An Overview of the New Governance Rules in the UAE: Part III

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- list a set of new corporate governance rules in accordance with, and to adhere to, the Commercial Companies (Federal Law No. 2 of 2015) ('CCL'); and
- repeal the UAE Ministerial Resolution on Governance Rules and Corporate Discipline Standards (Ministerial Resolution No. 518 of 2009) ('Repealed Governance Rules').

The purpose of this article is to compare the New and Repealed Governance Rules and highlight some of the provisions that are related to 'Related Parties', 'Insiders' and 'Conflict of Interest' that we consider would benefit from clarification from SCA.

It is worth mentioning that any capitalised terms used in this article have the same meaning to those mentioned in the New Governance Rules, unless provided otherwise in this article.

Definitions

For the purposes of this article, it is important to refer to the following definition under the New Governance Rules:

'**Deals**: Transactions, contracts or agreements entered into by a public joint stock company that is listed in the market and do not fall under the main activity of such company or by way of including preferential terms that are not usually granted by the company to its clients, in addition to any other deals to be specified by SCA from time to time by virtue of a resolution, instruction or circulation issued thereby.'

Related Parties

The new definition of the term 'Related Party' (which is now exactly the same as the definition provided in the CCL) was amended under the New Governance Rules to limit the Related Parties to the Chairman, Board Members, members of the Senior Executive Management, and the employees of the Company, in addition to the companies to which any of such persons own at least 30 per cent of their share capital, as well as Sister and Allied companies and Subsidiaries.

The reason for such limitation can be regarded to the fact that these are the only persons that hold an obligation to disclose any dealings they have or intend to have with the Company. Expanding the scope of the definition to include parties who have no direct relation with the Company, such as Relatives, is impractical and it makes no sense to burden such parties with disclosure obligations toward the Company, thereby making it impossible to implement in reality.

Another major difference between the old and new definition with regards to Related Parties is that the new definition considers companies where at least 30 per cent of its shares are owned by the Chairman, Board Members, members of the Senior Executive Management, or the employees of a publicly listed company to be a Related Party while the old definition considered Related Parties to be companies controlled by such persons, which is no longer the case. The issue of whether owning 30 per cent of the shares has to be directly or indirectly is raised again since the New Governance Rules is silent in this

regard. In our opinion, the 30 per cent shareholding can be either direct or indirect since, again, indirect owners have the same benefits as direct owners.

With regard to the Deals concluded with Related Parties, the main difference between the two rules is that the New Governance Rules have set an obligation, in accordance with Article 152 of the CCL, that any Deals between the Company and a Related Party has to be approved by the Board of Directors, if the value of the Deal is 5 per cent or less than the Company's capital, and the approval of the Company's general assembly, if such value exceeds 5 per cent. The Repealed Governance Rules, on the other hand, only required the approval of both the Board of Directors and general assembly if the Deals' value is 10 per cent or more of the Company's total assets.

Another difference is that the New Governance Rules further stipulate that any Deals which value exceeds 5 per cent of the Company's capital has to be evaluated by a valuator that is accredited by SCA before obtaining the approval of the Company's general assembly, in order for such Deal to be concluded. Such obligation did not exist in the Repealed Governance Rules.

However, the main issue that rises in this regard is whether the value of the Deals should be aggregated or if the calculation is per each Deal per se (i.e. whether the obligation to obtain the approval of the general assembly for Related Party Deals that exceeds 5 per cent of the Company's capital is required for the accumulative value of Deals concluded between the Company and a specific Related Party or is it calculated per each Deal only, irrelevant to whether it is the same Related Party in each Deal or not). The problem is that the wording of 'Deals' in Article 15 of the New Governance Rules (which is the same as Article 152 of the CCL) comes in the context of a plural, which may mean that if the value of the total Deals concluded with a certain Related Party, whether all Deals are to be concluded at the same time or on different occasions throughout the year for example, exceeds 5 per cent of the Company's capital, then the approval of the general assembly will be required.

The problem is that the New Governance Rules were issued recently and, therefore, have not been put into practice, which creates substantive confusion in this regard. Our interpretation is that, even if there are several Deals with a single Related Party, whether they are all at the same time or on different occasions, each Deal will still require a separate evaluation as long as such Deals are not related to each other. This can be based on the following:

- From a practical perspective, it will create many practical issues to have to wait till the aggregate value of the Deals concluded with a certain Related Party exceeds 5 per cent of the Company's capital and then evaluate such Deals, since some Deals may have already been carried out or finalised, or the valuation of certain Deals at the time of concluding it with the Company may be different from the time on which it will be evaluated once the aggregated value of Deals concluded with Related Party has exceeded 5 per cent of the Company's capital;
- If the New Governance Rules do mean the aggregate value of the Deals concluded with a certain Related Party, then it should have mentioned a time frame for such Deals (i.e. Deals concluded, for example, in the last six or twelve months, since not all Deals have to be concluded at the same time; and
- The definition of 'Deals' is already mentioned in the plural context in Article 1 of the New Governance Rules; therefore, it can mean a single or more than one Deal.

Having said this, we do not believe that this should mean that the Company has the right to break down a Deals' value that exceeds 5 per cent of the Company's capital to more than one transaction, whereby the value of each transaction is less than 5 per cent of the Company's capital. In this case, the Company still has an obligation to evaluate the aggregate value of such Deal and obtain the approval of the general assembly.

Bearing in mind the definition of 'Deals' mentioned above, it is further worth mentioning that Article 15 of the New Governance Rules may seem to contradict with Article 152 of the CCL in terms of whether the

valuation of Deals whose value are less than 5 per cent of the Company's capital is required or not. The wordings of Article 152 of the CCL appear to mean that such evaluation is required, while the New Governance Rules explicitly mentions that it is not. Taking into consideration that the New Governance Rules are enacted by SCA, which is the regulatory body whose objectives include ensuring the compliance of publicly listed companies with the CCL, it is therefore understood from the New Governance Rules that SCA's interpretation of Article 152 of the CCL is reflected in Article 15 of the New Governance Rules. This means that the valuation of Deals, whose values are less than 5 per cent of the Company's capital, is not required.

As for disclosure by Related Parties, the main difference between the two rules is that the New Governance Rules have set an obligation that any Deals between a Related Party, on one side, and the Company, a Subsidiary, or a Sister Company, on the other side, has to be disclosed to the Board of Directors, whatever is the value of the Deal. The Repealed Governance Rules, on the other hand, only required the disclosure if the Deals' value is 10 per cent or more of the Company's total assets. The New Governance Rules further introduced a new obligation on the Company, under Article 16, to maintain a register for Related Parties, where the names of such parties are to be recorded together with their Deals, in detail, and actions taken in relation thereto. The Company (i.e. the Board of Directors) also has an obligation under the same article to provide documents and information of the Deals with Related Parties and the nature, size, and details of each Deal to the general assembly.

In all events, Deals with Related Parties have to be disclosed to SCA, as per Article 17 of the New Governance Rules, as was also stipulated under the Repealed Governance Rules, by way of notice sent by the Company's Chairman. Such notice is to include the data and information of the Related Party, the details of the Deal, the nature and the benefit of the involvement of the Related Party in the Deal, together with a written confirmation that the terms of the Deal with the Related Party are fair, reasonable, and in favor of the Company's shareholders.

The main issue here is whether or not there is an obligation to obtain the approval of the Board of Directors or the general assembly (whichever is applicable in accordance with Article 15 of the New Governance Rules) if the Deals are concluded between the Related Parties themselves, without having the Company as a party to such Deal, such as having a Deal concluded between a Board Member and a Subsidiary. Unfortunately, the New Governance Rules are silent in this regard; therefore, it is indirectly interpreted that no approval is required since the definition of the Company does not include Subsidiaries or Sister or Allied companies. On the other hand, the 'Related Party' provisions are applicable only if the Company is entering into a transaction with a Related Party. In all events, such a Deal has to be disclosed to the Board of Directors, as per Article 18 of the New Governance Rules, and the Board of Directors will then have the right to discuss the matter and decide the best course of action to be taken that serves the best interest of the Company. Such Deals will have to also be disclosed to SCA and the Market. Additionally, the details and conditions of the said Deals and the conflict of interest of the Related Party are to be included in the annual financial statements of the Company presented to the general assembly meeting, in addition to publishing such details on the websites of both the Market and the Company.

The Repealed Governance Rules stipulated, however, that if the concerned Related Party fails to disclose the Deal with the Company, Subsidiary, or Sister Company, the Board of Directors, or any shareholder holding 5 per cent or more of the Company's shares, may bring a claim against the Related Party before a competent court requesting to suspend such Deal and compel the said Related Party to pay the Company any profits or benefits gained. Such clause exists in Article 19 of the New Governance Rules giving such right only to the shareholders holding 5 per cent or more of the Company's shares but, it is silent on whether or not the Board of Directors shall have the same right. We believe that the Board of Directors may still bring such a claim against the relevant Related Party as a penalty for failing to disclose since the Board of Directors holds the obligation to take any and all actions that serves the best interest of the Company.

In terms of shareholders' access to Deals concluded with Related Parties, there is no material difference

between both rules except that the wordings of the Repealed Governance Rules are very comprehensive on the course of action to be taken by a shareholder holding 5 per cent or more of the Company's shares against the parties of a Related Party Deal by way of referring to the exact articles of the Evidence Law and the Civil Procedure Law. Article 2 of the New Governance Rules, on the other hand, has made a general reference that the said rules are subject to the Evidence Law and the Civil Procedure Law; therefore, a shareholder holding 5 per cent or more of the Company's shares may file the lawsuit in accordance with the said laws that are applicable, in the event a shareholder decides to opt to the court to file a claim against the Board Member, the Board of Directors, or the Company.

Insiders

The New Governance Rules introduced new provisions for 'Insiders' (Article 12) and 'Confidentiality' (Article 13) that did not exist under the Repealed Governance Rules. Unfortunately, the New Governance Rules do not define an 'Insider'; therefore, it is difficult to determine who qualifies to be, or not to be, an insider. We assume that it is up to SCA's sole discretion to determine who qualifies to be an insider on a case-by-case basis. It can be, however, assumed from Article 12 that 'insiders' are defined to be any of the Company's Related Parties, their Relatives, and persons who could be considered as insiders on a temporary basis and are entitled to or have access to inside information of the Company prior to publication, such as advisors and consultants retained to advise on a certain Deal. The question is whether relatives of persons with temporary access to inside information of the Company are considered to be insiders or not. We believe that the answer is not to consider such relatives to be insiders unless they also have access to such information. In all events, persons with temporary access to inside information of the Company hold the same liability as the Board of Directors if they tip-off or whistle-blow any inside information before its publication, whether to their relatives, friends, or any third party, and whether or not such tip-off or whistle-blow is of consideration.

Article 12 further requires the Board of Directors to set written rules for the Company's Board of Directors and employees regarding trading in the securities of the Company or its Parent, Subsidiary, or Sister Companies. Another obligation on the Company is to have a register for permanent and temporary insiders, and to also include in it the prior and subsequent disclosures of the insiders.

Moreover, it is worth mentioning that Article 13 of the New Governance Rules provides that the Board of Directors shall (i) take all measures to accurately maintain strict confidentiality of the Company's data and information in a way that ensures it is not exploited; (ii) develop effective contractual arrangements that require the other parties who have access to internal data and information related to the Company and its customers to maintain the confidentiality of such data and information, and not misuse or transfer it, or cause it to be transferred directly or indirectly to other parties; and (iii) ensure that each insider signs formal declarations to confirm his/her knowledge of his/her possession of internal data and information regarding the Company and its customers, and that he/she shall bear all the legal consequences in case of leaking such information or data, or giving advice on the basis of the information in his/her possession, in addition to his/her commitment to notify the Company of any trade carried out on the securities of the Company or its Parent, Subsidiary, or Sister Companies before and after those trades.

Conflict of Interest

Another new provision that did not exist under the Repealed Governance Rules is Article 14 concerning 'Conflict of Interests', which mirrors the same obligations under Article 150 of the CCL. Such article simply provides that if a member of the Board of Directors has a joint interest or a conflict of interest with the Company in a Deal presented to the Board of Directors to take a decision in relation to such Deal, such member must inform the Board of Directors of the conflict of interest and record it in the minutes of the board meeting. Furthermore, such member shall not participate in the voting on the decision relating to the said Deal. This includes representatives of corporate or governmental bodies, and such disclosure extends to reach interests with the bodies that such member represents.

If the member of the Board of Directors fails to inform the Board of such joint interest or conflict of interest, the Company or any of its shareholders may resort to the competent court to invalidate the Deal or order such member who acted in contravention of such provision to return to the Company any profit or benefit obtained as a result of entering into this Deal.

The only addition introduced by Article 14 is that the Company shall maintain a special register for conflicts of interests in which such conflicts are recorded in detail, together with the measures taken in this regard. Even though the New Governance Rules are silent on this matter, we believe that the same provisions of the New Governance Rules that apply to both the Related Parties' register and the insiders' register also apply to the conflict of interests' register, including the disclosure of its content to SCA, the Market and the shareholders of the Company.