Hostile LLC takeovers under the new 100% UAE ownership laws

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An announcement took place on 23 November 2020 that foreign investors can have complete ownership of Emirati companies that are governed by the Federal Commercial Companies Law ("CCL") otherwise known as "on-shore" companies.

The concession is limited to limited liability companies and private joint stock companies, including those owned by a single shareholder.

The most common form of corporate formulation is generally a limited liability company, with 49% of the shares of the company owned by a foreign investor (or investors), and 51% owned by a national shareholder (or shareholders).

It goes without saying that this development grants substantial flexibility to new foreign investors.

But here we consider certain implications for currently existing companies.

Minority shareholders who currently own 49% or less of a business will look to expand their ownership.

Amicable negotiations to buy-out the shares of the majority shareholder may not succeed for various reasons, such as the majority shareholder leveraging their position to sell their shares at exorbitant valuations.

And majority shareholders who currently own 51% or more of a

business will look to protect their ownership.

What ensues from these machinations will be attempts at hostile takeovers.

What is a hostile takeover?

In a general sense, a hostile takeover is in reference to forcible buyouts of a publicly listed company when the board of the public company is rejecting the sale.

Different strategies are employed such as “bear hugs” where the acquirer would issue a tender offer to the public stockholders to buy the publicly traded shares at a value higher than the publicly traded value.

Or “dawn raids” where the acquirer would purchase all the publicly traded shares as soon as the stock exchange is open for business.

Or a “proxy fight” which is basically an attempt to reform the board of the public company for a new board to approve the acquisition.

Notwithstanding, hostile takeovers are in essence an attempt by a person/company to forcefully – and with hostile tactics – acquire all or controlling interest in a business.

In this article, we detail hostile takeovers in the manner between a minority and a majority shareholder of a limited liability company (“LLC”) – where the minority shareholder (the “predator”) may attempt to forcibly takeover all of the target shares of the majority shareholder in the LLC, or enough shares to grant the predator controlling interest.

Although there are many strategies, here we discuss examples of five offense strategies that a predator may employ, and five defense strategies that a majority shareholder could trigger, in a hostile takeover attempt.

Offense strategy: interlocking takeover

An interlocking takeover would occur where there are more than two shareholders, and the predator and another shareholder (the "interlocking shareholder") jointly own over 50% of the share capital and use their combined controlling interest to remove the third shareholder target and obtain its target shares.

Article 677 of the Federal Civil Transactions Law ("CTL") grants the shareholding majority the right to apply to the court for removal of any shareholder if the request is based on sound grounds.

Sound grounds could include where a shareholder is engaged in competing business or is convicted of a felony (such as money laundering), and so on, but this would ultimately be up to the judge's discretion.

As to continuity in the business, a lawsuit aimed at removing a shareholder would not generally prejudice the continuing operations of the LLC.

"That when the decision is made to remove a shareholder from the company, the company continues among the rest of the shareholders, and the separated shareholder in this case deserves his share and this share is estimated according to its value on the date of filing the lawsuit." (Federal Supreme Court Judgment No. 933/2019)

The interlocking shareholder may subsequently sell its shares to the predator, granting the predator complete share ownership of the LLC.

Offense strategy: grey knight takeover

A grey knight takeover is where the predator engages another person/company (known as a "grey knight") to acquire the target shares of the majority shareholder which would result

in the predator and the grey knight jointly owning simple majority (over 50%) or a supermajority (75% and above) of the LLC's share capital.

A grey knight is generally an offeror who purchases shares without expressing any hostility and represents itself as a neutral share purchaser.

If the share ownership of the predator and the grey knight jointly grants a supermajority of 75% that would fulfil the quorum for convening a general assembly (Article 96 of the CCL), and voting on matters that require extraordinary general assembly consent such as amendment of the articles of association of the LLC (101 of the CCL).

The predator and the grey knight could also trigger Article 677 of the CTL to obtain the target shares.

Offense strategy: creeping parent takeover

A creeping parent takeover occurs where the majority shareholder is a company rather than a natural person, and the predator gradually and interceptively acquires controlling interest of the majority shareholder company.

At times, the majority shareholder parent company is a non-active, invaluable entity and any offers to purchase shares of the majority shareholding company at above-market values would be too attractive to refuse.

Article 77 of the CCL establishes the principle of non-divisibility of shares owned by a company. This means that the target shares would be owned indivisibly by that company (not divisibly by its parent level shareholders), hence once the predator has controlling interest at the parent level of the majority shareholder, the predator may *de facto* control the target shares, and ultimately the LLC.

The predator may also engage a grey knight for takeover of the

controlling interest of the majority shareholder parent company.

Formulation:

Company A (the predator) owns 49% of Company X.

Company B owns 51% of Company X (the target shares).

Company X is the valuable entity.

Company A (or the grey knight) offers to purchase minor or all shares of Company B at a premium price.

Company A eventually owns controlling interest of Company B.

Offense strategy: toehold takeover

A toehold takeover is the acquisition by the predator of minimal additional shareholding (usually 5% or less) to gain a toehold into majority shareholding as precursor to a hostile takeover action.

For example, if the predator owns only 49%, they may purchase 1.1% at minimal to own a total of 50.1% of the share capital of the LLC.

Subsequently, the predator may trigger Article 677 of the CTL as described above.

Offense strategy: black knight takeover

A black knight takeover occurs where the majority shareholder is in debt to a third-party creditor, and the creditor triggers Article 20 of the CCL to enforce its debt against the target shares of the majority shareholder.

The shares would then be sold at court auction, granting the predator the opportunity to purchase the shares at the auction.

The black knight may also be the predator itself, if the predator has proven debt against the majority shareholder.

Defense strategy: safe harbor

A safe harbor defense would occur where the majority shareholder, facing a hostile takeover, would add a commercial activity to the LLC which falls outside Cabinet Resolution No. 16 of 2020 (Concerning the Determination of the Positive List of Economic Sectors and Activities Eligible for Foreign Direct Investment and Percentage of their Ownership).

By adding an activity that falls outside Cabinet Resolution No. 16 of 2020, the predator would no longer be able to comply with the complete foreign ownership requirements and be prevented from owning more than 49% of the LLC by the regulators.

Defense strategy: backward integration

A backward integration defense involves the majority shareholder acquiring the source of the LLC's business; such as the producer of raw materials that the LLC uses for its commercial activities, or the ancillaries which are necessary to the LLC.

By controlling the source of the LLCs commercial activity, the majority shareholder would have leverage to prevent hostile takeover action by the predator.

Defense strategy: golden parachute

A golden parachute defense occurs when the majority shareholder has, or obtains, a managerial role in the LLC with extensive benefits and end of service gratuity that would render the removal of the majority shareholder financially detrimental to the LLC that the predator is dissuaded from a hostile takeover action.

Defense strategy: show-stopper

A show-stopper defense essentially involves the majority shareholder commencing trial proceedings to prevent hostile takeover action.

Defense strategy: forward integration

A forward integration defense mirrors a backward integration defense except the majority shareholder would purchase the businesses that make use of the LLC's services or products to control the market of the LLC.

Using deal counsel as raiders or killer bees

Predators looking to engage in hostile takeover action would engage a raider as a takeover artist to lead the hostile takeover action. This is generally the law firm / counsel in charge of the hostile takeover.

Majority shareholders looking to defend against hostile takeover action would engage a killer bee to fend off the action. A killer bee would generally be the law firm / counsel in charge of defending against a hostile takeover.

Both predators and majority shareholders need to consider whether their deal counsel (i.e. their law firm / counsel that assisted in establishing the relationship / the LLC) should also act as their raider or killer bee, respectively, in hostile takeovers.

An initial thought may be that the deal counsel who had assisted in advising on the deal and setting up the LLC should also be the raider or killer bee because they are already familiar with the corporate structure and nuances that took place during the incorporation process.

But before this initial thought is acted upon, a predator should ask whether the deal counsel had advised on including provisions in the articles of association of the LLC that require the majority shareholder to sell to the minority

shareholder where there is a change of law.

If not, then the deal counsel may face “confirmation bias” which reflects a strong view favoring a position during the deal, which may be difficult to alter for the deal counsel to act as the raider.

Another concern is that deal counsel may be subject to discovery proceedings if trial takes place.

For example, if an expert is appointed during trial proceedings pursuant to Federal Law 10/1992 on Evidence in Civil and Commercial Transactions, the expert may be granted powers to investigate correspondences, documents, or any other potential evidence that took place at the time of the deal/corporate establishment, including those prepared by the deal counsel.

Hence, trial proceedings may be negatively affected if the raider or killer bee is the same as the deal counsel.

Another conflict of interest may occur if the deal counsel had been jointly engaged by all the shareholders to conclude the deal / establishment process, rendering the deal counsel incapable of being engaged by the predator or the majority shareholder, as a raider or killer bee, due to direct conflict of interest.

Ultimately, it may be appealing to revert to deal counsel to act as the raider or the killer bee, but the risks may outweigh the presumed benefit, which results in favoring new counsel to effectively manage the hostile takeover.

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