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Initial Public Offerings under the New UAE Commercial Companies Law

The long anticipated UAE Federal Commercial Companies Law no. 2 of 2015 (the "New Companies Law") was issued on 25 March 2015 and will be in force by 1 July 2015, replacing UAE Federal Commercial Companies Law no. 8 of 1984 (the "Former Companies Law"). Following our recent Client Alert concerning the impact of the New Companies Law on bond and sukuk issuances (click here), this Client Alert considers the impact of the New Companies Law on initial public offerings ("IPOs") and its implication for issuers and financial advisors.

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The New Companies Law includes a number of welcome changes with respect to IPOs of companies in the UAE, whether by conversion of an existing company to a public joint stock company ("**PJSC**") or through a green-field establishment. While rules and regulations issued from time to time by the Emirates Securities and Commodities Authority ("**SCA**") will be the primary body of regulation affecting IPOs, it is apparent that the UAE legislators have sought to support further IPOs by adding flexibility for issuers, clarifying in the New Companies Law certain matters that would previously have required specific dispensations from the SCA or the UAE Cabinet of Ministers (the "**Cabinet**").

Of course, it is worth noting that the Former Companies Law was drafted prior to the establishment of the SCA in 2000. As a result, the scope of the SCA's decision-making abilities with respect to PJSCs and the IPO process was limited in a number of respects, creating various challenges for all of the stakeholders in the IPO process. Under the New Companies Law, the SCA's jurisdiction with respect to regulating PJSCs is both broadened and clarified further, which we expect will help streamline and add efficiency to the IPO process.

Overview of Key Changes

Reduced minimum offering size

Under the Former Companies Law, founders looking to raise new capital through an IPO could only retain between 20% and 45% of the issuer's issued share capital post-IPO (other than family offices, which were permitted to retain up to 70% of the issued share capital post-IPO). This often posed challenges with respect to the offering size (being between 55% and 80% of the issued share capital) as well as the level of control held by the founders and the ability to consolidate accounts, post-IPO. The New Companies Law provides that, for all IPOs, founders may own up to 70% (but no less than 30%) of the issuer's issued share capital following the IPO, thereby allowing founders to maintain substantial control and potentially consolidate accounts with the issuer.

Reduced minimum number of founders

The number of founders required to establish a PJSC has been reduced to five under the New Companies Law. However, Article 107 provides that there is no minimum number of founders in the event that an existing company (being a limited liability company or private joint stock company) is being converted to a PJSC.

No valuation committee

In connection with the conversion of an existing company to a PJSC and the related in-kind contribution, the concept of the valuation committee has been abolished and Article 118 provides that the valuation of the in-kind contribution shall be by way of a third party consultant approved by the SCA. The abolishment of the valuation committee is expected to increase transparency and promote efficiency in the valuation process, while giving the SCA greater oversight over the process than was previously the case under the Former Companies Law.

Authorised share capital recognised

The New Companies Law brings with it a number of significant developments with respect to share capital. While the minimum share capital required for a PJSC has been increased to AED 30 million, the concept of authorised (but unissued) share capital is now recognised, such that a PJSC may have an authorised share capital of up to two times its issued share capital (Article 193 of the New Companies Law) – subject always to regulations to be issued by the SCA. Under Article 194 of the New Companies Law, the board of directors of a Company will have the authority to increase the issued share capital within the limits of the authorised share capital, subject again to regulations to be issued by the SCA.

Additional share classes

Perhaps one of the most interesting developments with respect to share capital is that the New Companies Law also opens the door for additional share classes (prohibited under the Former Companies Law). While the New Companies Law stops short of providing blanket approval for additional share classes, Article 206 does provide that additional share classes may be permitted subject to a resolution of the Cabinet setting out the rights, terms and conditions attached to such shares.

Book-building addressed

While the concept of book-building in respect of pricing an IPO was previously addressed in Ministerial Resolution no. 728 of 2008, the New Companies Law grants the authority to the SCA to issue regulations relating to the book-building process. We understand that the SCA is currently in the process of preparing the relevant regulations and it is yet to be seen whether the regulations issued by the SCA will do away with the current practice at the SCA of requiring a third party valuation to be submitted to the SCA, notwithstanding that the pricing of the IPO will be determined based on book-building.

Underwriting permitted

Another significant development is the introduction of underwriting, as detailed in Article 123 of the New Companies Law. This provides that one or more underwriters approved by the SCA may underwrite an IPO, subject always to regulations to be issued by the SCA. As such regulations in respect of underwriting have not yet been issued by the SCA, it remains to be seen whether the regulations will sufficiently provide for a robust underwriting process in line with international market practice, but the recognition of the concept in the New Companies Law is a clearly progressive step.

Increased flexibility in respect of undersubscribed offerings

In respect of the offering period, the New Companies Law allows for an offering period of between 10 and 30 business days, which may be extended for another 10 business days with the approval of the SCA if there is no underwriter. To the extent that any shares have not been subscribed for and the founders are subscribing for less than the maximum of 70% of the issued share capital, the founders may subscribe for the balance of such shares up to the 70% limit. While this new provision remains somewhat restrictive, it is an improvement from the position of the Former Companies Law which required approval of both the Minister of Economy and the SCA before the founders were able to subscribe for any of the offered shares.

Potential for discretionary allocation

Under the Former Companies Law, any issuer seeking to apply discretionary allocation in respect of subscriptions for shares (as opposed to pro rata allocation in proportion to the amount of subscription applications received for a particular tranche) was required to seek a dispensation from the Cabinet (which was generally only provided in respect of government-owned or quasi-governmental issuers). While Article 125 of the New Companies Law sets a pro rata default allocation mechanism, it also gives the SCA the authority to approve a different allocation process. It is not yet clear how this will be applied by SCA, but it signals the potential to move the practice in the UAE in line with international market practice and allow for discretionary allocation by the issuer.

Lock-in may be extended

While the lock-in period for the founders of two financial years from listing remains as it was under the Former Companies Law, Article 215 of the New Companies Law provides that the board of directors of the SCA may issue a decision to extend the lock-in period such that founders are locked in for up to three years from listing. It is not clear, however, in which context such an extended lock-in would be applied by the SCA.

New corporate governance regulations

While the corporate governance rules applicable to PJSC were previously set out in Ministerial Resolution no. 518 of 2009, Article 6 of the New Companies Law provides that the SCA shall issue regulations in respect of corporate governance matters relating to PJSCs (other than those regulated by the Central Bank of the UAE). Interested parties should monitor closely to determine whether the new regulations to be issued by the SCA result in any material changes to the current corporate governance regime.

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Employees share ownership plans allowed

Another significant development under the New Companies Law is the introduction of employee share ownership plans ("**ESOPs**"), allowing the company to issue shares to employee without such shares being subject to statutory pre-emption rights. ESOPs were previously not recognised in the Former Companies Law, in consequence of which issuers were required to pursue creative ownership structures or establish phantom share ownership schemes – usually with material limitations. Under the New Companies Law, subject to general assembly approval, a PJSC may have an ESOP in place (provided that no ESOP shares may be offered to directors), and ESOPs will be subject to regulations to be issued by the SCA. This is another area where issuers (and currently-listed PJSCs) will be closely following the regulatory developments to ensure that the new regulations in respect of ESOPs provide them with sufficient flexibility to achieve their commercial objectives.

Potential for Further Development

While the New Companies Law brings with it a host of welcome changes, there are a number of areas where issuers, banks and investors are all eagerly awaiting news of further developments – in particular in relation to the adoption of implementing regulations by the SCA. It remains to be seen how such regulations will impact key matters in respect of IPOs and whether SCA will use this authority to shift market practice in the UAE, particularly in areas where such practice currently diverges from what is otherwise seen in international practice.

Further, foreign investment laws in the UAE currently remain unchanged and foreign (non-GCC) ownership of PJSCs remains limited at 49%. This remains a limiting factor for foreign participation in IPOs, and potential issuers and investors will also closely watch for further developments in this area.

Conclusion

While certain matters still remain to be addressed or clarified, particularly through the adoption of operative regulations by the SCA, it is expected that the changes under the New Companies Law will have an overall positive impact on the UAE business environment. With the New Companies Law also having introduced a number of other material improvements for debt capital markets and the issuance of bonds, convertible bonds and sukuk (as addressed in our earlier client alert (click here)), perhaps an upturn in both debt and equity capital markets activity by new issuers to the market will follow post Ramadan.