Company & Commercial - United Arab Emirates

Postponement of Anti-concealment Law

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Introduction

The UAE Companies Law (8/1984) concerning commercial companies (as amended) provides for seven types of entity through which business may be conducted in the United Arab Emirates.(1) This excludes free zone entities which may be established in any of the UAE free zones and which generally require further licensing onshore in the United Arab Emirates in order to conduct business outside of the free zone in which they have been established. Of the seven entities, the limited liability company (LLC) is the form most commonly adopted by foreign investors in order to conduct business in the United Arab Emirates. However, pursuant to Article 22 of the Companies Law, no fewer than 51% of the shares of an LLC must be held by a UAE national or a company wholly owned by UAE nationals. As a consequence, a foreign investor is unable to own 100% of an LLC. Whereas in certain other jurisdictions this problem of a foreign investor having to cede control of its LLC to a UAE national could be solved by issuing different classes of share, the Companies Law does not allow for different classes of share. Article 227 of the Companies Law specifically states that the share capital of LLCs must consist of equal shares and Article 245 provides that each shareholder must have a number of votes equal to the number of shares it owns or represents.

Side Agreements

In order to overcome a foreign investor's lack of control over an LLC and attempt to protect its investment, a custom has developed pursuant to which foreign investors enter into side agreements with the UAE national that holds 51% of the LLC's shares. One such agreement is a trust and sponsorship arrangement, pursuant to which the UAE national agrees to act as trustee and hold 51% of the shares of the LLC for and on behalf of the foreign investor as the beneficial owner thereof. Another side agreement is a loan and pledge arrangement, pursuant to which the shareholders enter into a loan and pledge agreement which provides that the foreign investor will contribute the UAE national's 51% share of the minimum share capital of the LLC and pledge its shares and all rights attaching thereto to the foreign investor as security for the loan.

The common characteristics and aims of these side agreements are generally as follows:

- The UAE national is paid an annual sponsorship fee;
- The foreign investor contributes the entire minimum statutory required share capital; and
- The UAE national is not involved in the LLC or its day-to-day management.

The enforceability of such side agreements is not certain and the prudent view is that a UAE court will view such side agreements as an attempt to circumvent Article 22 of the Companies Law.

Anti-concealment Law

The Law on the Combating of Commercial Concealment (17/2004) which was published in November 2004 in *Federal Official Gazette* 422, aims to criminalize the practice of enabling a non-UAE entity to conduct an economic or professional activity which is prohibited by UAE law. This will include where the activity is conducted on its own account or in participation with a third party, and where assistance is rendered to a foreigner to avoid its obligations. Thus, the law appears to target the arrangements put in place by side agreements.

Article 2 of the law specifically prohibits a UAE national from concealing a foreigner or allowing a foreigner to use his or her name or licence. A UAE national who contravenes the law faces a fine of up to Dh100,000 (per concealment) for a first offence and a maximum prison sentence of two years, and an additional Dh100,000 for each repeated concealment. The foreigner will be subject to the same penalties and deportation after serving the prison sentence. In addition, a conviction will result in the revocation of the UAE national's licence and a ban on carrying out the activity listed on the licence for a period of two to five years.

Indications are that the decision to set November 15 2007 as the law implementation date was aimed at allowing sufficient changes in legislation to provide improved protection for both UAE businesses and foreign investors in the absence of side agreements. These legislative changes, which have not yet been introduced, are expected to include amendments to the Companies Law which would allow foreign investors increased ownership of certain business forms and in certain industries in the United Arab Emirates, in line with recent recommendations of the World Trade Organization. Recent media reports have quoted Minister of Economy Sheikha Lubna Al Qasimi as stating that amendments to the Companies Law would open up certain areas within the services sector to 100% foreign ownership. Without such legislative amendments, foreign investors may be discouraged from investing in the United Arab Emirates and existing investors may reconsider their activities in the United Arab Emirates. This in turn would negatively impact on the UAE economy due to the effect on UAE businesses as well as the loss to UAE nationals of income generated by sponsorship fees.

Postponement of Law's Implementation

Cabinet Resolution 22912/2007 has now postponed the implementation of the law until December 31 2009. Recent statements in the media which have been attributed to representatives of the Ministry of Economy indicate that the decision to postpone the implementation of the law is linked to the fact that the necessary amendments to the Companies Law have not yet been made and that these amendments will be phased in over a period of time.

Alternatives to Side Agreements

Foreign investors would be well advised to discuss alternatives to side agreements which would not fall foul of the law and would avoid, as far as possible under UAE laws, prejudicing their investment in an LLC upon implementation of the law in 2009. Such alternatives could include elements of the following:

- According to Article 227 of the Companies Law, the profits of the LLC must be distributed *pro rata* to the shareholders, unless the memorandum of association provides otherwise. The shareholders may thus agree to a distribution of profits which does not reflect their shareholding proportions and thus allows the foreign investor to receive more than 49% of the profits. Article 18 of the Companies Law prohibits the memorandum of association of an LLC from depriving a shareholder entirely from a share in the profits of the LLC, and the authorities in Dubai currently allow a maximum distribution of 80% of the profits of an LLC in favour of a foreign shareholder.
- Management control of the LLC could be achieved by the foreign investor being appointed as manager in the memorandum of association and a notarized management agreement being executed between it and the LLC.
- In addition to matters which by law require the consent of shareholders representing no less than 75% of the shares, the

shareholders could include in the memorandum of association additional reserved matters which would require such a majority instead of a simple majority, which the 51% UAE national shareholder could achieve.

The alternatives to side agreements to be considered by foreign investors could be affected by the expected changes to the Companies Law. Foreign investors should look to their legal counsel to propose solutions best suited to their particular needs and the industries in which their LLCs operate, taking into consideration the amendments to the Companies Law when they are promulgated and implemented.

For further information on this topic please contact Pier Terblanche at Key & Dixon by telephone (+97 14 332 3324) or by fax (+97 14 332 3325) or by email (pier.terblanche@keydixon.com).

Endotes

(1) These are: limited liability company, public joint stock company, private joint stock company, general partnership, simple commandite company, private unlimited company and share commandite company.

Comment or question for author

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