

Insight: Capital Markets

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Bonds and Sukuk Issuances 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 to replace the existing UAE Federal Commercial Companies Law no. 8 of 1984 (the "Former Companies Law"). The New Companies Law implements a number of important changes to the existing positions under the Former Companies Law, and in some cases, clarifies a number of issues that existed under the Former Companies Law. In this Client Alert, we will specifically look at the impact of the New Companies Law on fixed income instruments such as bonds, convertible bonds and trust certificates ("sukuk") and its implication for issuers, arrangers and bondholders alike.

Corporate Bonds and Sukuk

What type of company can issue bonds and sukuk?

Article 31 of the New Companies Law confirms the existing position that only a Private Joint Stock Company or a Public Joint Stock Company may issue bonds and sukuk. In addition, the New Companies Law reiterates the existing position that only Public Joint Stock Company may offer securities by way of "public subscription". Although the definition of "public subscription" is on its face very broad and theoretically covers "any invitation for any natural or juristic person or class or classes of persons to purchase any Securities", one would expect that the UAE authorities will, in line with current practice, only treat securities that are offered in general advertising campaigns as securities offered for "public subscription". If current practices continue, then a Private Joint Stock Company should be able to continue to offer securities to sophisticated and/or high net worth investors in private placements.

One interesting change, is that where a Limited Liability Company or another form of company under the New Companies Law converts to a Public Joint Stock Company, for example, to enable it to issue bonds and sukuk, the converted company will be exempted from the default requirement that a Public Joint Stock Company shall comprise of five or more founders. In contrast, a Public Joint Stock Company can only be constituted with at least ten founders under the Former Companies Law. Such amendment should provide some flexibility in the event of a conversion to a Public Joint Stock Company.



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Is the Article 180 leverage restriction still relevant?

One important development that will be welcomed by the debt capital market and issuers alike is the abolition of the leverage restriction previously set out in Article 180 of the Former Companies Law. Article 180 prohibited the issuance of bonds and/or sukuk by a Joint Stock Company in an amount that exceeds its “available capital as shown in the last balance sheet” (unless such company is permitted to do so under its incorporation decree or unless the bonds and/or sukuk were guaranteed by the State or a State bank). This restriction until now has been perceived as a hurdle for UAE companies wishing to access the debt capital market through direct issues; many issuers have had to amend its incorporation decree or incorporate an offshore subsidiary to issue debt securities where the proposed issue amount (whether alone or in aggregate) would exceed its available capital.

What type of shareholders’ authorisation is required?

In terms of shareholders’ authorisation, the Former Companies Law requires a Joint Stock Company to obtain the approval of its shareholders by a General Assembly for any issue of debt securities. The need for shareholders’ approval continues under the New Companies Law which requires an issue of debt securities to be approved by a special resolution of the shareholders by a General Assembly, but with a twist: the issuance, once authorised, must take place within one year of the approval. To put this in another way: any such shareholders’ approval for the debt issue will become “stale” after 12 months. This is perhaps less of an issue for issuers of standalone bonds as such issuers will generally seek separate shareholders’ approval for the transaction. However, this will present new procedural hurdles for issuers that will establish or have established medium term notes programme (“**MTN Programme**”), where previously, they could often rely on an one-off shareholders’ approval. Once the New Companies Law comes into force, MTN Programme issuers that wish to undertake direct issues in particular should ensure that shareholders’ approval

are obtained every year, preferably, at the annual General Assembly of the shareholders to avoid having to convene a separate General Assembly if the existing shareholders’ approval becomes stale-dated prior to a drawdown or tap under the issuer’s MTN programme.

In addition, the New Companies Law now prohibits a company issuing bonds or sukuk from advancing or delaying the date of payment of such bonds or sukuk unless this is provided for: (i) in the prospectus and (ii) by the special resolution issuing the bonds or sukuk. Although customary provisions in the terms and conditions of the bonds should already provide for potential further amendments to the terms thereof (and therefore, satisfy the first requirement), the second requirement is likely to present a new procedural hurdle. Accordingly, it is advisable for issuers to include in their shareholders’ special resolution authorising the issuance of the bonds or sukuk, specific authority for the directors and/or authorised officers to agree, on behalf of the company, advances or delays in the date of payment of such bonds or sukuk in case such flexibility is needed at a future point in time.

Bonds and sukuk that are not offered for public subscription

The New Companies Law confirms the existing practice that the terms of bonds and sukuk (including the rights of the holders of such instruments) which are not offered for public subscription shall be determined by the terms and conditions of such instruments. In addition, Article 234 of the New Companies Law now creates minimum standards for such bonds and sukuks. For instance, it stipulates that the terms and conditions governing bonds and sukuk which are not offered for public subscription should set out procedures for holding meetings of bondholders or sukukholders, voting rights and the procedures for appointing committees. It also notes that the UAE Securities and Commodities Authority (“**SCA**”) may issue further decisions to regulate the rights of holders of bonds or sukuk (also see “*Further Developments*” below).

Concluding thoughts

Going-forward, the leverage restriction imposed by Article 180 will no longer be a hindrance to UAE

Joint Stock Companies that wish to tap into the debt capital market as an alternative source of funding to bank financing. However, issuers and potential issuers should nonetheless be mindful of the new shareholders’ special resolution requirements under the New Companies Law (i.e. that shareholders’ special resolution is only valid for 12 months in respect of a debt issue and special resolution is also required if the company wishes to change the tenor or date of payment of any bonds or sukuk). A company that intends to seek any such special resolution at the annual General Assembly of shareholders should also ensure that these proposed resolutions are included in the agenda for the invitation to shareholders; the General Assembly does not have the authority (other than in limited circumstances) to consider issues that are not already listed in the agenda. To the extent that these new procedural hurdles for shareholders’ approval will be an issue for MTN issuers wishing to do a direct issue, the offshore issuer structure will continue to be relevant under the New Companies Law.

Convertible Bonds

Convertible Bonds continue to be recognised under the New Companies Law although it now explicitly contemplates that Joint Stock Companies may issue convertible bonds. In line with the Former Companies Law, mandatory convertible bonds continue to be prohibited under the New Companies Law and holders of convertible bonds will have the option, as a matter of law, to be repaid in cash or in shares, at the holders’ option. The position under the Former Companies Law that the nominal value of the shares in a company may not be less than one dirham continues to be relevant. In addition, it would seem that Article 201 appears to formalise SCA’s involvement in the issuance of convertible bonds; previously parties would customarily seek SCA’s approval even though this was

not expressly required under the Former Companies Law. However, Article 201 of the New Companies Law now expressly requires SCA's approval of the prospectus and the conditions for convertible bonds.

Companies that previously sought to introduce a strategic investor (without triggering pre-emption right) through the issuance of convertible bonds will no longer need to resort to equity-linked debt instruments. The New Companies Law specifically creates classes of exemptions to the pre-emption right regime and the introduction of a strategic investor is included as one of the exemptions. While this is a welcome development for companies seeking to introduce a strategic investor, the pre-emption right regime continues to be an issue for a general convertible bonds offering as this is not exempt from the pre-emption right regime. Accordingly, it remains to be seen whether the SCA will continue to informally approve a company's request to seek a waiver of pre-emption rights by shareholders at the General Assembly in line with current practice.

The New Companies Law also introduces additional statutory protection for holders of convertible bonds and sukuk. Article 231 introduces statutory anti-dilution provisions to protect the value of the holders' conversion option from certain actions of the company; for example, a company that has issued convertible

bonds or sukuk may not, until the date of conversion or their repayment, decrease its capital or increase the rate it decides to distribute to shareholders as minimum limit of profits. Moreover, if the capital of the company decreases as a result of a decrease in the nominal value of its shares or forfeiture of shares, the capital shall decrease accordingly as if the holders of convertible bonds were shareholders. Although similar anti-dilution protection would customarily be included in the terms and conditions of the convertible bonds or sukuk, this is now reinforced by Article 231. In addition, Article 232 provides further dividend protection for holders of convertible bonds that have elected to convert their bonds or sukuk to ordinary shares: holders that have opted for conversion will have their share of the profits resolved to be distributed by the company for the financial year during which the conversion is made, from the date of such conversion until the end of that financial year.

Secured Debt Transactions

For transactions that rely on UAE property to secure the indebtedness of the borrowers, guarantors or obligors that are Joint Stock Companies, the New Companies Law stipulates that a special resolution of the shareholders by the General Assembly is now required to approve the provision of any mortgage of movable or immovable properties. Previously, under the Former Companies

Law, the provision of mortgage of property (other than real property or the company's place of business) was within the Board of Directors' general power and General Assembly approval was only required for a mortgage of real property or the company's place of business. For project development using limited recourse financing and security over land situated in the UAE, this particular article will be highly relevant.

Further Developments

The New Commercial Companies Law contemplates that SCA and, in some cases, in conjunction with the UAE Central Bank (the "**Central Bank**") may issue further regulations and decisions to regulate, among others, the rights of the holders of bonds or sukuk (including convertible instruments), the conditions and procedures relating to, among other things, the issuance of bonds and sukuk and other debt instruments and the entry of the strategic partner as a shareholder of the company. This is a space to watch as these additional regulations and decisions may impose further requirements or create new rights for investors.