

Practical Insights onto UAE Merger Regime

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In this article we examine a key form of transaction offering growth and liquidity options. Without doubt, mergers are becoming more crucial in the UAE, post the global financial crises as companies search to improve their critical mass and liquidity. A key strategy available for companies is merger. Here we examine the UAE merger regime under the UAE Commercial Companies Law, Federal Law no. (8) of 1984, as amended, (the "CCL").

Background to Merger Debates:

Before analyzing the provisions regulating the UAE merger regime, it's worth noting the economic debates for and against mergers as a means of improving value. Several empirical studies indicate the value of companies tend to increase following a merger, although this outcome can be subject to many variables. Measuring the improvement in value is not a matter that can be assessed at the time of announcing a merger or completion of the same. The process involves a long term, post-merger study to assess the overall position of the merger targets in terms of value, and the progress of business post-merger.

Having said that, there are undoubtedly companies where mergers can improve the overall quality and diversity of the underlying assets; and would bolster the value of both merger parties.

Financial analysis is beyond the scope of this article, but it's crucial to understand the arguments for and against mergers from a financial and market perspective.

UAE Merger Regime

1. Characterization of the Merger Agreement

A merger agreement is a form of legal and financial consolidation of two or more companies under one entity, involving all the companies that will be part of the transaction. The underlying merger agreement can be characterized as an "exchange agreement" for the purposes of Articles 607-611 if the UAE Civil Transactions Code (the "CTC"). Such an agreement is very similar to a sale agreement, regulated under Articles 489-510 of the Civil Transactions Code, yet the key distinction is that the consideration under exchange agreements is not cash but shares.

2. The Companies Law Merger Regime

Mergers of companies are mainly regulated under Articles 276-280 of the CCL. These CCL provisions create an avenue for mergers between companies. Two alternative blueprints for merger are embedded in Article 276 of the CCL. First a merger can take place through "acquisition consolidation", where one of the two companies becomes the target of a merger and is dissolved, and its shareholders are provided a stake in the surviving company by means of a capital increase allocation. In other words, the shareholders of the dissolving company will exchange their old shares for new shares in the enhanced capital of the surviving company. The diagram below outlines the structure of such a merger, under which (A) will be the surviving entity while (B) will be the dissolving entity.



Secondly Article 276 permits a merger by means of integration i.e., by merging two or more companies to establish a new company (in which all shareholders of the underlying companies will be shareholders in such new company). The diagram below displays the structure for an integration merger.

The merger debate has in some respects been similar to the debate over the UAE insolvency and bankruptcy regime, during which many commentators claimed incorrectly that the UAE had no legal regime. Likewise, many corporate law practitioners have suggested that the UAE lacks a merger regime.

The UAE clearly does have a merger regime under the CCL. However, this regime has not been tested aggressively in practice. The largest merger seen in the UAE in recent years, did not rely on the CCL merger provisions, rather designated special process. The absence of UAE mergers may be attributed to many factors such as differing dynamics of the UAE economy, lack of market precedents, and the recently established UAE capital markets being evolving markets. Therefore, proposing to apply complex merger models employed in markets like the UK and the US would be impractical.

Local considerations require thorough assessment before utilizing methods in other jurisdictions, which differ in their legal environments. One vivid distinction between foreign and GCC regimes is the difference between civil code and common law systems. The underlying agreements are the main source of law regulating the parties' relations under common law systems, while the civil code provides extensive gap fillers for common legal relationships.

How does the UAE Merger Process work?

The CCL addresses the process of a merger, by requiring shareholders' resolutions for a merger, in accordance with the parties' respective Articles of Association. The CCL outlines the process for evaluating the assets of the defunct company which is absorbed in the surviving one, where the merger is one by means of an acquisition.

The valuation process also involves a valuation to conclude a swap-ratio formula assessing how many shares of the entity being absorbed, are equivalent to shares in the rights issue of the surviving entity. The same would apply to assess the swap-ratio formula for how many shares the entity, which will be absorbed into a new entity, will equate in the new entity's shares. The latter is a more simplified process considering it involves a new entity that does not yet have a particular market or book value.

Article 280 of the CCL allows creditors with outstanding debts, to object to the merger within 3 months from announcement. (i.e. its registration on the commercial register). An objection can be referred to the court to issue a final judgment as to the validity of the same or can be settled with the creditors. Upon the expiration of the 3 month period noted above, and without any further objections by creditors, the merger becomes final and binding. In this case, the surviving entity, whether existing or new, becomes a successor of the entity (ies) dissolved in the merger process.

Analyzing these concise provisions of the CCL, it is noted that such provisions include the key components required to implement a corporate merger process. A merger process can be tailored by companies and their advisors in close coordination with relevant authorities, notwithstanding the lack of case studies and practices. However, if companies approach the authorities with a merger model that is complex and doesn't recognize the local regime nor the nature of the local market, it will likely not succeed. It is a simpler and more elegant solution to design a merger transaction which fits the merger regime, in addition to a few components taken from best international practice. Such a progressive combination should be undertaken without stretching the process too much, in order to not become a complex, unrealistic structure that would not be enforceable locally.

Conclusion:

I believe many companies overdraft the complexity of the UAE merger process. The UAE authorities are open to realistic and practical solutions for local mergers.

This isn't to say that there are no space for expansion of the UAE regime governing mergers and acquisitions. For example, the UAE regime should address issues such as takeover / tender offers in respect of public companies, which in particular raise a degree of uncertainty.

The UAE regime has basic but effective machinery enabling corporate mergers to be implemented via a set of enabling provisions covering the merger process. There is a case for market players to look first to this simple but effective machinery, before they try to replicate exotic merger structures designed to fit common law legal systems and foreign tax regimes.