Article 279 of the New UAE Federal Commercial Companies Law Limits on the size of a sell-down offering and its implications

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The long awaited new UAE Federal Commercial Companies' Law was finally enacted on 25 March 2015 (Federal Law No. 2 of 2015, the "New Law") and entered into force on 1 July 2015.

One of the main objectives of the New Law was to boost IPO activities in the UAE and align UAE capital markets, to the extent possible, with international standards and practices. Hence, most of the key amendments and increments of the New Law were focused in the chapters relating to public offerings and public joint stock companies. The new provisions aim to provide more comfort to investment banks and issuers, facilitate the offering process and enhance corporate governance practices of public joint stock companies.

Interestingly, however, Article 279 of the New Law does not appear to be consistent with the liberal spirit and objectives of the New Law. This article will briefly shed the light on the implications of Article 279 on future IPOs, in particular those which will be structured as secondary offerings or a combination of both primary and secondary offerings.

By way of background, public offerings may take one of three forms: primary, secondary and a combination of both. A primary offering is essentially the offering of new shares in a company by way of capital increase. The proceeds of a primary offering are usually used to finance the company's operations and expansion. A secondary offering is one where one or more of the founding shareholders in a company sell a portion of their stake in the company, without increasing the capital of the company in question. It is simply a sale of shares to the public whereby the selling shareholders collect the proceeds of the sale. Hence, a secondary offering offers a viable exit option to the selling shareholder(s). Other offerings may be structured to combine both a primary and secondary offering.

The rules and regulations of financial markets sometimes set a number of restrictions and limitations on the selling shareholders in secondary offerings, and these limitations include a limitation on the number or percentage of sale shares. In this regard, Article 279 of the New Law provides:

- "Subject to the provisions of Article 117/2 of this Law, a company proposing to be converted into a Public Joint Stock Company may sell by way of public subscription 30% maximum of its share capital upon assessment in accordance with the provisions of Article 118 of this Law.
- The Chairman of the Authority shall issue a Resolution including the conditions and procedures for the sale of part of the shares of the company upon its conversion"

Put simply, under the New Law, in a secondary offering, selling founders may not sell shares to the public in excess of 30% of the issued capital of the company.

Such limitation may have negative implications on the appetite of investors to explore an IPO exit option in the future which will consequently impact the UAE capital markets. In fact, such limitation may inevitably push selling shareholders to look for other financial markets and listing venues to sell their shares. Therefore, and contrary to the objectives behind the New Law, particularly in respect of the leadership of the UAE financial market in the GCC region, Article 279 may end up undermining the position of the UAE when compared to other financial markets.

The issue of secondary offerings was not addressed under the old Commercial Companies' Law (Federal Law No. 8 of 1984); only primary offerings were permitted with a cap of 80%. Under the New Law, the size of primary offerings was capped at 70% of the share capital of the company; while secondary offerings were capped at 30%. This variation in the sizes of the primary and secondary offerings under the New Law may not necessarily be justified.

As a note of interest, we should bear in mind that the selling shareholders are subject to a two years lock-up period. As a result, selling shareholders will not be able to sell any additional shares in the company for two years following the offering. Therefore, the limitation of Article 279 materially dilutes the purpose of a secondary offering.

One may argue that the limitation set out by Article 279 is justified on the basis that there is a need to protect public or non-sophisticated investors by requiring the selling founders to maintain their control of the company. According to this point of view, forcing the selling shareholders to keep 70% of the share capital grants the public more comfort and assurance that the selling shareholders will remain locked in and continue to be responsible for the management of the company. This argument seems to have its underlying rationale, but the question remains why this limitation is not applicable to primary offerings as well. Public investors are worth protecting in both offerings. In all cases, protection of investors could be achieved by many ways depending on various factors including, inter alia, the size of the company's business, its financial position and business track record and feasibility.

In order to circumvent the limitation in question, some shareholders, who are still keen to list their shares on a UAE stock exchange, may consider carrying out a dual listing, in order to sell more than 30% of the share capital. A dual listing of shares is a process whereby a company lists its shares on a foreign stock exchange in addition to its domestic exchange. In our case, the selling shareholders, instead of listing their shares on a UAE stock exchange only, will first sell their shares on another financial market which allows a sale exceeding the 30% ceiling. Then will follow it by a listing on a UAE stock exchange. As the rules of the "main" market will apply, the selling founders will be able to trade in more than 30% on the UAE market. However, going through the dual listing route is not time and cost efficient and will always be associated with arbitrage, as listing on two different markets might entail different share prices, exchange rates, trading times and liquidity rates etc.

To protect public investors and facilitate secondary offerings in the UAE, it would be more useful and effective if, instead of fixing a limit on the percentage of shares that can be sold in a public offering, a free float minimum requirement was set (ie. the minimum percentage that has to be sold to and held by the public). The determination of the offering size could be determined at the regulator's (ie. in the UAE, the Securities & Commodities Authority) and the market authority's discretion, in light of the size of the company, its type of business, market conditions, the investor's risk appetite and the post-IPO guaranties provided by the selling shareholders etc. Despite the risk of this discretion being exercised arbitrarily, which is inherent in such a solution, this method may be best suited to serving both the selling founder's and investor's interests.