M&A transactions in the United Arab Emirates: an overview

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Introduction

In 2016 the M&A market in the United Arab Emirates slowed down. With the oil price recovering from below $30 per barrel in January 2016 to over $50 in early 2017, the economy has experienced an upswing over the past year. As a result, there was an increase in transactions and deal values in the United Arab Emirates and the broader Gulf Cooperation Council (GCC) in the first half of 2017. Further, because the United Arab Emirates put its plans to diversify its economy away from a dependency on oil into action, M&A activity outside the oil sector has been bolstered. In particular, there has been growth in the healthcare, education and retail sectors. Thus, the 2016 slowdown appears to have been but a bump in the road.

Considering the uptake in the M&A market, as well as recent changes in the corporate and commercial law regime of the United Arab Emirates, a closer look should be given to the laws and regulations governing M&A transactions in the country.

Recent legislative reforms

In 2015 the United Arab Emirates enacted the new Commercial Companies Law. Further, in 2016 the country enacted a new bankruptcy law. Thus, the UAE corporate law regime has seen significant amendments during the past few years. While no significant corporate law reforms are pending in the main land, the implementing regulations for both laws have yet to be published. Moreover, the different free zone authorities have followed suit and amended the corporate regulations governing the free zones under their authority. New corporate regulations have been issued for, among other things, the Jebel Ali Free Zone, the Dubai International Finance Centre, the Ras Al Khaimah Free Zone and the free zones governed by the Creative Cluster Authority.

Legal framework

The vast majority of onshore companies – that is, companies registered in the UAE mainland outside the free zones – are regulated by the UAE Commercial Companies Law (Federal Law 2/2015). Part 7 of the law sets out the rules for transformations, mergers and acquisitions of companies. Listed companies must also observe the Corporate Governance Code and other circulars and regulations issued by the Securities and Commodities Authority.

Yet, some onshore companies follow regulations that may differ from the Commercial Companies Law. These are:

- companies wholly owned by UAE federal or local governments;
- companies excluded from the application of the Commercial Companies Law by resolution of the federal cabinet; and
- energy or infrastructure companies in which the federal or a local government directly or indirectly holds 25% of the capital.

Companies registered in a free zone also are not necessarily governed by the Commercial Companies Law. The free zones established in the United Arab Emirates have been granted different levels of legislative authority. Regulations issued by a free zone legislature – these are generally the competent free zone authorities – have precedence over laws applicable in the mainland. Thus, where corporate regulations have been issued for a free zone, the Commercial Companies Law applies only where a matter is not covered in the free zone corporate regulations. Certain free zone authorities (eg, the Dubai International Finance Centre and the Abu Dhabi Global Markets) have been provided with comprehensive regulatory powers. Other free zone authorities have less legislative authority. Still, while their scope may vary somewhat, corporate regulations exist for all free zones.

Aside from corporate and financial legislation, sector-specific rules may also impact M&A activity in certain industries. For instance, Ministry of Health regulations include provisions that have implications for M&A transactions in the healthcare sector and Central Bank regulations will affect activity in the banking sector. Further, transactions involving stock market registered entities are governed by the regulations applicable to the relevant stock exchange. The UAE stock exchanges are:

- the Dubai Financial Market;
- the Abu Dhabi Stock Exchange; and
- NASDAQ Dubai.

The M&A regimes applicable to targets listed on the Dubai Financial Market and the Abu Dhabi Stock Exchange are broadly the same. Bidders for companies listed on the Dubai Financial Market or the Abu Dhabi Stock Exchange must make an immediate post-transaction disclosure when:

- a shareholding in the company:
  - meets or exceeds 5% of the company's share capital; or
  - increases by 1% over the 5% threshold; or
- a shareholding in a parent, subsidiary or affiliate of the company meets or exceeds 10%.

The bidder must also make a pre-transaction disclosure before purchasing 20% or more of the company's shares. The Securities and Commodities Authority and the relevant stock exchange have the right to prevent such an acquisition.

The regulations applicable to M&A transactions involving companies listed on the Dubai NASDAQ are somewhat different. Bidders for such companies must notify the Dubai Financial Services Authority and the target within five business days of:

- any holding of 5% of votes attaching to all securities; or
- any further increase or decrease of 1% in the bidder's shareholding in the company above or below 5%.

Any dealings by the bidder and any person acting in concert during the bid period must be disclosed without delay to the Dubai Financial Services Authority and NASDAQ Dubai and be announced on the target's website.

Due diligence

As in other jurisdictions, what level of due diligence is required will depend on the target's business and the transaction's circumstances. However, due to the lack of freely available information on companies registered in the United Arab Emirates, buyers will have to rely much more on the assistance of the target and the seller to complete their due diligence process than in other jurisdictions outside the GCC.

As in other GCC countries, company searches are generally unavailable for companies registered in the UAE mainland or its free zones. Only the relevant company – or an individual authorised by a power of attorney given by that company – can obtain a copy of the company's trade licence and commercial registration certificate. Further, articles or memoranda of association, financial information and other relevant information are not freely available and thus need to be acquired from the target.

Documentation

Preliminary documentation
The key terms of a transaction are often recorded in writing in preliminary documentation such as heads of terms or memoranda of intent. Concluding such documentation may be feasible to document the state of negotiations and outline the envisaged transaction. To that effect, the parties should describe the relevant parameters of the envisaged transaction and determine whether the terms of the preliminary document should be legally binding or not. Whether the terms are legally binding is left up to the parties to decide. The parties may also choose to draft certain provisions of preliminary documentation as legally binding while other terms remain non-binding.

When dealing with the legal effect of preliminary documentation for M&A transactions involving companies registered in the United Arab Emirates, special attention must be paid to the wording of the relevant documents. Under UAE law, the requirement of good faith is applied much more comprehensively than in most western jurisdictions. Therefore, it may create an enforceable obligation to proceed in accordance with the provisions of the preliminary documentation where they are not precisely drafted.

While preliminary documentation may be governed by either foreign law or UAE law, the UAE courts and authorities will often disregard a choice of law clause and apply UAE law. Therefore, UAE law should be considered when drafting preliminary documentation regardless of the applicable law chosen.

Confidentiality agreements
In addition to preliminary documentation, the parties to an M&A transaction will usually conclude a confidentiality agreement. The buyer will usually require extensive information on the target to evaluate the company. This will necessarily include information deemed sensitive by the target and the seller. To allow the buyer to conduct an effective due diligence and secure the interests of the target, confidentiality obligations are typically imposed on the buyer through a confidentiality agreement.

When conducting an effective due diligence and organising the transaction (ie, by securing financing), the buyer will incur considerable costs. Therefore, the buyer will be interested in committing the seller to the transaction. To do so, an exclusivity period is commonly included in the confidentiality agreement or other documents, which compels the seller to refrain from engaging other potential buyers. Such an exclusivity provision can be further supported by a liability clause under which the buyer may hold the seller liable for infringing on the exclusivity clause. Such liability clauses are commonly drafted as a liquidated damage provision. Under UAE law, such liquidated damage clauses are treated somewhat differently than in western jurisdictions. In particular, the amount of damages agreed on may be adjusted to reflect the actual amount of damages sustained by the competent courts on application by a party to the relevant contract.

Primary transactional documentation
The central document of any M&A transaction will be – depending on the type of transaction – the merger agreement or the sale and purchase agreement. To affect the transaction, this agreement must be notarised by a notary public of the United Arab Emirates. This adds some complexity to transactions. UAE notary publics commonly refuse to notarise complex transactional documents. Therefore, it is common practice to conclude two agreements:

- A simple transfer or merger agreement the scope of which is limited the actual transfer and will be notarised. This agreement will include only the substantial provisions essential to the transaction such as purchase price, transfer of shares or merger. It must to be executed in Arabic (it may also be concluded in bilingual form) and subject to UAE law.
- To cover the details of the transaction, the parties can conclude an additional 'internal' agreement. This agreement will address all other issues the parties wish to regulate, such as purchase price adjustments, limitations of liability, warranties, indemnities, conditions for transfer of share or merger, closing provisions, non-compete clauses, choice of law and dispute resolution.

Where the parties to the transaction are corporate entities, the notary public will require shareholder resolutions from the buyer and seller providing for the transfer of shares or merger. In addition, explicit powers of attorney authorising the relevant representative of the parties to sign and execute the transactional agreements and take all other necessary action to finalise the transaction should be issued.

Valuation and consideration

There are no specific valuation requirements for private companies under UAE law. On takeover, the value of the shares of a public company must be assessed by a financial consultant to be elected by:

- the Securities and Commodities Authority from its roll of approved financial consultants; or
- entities with financial and technical valuation experience approved by the Securities and Commodities Authority.

The Securities and Commodities Authority may object to the assessment and appoint another assessor to conduct a second valuation.

M&A transactions between companies listed on NASDAQ Dubai are regulated by the Takeover Rules Module of the Dubai Financial Services Authority Rulebook. The rulebook provides that the person providing a valuation of assets must ensure that the valuation is supported by the opinion of an appropriate external and independent valuer.

UAE law does not regulate the form of consideration. Cash is the most common form of consideration. However, in the Dubai International Finance Centre, consideration in M&A transactions must be cash or a cash alternative.

Risk allocation

Warranties and indemnities
Warranties and indemnities in M&A transactions involving the United Arab Emirates typically cover a broad range of issues relating to the target, including:

- title;
- tangible and intangible assets (eg, accounts, real estate, intellectual property and active contracts);
- liabilities arising out of contracts, pledges and guaranties;
- liabilities arising under public law (eg, environmental matters, licensing, zoning and building codes);
- employment and pensions; and
- tax covenants.

A tax covenant may be less relevant in the United Arab Emirates than in other jurisdictions, given that many of the taxes applicable in other jurisdictions do not apply in the United Arab Emirates. Still, the assumption that no tax exists in the United Arab Emirates is false. Businesses in the oil and gas sector are subject to corporate income tax, and the United Arab Emirates committed to introducing a value added tax (VAT) by 2018. Further, companies registered in the United Arab Emirates may have engagements in other jurisdictions that may be subject to taxation.

Limitations and time limits

A seller may seek to limit its potential exposure to warranty claims. UAE law is more restrictive than western jurisdictions when it comes to limitations of liability. This is in part due to the fact that the law is founded in Islamic law. This must be observed when drafting clauses limiting the seller's liability for breach of warranties.

Limitation periods are governed by the Civil Code (Federal Law 5/1985). It provides a 15-year limitation period for civil claims. However, this period may be limited by agreement.

As in other civil law jurisdictions, UAE law requires parties to perform their obligations under a contract in good faith. Therefore, a buyer may not bring a claim for breach of contract in bad faith. Thus, for example, a buyer may not claim damages for a breach of warranties by the seller at the time it entered into the contract, if the buyer had knowledge of a seller's breach of warranty.

Tax and fees

At present, the United Arab Emirates has no general corporation, corporate or personal income, capital gains, withholding or sales tax. Only profits earned in the oil and gas sector are subject to corporate income tax. However, as all GCC members, the United Arab Emirates has committed to introducing VAT by January 1 2018. VAT in the United Arab Emirates will be charged at a rate of 5%. Businesses with turnover in excess of Dh375,000 (approximately $100,000) will be required to register for VAT. The UAE government is also exploring other tax options in an effort to diversify its tax base.

A transfer fee of 0.5% of transfer value capped at Dh15,000 (approximately $4,000) is payable to the notary public on the transfer of shares in UAE companies. A transfer fee of between 1% to 4% – depending on the emirate where the property is located and the nature of the interest therein being transferred – is levied on the transfer of real estate in the United Arab Emirates.

Management and directors

Pursuant to the Commercial Companies Law, a company's articles or memorandum of association or others agreements (eg, shareholders or joint venture agreements transfer of share in a company or its merging with another company) may be subject to certain conditions, including approval of the company's general assembly or waiver of right of first refusal. General managers and directors must act in accordance with such provisions and ensure that a transaction is conducted in accordance with the law and the applicable agreements. Where general managers or directors fail to do so, they may be held liable.

Each general manager or director is liable towards the company and third party for any fraudulent actions that he or she carries out. Further, he or she will be required to compensate the company for any losses or expenses incurred due to his or her:

- abuse of power;
- violation of the applicable laws, the company's articles or memorandum of association or his or her contract of appointment; or
- gross error in management.

Further, misconduct of general managers and directors is punishable by up law.

Employees

No specific obligation to consult with employees on a merger or acquisition exists under the UAE law.

On a share deal, existing employment contracts remain in place and unchanged as there is no change to the employer. Should the employer wish to terminate employment contracts, the employer must follow normal procedures for termination, including serving a termination notice, observing the notice period and paying contractual and statutory entitlements.

There is no statutory provision for the automatic transfer of employees on a transfer of business through an asset deal. Where a buyer wishes to retain all or part of the businesses staff, the seller usually agrees to terminate employees' employment contracts and the buyer then agrees to re-hire the employees, usually on the same or similar terms and conditions. In this arrangement, preparations must also be made to cancel the immigration sponsorship of expatriate employees by the seller and to install the buyer as the new immigration sponsor. How contractual and statutory entitlements of the employees are dealt with is left up to the parties to decide. The seller is liable for such contractual and statutory entitlements towards the employees. However, the buyer may agree to compensate for these.

In certain instances, it may not be possible to transfer an employee by terminating and re-hiring him or her. For instance, an employee cannot be terminated where the employee is on maternity or annual leave or off work for health reasons. In this case, the transfer would have to be made by agreement with the employee.

Pensions are less relevant in M&A transactions in the United Arab Emirates. Only UAE and GCC nationals working in the United Arab Emirates are eligible for state pensions. Other employees are instead entitled to an end of service gratuity. A private pension scheme may be offered as an alternative to the statutory end of service gratuity provided that it is no less beneficial. However, such schemes are not widely used in the United Arab Emirates. On a transfer of shares, the obligation to pay end of service gratuity remains in place. Where employment is transferred by termination and re-hiring the end of service gratuity must be paid by the seller. Once the employees is re-hired by the buyer, a new obligation to pay end of service gratuity arises for the buyer.

Hostile takeovers

Hostile takeovers of onshore companies by foreign investors are generally not possible. Foreign ownership of onshore companies is restrictions to a maximum of 49%. Still, many onshore companies are structured so that the vast majority of the economic rights and obligations, as well as voting rights, are effectively vested in the foreign shareholders. Thus, where the existing foreign shareholders of a company registered in the United Arab Emirates are treated favourably in respect to rights and obligations, a foreign investor could launch a hostile takeover not in the legal, but rather in the economic sense.

A UAE national or a company the beneficial owners of which are UAE nationals could launch a hostile bid only against a UAE public company. However, given the UAE business culture, in which many public companies are government or family owned, this is unlikely in practice. If a target were subject to a hostile takeover, it could approach the regulatory authorities with a view to blocking the takeover or requiring the bidder to increase its offer price.

Preparing a company for sale

Where shareholders wishes to prepare a company or the shares they hold therein for sale, the same issues apply in the United Arab Emirates as in other jurisdictions: company books, accounts and filings should be up to date and information on the target and its business should be clearly organised and made readily available. Where only part of the shares in a company are sold, waiver rights of first refusal of the remaining shareholders in respect of the sharers to be sold should be obtained. In the United Arab Emirates, many companies are government or family owned. Where this is the case, it is particularly important to consider the separation of the target from other interests.

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