

Merger Formula in the UAE: Can the market decide?

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August 2015

On 26th May 2015 Cheil Industries (“Cheil”) and Samsung C&T Corporation (“Samsung C&T”) announced proposals for the acquisition of Samsung C&T by Cheil by way of an all-shares merger.

Cheil is the de facto financial holding company of Samsung Group, South Korea’s biggest conglomerate which owns the world’s largest electronics company. Samsung C&T is the construction and trading arm of Samsung Group, which built Dubai’s Burj Khalifa, the world’s tallest building. However, for the last few months the proposed takeover has come under attack from a hedge fund, Elliott Associates LP and the third largest shareholder of Samsung C&T which challenged the valuation process used in the transaction. Despite the outcome of the shareholders’ vote approving the takeover, this battle is likely to be prolonged as it raises questions about South Korea’s corporate governance standards.

In this article, we briefly describe the statutory valuation method used in Korea and compare it to the current law in the UAE relating to the subject of asset valuation, which remains a topic that all listed companies, consultants and government authorities need to be conversant with.

Market based valuation – Korea

Korean law mandates that merger ratios be decided based on recent share prices, on the premise that such share prices, which are market prices and are deemed to always incorporate and reflect all the information made available to market participants at any given time, are the most reliable and objective tools in valuing the companies to be merged. In cases of a merger between listed corporations, the merger price is calculated in accordance with Article 176-5, Paragraph 1, Item 1 of the Enforcement Decree of the Financial Investment Services and Capital Markets Act in Korea, and the merger ratio is calculated accordingly. Therefore the merger ratio in Korea is a matter of simple maths and companies are not allowed to exercise their discretion in determining the ratio; nevertheless they can set up the timing of the merger monitoring the stock changes and may use a certain level of influence over the market itself.

This type of market-based valuation in determining merger ratios is commonly used in mature markets such as the UK and the US, so long as such a merger ratio calculated in accordance with the statutory requirements are approved by the board of directors who have a fiduciary duty of loyalty to act in the best interest of the company and its shareholders at all times. For the board to fulfil their fiduciary duties, it must be clear that the price is fair to all shareholders and fully recognizes the value of the company. Although the merger formula is inflexible in certain jurisdictions that does not excuse the board from discharging its duties when assessing whether or not to enter into a proposed transaction.

Asset based valuation – UAE

Before the 2015 Commercial Companies Law (Federal Law No. 2 of 2015) the UAE had no explicit provisions concerning takeovers or merger control requirements. Now Article 292 of the 2015 law stipulates that:

“any person or group of associated persons or related parties desirous of purchasing or undertaking any transaction involving the acquisition of shares of capital stock or convertible Securities in a Public Joint Stock Company (“PJSC”) in the UAE, which offered its shares for public subscription or listed in a Financial Market in the UAE, shall comply with the Securities and Commodities Authority (“SCA”)’s provisions and resolutions on the rules, conditions and procedures for acquisition.”

It is expected that the SCA will develop a new takeover code in due course as the above provision implies. We set out below some of the current requirements governing valuation in takeovers applicable to companies listed in the UAE as a reference.

- Article 118 (2) of the 2015 law requires the shares to be assessed by a financial consultant to be elected by the SCA from its roll of approved financial consultants or by entities with financial and technical experience in the subject matter of the valuation, as approved by the SCA. Further, the SCA may object to the assessment and appoint another assessor as required (Art. 118 (5)).
- SCA Ministerial Resolution No. 70 of 2009 (Concerning the Shareholding Companies Shares Valuation Committees and the Mechanism thereof) mandates that a government appointed committee be established (Art. 2), and that its action plan include the methods to be used in the valuation of the assets and activities, valuation implementation steps and the timeline for the completion of valuation (Art.7). The valuation must then be approved by the shareholders of the company.
- M&A transactions between listed companies in the DIFC are regulated by the Takeover Rules Module (TKO) which is a part of the Rulebook administered by the Dubai Financial Services Authority (DFSA). Rule 10.1.1 of the TKO 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.

Further, in cases where certain companies find difficulty in obtaining the opinion of an appropriate external valuer to support an asset valuation, TKO allows the DFSA to permit informal valuations where the interests of shareholders appear on balance to be best served.

Based on these provisions it seems that there is a certain amount of flexibility for market players, including companies and external advisors working in close coordination with relevant government authorities, to devise practical solutions to prevent unfair takeovers even if the market is not in fact efficient.

Conclusion

Market price is a better measure than asset valuation to determine the merger ratio since it is a measure incorporating tangible synergies and asset valuation by market players so long as the market functions efficiently. However, even after several decades of empirical research and studies, economists have not yet reached a consensus about whether the market (a financial market in particular) is efficient. Often the market fails and it is always important to note that any proposed merger needs to be fairly assessed based on the fair values of the two companies.

Given the absence of a separate legal regime for a statutory valuation method under UAE law, we expect the government in time to examine the extent to which similar provisions could apply to companies operating under the civil law system here and further to set out clear guidance on the regulatory framework for the valuation of listed companies as part of its continuing efforts to introduce international best business practices in the UAE.