Linklaters

March 2011

Foreign investment in the United Arab Emirates.

Overview

Regional insight and awareness of the local legal landscape is key for global companies and financial institutions doing business in the United Arab Emirates (the "**UAE**"). Liberalisation of rules on foreign investment in the UAE has been a feature of this landscape in recent years, with the UAE taking steps to open up its economy to foreign investors. Nonetheless, investment in companies incorporated in the UAE (as opposed to in free zones in the UAE) still poses challenges for foreign investors. This alert will examine some of the issues foreign investors face when doing business in the UAE.

Navigating current UAE law and practice

In common with other jurisdictions in the Middle East, UAE law contains certain restrictions that favour state nationals in the pursuit of commercial activities and protect strategic sectors from foreign investment. Ownership restrictions are imposed by the UAE Commercial Companies Law (the "**CCL**") which require every company incorporated under the CCL (a "**UAE company**") to have not less than 51 per cent. of its share capital owned by UAE nationals (subject to certain exceptions). Often described as the "51/49 rule", this rule effectively prevents foreign investors from owning more than 49 per cent. of UAE companies (as opposed to companies incorporated in free zones in the UAE).

Ownership restrictions may be greater in certain circumstances and sectors. For example, statutory ownership restrictions exist in the insurance sector (where foreign ownership is limited to 25 per cent.), the financial services sector in relation to "finance companies" (where foreign ownership is limited to 40 per cent.), the real estate sector (where, in certain circumstances, no foreign ownership is allowed) and the operation of commercial agencies (where no foreign ownership is allowed). Further restrictions may be contained in a company's Articles of Association. In addition, the articles may restrict one shareholder from holding more than a certain percentage of a company's shares.

We have seen a range of bespoke measures used in practice to mitigate the effect of the 51/49 rule and allow collateral means of control – effectively allowing the minority foreign shareholder in practice to have the benefits that full or near full ownership of the UAE company would offer. Using such

Contents

measures is not without risk as, to the extent that such measures allow the foreign shareholder to practice a commercial activity in the UAE that is not otherwise open to it, they may fall foul of UAE Federal Law No. 17 of 2004 Regarding Commercial Concealment. However, we are not aware of any instances where that law has yet been enforced. Such control measures are commonly used in relation to private as opposed to public UAE companies. The measures that we have seen used in the market include the following:

> *Constitutional Documents* - A number of controls may be entrenched in the UAE company's constitutional documents such as rights to appoint the board, veto rights over key matters and enhanced dividend rights (e.g. 80% of the profits being distributable to the foreign 49% shareholder). Such controls are fairly common in relation to private UAE companies.

> *Shareholders Agreement* - The foreign investor may enter into an agreement with the local shareholder to agree that the latter will use its power to provide the former with negative and positive controls over the UAE company that go into further detail that the controls entrenched in the constitutional documents.

> *Nominee Arrangement* - Nominee arrangements under which a registered shareholder holds its shares as nominee (effectively on trust) for the foreign shareholder giving the latter control of 51% or more of the UAE company's share capital. Such arrangements are not uncommon in relation to private companies but are rare in a public company context.

> *Management Agreement* – The UAE company may appoint the foreign shareholder to provide management services to the UAE company in exchange for a fee. This is another way for a foreign shareholder to enhance the returns from its investment in a UAE company.

The current restrictions pose challenges for various types of investors. Careful navigation around the laws is required by, among others, foreign companies seeking to acquire a controlling stake in a UAE company (whether by takeover or otherwise), private equity houses seeking to structure local acquisitions and form exit strategies and foreign lenders seeking to enforce security over shares in UAE companies.

Regional nuances

The interpretation and application of the 51/49 in the UAE remains somewhat opaque. In theory, the minimum national ownership requirements in the UAE regard nationals of the other Gulf Cooperation Council ("**GCC**") region (Bahrain, Kuwait, Oman, Qatar and Saudi Arabia) states as foreigners for this purpose. However, GCC nationals may, in practice, be deemed to be UAE nationals for the purposes of UAE company ownership (but this may vary on a case by case basis depending on a number of factors, including, for example the policy of the relevant licensing authority, national participation in the business, the involvement of government or other influential shareholders and mutual recognition between the two GCC countries in relation to the sector in question).

The trend towards liberalisation

The UAE is taking steps to facilitate and attract foreign investment in the UAE. These steps include the continued establishment of free zones and reform initiatives. UAE initiatives to liberalise form part of a general trend to adopt a more harmonised approach to foreign investment into the Middle East region. The move to attract foreign investment has been driven by the need to diversify the UAE economy, foster private sector growth, create employment for nationals and attract training. While many countries in the Middle East have enacted new foreign investment regimes, currently the UAE still relies on older legislation and practice.

Free zones

The individual Emirates that comprise the UAE have established free zones which, to a varying extent, operate outside of the laws of the local Emirate and federal laws of the UAE in terms of foreign ownership (including the CCL) and, in particular, typically allow 100 per cent. foreign ownership of companies incorporated in the free zone. The principal free zones include the Dubai International Financial Centre (DIFC), Jebel Ali Free Zone (JAFZ), Dubai Airport Free Zone (DAFZ) and the Dubai Technology and Media Free Zone (TECOM).

Reform initiatives

An amendment to the CCL is proposed to relax the rules regarding foreign investment. There are no official consultations on draft legislation in the UAE and draft legislation is not made publicly available. It is not therefore possible to be definitive as to how the amended law will be framed. Press reports indicate that the new regime will include incentives to encourage local and foreign investment, including potentially allowing 100 per cent. foreign ownership in certain sectors. Exceptions to liberalisation are reported to include investments in the oil, gas, electricity and water sectors. The draft amendment to the CCL is reported to have been approved by the UAE Federal Supreme Legislative Committee. The next steps are for the draft law to be submitted for approval to the Council of Ministers and then the Federal National Council. The legislative process in the UAE can be unpredictable. There is no official timetable in place for adoption of the amended law (which has been in progress for several years) and so it is uncertain when the new rules may come into force. Recently, His Excellency Sultan bin Saeed Al-Mansoori, the UAE Minister of Economy, was reported as saying "it could be any time this year" and that "it could be this week or next week or next month. From the ministry level, our work is done.". Once in force, sector specific authorities in the UAE will need to amend their regulations to bring them into line with the new law for the amended CCL to have the practical effect envisaged.

Many countries in the Middle East region have already enacted tailored foreign investment laws in recent years. It is to be hoped that an updated foreign investment regime, which recognises global business practices and facilitates inbound investment by foreign companies, will be enacted in the UAE in the coming months.

Linklaters

Contacts

For further information please contact:

Ewan Cameron
Regional Senior Partner

(+971) 4 369 5810

ewan.cameron@linklaters.com

Scott Campbell
Partner

(+971) 4 369 5811

scott.campbell@linklaters.com

Nick Garland
Partner

(+971) 4 369 5818

nick.garland@linklaters.com

Hardeep Plahe
Counsel

(+971) 4 369 5820

hardeep.plahe@linklaters.com

Michael Lappe
Partner

(+49) 89 4180 8130

michael.lappe@linklaters.com

Ninth Floor, Currency House

Dubai International Financial Centre

PO Box 506516, Dubai

United Arab Emirates

Telephone (+971) 4 369 5800
Facsimile (+971) 4 369 5801

Linklaters.com

Authors: Caroline Cheney, Hardeep Plahe, Nick Garland