CLIFFORD CHANCE

THE NEW DIFC COMPANIES LAW: KEY CHANGES AND WHAT IT MEANS FOR YOUR BUSINESS

The new DIFC Companies Law (Law No. 5 of 2018) (the **Law**) came into effect on 12 November (the **Enactment Date**) and brings with it a number of important changes.

Practical considerations for DIFC companies

- Reclassification into Public or Private companies
- LLC vehicle abolished
- Update company name in company communications
- Update articles of association
- Public companies - increase share capital?

ENHANCED REGULATORY FRAMEWORK

In addition to updating the Law, the DIFC has also enhanced the wider corporate regulatory framework. Alongside the Law sits a new set of Companies Regulations, which now deal only with matters specifically relating to DIFC companies. In addition, a new DIFC Operating law and Operating Regulations have been enacted to deal with, amongst other things, the role of the DIFC's Registrar and the Registrar's increased monitoring powers and functions within the DIFC. Additionally, in line with global trends towards transparency and accountability, the new UBO Regulations set out a framework for increased reporting in relation to ultimate beneficial ownership of DIFC entities. New Protected Cell Company and Investment Company Regulations have also been published.

KEY CHANGES FOR CORPORATES

Re-classification of companies

One of the most significant changes under the Law is the re-classification of entity types. Under the previous law three types of company were recognised: i) Companies Limited by Shares; ii) Limited Liability Companies, or LLCs; and iii) Recognised Companies (i.e. branches of foreign companies). Now, Limited Liability Companies (which were the least common form of corporate vehicle utilised in practice) have been abolished and Companies Limited by Shares will be classified as either Public Companies or Private Companies. The Recognised Company regime has been retained.

Why distinguish between public and private companies?

Public companies typically have a greater number of shareholders than private companies and either offer their shares to the public via a public exchange or, if they are not listed, are usually an eligible corporate vehicle type for future listing. A distinction between public and private companies therefore allows for variation of treatment between these types of entity. Specifically, under the Law more onerous rules apply to Public Companies in some areas, to reflect their greater governance responsibilities, whilst more flexibility is afforded to Private Companies.

For instance, Public Companies are subject to more extensive accounting and reporting requirements than Private Companies, with carve-outs available for small Private Companies (see paragraph "Enhanced company accounting and reporting requirements" below for further detail). The Law also retains the financial assistance prohibition for Public Companies only. Broadly, subject to certain exceptions, a Public Company is prohibited from giving financial assistance for the acquisition of its shares or those of a holding company that is a Private Company, and a Private Company is prohibited from giving financial assistance for the acquisition of shares in its parent Public Company.

On the other hand, in line with a more flexible approach, and in addition to the less onerous reporting requirements, Private Companies are no longer required to hold an annual general meeting unless expressly mandated to do so under the company's articles.

Which entities will be classified as Private Companies or Public Companies?

On the Enactment Date, with the exception of Recognised Companies, each DIFC company was automatically converted into either a Private Company or Public Company on the basis of the following criteria:

Private Companies: a company with at least one and no more than 50 shareholders and that would otherwise not be classified as a Public Company.

Public Companies: a company that immediately before the Law came into force:

- was a Company Limited by Shares; and
- was listed on the NASDAQ Dubai, or had any of its shares admitted to trading on a regulated market; or
- had more than 50 shareholders.

What will companies need to do?

Raise share capital (Public Companies only): Although, in practice, it is unlikely that those entities that converted to Public Companies on the Enactment Date had a share capital lower than US$100,000, Public Companies are required to meet this minimum threshold (paid up to at least one-quarter of its value, except where shares are allotted pursuant to an employee share scheme). Any company that converted to a Public Company and does not meet this minimum requirement must increase its share capital to meet the threshold within 12 months of the Enactment Date. Failure to meet this deadline may result in a fine, although the exact amount of this fine is not specified under the Law.

Change of name: An adjustment to the suffix of company names is required, although, again, in practice this will unlikely affect Private Companies that already use the required form. Nevertheless, for Private Companies the suffix "Limited Liability Company", "LLC", "Limited" or "Ltd" must be used and for those entities that converted to Public Companies, the suffix "Public Limited Company", or "PLC" must be used.

Company names were automatically updated on the companies register following enactment of the Law. However, companies have 12 months from the Enactment Date to update their company stationery, email signatures etc. to take account of any change of name, in order not to mislead third parties dealing with the entity, as a matter of good corporate governance and to avoid potential penalties.

Update Articles of Association: To the extent necessary, all entities will need to update their Articles of Association so that they are consistent with the Law. Companies will have 12 months from the Enactment Date to update and re-register their Articles with the DIFC Companies Registrar. At least one director of the company must certify that the proposed amendments comply with the requirements of DIFC Laws. A new standard form set of articles for Private Companies is set out within the new Companies Regulations. Failure to meet this deadline may result in a fine. Although the exact amount of this fine is not specified under the Law, a general penalty of US$15,000 may be imposed on anyone who contravenes any laws or regulations administered by the Registrar. In practice we anticipate that limited amendments will be required in most instances, although companies may wish to take the opportunity to reconsider their articles more generally, in particular where the Law affords greater flexibility.

Defunct entity: LLCs are no longer a recognised entity type and previous membership interests in these types of vehicles will convert into shares from the Enactment Date. In addition, managers of such entities will be deemed to be directors and will need to comply with the enhanced directors' duties prescribed under the Law (see paragraph "Enhanced directors' duties" below for further detail).

OTHER KEY CHANGES

ENHANCED COMPANY ACCOUNTING AND REPORTING REQUIREMENTS

Both Public and Private Companies will continue to be subject to requirements in respect of preparing annual audited accounts and filing these with the Registrar, with the exception of publicly listed companies or recognised persons that are subject to separate reporting requirements under the DFSA rules. However, Public Companies will be subject to the further requirement of preparing (and filing) a directors' report. The directors' report must contain, amongst other things, a review of risks facing the company's business and "an analysis of the development, performance and position" of the business for the relevant financial year. In addition, the directors must confirm that they are not aware of any relevant audit information that the company's auditor is not aware of, and that they have taken all reasonable steps to become aware of such relevant audit information. Additionally, only Public Companies must provide to shareholders at a general meeting the accounts, auditors' report and directors' report for the relevant financial year for discussion, and if thought fit, approval, by the shareholders. However, both Public and Private Companies must circulate copies of the accounts, auditors' report, and in the case of Public Companies, the directors' report, to their shareholders within six months after the end of the financial year. Within 30 days after circulation to the shareholders these documents must also be filed with the Companies Registrar.

A carve-out for small Private Companies has been included in the Law. Subject to anything to the contrary in the company's articles, a small Private Company that for a relevant financial year (and if the company has existed for more than one financial year, the year preceding the relevant financial year) has: a) a turnover of US$5,000,000 or less (calculated on a consolidated

Key changes

- Enhanced regulatory framework
- Enhanced company accounting and reporting requirements
- Statutory pre-emption rights for Public and Private Companies
- Restrictions on non-cash consideration for shares of Public and Private Companies
- Express treasury shares regime
- New mergers regime
- Enhanced directors' duties
- New Ultimate Beneficial Ownership ("**UBO**") requirements, potentially affecting share transfer registration.

basis to include all subsidiaries); and b) not more than 20 shareholders for the entirety of the relevant financial year, is not required to: i) prepare audited accounts; ii) circulate accounts to shareholders; or iii) file copies of annual accounts with the Registrar. Nevertheless, shareholders representing 10% of the nominal value of the share capital may demand that audited accounts are prepared.

STATUTORY PRE-EMPTION RIGHTS

The previous law did not set out statutory rights of pre-emption in respect of an issue of shares by a company, although companies were free to include such rights in their articles of association (or shareholders could agree them as a contractual matter). Now statutory pre-emption rights have been expressly introduced in the Law for both Public and Private Companies on the allotment of "Equity Securities" in a company i.e. ordinary shares in the company, or the grant of a right to subscribe for or convert securities into ordinary shares in the company. Pre-emption rights also exist in favour of Equity Securities that, immediately before the sale, were held by the company as treasury shares. Exceptions to the right of pre-emption include Equity Securities: i) that are bonus shares; ii) that would be held or allotted pursuant to an employee share scheme; iii) that will not be paid for in cash; iv) in a Private Company, to the extent that the pre-emption right has been excluded or varied in its articles of association; or v) by any company that has excluded or varied the pre-emption rights by way of special resolution (unless a higher threshold is prescribed under the company's articles of association) provided that the special resolution has been recommended by the directors in a written statement circulated to all shareholders of the company and includes the amount to be paid to the company in respect of the allotment and the directors' justification for that amount.

TREASURY SHARES

An express treasury share regime has also been introduced under the Law (although this was previously recognised in practice). Treasury shares are shares that, effectively, a company holds in itself. Shares can only be transferred into treasury: i) where there is no restriction in the company's articles; ii) it is sanctioned by a special resolution (for off-market purchases, unless the company is a wholly owned subsidiary) or ordinary resolution (for a market purchase); and iii) the purchase otherwise complies with the treasury share regime under the Law.

NON-CASH CONSIDERATION FOR SHARES

Non-cash consideration for shares was permitted under the previous law subject to certain restrictions such as the need for the directors to determine the reasonable cash value of the shares and that any non-cash consideration offered was fair and reasonable to the company and all existing shareholders. Similar restrictions continue to apply to Private Companies under the Law. Public Companies are also restricted from accepting non-cash consideration for shares unless the company has obtained an independent valuation of the non-cash consideration within six months of the proposed allotment, a copy of the valuation report has been sent to the proposed allottee and copies of the valuation, relevant resolutions and allotment notice have been submitted to the Companies Registrar. However, certain circumstances exist where non-cash consideration for shares in a Public Company is not permitted. For instance, where it comprises an undertaking to perform work or services that may be performed five years after the date of the allotment or in connection with shares traded on an exchange.

NEW MERGERS REGIME

The Law introduces a statutory merger regime (modelled on the Jersey merger regime). The regime may be utilised by both Public and Private companies, provided in the latter case that this is permitted under the company's articles of association or by way of special resolution of the shareholders. The regime could further provide greater flexibility for structuring M&A deals or restructurings, for instance, providing companies with a more streamlined route for consolidating their group structures.

ENHANCED DIRECTORS' DUTIES

Directors' duties have been expanded through a codified set of duties owed by directors to the company that reflects the codified common law and equitable duties of directors under the English Companies Act 2006. Whilst directors' duties under the Law have been expanded, duties under the old law were relatively broad in scope, not least because directors are subject to broad fiduciary duties under the DIFC Law of Obligations and the DIFC courts have largely looked to English case law when determining breach of duty cases. Nevertheless, the Law sets out a wider range of specific duties owed by directors, which provides helpful clarification.

NEW ULTIMATE BENEFICIAL OWNERSHIP ("UBO") REQUIREMENTS

Subject to certain exemptions, and in respect of entities that fall within the scope of the regulations, an Ultimate Beneficial Owner is a natural person: i) that owns or controls (directly or indirectly) at least 25% of a company; or ii) has the legal right to exercise, or actually exercises, significant control or influence over the activities of a partnership; or iii) in relation to a foundation or a Non-Profit Incorporated Organisation has the legal right to exercise, or actually exercises, significant control or influence over the activities of the governing body, person or other arrangement administering the property or carrying out the objects of that entity.

Broadly, most DIFC registered entities will be subject to the UBO Regulations (the "**Applicable Entities**"), with the exception of: entities listed on a regulated exchange or regulated by a recognised financial services regulator; branches of foreign companies/partnerships and whose "parent" is subject to equivalent international standards; wholly owned government entities or entities owned by government agencies; and entities established under UAE law to perform "governmental functions".

The regulations require Applicable Entities to establish and maintain a register of beneficial ownership and provide relevant details of ultimate beneficial owners to the Registrar within 90 days of the Enactment Date. On an ongoing basis, the Applicable Entity must record any changes to the register within 30 days of becoming aware of any changes to its beneficial ownership. This includes in relation to share transfers, whereby an Applicable Entity must not register, recognise or give effect to a transfer, unless it is also provided with a statement by the transferee that states: i) whether the transfer will result in a change of ultimate beneficial ownership of the Applicable Entity; ii) if there is a change, the nature of that change; and iii) provides the relevant UBO particulars in respect of each new ultimate beneficial owner, as a result of the change.

Similarly, nominee directors of DIFC companies (i.e. those individuals that are under an obligation to act in accordance with the directions, instructions or wishes of another person in respect of a company) are under a duty to inform the company of their nominee director position, personal particulars and the date on which they became or ceased to be a nominee director. Again, Applicable Entities must establish and maintain a register of this information within 60 days of the Enactment Date and provide relevant details in respect of this information to the Registrar within 90 days of the Enactment Date.

CONCLUSION

Whilst the changes to the Law and the enhanced regulatory framework are not necessarily game changing, the regime can be seen as an evolution from the repealed framework. The distinction between Public and Private Companies is welcomed and the Law brings with it a number of helpful additions and clarifications.

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