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ALERT MEMORANDUM

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ADGM consultation – key features of draft companies and insolvency regulations

This is our second alert memorandum covering the consultation papers on the laws and regulations that will apply to companies operating within the Abu Dhabi Global Market (ADGM), Abu Dhabi's nascent financial free zone. Our first alert memorandum, which gives some background on the ADGM and the consultation process and explains the general application of English law within the ADGM, can be found here.

Of particular interest are the draft Companies Regulations and Insolvency Regulations. This alert memorandum explains some of the principal features and key questions raised by the consultation papers for these regulations.

Companies Regulations

The draft Companies Regulations follow the UK Companies Act 2006 very closely with some exceptions. The consultation paper explains the respects in which the draft ADGM Regulations differ from the UK Companies Act. A number of the changes are designed to address criticisms of the UK law. Others, such as the introduction of restricted scope companies and cell companies, are clearly intended to make the ADGM a desirable location for the types of institutions (including private banking, wealth and asset management firms) that Abu Dhabi hopes to attract to the new free zone.

The Companies Regulations adopt the main UK forms of company (private limited company and public limited company, as opposed to the various public and private joint stock companies, limited liability companies and other entities currently available in Abu Dhabi) and most of the draft regulations (comprising over 1,000 sections) will be recognisable to anyone familiar with the UK Companies Act. However, some of the key differences are listed below:

- Restricted Scope Companies
  - A new type of company is proposed, to be used predominantly as a holding vehicle for professional investors and institutions.
  - The Restricted Scope Company (RSC) is a deregulated vehicle with less onerous disclosure and compliance requirements.
  - One of the questions asked by the consultation paper is whether individuals or single family offices should also be permitted to establish RSCs, or whether they should only be available as subsidiaries of (i) groups that publicly file consolidated accounts or (ii) companies formed by decree.

- Cell Companies
  - The Companies Regulations also introduce a second innovation in corporate form, as compared to the UK system: protected cell companies and incorporated cell companies.
  - Although not a feature of UK company law, cell companies (or similar) are available in a number of (mainly "offshore") jurisdictions, such as Guernsey, Delaware, Jersey, the Cayman Islands, the British Virgin Islands, Bermuda and Qatar.
  - Cell companies are popular in the investment funds industry because they can be used to segregate portfolios into individual cells whose assets and liabilities are separate from each other and from those of the company itself. By treating each cell as a separate entity, it is intended that any claims by persons transacting with a particular cell can be brought only against the relevant cell and not against the other cells or the company itself. In the case of incorporated cell companies, this concept is strengthened by giving each cell separate legal identity as a separate company.
  - These aspects of the Companies Regulations are based largely on Jersey law.

- Share Capital
  - Unlike in the UK, it is proposed that shares in ADGM companies will have no nominal/par value.
  - This makes the concept of share premium redundant and thus obviates the need for share premium accounts.
  - Bearer shares and bearer warrants would not be permitted in the ADGM.

- Continuance
  - Continuance provisions are included, based on the equivalent Jersey law, to enable companies to redomicile into the ADGM from another jurisdiction.

- Directors' Duties / Conflicts of Interest
  - It has been argued that the UK rules on directors' conflicts of interest are confusing as the duty is to avoid a conflict, rather than a duty to take (or not take) certain actions when in a conflict scenario.
  - The Companies Regulations seek to avoid this uncertainty, by imposing a duty on directors not to act in relation to matters in respect of which they have an actual or potential conflict, unless the unconflicted directors or shareholders give their approval.

- Derivative Claims
  - In the UK, any shareholder, perhaps holding only one share in the company, can bring a derivative claim (a claim launched by a shareholder on behalf of the company against a director, e.g. for negligence or breach of duty).
  - To avoid ADGM companies being as vulnerable to activists as those in the UK, the Companies Regulations propose that only members holding 5% or more of the company's shares will be able to bring derivative actions.

- Schemes of Arrangement
  - Similar concerns have resulted in the removal of the need for a majority in number of shareholders to approve schemes of arrangement as required for schemes under the UK Companies Act.
  - A scheme is a court-sanctioned procedure used in restructurings and takeovers: with the approval of 75% by value (and, in the UK, over 50% in number) of creditors/shareholders, a restructuring or takeover scheme will (with court approval) become binding on all creditors/shareholders.
  - The "majority in number" requirement makes it possible for minority shareholders of UK companies to obtain disproportionate influence in the vote to approve the scheme, by splitting their shareholdings into many smaller units held by affiliates, thus requiring their and their affiliates' approval to satisfy the majority in number test.
  - Schemes of ADGM companies will be able to proceed with the approval of 75% of voting rights, regardless of whether a majority in number of shareholders (or creditors) voted in favour.

- Mergers and Divisions
  - The UK Companies Act contains provisions governing mergers (and divisions) of companies, based on EU law, but these rules are untested in the UK, where M&A activity universally takes the form of private share purchases or asset sales or public takeover offers (often through a scheme of arrangement as described above).
  - Although untested in the UK, the Companies Regulations adopt the same approach, but whereas in the UK a merger would involve the transfer of assets and liabilities from company A to company B and subsequent dissolution of company A, the Companies Regulations adopt the "universal succession" concept, whereby companies A and B are consolidated into one entity without the need to dissolve either of them.
  - Mergers under the Companies Regulations are not only open to public companies: a merger can be of any two companies, provided that one of them is ADGM-registered.
  - One key question posed by the consultation paper is whether, and when, an expert's report should be required in connection with a merger: (i) never; (ii) where shares in one company are exchanged for shares in another (i.e. a report on the share exchange ratio), which is the option proposed in the draft; or (iii) also where the consideration is a form of property other than shares or cash.

- Takeovers
  - The Companies Regulations do not contain equivalent provisions to Part 28 of the UK Companies Act, on takeovers.
  - It is proposed that takeovers will be dealt with in separate Takeover Regulations, to form part of a separate, future consultation.

Insolvency Regulations

The draft Insolvency Regulations also follow the UK insolvency laws but here the UK position is slightly more complicated than for company law: the UK Insolvency Act 1986 and Insolvency Rules 1986 are the starting point, but these are supplemented by other legislation and the UK Insolvency Rules 2015, which were designed to consolidate and modernise the UK's secondary legislation on insolvency and have been the subject of a consultation process in the UK in 2013/2014, but are not yet in force.

The draft ADGM Insolvency Regulations follow the "rescue culture" approach that the UK has tried to implement, in particular through the adoption of administration as the main insolvency procedure. Some of the key features are explained below:

- Administration
  - An administrator can be appointed by the Court, the holder of a qualifying charge, the company or its directors.
  - The administrator is required to act in the interests of the creditors as a whole and the administration procedure is designed to achieve the following purposes (in order of priority):
    - rescue the company as a going concern;
    - achieve a better result for creditors than a winding-up; or
    - realise property for the company's secured/preferential creditors.

- Creditor Compromise Procedures
  - One of the options that the administrator will have as an exit route for the company from the administration procedure is to implement a "Deed of Company Arrangement", a compromise arrangement with the company's creditors.
  - If the compromise arrangement is approved by a majority of the creditors, the resulting Deed of Company Arrangement will become binding on all creditors.
  - In this context, "majority" means that a simple majority of more than 50% (by value) of creditors have approved the arrangement, provided that the approval does not count if more than 50% (by value) of creditors who are unconnected to the company vote against the arrangement.
  - The Deed of Company Arrangement is based on Australian rules and is included in the Insolvency Regulations instead of the UK "company voluntary arrangement" procedure.

- Administrative Receivership
  - By contrast to an administrator, who must have regard to the interests of the creditors as a whole, the primary concern of an administrative receiver (appointed by one secured creditor in respect of all or substantially all of the assets of the company) is to ensure that the appointing creditor has its debts repaid by selling the company's assets.
  - This is arguably not in keeping with the "rescue culture" approach, so the consultation paper asks whether secured creditors should benefit from this self-help remedy at all.

  - If administrative receivership is included in the final regulations, the proposal is that this option should only be available to secured creditors who obtain qualifying charges in connection with capital markets arrangements or project financings.

- Floating Charges
  - A "floating charge" is a charge over all the assets (or all of a class of assets) of a company "from time to time" that, upon an event of default, crystallises into a fixed charge over all the assets at that point in time.
  - The consultation paper explains that the floating charge concept is not generally recognised in the UAE, but it will become part of ADGM law due to the adoption of English common law in the ADGM.
  - The draft Insolvency Regulations remove the distinction between floating and fixed charges, for example allowing a secured creditor to appoint an administrator if it holds security over the whole or substantially the whole of the company's assets (whether through a floating charge or a fixed charge).

- Netting and Financial Collateral Arrangements
  - The Insolvency Regulations contain netting-related provisions derived from the ISDA Model Netting Act and the UK's Financial Collateral Regulations that:
    - allow netting provisions to be enforced even if one party has become insolvent; and
    - allow a person to enforce against certain collateral arrangements entered into between parties even if the collateral provider has entered insolvency proceedings.

- Insolvency of Regulated Financial Institutions
  - The draft ADGM Insolvency Regulations currently being consulted on do not deal specifically with insolvency of regulated financial institutions.
  - It is expected that draft regulations providing a specific insolvency regime for regulated financial institutions will be the subject of a separate consultation at a later date.

The consultation papers and draft regulations are available on the ADGM website: http://www.adgm.com/about-us/overview/. The deadline for responding to the consultation papers is 5 February 2015. Should you have any questions about the consultation papers, or should you wish to submit comments, please get in touch with your regular contacts at the firm or, in the Abu Dhabi office, Gamal Abouali (gabouali@cgsh.com), Matteo Montanaro (mmontanaro@cgsh.com) or Chris Macbeth (cmacbeth@cgsh.com).

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