

Mergers in the UAE: Opportunities to Rationalise and to Reduce Costs

James MacCallum - Partner - Corporate / Mergers and Acquisitions / Commercial
j.maccallum@tamimi.com - Abu Dhabi

November 2016

Means of Implementing Mergers:

It is symptomatic of times when economic conditions appear favourable to business growth that businesses expand rapidly, but not necessarily in the most cost-effective and streamlined manner. When economic conditions change and become less favourable, as during present times, it becomes more important for businesses to operate in a more cost-effective and efficient manner in order to maximise profit margins and under-cut their competition by reducing their costs base. An important tool in the drive to rationalise and reduce costs is the merger of operations, where circumstances allow and where benefits can be gained. This can assist to cull the profligate and inefficient corporate structuring that often flourishes when businesses are focusing more on keeping up with burgeoning and evolving client demand, rather than on optimal corporate structure planning.

There are a myriad of different means by which companies or organisations can merge with one another. Each different mechanism will be selected for particular reasons and will produce a different outcome. The three classic means of effecting a merger of corporate entities are as follows:

1. Common Holding Company

This would involve bringing different companies/businesses together under a common holding or parent company. This can assist in slimming down the management structure, facilitating the sharing of resources and support functions as well as enabling the uniform implementation of policies and procedures across a merged group, together with aiding access to finance for the companies and businesses brought together by the merger.

[image height="312" src="https://www.tamimi.com/en/media/get/20161204_Screen-Shot-2016-11-10-at-11.16.16-AM.png" width="600" class="__image__" imageId="5053"]

2. Business and Assets Transfer

Such a transaction involves transferring a business, assets and personnel from one or more companies into another company, thereby merging the businesses of the two or more companies into a single company structure ("Business Transfer"). This may engender each of the advantages described under 1. above as well as reducing the number of companies within a group, further allowing for synergies between business-streams to be exploited and offering a greater opportunity to reduce management, support personnel and infrastructure (such as office space, workshops, machinery and so on). Typically, the company or companies that transfer their businesses, assets and personnel to another will in due course be wound-up and dissolved.

[image height="280" src="https://www.tamimi.com/en/media/get/20161204_Screen-Shot-2016-11-10-at-11.16.27-AM.png" width="600" class="__image__" imageId="5054"]

3. Legal Merger

A legal merger pursuant to the UAE Commercial Companies Law No. 2 of 2015 ("CCL") ("Legal Merger") enables different companies to be fused together to become one. All of the businesses, contracts, other assets and liabilities, as well as personnel will come together within the sole surviving merged company. This procedure, which is made possible by articles 283 to 291 of the CCL, may engender all the advantages under 1 and 2 above, but without the need (as under 2.) to seek the consent of each and every customer, supplier and employee of the businesses to be brought together and to effect transfers of each of them.

[image height="312" src="https://www.tamimi.com/en/media/get/20161204_Screen-Shot-2016-11-10-at-11.16.35-AM.png" width="600" class="__image__" imgId="5055"]

Furthermore, under 2. above, given that the UAE does not have a regime similar to the European Transfer of Undertakings regulations, whereby personnel working within a particular business will transfer with that business when a merger occurs, in the UAE there will in effect be a negotiation with each and every employee, who needs to agree to terminate their current employment contract and enter into a new one with the company that survives the merger.

A Legal Merger can therefore make for a much cleaner and neater solution and can substantially reduce the costs and timeframe of implementing a merger.

If properly planned, a Legal Merger of businesses previously operating within separate companies can bring benefits in terms of operational cost-savings through reducing expensive management, support functions, and auditing requirements; simplifying corporate governance; affording other reductions by eliminating duplicated personnel and resources, and licensing and compliance costs; enabling synergies of ideas, technology, intellectual property, expertise, and the common utilisation of other assets and infrastructure; as well as significantly reducing the time, costs and effort in implementing the merger itself.

The former UAE Commercial Companies Law No. 8 of 1984 also provided for corporate mergers, but the new 2015 law addresses them in much more detail and offers further assurances and opportunities.

Comparison of Merger Mechanisms - Legal Merger vs. Business Transfer:

When determining which of these two types of merger mechanism will offer the optimal structuring route to achieve the desired end result, a number of key issues fall to be considered. There follows an outline description of certain key features distinguishing a Legal Merger from a Business Transfer.

Documentation: Under a Legal Merger, all of the assets of the merging companies will automatically be brought together within the surviving company without the need for them to be individually identified and transferred, so full and clear title to each asset on a transfer to the surviving company should be achieved without anything being left behind. Under a Business Transfer, it is necessary to identify each and every asset of the businesses being transferred, so that steps can be taken to ensure that each of them is effectively moved across, which will in all likelihood involve a complex series of enquiries and a certain amount of transfer documentation.

Steps involved: The CCL requires that shareholders holding at least 75 per cent of each company involved must pass resolutions to approve a Legal Merger. This is interesting, because it means that shareholders holding up to 24.9 per cent of the shares in non-surviving companies can be forced to accept the exchange of their interests in the share capital of such companies for shares in the surviving company. This contrasts markedly with the well-recognised lack of a 'squeeze-out' mechanism in a normal corporate acquisition or tender offer scenario in the UAE, where any small minority of shareholders opposed to a sale of all the shares in a company can frustrate such a sale by digging in their heels and refusing to cooperate.

Therefore, on approval by a 75 per cent majority of the shareholders of each company involved and a

green-light from each of the relevant supervising governmental authorities, a Legal Merger will result in all shareholders of the non-surviving company automatically becoming shareholders in the surviving company.

Conversely, in a Business Transfer, the cooperation of each shareholder is required, because for them to acquire new shares in the surviving company simultaneously with a transfer of assets out of the non-surviving company, the shareholders would each individually need to consent and subscribe for new shares in the surviving company. Further, rather than the business, assets and personnel automatically transferring into the surviving company, they need painstakingly to be identified and transferred, if not by simple delivery, then by whatever legal and documentary process applies to them. Furthermore, the non-surviving entity will need separately to be wound-up and dissolved, requiring it to be placed into liquidation, the appointment of a liquidator and the various procedures to be complied with to bring about its ultimate dissolution. Typically, it will only be when the non-surviving company has relatively few assets and contracts, which can easily be shifted to the surviving company, that it may be faster and more convenient to undertake a Business Transfer instead of a Legal Merger.

In terms of timing, for a Legal Merger, once shareholder resolutions have been adopted and relevant governmental approvals have been obtained (and assuming no qualifying objections are raised to hinder the merger), then the merger will be effective immediately following its date of registration in the relevant commercial register. Whereas, for a Business Transfer, the timeframe will depend on the nature of the assets and contracts to be transferred. Typically, for the negotiation and novation of all key contracts, the identification and transfer of all relevant assets, for the revision of the licence of the surviving company with approvals from each relevant supervising authority, and for the winding-up and dissolution of the non-surviving companies, the process overall can be expected to take significantly longer.

Third party consents: For a Legal Merger, third party consents will be required only for contracts specifically stating consent requirements in case of a corporate restructuring (which are likely to be few in number). Whereas, in a Business Transfer, there will likely be a need to obtain many more third party consents to the transfers of assets and the novation of business contracts, because every customer, supplier and financier will need to agree (either explicitly or impliedly) to the termination of its contract with each non-surviving company and its entry into a fresh contract with the surviving company. It is worthy of note that in a Legal Merger, the CCL enables creditors and other interested third parties to petition the court within 30 days if they oppose a proposed Legal Merger. In considering the petition, the court will look to see whether the petitioning parties would likely be unfairly prejudiced by the implementation of the merger.

Transfer of employees: One very significant area in which a Legal Merger scores over a Business Transfer relates to human capital arrangements. In a Legal Merger, it is possible for personnel of merging companies simply to be brought together with merely an amendment being made to the files of the labour and immigration authorities, rather than the tedious and costly cancellation of work permits and visas by the non-surviving company and the grant of new ones by the surviving company as their new employer and sponsor. Accordingly, the cost-saving potential of a Legal Merger in this respect can be very significant for businesses with substantial numbers of employees.

Accounting: Other potential advantages arising out of a Legal Merger, that are not available when effecting a merger by way of a Business Transfer, include the merging of profit and loss, and balance sheet statements. For instance, it can be possible for the surviving company to utilise the profits and losses on the financial statements of the non-surviving company to its advantage, which is not possible where the non-surviving company will remain separate and simply be wound-up and dissolved.

Further, in a Legal Merger, the share capital of each of the companies involved will be merged resulting in the merged company going forwards with an enhanced paid-up share capital. In most jurisdictions, where taxation is a key feature of planning corporate transactions, an assessment of the tax effects of either merger mechanism will be critical. Due to the scant nature of the UAE taxation regime, tax will likely be of

little significance, but in most of the other jurisdictions of the GCC and Middle East region, tax planning will feature in designing a successful merger.

Closing Comments:

The new CCL opens the door further for companies to reap the benefits of effecting corporate mergers to rationalise business operations at less cost. From a legal perspective, a Legal Merger, whereby one surviving company remains following the merger of two or more companies, often represents a particularly attractive route. This is due to the various reasons summarised above, but in essence the time, effort, disruption to business and impact on relations with third parties (customers, suppliers and financiers) will be significantly reduced, as typically will be the costs of proceeding with a Legal Merger.

Ultimately, when preparing for a merger structure, it is important to consider the optimal transaction structure. This article deals briefly with just a few of the key issues pertinent to planning and implementing a merger transaction, but its principal aim is to highlight the opportunities for the rationalisation of resources and cost-savings that mergers, and the implementation of them by different means, can bring about. Accordingly, it is important to assess the steps, features and timeframes applicable to a Legal Merger, a Business Transfer or another form of merger, taking account of the nature and extent of the assets, contracts and consents involved, in order to identify which structure is preferable in the context of a particular business amalgamation.