general assembly without the additional hurdles set out in these articles of the Draft CCL.
- **Capitalisation of cash debts.** The Draft CCL allows a JSC to capitalise its cash debts without a pre-emptive offer to existing shareholders, subject to certain conditions. Debts owed to the Federal government, the government of any Emirate, the public authorities and establishments of the UAE, banks and financing companies shall be deemed to be cash debts (Art. 229.3). The conditions relating to such an issue are: (i) a presentation by the board of directors to the general assembly of the necessity for the capitalisation of debts; and (ii) a special resolution approved by shareholders holding at least 75 percent of the votes represented at the general assembly (Art. 229). In addition, the SCA will issue a resolution determining the conditions and procedures to capitalise cash debts (Art. 229). Once again, this provision appears unnecessarily cumbersome, but it addresses a shortcoming in the Existing CCL.
- **Employee share schemes.** The Draft CCL provides for issuance of shares to employees without a pre-emptive offer to existing shareholders, subject to certain conditions. The conditions relating to such an issue are: (i) a presentation by the board of directors to the general

assembly of a scheme to encourage employees to hold shares of the company; and (ii) a special resolution approved by shareholders holding at least 75 percent of the votes represented at the general assembly (Art. 230). In addition, the SCA will issue a resolution determining the conditions and mechanism to implement an employee share scheme (Art. 230).

- **Auditors.** The Draft CCL maintains the requirement for every JSC to have an auditor audit its accounts on an annual basis and provides additional details relating to the appointment, responsibilities and removal of the auditors. The auditor is nominated by the board of directors and approved by the general assembly for a term not exceeding three successive years (Art. 247). An auditor must be approved by the SCA and must satisfy the following new conditions: (i) experience in auditing companies for at least five years; (ii) approved by the Central Bank in the case of audits of banks, financing and financial investment companies, exchange companies and cash brokerage companies and (iii) professional insurance as required by the SCA (Art. 248). The allocation of duties between multiple auditors is clarified (Art. 249 and Art. 250). The auditor's report to the general assembly must address additional matters including purchase of stock by the company, related party transactions, penalties incurred by the company and the consolidated statements for holding companies (Art. 254). In addition, there are new provisions imposing a prohibition on insider trading by an auditor and an obligation on auditors to notify the authorities of any crimes (Art. 252 and 253). Finally, the process for removal or resignation of auditors is stipulated (Art. 255 and 256).
- **Further rules.** The Draft CCL provides that certain rules regarding share capital and shareholder rights may be determined by a resolution of the Cabinet or the SCA in due course. For example, (i) the Cabinet may issue a resolution determining the conditions for issuing different classes of shares and their corresponding rights (Art. 210); and (ii) the SCA may issue a resolution regulating the conditions and procedures for a shareholder to sell a pre-emption right (Art. 201).

This issue of the *Briefing Series* does not cover changes relating to initial public offerings of PJSCs. We will publish a separate note on these changes in due course.

Endnotes

- ¹ The Draft CCL provides that, other than the provisions relating to public subscription, the provisions concerning public joint stock companies (PJSCs) also apply to private joint stock companies (PrJSCs) (Art. 269).
- ² "Related parties" is defined in the Draft CCL as "the Chairman and other directors and the senior executive management of the company, such companies in which any of such person holds at least 35% of their share capital and subsidiary, associated or sister companies." (Art. 1).
- ³ See footnote 2 for the definition of "related parties".

If you would like any further information on the matters covered in this Issue No. 3, please contact one of the attorneys below.

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