Minority shareholder protections in the UAE

AFRIDI & ANGELL
LEGAL CONSULTANTS

Emirates Towers Offices, Level 35
Sheikh Zayed Road
Dubai, United Arab Emirates
Tel: +971 4 330 3900
Fax: +971 4 330 3800
Email: dubai@afridi-angell.com
www.afridi-angell.com

By James Bowden, Afridi & Angell

Foreign investors have long struggled with the 51% local ownership requirement under UAE law. The goal has always been to devise ways of approximating 100% beneficial ownership by the foreign minority shareholder while still satisfying the local ownership requirement.

This has been a feature of the UAE corporate landscape for so long that those familiar with doing business in the UAE seem to have become complacent, waving away the fundamental fact that they are only minority owners of what they view as their wholly owned entities with vague references to "side agreements" or "scheme documents" that have become the norm when structuring minority protections in UAE limited liability companies (LLCs), by far the most common vehicle for foreign investment in the UAE.

'Side agreements'

Briefly, the so-called "side agreements" are a set of documents pursuant to which a UAE national who owns 51% of an LLC agrees to transfer all of the economic benefit and control over those shares to the foreign 49% shareholder (or its nominee), creating a plausible commercial construct to make the arrangements appear legitimate (when in reality the construct is entirely false), thereby giving them a better chance at enforcement by a UAE court if challenged.

These documents are a good idea, but no legal adviser in the UAE will ever give a clean opinion on their enforceability, and every UAE law firm qualifies its advice with phrases like "These agreements have not been tested in UAE courts, and their enforceability may be subject to challenge." This means that no one is sure how a court would deal with the agreements. For many, this is simply not a sufficient level of comfort, so it is worth knowing what options exist.

Some options available to improve a foreign minority shareholder's position are summarized below.

Four options

(1) Avoid the problem altogether by establishing a UAE branch of a foreign company rather than a UAE LLC. The branch will require a UAE national agent to be appointed, but the agent does not have any ownership or management rights in the business of the branch. This is a good option when a UAE-based legal entity is not required, and when the licensed activities being sought are not restricted to LLCs or joint stock companies (e.g. some oil and gas or trading activities, and some more regulated ones like certain financial or telecom activities).

(2) Consider appointing a corporate service provider as the UAE national shareholder. Such providers offer the services of companies that are wholly owned by UAE nationals, for a fee. Since this is their primary business, they sponsor many companies and rely on their reputation for continuity of business and therefore have a strong interest in ensuring that the UAE national shareholders in their employ honour their agreements to be silent non-participating shareholders. These arrangements also involve the usual side agreement structure and cost about 25% more in annual fees than arrangements with individual UAE nationals.

(3) Another structure involves the majority interest in the LLC being held by a further UAE LLC, in which the foreign shareholder owns a minority interest. The advantage of this structure is that the minority shareholder can control the management of the "shareholder LLC" if structured correctly, and this would be set out in the notarized constitutional documents of the shareholder LLC, and therefore reliably enforceable. The minority shareholder would also enter into certain side agreements with both the LLC and shareholder LLC to help strengthen its position, but the reliance on side agreements is substantially reduced. This structure is more expensive since it requires the formation of two LLCs.

(4) Some relatively new structures are making creative use of Dubai International Financial Centre (DIFC) trusts, which transfer beneficial ownership in a manner compliant with UAE law. As with any other structure, there is no guarantee that a UAE court would uphold such structures if challenged, but they are ostensibly better than conventional structures. This option would be more expensive to put in place than any of the options discussed above.

Conclusion

Options 2, 3 and 4 are simply various attempts to circumvent a requirement of UAE law, and as such, none of them should be considered foolproof. The most useful steps you can take are those which ensure that you will not need to rely heavily on those arrangements. Control the LLC's management, control its bank accounts, and try to keep the assets controlled by the LLC to a minimum so that if an ownership dispute arises there is little to lose.

James Bowden is a partner at Afridi & Angell, a UAE-based law firm with offices in Abu Dhabi, Dubai, the DIFC and Sharjah.