Corporate Exit Strategies and the Legal Considerations UAE

Looking further into the legal considerations surrounding corporate exit strategies, we look towards the United Arab Emirates (UAE) by speaking to Danielle Lobo from leading full service law firm, Afridi & Angell. Established in 1975, it is one of the longest established law firms in the UAE.

What are the main challenges to arise when planning a corporate exit?

The most common form of corporate entity in the UAE is a limited liability company ("LLC"), however a LLC can bring certain practical difficulties to a corporate exit.

Firstly, the Federal Law No.8 of 1984 on Commercial Companies (the "Commercial Companies Law") contains pre-emption rights on the transfer of shares in a LLC.

In addition, whilst there is no concept of beneficial ownership under UAE law, shares in a LLC are commonly held by nominee shareholders for the benefit of the "beneficial" owners. As part of this arrangement, a power of attorney is usually granted by the nominee shareholder in favour of the "beneficial" owner which allows the "beneficial" owner to carry out certain actions in relation to the shares, including the right to sell the shares. However, under UAE law, a power of attorney cannot be irrevocable and therefore it is possible for the nominee shareholder to revoke such power of attorney at any time.

In the UAE issues can also be faced when a shareholder attempts to enforce a put or call option. Again, a power of attorney can be put in place in advance in order to deal with such issues however the risk that the power of attorney will be revoked remains.

Whilst parties may attempt to deal with these matters in advance in a shareholders agreement, such rights can be difficult to enforce in the UAE. This is because specific performance and other equitable remedies are generally not granted by the courts in the UAE in cases where an award of damages would be considered an adequate remedy.

In respect of public joint stock companies ("PJSCs"), the Commercial Companies Law also provides that founder shares in a PJSC may not be transferred for a period of two years from the date of the PJSC's establishment.

How can you navigate these challenges?

It is advisable to plan early for an exit. Exit routes should be considered at the time of starting up the business. Often, at the time of making its initial investment, a private equity investor will request that the investment agreement contains a statement confirming the parties' intention to work towards an exit by no later than a certain date. This allows a private equity investor to plan for the realisation of the targeted return on its investment.

Further, in small and medium sized companies the financial statements of the company are often not a focus. Exits often involve the preparation of financial statements for a number of years.

How effective a strategy is corporate divesture?

Corporate divesture by way of a sale to a trade purchaser or an asset sale are the most common and most effective exit strategies. In a corporate divesture, the seller will usually have more flexibility around the negotiation of the purchase price. This can be due to the fact that the trade purchaser is looking to make a strategic acquisition in order to expand into a new market or offer a new product or service to its customers which compliments their current offering. Another advantage of a corporate divestiture is that you can end up with multiple potential purchasers involved in a bidding war or a formal auction process for the target company or the carve-out business.

Corporate divestitures can take up a lot of management time and nearly always take longer than expected, even for smaller businesses.

In addition, sellers must be mindful of the fact that they will usually be required to abide by non-compete provisions restricting their ability to carry out similar or competing businesses in the future.

Finally, in a carve-out transaction involving the sale of part of a business, the carved out business may need to function as a stand-alone entity post-closing and consequently the transitional service arrangement between the seller and the buyer is a critical component of a transaction of this nature.

In terms of other types of corporate divestiture, one-step equity spin offs, two-step equity spin offs and split-off transactions are not commonly encountered in the UAE.

What other strategies would you recommend?

Other potential exit strategies could include an initial public offering and a management buy out.

What should people be most aware of in terms of tax implications when looking at a corporate exit?

In the UAE, there is no personal income tax and there are no taxes on dividends. Therefore, the tax structuring of a corporate exit involving a UAE entity is not a consideration as it would be in other jurisdictions.

What other legal implications are there to be aware of?

In a corporate divestiture comprising of a "carve out" transaction it will also be necessary to consider whether the purchaser has the appropriate licences and approvals to carry on the business going forward. In the UAE, banks and financial institutions require to be licensed by the Central Bank. Other authorities such as the Insurance Authority and the Knowledge and Human Development Authority also deal with the licensing of businesses. **LM**

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