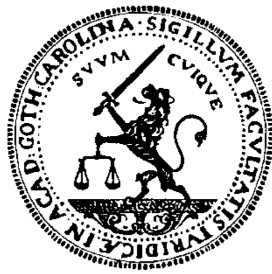

FACULTY OF LAW
Lund University

Anna Vallander

Relaxing or Constraining Foreign Ownership Structure in the United Arab Emirates

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Summary

This essay covers the subject of foreign ownership restrictions in LLCs in UAE mainland. In the beginning the study will guide us through an overview of the incorporation process and recognized company structures, which further specifies the differences between free zone and mainland. Accordingly, the study narrows down to focus on mainland LLCs, where the 49/51 rule, which restricts foreign investors to own more that 49% of a company in UAE mainland, will be presented.

As the restriction on foreign ownership rights often results in conflicts between concerned shareholders, the paper investigates strategies to resolve such disputes. What we find is that conflicts between a foreign owner and a local owner usually origin in the ownership structure. The problem is to determine which is the "valid" structure: is it the registered structure (accordingly with the 49/51 rule)? Or, is it a different structure agreed in a separate contract, i.e. *side agreement*? Side agreements usually stand as an affirmation of trust to specify that the UAE shareholder is not in fact the real owner of 51% share capital but rather the agent holding the same for the benefit of the foreign shareholder. Several studies are included to provide diverse conclusions and perspectives on foreign ownership restrictions, and a significant passage through case law presents deliberations of side agreement's "validity".

UAE's legal development in terms of the New CCL and the Anti-Fronting Law is then identified and explained. While the New CCL aims to relax foreign ownership restrictions in certain sectors, the Anti-Fronting Law's target is to prohibit side agreements. It is found that the UAE will face a period of thoughtfulness, as it is necessary to find a balance between the country's intentions of attracting international capital whilst ensuring a central role for UAE nationals in the domestic economy.

It is also discovered that prohibiting side agreements could have a rather harsh impact on minority shareholders, who often relies on such arrangements. This further strengthens the support against the adoption of the Anti-Fronting Law.

Ultimately, the thesis will outline advantages and disadvantages while considering if foreign ownership structure should be restricted or relaxed in light of the two new laws and of side agreements. It is determined that the New CCL's positive implications overtake the negative aspects. Side agreements are proven valuable tools, if it keeps all parties satisfied and reflects the true agreement. Evidentially, it is found that the there should be no adoption of the Concealment Law. Focus should lie on the New CCL, providing relaxed ownership structure toward foreign investors. Side agreements should instead be acknowledged along with the 49/51 rule in the New CCL.

Sammanfattning

Denna uppsats behandlar restriktioner för utländskt ägande i aktiebolag i Förenade Arab Emiraten (UAE). Till en början kommer studien att guida oss genom en översikt av bolagsetablering samt bolagsstrukturer i landet, vilket sedermera leder till att specificera skillnaderna mellan frizon och fastland. Följaktligen avgränsas studien för att snävare fokusera på aktiebolag i fastlandet. Här presenteras ”49/51 regeln”, vilken begränsar utländska investerare att äga mer än 49 % i ett sådant bolag.

Eftersom en restriktion av utländsk äganderätt ofta resulterar i konflikter mellan berörda aktieägare, undersöks olika strategier för att lösa sådana tvister. Vad vi finner är att konflikter mellan en utländsk aktieägare och en lokal aktieägare ofta har sitt ursprung i just ägarstrukturen. Problemet är sålunda att avgöra vilken struktur som är den gällande: är det ägandestrukturen som har registrerats hos myndigheterna (i enlighet med 49/51 regeln)? Eller, en annan, olik, struktur som överenskommits i ett separat kontrakt, dvs. *sidoavtal*? Sidoavtal mellan aktieägare i UAE utgör ofta en bekräftelse på att den lokala aktieägaren i själva verket inte är ägare till 51 % av aktiekapitalet, utan snarare en ”agent” innehavande samma ägandeandel till förmån för den utländska aktieägaren. Ett flertal studier analyseras och bidrar till olika perspektiv gällande ägarerestriktioner och en betydande vandring genom rättspraxis presenterar diskussioner och beslut gällande sidoavtal.

Följaktligen genomgår uppsatsen UAE:s rättsliga utveckling i förhållande till *the New CCL* och *the Anti-Fronting Law*. Medan *the New CCL* bland annat syftar till att minska restriktioner för utländskt ägande i vissa sektorer, är *the Anti-Fronting Law:s* mål att förbjuda sidoavtal kringgående 49/51 regeln. Resultatet visar att det blir nödvändigt för UAE att, i ljuset av dessa två lagar, finna en balans mellan landets avsikt att attrahera internationellt kapital och samtidigt bevara en central roll för lokala medborgare i den inhemska ekonomin. Vidare framför studien att ett förbud mot sidoavtal*,* i syfte att undkomma 49/51 regeln, kan ha en relativt drastisk påverkan på minoritetsägare som ofta förlitar sig på sådana uppgörelser. Detta påvisar bland annat stöd emot antagandet av *the Anti-Fronting Law*, samt en positiv inställning till sidoavtalets existens.

I slutändan utvärderas fördelar och nackdelar med restriktioner av utländskt ägande. Detta skildras i bemärkelsen av de två nya lagarna samt i betydelsen av *sidoavtal*. Vi finner att *the New CCL:s* positiva verkningar övertar de negativa aspekterna. Sidoavtal bevisas var en fungerande metod; om alla parter hålls nöjda samt om sådana avtal återspeglar den verkliga ägandestrukturen. Följaktligen resoneras att *the Anti-Fronting Law* inte bör implementeras. Fokus torde istället ligga på *the New CCL* som syftar till att minska restriktioner för utländskt ägande i vissa sektorer. Sidoavtal bör erkännas tillsammans med 49/51 regeln i *the New CCL*.

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Anna Wallander

Abbreviations

AED	Emirati Dirhams (UAE currency)
CCL	Federal Law No (8) of 1984
New CCL	Amendment to Federal Law No (8) of 1984
Civil Code	Federal Law No. (5) of 1985
DFSA	Dubai Financial Services Authority
DIFC	Dubai International Financial Center
FDI	Foreign Direct Investment
GAO	The General Accounting Office
GCC	Gulf Cooperation Council
Jafza	Jebel Ali Free Zone Authority
LLC	Limited Liability Company
MOA	Memorandum of Association
UAE	United Arab Emirates
US	United States
USD	United States Dollar

1 Introduction

Full foreign ownership of companies in the United Arab Emirates (UAE) is only allowed in designated areas known as free zones that are designed to encourage foreign investments in the country.[1] Outside these areas, 'UAE mainland,' all locally formed limited liability companies (LLC) must by law be owned by at least 51% (49/51 rule) by a UAE national or a locally owned entity.[2]

Foreign investors in the UAE regularly circumvent the 49/51 rule by entering 'side-agreements' with local sponsors.[3] These eliminate the powers and rights of the majority shareholders of a company leaving the foreign party as the 'actual' owner.[4] The Dubai Court of Cassation has several times acknowledged side agreements upon documented proof, but a recent case by the Federal Supreme Court dismissed such arrangements, creating an uncertainty whether side agreements are legally permissible in the UAE.

In 2004, the Federal Council of the UAE tried to prevent side agreements by introducing the Federal Law No. 17 ("the Anti-Fronting Law") whose purpose it is to avoid all arrangements conflicting with UAE's federal laws.[5] But the adoption of the Anti-Fronting Law has been put on hold by the government, pending the implementation of a new Companies Law (New CCL),[6] which aims to relax restrictions on foreign ownership structure. The New CCL is planned to be implemented by the end of 2013.[7]

These legislative changes must balance the national and cultural concerns of the nation, such as to promote an increased role of Emirati nationals to partake in the country's economy (the local citizens make up to less than a fifth of the population).[8] This is supposed to uphold the recognition of the UAE's culture as well as to build domestic know-how in line with the fundamental principles set forth in the UAE Vision 2021.[9]

Accordingly, this study will analyze how the UAE government should move forward with these legislative changes as well as conflicting interests. The pressure for judicial transformation is tangible from several distinctive standpoints, and as time passes, concerned actors awaiting the legal reforms will increase the pressure on the authorities to speed up the legislative changes.

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[1] Arab Center for the Development of the Rule of Law and Integrity (2008) p 50 f.
[2] *UAE mainland is the territory that falls outside the free zones*, Noor and Anani (2012a).
[3] *Side agreements are contracts between a company's related shareholders, often internally referred to on top of the registered MOA,* Hadef & Partners. (2010).
[4] Khodeir and Wallaman (2010).
[5] Smith (2010).
[6] Amendment to Federal Law No (8) of 1984.
[7] Al-Shukairy (2013).
[8] World Bank (2013).
[9] UAE Vision 2021; Williams (2011).

1.1 Background

Forty years ago the UAE was one of the least developed nations of the world. Today, it has reached an income level equivalent to that of the industrialized nations, without passing through the hypothetical progress "stages" that most developed countries have faced.[10] Since its formation in 1971, the country has witnessed dramatic changes using the revenues from its oil and gas production to finance major infrastructural developments. As a result, the nation has become a major business hub in the Middle East.[11]

In the wake of the financial crisis, foreign direct investments (FDI) collapsed in 2007 and declined steadily until 2009.[12] Despite offering a tax-free business environment and an excellent physical infrastructure, the UAE has fallen behind in its plans to liberalize the economy. However, recent government initiatives, e.g. economic policy reforms, modernized foreign investment regulations, and a multicultural lifestyle, have resulted in economic growth. These schemes are thus anew contributing to attract FDI according to the country's ambitions.[13]

Knowing how quickly, in its relatively short history, the UAE has developed its business environment; it makes sense that the legal framework has not yet progressed as far. The result is a nation highly attractive for foreign investors, but with poor legal security, often related to the 49/51 rule.[14]

1.2 Research Objective

This thesis examines foreign ownership restrictions of LLCs in UAE mainland. The purpose is to investigate these restrictions in the light of side agreements, the Anti-Fronting Law and the New CCL. The idea is to balance the demand for a relaxed ownership structure with the intention of prohibiting side agreements and thus activating UAE nationals.

In order to take a position, three questions set forth to respond within this project:

- Main Question: Should the foreign ownership structure be relaxed or constrained in the UAE?
- Sub Question 1: How can a balance be found between the need to stay nationalized and the goal to attract foreign investors?
- Sub Question 2: What are the advantages of side agreements and should they be legally recognized in respect to ownership structures?

[10] Shihab (1997) p 249.
[11] Zayed University.
[12] Hasan (2010) p 50 f.
[13] Hasan (2010) p 48 f., 53 f.
[14] Ahnish (2012).

The main question is comparing advantages and disadvantages with the current foreign ownership restrictions in UAE mainland. It is taking into considerations the new legal reforms and habitual strategies of setting up a business in this area. The first sub question is looking into the balance between the country's aim of turning into a globally recognized business hub and thus attracting of FDI and the strive to remain nationalized by for example forcing private entities to entitle national Emiratis to a certain percentage of the employees. Finally, the second sub question takes notion on side agreements as whether or not they should be legally recognized. It will be discussed based upon the two former questions, both from the UAE's perspective and from foreign investors standpoint.

1.3 Methodology and Data

In order to meet the purpose of the thesis, the traditional *legal dogmatic method* is employed, which entails the description and analysis of different sources of law.[15] In this case, descriptions of the domestic laws and national case law will be used, which ranges from acts of primary and secondary law to the case law of the UAE Federal Supreme Court as well as the Dubai Court of Cassation. The principal case in this study, by the Federal Supreme Court, is designated "Case X" as a result of its unofficial stipulation.[16] Despite its standing, Case X has a central impact on this research as it contributes heavily to the discussion on side agreements.

To answer the questions presented in 1.2; this study further analyzes trade and investment data, which can be related to the UAE Federal Laws and the CCL in particular. Relevant reports and articles, mainly gathered from online databases, will be searched and applied throughout the study and references will be visibly marked when necessary. Four interviews have been carried out to fulfill the gaps whenever needed material has been inaccessible.

Since law firms have played a crucial role in the development of the country's legal system, they are an effective source in this study. Legal firms were the ones who first met with the foreign investors, recognized their needs and developed judicial solutions. The courts have learned and advanced from experienced lawyers coming to Dubai from all over the world.[17] Hence, information from the most prominent and well-established local law firms, known for being reliable and English-friendly, is central. The dependence on legal firms is furthermore a result of the deficiency of accessible material. Extensive discussions are limited and the developing stage creates a somewhat innovative situation. For instance, legal reforms established long ago in the West are not even on the agenda in the UAE

[15] *The legal-dogmatic method applies "within specialist analyses carried out in various areas of law",* Stelmach and Brozek (2006) p 9.
[16] Qudah (2013).
[17] Matthews (2013).

until recently, such as the soon-to-be-implemented Competition Law.[18] The reader should know that there are hardly any existing studies in the academic literature on the effect of ownership requirements in the UAE.[19]

Besides the area of law, the thesis also provides an economic approach to justify the legal development on foreign ownership structure in respect to UAE's economic progress. This is considered from both the foreign investors' and the UAE's perspective.

In order to have a clear picture of free zones v mainland, two supplementary documents will fill out the end of the study. *Appendix A* demonstrates a tablet of the recognized company structures, by the CCL, in UAE mainland. It also includes the branch and representative structures, which are not considered independent legal entities, but foreign investors frequently adopt them. *Appendix B* shows a list of all free zones in the UAE. It is distinctly showcasing that most free zones are based in Dubai, which has its origin in the Emirate's strive to be a global business hub.[20] In addition, there is also *Appendix C*, which explains why Case X cannot be named officially.

1.4 Delimitations

The legal changes in respect to the foreign ownership structure in this study concerns first and foremost LLCs. The discussion will only encompass other company structures initially and when relevant.

Naturally, the CCL will be of particular interest since it directly relates to FDI in UAE mainland. The Civil Code among other laws will therefore be mentioned only to a limited extent.

I will only study the foreign ownership structure in the UAE. It might be of interest to compare with other countries, but because the already extensive discussion within the UAE, the study could potentially be disorganized in a comparative research.

For the sake of clarity, the amendments of the CCL and the Anti-Fronting Law are not yet implemented, but will be discussed as if they are to be adopted. Even though there is no decided framework over the Articles in the amended CCL, it will be speculated to the same extent as other organizations, law firms and institutions grasp it.[21]

Moreover, there is an undoubted limitation of sources in regards to this subject. First there is the language barrier: despite that many translations are being made, translations are often not in exact harmony with the original

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[18] Freshfields Bruckhaus Deringer (2013) p 2.
[19] Azzam and Rettab (2011) p 16.
[20] Zayed University.
[21] Ahnish (2012).

Arabic scripts. Hence, it is crucial to be observant with translated laws.[22] Another reason is the age of the country, which leaves us with limited sources of material i.e. research work and legal praxis.[23] Therefore, I have primarily focused on analyzing the Articles in relevant laws. I have also received a lot of help from legal firms in the UAE, both from their published articles and through interviews. In addition, official numbers and figures are not unusually being scrambled and thus it is crucial not to push too much gravity on official numbers and instead consider them with precaution.

Finally, despite the importance of *licensing* in accordance with the incorporation process in the UAE, I will not refer to discuss this, as it tends to remove focus from foreign ownership structure.

1.5 Outline of study

This first chapter's introduction is followed by an overview of the incorporation process in the UAE, as well as the recognized company structures, which further specifies the differences between free zone and mainland.

The third section examines the concept of foreign ownership structure focusing on the restrictions, particularly the 49/51 rule. Interviews have been integrated to understand the strategies of how to overcome investors' disagreement and thus enhance shareholders cooperation in terms of side agreements. Several studies providing distinct conclusions are also included to stimulate the discussion and a passage through significant case law is being carried out.

In the fourth section, UAE's legal development in terms of the New CCL and the Anti-Fronting Law is identified and explained. The chapter provides an analysis on the balance between the potential legal reforms and scenarios where the laws will be implemented.

Section five describes the affect on minority shareholders as an outcome from the Anti-Fronting Law or any elimination on side agreements. Disputes between shareholders are emphasized on the background of Case X and an examination on the possibility to remove a minority shareholder is especially in focus.

The last section includes an analysis in regards to section 2-5 concentrating on the pros and cons with the adoption of aforementioned laws. The analysis intensely focuses on side agreements to investigate if such arrangements should be a part of UAE's legal development of foreign ownership structures. Most importantly, the analysis will take into consideration the three decided research questions trying to emphasize them as much as possible, and lastly my conclusions.

[22] Huda (2013).
[23] Azzam and Rettab (2011) p 16.

2 The Incorporation Process

2.1 Introduction

Among all jurisdictions, market economies in particular, business corporations have a fundamentally similar set of legal characteristics, which respond to the economic exigencies of the large modern corporation. These are: legal personality, limited liability, transferable shares, delegated management under a board structure, and investor ownership. Together they make the entity exceptionally attractive for organizing productive activity.[24]

All jurisdictions in well-developed economies have at least one core statute that establishes a basic corporate form with these five characteristics, usually and particularly to permit the formation of public corporations. For example, the French SARL, the German GmbH, or the American close corporation and limited liability company.[25]

The commercial company law in the UAE, the CCL, follows the theory of the legal personality of a company[26] and regulate the transfer of rights and obligations of shareholders.[27] It further recognizes the limited liabilities form,[28] delegate management under a board structure,[29] and permit investor ownership.[30] However the CCL does not recognize the concept of authorized but unissued shares, which is the case in many other jurisdictions.[31] This makes the UAE's limited liability company a *"partial corporate form"*, which can be used to form business corporations with all the five characters, though some by contract.[32]

Moreover, regarding the nature and number of corporate shareholders, it differs noticeably even among the most developed economies, which leaves a flagrant mark on the structure of corporate law. For example, in the US, many publicly traded companies have dispersed share ownership (e.g. no single shareholder).[33] In the UAE, in contrast, firms with publicly traded shares have a *controlling* shareholder (LLCs in UAE mainland, Article 22 of the CCL).

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[24] Kraakman and Armour with others (2009) p 5-6.
[25] Kraakman and Armour with others (2009) p 16-17.
[26] Once an LLC is registered in the Commercial Register, it will be considered an independent legal entity with corporate personality distinct from the shareholders. It will: have separate financial capacity, have the capacity to conduct its business within statutory limits and the ambit of its memorandum of association, and be able to sue and be sued in its own name (Article 12, CCL). In addition, a shareholder will be liable only to the extent of its share in the capital of the LLC, Article 218, CCL.
[27] Articles 218, 221 and 222, CCL; Al-Hemyari (2012) p 99-100.
[28] Articles 21 and 219, CCL.
[29] Article 235, CCL.
[30] Articles 17 and 22, CCL.
[31] Articles 218, 221 and 222, CCL.
[32] Kraakman and Armour with others (2009) p 17.
[33] Kraakman and Armour with others (2009) p 29.

Despite which form of corporate law a country relies on, the objective stays the same; to serve the interests of society as a whole. In other words, "to advance the aggregate welfare of all affected by a company's actions," including: shareholders, employees, suppliers, customers and third parties (e.g. banks, local communities and beneficiaries of relevant environment).[34]

2.2 UAE's Legal Environment

The UAE is a federation of Seven Emirates, each governed by an inherited *emir*, who chooses one of their members to be the leader of the federation.[35] The country is ruled both by federal laws (e.g. the CCL and the Civil Code), and by local laws determined by each Emirate. The federal laws have supremacy over the laws of the individual emirates.[36] A comparison can be drawn to the federation of the United States (US).[37]

The country's jurisdiction is based on Civil Law. It has been deeply influenced by the Egyptian legal system, which has its roots in French and Roman law. Islamic law, which is codified in the Shari'ah, is applied in family courts but is less evident in the commercial scope. The increasing presence of international companies from common law countries (particularly the United Kingdom and the US) has led to influences from common law codes in the commercial judiciary.[38] For instance, rulings by the UAE Federal Supreme Court may be useful for courts when judging in comparable cases; however, there is no doctrine of binding practices or *stare decisis* "to stand by things decided".[39]

In addition, The UAE Constitution permits each Emirate to have its own legislature, judges and courts.[40] All Emirates except Dubai and Ras Al Khaimah have chosen to operate their courts according to the uniform federal model (federal courts). Consequently, the Dubai Court of Cassation, which is the third and superior degree of litigation in the Emirate of Dubai's judicial system, provides the same affect as the Federal Supreme Court.[41]

It is relevant to mention the UAE Civil Code, as it will be reflected later in the thesis.[42] Entities formed under the Civil Code are limited to carrying out

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[34] Kraakman and Armour with others (2009) p 28.
[35] Hermansson (2013).
[36] Nishimura & Asahi. (2011) p 1.
[37] ***"****This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding",* U.S. Constitution, Art. VI, cl. 2.
[38] Nishimura & Asahi (2011) p 1.
[39] Arab Center for the Development of the Rule of Law and Integrity (2008) p 20.
[40] Nishimura & Asahi (2011) p 1; Articles 121, 122 of the UAE Constitution.
[41] Articles 173-188 of the Civil Procedures Law No. (11) of 1992, Law No. (3) of 1992 on the Formation of the Courts in Dubai, Federal Law No. (30) of 2005, amendment to Civil Procedure Code of 1992, Government of Dubai (Dubai Courts).
[42] Federal Law No. (5) of 1985 on Civil Transactions; Zurich General Insurance (2013) p

"non-commercial" or civil activities: for example, the practice of law, medicine and research activities.[43] The Civil Code is considered the father of laws in the UAE and will apply both when there is no specific legislation to the contrary, and when specific legislation is silent on a point of issue.[44] However, the Civil Code is rarely used in relation to foreign establishments and ownership structures,[45] as these cases primarily are subject to the CCL.[46]

The CCL set forth provisions governing conversion, merger and dissolution of companies. The law's most relevant provision in respect to this study is the 49/51 rule,[47] which for long has been an obstacle for foreign investors seeking to establish in the UAE. To solve this issue, the government has inter alia setup free zones around the country, mainly in Dubai, where foreign entities may establish with 100% ownership rights.[48]

It is necessary to divide free zones from mainland. In contrast to mainland where companies act under the federal laws and the CCL, companies within the free zones are not bound by the CCL. Instead, such regulations are enacted by each free zone. The only exception is the *Dubai International Financial Center* (DIFC), which has its own labor and civil laws.[49] The DIFC is an arrangement between the federal UAE authorities and the local authorities of the emirate of Dubai. According to this arrangement, the federal authorities agreed to discharge the DIFC from being subject to the federal civil and commercial laws.[50] As a result, the DIFC is the only free zone in the UAE settled from federal laws. Later we will see how the DIFC differ from other free zones and how its judiciary is set up.

787; *The UAE Civil Code, promulgated in 1985, adopted a different classification of companies than the Companies Law. "It provide for: "1 Work Companies: companies where two or more partners join together to perform specific work, 2 Persons' Companies: two or more persons join together to purchase goods on credit based on goodwill and reputation to sell such goods for a profit, 3 Speculative (Mudharaba) Companies: companies in which a person lends capital to another to carry out speculative business." The main difference between civil and commercial companies depends on the intention to trade and can be compared to the distinction made between a 'merchant' and 'investor'*, Mahmoud (2008) p 2 f.

[43] *"The attached Law shall have effect in respect of civil transactions in the State of the United Arab Emirates,"* Federal Law No. (5) of 1985; Business Laws of the United Arab Emirates (1987) p 2 ff.

[44] Business Laws of the United Arab Emirates (1987) p 1 f.

[45] Zurich General Insurance (2013) p 787.

[46] Lester and O'Keefe (2011) p 3.

[47] Arab Center for the Development of the Rule of Law and Integrity (2008) p 33-34; *"Observing that certain commercial activities are confined to nationals as provided in this law or in any other Law, every company incorporated in the state must have one or more nationals whose share in the company capital must not be less than (51%) of the company capital",* Article 22 CCL.

[48] Arab Center for the Development of the Rule of Law and Integrity (2008) p 50 ff.; *Free Zones are part of the country's territories but considered to be outside the customs territory and subject to customs control other than normal customs procedures*, Department of Economic Development.

[49] Arab Center for the Development of the Rule of Law and Integrity (2008) p 30.

[50] Arab Center for the Development of the Rule of Law and Integrity (2008) p 25.

Another exemption from the 49/51 rule is granted to nationals of the states of the Gulf Cooperation Council "GCC" (the UAE, Saudi Arabia, Sultanate of Oman, Qatar, Kuwait and Bahrain).[51] As an example, the UAE Federal Law no (2) of 1989 permits citizens of the GCC to conduct wholesale trade or industrial operations in the UAE without an Emirati partner. Yet, if the investor is a juridical person, it must be in the form of a company owned not less than 51% by UAE nationals.[52]

2.3 Company Structures

To understand foreign ownership structure in the UAE, it is necessary to analyze which incorporation structures that are available, both in free zones and in mainland. Several laws collectively address these business configurations, yet the most prominent to foreign investors establishing in mainland is the CCL under Federal Law No (8) of 1984.[53]

2.3.1 Establishing in Mainland

The table in *Appendix A* shows the major differences between company structures recognized under the provisions of the CCL. Of the seven entities listed, the majority of foreign businesses in mainland UAE choose to incorporate under the LLC structure as foreigners can exert significant control and because it requires a relatively small capital investment.[54] This is furthermore the reason why we have chosen to focus on LLCs.

LLC

In an LLC, shares should be distributed among all partners, maximum fifty and minimum two.[55] The objects should be specified in the Memorandum of Association (MOA).[56] It may contain any form of legitimate business, with the exception of insurance, banking, and investment of funds belonging to others.[57]

Despite the fact that a local partner must hold the majority shares in an LLC (49/51 rule),[58] a foreign partner can exercise absolute control over management decisions as long as it is stipulated in the MOA, either by

[51] *The Gulf Cooperation Council "GCC" signed the United Economic Agreement in Riyadh on 7 June 1981 (endorsed by the UAE in 1982), in order to harmonize and unify economic, financial, monetary, commercial and industrial legislations. According to article 4 of the GCC Charter, the ambition is deepening and strengthening of relations, links and areas of cooperation among their citizens.*
[52] Federal Law No. 2 of 1989; Al Tamimi & Company (2009) p 17.
[53] Zurich General Insurance (2013) p 786.
[54] Nishimura & Asahi (2011) p 9 ff.
[55] Article 218 CCL.
[56] Article 223 CCL.
[57] Article 220 CCL.
[58] Arab Center for the Development of the Rule of Law and Integrity (2008) p 33-34.

himself or through the appointed representatives,[59] which is one of the most central reasons why this structure is the preferred choice among foreign investors:

Article 237, CCL

"Unless the powers of the manger are fixed in the company Memorandum of Association, the company manager shall have full powers to carry out management affairs of the company, and his actions shall be binding on the company, provided that they are substantiated by the capacity under which he acts."

In addition, the proportion of profits and losses to be shared can be agreed separately by the partners, and do not have to reflect the proportion of the capital contribution (up to 80% to the foreign investor holding 49% of the shares).[60] Furthermore, if the UAE shareholder is an ineffective partner, ownership benefits might be circumvented through *side agreements* reflecting the "actual" ownership by the foreign shareholder. Such agreements can be recognized as a declaration of trust to specify that the UAE shareholder is not actually the real owner of the 51% share capital but instead the "agent" holding this percentage for the benefit of the foreign shareholder.[61]

Even if side agreements are not registered with any authority and not recognized by the CCL, the courts may acknowledge them. For example, the Dubai Court of Cassation in Case No. 2008/212 ruled that the ownership structure in a side agreements can be recognized as the "actual" structure between a company's shareholders, if the agreement is documented and can be introduced into evidence.[62] Although, a recent case dismissed such arrangements, creating an uncertainty as to if side agreements are legally permissible on LLC's in the UAE.[63] The method of circumventing CCL's required ownership structure through side agreements is a crucial and highly vibrant topic in the ongoing developments of the UAE legal system. Therefore we will come back to elaborate on this in chapter 3.

The only way to *legally* circumvent the required ownership structure, if you are not a citizen of the GCC, is by establishing in a free zone.[64] In 1998, the

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[59] *The manager shall have full authority to manage the Company and his actions shall be binding on the Company unless specific limitations are imposed,* Articles 235, 237 CCL.
[60] Arab Center for the Development of the Rule of Law and Integrity (2008) p 37; "*There is no law with respect to the maximum amount of profits that a local entity may distribute to a foreign shareholder. However, as a matter of local practice, the foreign shareholder may receive up to 85 per cent of the profits of a company incorporated in Abu Dhabi and the foreign shareholder may receive up to 80 per cent of the profits of a company incorporated in Dubai",* Lester and O'Keefe (2011) p 13.
[61] Arab Center for the Development of the Rule of Law and Integrity (2008) p 37-38.
[62] Case No. 2008/212.
[63] Case X.
[64] *There are around 20 free zones in Dubai alone, six in Abu Dhabi, two each in Ras Al Khaimah, Fujairah and Sharjah, and one each in Ajman and Umm Al Quwain. The number of free zones in Dubai dwarfs that of Abu Dhabi*, Dore (2012) p 73; *An independent Free Zone Authority governs each free zone, and is the agency responsible for issuing the free*

UAE Federal Law no (15) of 1998 amended the CCL with respect to companies established in the free zones,[65] stating that: "the UAE Free Zone Regulations may have their own Companies Law." For this purpose, the CCL and the free zone regulations contain conflicting provisions on several matters.[66] The most flagrant example is reflected in Article 22 of the CCL, saying that UAE nationals must own not less than 51% of a company, while in a free zone foreign investors assume 100% ownership of the registered entity and do not have to deal with a local partner.[67]

Article 22, CCL

Without prejudice to commercial activities reserved only to nationals, as may be prescribed herein or in any other law, it is a requirement for the establishment of a company to have one or more national partner(s) whose share in the company's capital is not less than 51%.

2.3.2 Establishing in Free Zones

The "free zone strategy", which offers full foreign ownership of companies in a tax-free environment, attracts multinationals to incorporate in the UAE.[68] The free zones are independent geographical and jurisdictional areas located around the UAE.[69] Most of them exist within the Emirate of Dubai, which is a result of Dubai's strategy to attract foreign investment and to become a regional business hub. Abu Dhabi, estimated to have control over 90 % of the country's oil resources have chosen not to invest in free zones as heavily.[70] *See Appendix B for a list over all free zones in the UAE.*

In contrast to the seven recognized company structures by the CCL in UAE mainland, free zones usually recognize three forms of establishment: (1) a branch office of a foreign principal company; (2) a Free Zone Establishment (independent legal entity with the foreign principal company or individual being the only shareholders); or (3) a Free Zone Company (similar to a Free Zone Establishment but with multiple shareholding).[71] The major benefits with establishing in a free zone are as follows:

- 100% foreign ownership
- 100% import and export tax exemptions
- 100% repatriation of capital and profits
- No corporate taxes

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zone operating licenses and assisting companies with establishing their business in the FTZ, Nishimura & Asahi (2011) p 4.

[65] Federal Law no 15 of 1998.

[66] Nishimura & Asahi (2011) p 51.

[67] Zurich General Insurance (2013) p 786.

[68] Nishimura & Asahi (2011) p 29-30.

[69] Zurich General Insurance (2013) p 786.

[70] Zayed University.

[71] Nishimura & Asahi (2011) p 4-5.

- No personal income taxes.[72]

The free zones are moreover divided into different sectors. For example, Dubai Media City focuses on licensing companies to undertake media related activities, and Dubai Healthcare City focuses on healthcare and life science related companies and organizations.[73] Each one has its own laws and regulations independently from the Federal Companies Law (CCL).[74] What they all have in common though is the allowance for foreign entities to establish without any involvement of UAE nationals.[75]

Nevertheless, an incorporated company in a free zone can only trade inside the free zone or internationally. If a free zone company wishes to sell a product to a company in UAE mainland, it must appoint a distributor or an agent to transport the gods from the free zone to the end customer.[76] For example, the Swedish-American water technology provider "Xylem" is established in UAE's largest free zone "Jebel Ali."[77] Xylem has its regional office in Jebel Ali and appointed distributors in the UAE, Saudi Arabia and Qatar in order to conduct business in these countries.[78]

As we can see, the opportunity to establish a legal presence in one of the free zones carries several economical advantages attracting foreign investors to the UAE, and perhaps the most sovereign of them all is the DIFC.

DIFC

The Dubai International Financial Centre (DIFC) is an "onshore" financial centre.[79] Unlike other free zones that are only independent from the CCL, the DIFC has a significant number of its own laws. For example, it has its own court system, its own stock exchange and a separate financial regulatory authority known as the Dubai Financial Services Authority (DFSA).[80] Entities formed within the DIFC are subject to a notably different legal and regulatory regime than those formed in other free zones.[81] Moreover, the laws inside the DIFC, which are principle-based (i.e. under a common law system), are modeled on the best practices of the world's major financial jurisdictions.[82]

The financial free zone has two distinct characteristics. First of all, it is a

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[72] Arab Center for the Development of the Rule of Law and Integrity (2008) p 50-51.
[73] Zurich General Insurance (2013) p 786; Dubai Media City; Dubai Healthcare City.
[74] Federal Law No. (8) of 1984.
[75] Zurich General Insurance (2013) p 786.
[76] Rao (2000) p 255 f.; Dore (2012) p 73.
[77] *Jebel Ali Free Zone Authority (Jafza) was established in 1985 and is today one of the world's largest free zones, spread over an area of 48 sq. kms and is home to over 6400 companies*, Jebel Ali Free Zone.
[78] Hermansson (2013).
[79] DIFC.
[80] *DIFC's international stock exchange, NASDAQ Dubai, is "a trading platform for structured financial products and, most recently, equity derivatives"*, Tarbuck and Lester (2009) p 12 ff.
[81] Nishimura & Asahi (2011) p 25, 43 ff.; Zurich General Insurance (2013) p 787.
[82] DIFC.

geographical zone, i.e. like all other free zones it has to exist in a particular area where the companies' activities must be conducted.[83] Another example of this geocentric emphasis is the requirement to *physically* exist within the boundaries of the free zone.[84] The second character belongs to the activities carried out in the DIFC. They are exclusively financial activities.[85]

Additionally, the jurisdiction of the DIFC Courts is limited to disputes where a DIFC company is a party, or to disputes arising out of a transaction carried out in the DIFC.[86] The courts shall have jurisdiction over "civil or commercial cases and disputes involving the Centre or any of the Centre's Bodies or any of the Centre's Establishments".[87] As a result, the DIFC Courts can neither accommodate claims not involving the DIFC entities, nor non-financial claims.[88]

The difference between incorporating in a free zone and in mainland is central for foreign investors seeking to establish in the UAE, particularly in respect to requirements on ownership structure. We now know that companies in free zones can be 100% foreign owned, and that companies in mainland are restricted to 49%. The latter demonstrates the major issue to be discussed in this paper.

[83] *Article 2(2) of the Federal Law no (8) of 2004 states that the location of a "financial free zone shall be established by a Federal decree", and thus the boundaries of the DIFC were kept within the federal authorities' powers and not to the individual emirates as an indication of the limited scope that these zones should have*, Arab Center for the Development of the Rule of Law and Integrity (2008) p 25.
[84] Article 4(5) of the Federal Law no (8) of 2004.
[85] Articles 1, 3 and 7(3) of the Federal Law no (8) of 2004.
[86] Article 8(2) of the Federal Law no. 9 of 2004.
[87] Article 5(A)(1)(a) of Law no (12) of 2004.
[88] Arab Center for the Development of the Rule of Law and Integrity (2008) p 27; Federal Law No. 8 of 2004.

3 Foreign Ownership Rights

3.1 Introduction

Foreign investment is fundamental for the UAE's economic growth due to the country's inexpert and small population.[89] Major indications are the free zones and the fact that no personal or corporate taxes are applicable in the country.[90] At the same time, the absence of security among foreign companies, often related to the 49/51 rule, creates a fear to invest as there are no clear exit strategies. According to Mr. Smith, "Foreign ownership restrictions have been the greatest single impediment to foreign direct investment (FDI) in the Gulf region."[91]

This section examines constraints on foreign ownership rights in mainland LLCs in the UAE. We will study potential conflict scenarios as well as resolutions, where one of the major discussions to be brought up is side agreement.[92] Additionally, we will review findings in different studies and examine case law in respect to side agreements.

3.2 The Source of Restrictions

The restrictions on foreign ownership often depend on how 'strategic' or 'sensitive' a specific sector is to the country's economic growth or national security. The infrastructure and defense sectors normally have tighter restrictions, while the retail sector tend to be more relaxed. Other restrictions, such as requiring domestic firms to take a major part in the ownership (i.e. joint ventures) are meant to "tilt the distribution" of FDI project rents in favor of locals.[93]

Restrictions applicable to companies' structures in mainland UAE, outlined in Appendix A, generally prescribe that the principal office must be in the UAE; at least two shareholders must own the company; and UAE nationals must control at least 51% of the company.[94] However, constraints on foreign ownership are nothing unique to the UAE. These restrictions are seen all over the world, ranging from absolute prohibition to limiting the share of foreign ownership.[95] For example, the US require their nationals to hold the majority of shares in the airlines and shipping industries; Japan requires the same in telecommunications, and Iceland bans foreign ownership in the

[89] Shihab (1997) p 251 f.
[90] Nishimura & Asahi (2011) p 21.
[91] Smith (2010).
[92] Arab Center for the Development of the Rule of Law and Integrity (2008) p 37-38.
[93] Asiedu and Esfahani (1998) p 647 ff.; Azzam and Rettab (2011) p 2.
[94] Appendix A.
[95] Azzam and Rettab (2011) p 2.

energy and fishing industry.[96] In developing countries, restrictions are often upheld in electricity, telecommunication, transportation and financial services.[97] For example, in the UAE the telecommunications sector is monopolized by the government and divided into two organizations: du and Etisalat.[98] This is probably an outcome from the fact that these service sectors are strongly connected to a country's economy growth.[99]

3.2.1 Favoring Native Citizens

There is a fear in the UAE that FDI will grow too strong and eliminate wealth from the local population. Favoring the native citizens is therefore not a surprise action in the UAE. After all, the population makes up less than a fifth of the country's estimated 9.2 million residents and the ambition to preserve their heritage is strong.[100] Consequently, the UAE is taking actions to protect the domestic economy from potentially destabilizing capital flows as well as from an increasing foreign competition.[101] An indication of this is illustrated in the UAE's federal laws, where "Emiratization" (set quotas for UAE Nationals) is required in companies.[102] During 2002, the official unemployment figured among UAE citizens was at 16% and estimated to rise.[103] In response, the Emirates' rulers initiated the Emiratization programme to replace professional expatriate workers with national Emiratis. Hence, the programme is dedicated to find meaningful and empowering employment for UAE citizens to wane off foreign dependency.[104]

The lack of national workers, especially in the private sector, leads to serious skill and knowledge gaps among UAE citizens, which further generates a dependency on foreign know-how.[105] This presents a major obstacle for the UAE government to accomplish its strategic objectives of a more diversified and sustainable economy, as defined in the Dubai Strategic Plan 2015,[106] and in Abu Dhabi Economic Vision 2030.[107] At the same time, several international development circles state that restrictions on FDI are unproductive. In fact, many countries scale up their efforts to *attract* FDI,

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[96] Golub (2003) p 7.
[97] Golub (2003) p 17.
[98] *From 1976 to 2006 the Emirates Telecommunications Corporation (Etisalat) was the only telecommunications provider for the UAE. Exceptions were allowed in free zones and modern housing developments. In February 2006 the new telephone company and Internet Service Provider, du, was established to offer mobile services across the UAE and Internet and TV services to some free zone areas, and thus the monopoly became a duopoly,* Peterson (2007).
[99] Golub (2003) p 25.
[100] World Bank (2013).
[101] Godwin (2006) p 8-9; Azzam and Rettab (2011) p 2.
[102] Emiratization plan (2009-2012).
[103] Godwin (2006) p 9; Stevens (2002).
[104] Williams (2011).
[105] Hermansson (2013).
[106] Dubai Strategic Plan 2015.
[107] Abu Dhabi Economic Vision 2030.

which can be seen from the continuing liberalization of FDI policies.[108] For example, the authorities in Taiwan Province of China have lifted restrictions on direct investment into the mainland. The $50 million ceiling on individual projects has been removed and approval for investments of less than $20 million is now automatic. In 2002, the authorities also lifted the ban on investments in notebook computers, third generation mobile phones and consumer electronics products in the mainland.[109]

3.2.2 Paradoxical Studies

Over the past three decades, there have been more measures in developing countries to liberalize rather than to restrict inward FDI.[110] For example, in May 2003, the US President George W Bush proposed amending legislation to relax foreign ownership restrictions in US airlines by raising the permissible foreign ownership limits of voting stock from 25% to 49%.[111] Although, the resolution did not pass it resulted in the General Accounting Office study (GAO study) completed at the request of members of Congress.[112]

The most interesting outcome from the GAO study concerns *domestic competition*. The study stated that greater access to foreign capital would allow US airlines to enhance their domestic competitive position. This simply means that having access to additional sources of capital opens more avenues to seek capital.[113] This makes sense in the UAE, which has a rather small population, but also a strategic plan to become one of the worlds most important investment hubs. If the UAE seeks major capital investments only from domestic sources, they could be eliminated from a large segment of the world's capital markets.[114]

It is widely argued that superior productivity of foreign-owned firms over domestically owned firms is one of the major benefits of FDI.[115] This claim refers to the *general theory of internationalism* confirming that foreign-owned companies that enter into an unfamiliar economy must be "in possession of some ownership specific advantage, such as better product, more efficient production/marketing skills or an established brand name."[116] This would mean that the impact on productivity is positive only if joint ventures are unrestricted, indicating that companies limited from foreign

[108] Asiedu and Esfahani (1998) p 656; Azzam and Rettab (2011) p 2.
[109] UNCTAD (2002). P 58.
[110] Agosin and Machado (2007) p 1235 ff.
[111] *The amendment was an element of Vision 100 – the Century of Aviation Reauthorization Act, affecting several divisions of aviation support and strategy,* GAO-04-34R (2003).
[112] *GAO was asked to consider two topics: (1) "current proposals to revise U.S. limits on foreign ownership and control, including information on current shareholders and past examples of efforts by foreign interests to purchase significant equity in U.S. carriers, and (2) whether key analytical issues raised it the GAO's 1992 report on foreign ownership and control remain relevant",* Furlan (2006) p 25.
[113] GAO-04-34R (2003) p 7-8, 29.
[114] Furlan (2006) p 26.
[115] Bellak (2004) p 487 f.
[116] Karpaty (2007) p 242.

ownership are less productive.

From a different perspective, Azzam proves in his research that generalizations about the superior performance of foreign-owned firms (i.e. the *general theory of internationalism*) should be taken with cautiousness. His research estimates productivity gaps between entities with different shares of foreign equity. When comparing firms operating under the 51/49 rule in the UAE, he finds them just as productive as firms under full foreign ownership in the majority of sectors. The most expressive exception is the trading sector where foreign owned firms usually provide better results. The study concludes that foreign ownership is not necessarily the most important determination of productivity gaps between locally owned and foreign owned firms in the UAE. It could even be insignificant when also considering e.g. sectorial differences, co-existence of free zones and customs territory. Great thoughtfulness should therefore be considered before sweeping generalizations in favor of amending the 49/51 rule.[117]

In addition, a research made by Asiedu and Esfahani shows that ownership structure depends on the productivities of the investing transnational enterprise's assets, local entrepreneurs' capabilities and the host country's infrastructure and institutional setting. They suggest that removing equity restrictions may have little effect in the improvement for foreign investment, and that a more effective way of attracting foreign investment is to improve the country's physical infrastructure. If the business environment for instance is appealing to foreign investors, the host government's wish to retain larger excesses in the country strengthens, and the pressure for local equity participation increases.[118]

Here we have analysis promoting the removal of restrictions, and others encouraging the opposite. Despite in which direction the UAE's legal development will finally lead, there will undoubtedly remain dissatisfaction among certain groups. Even though restrictions on FDI are considered unproductive according to the *general theory of internationalism*, there are indications that the UAE will be vigilant about opening up the economy to foreign investors.

3.2.3 Shareholders Disagreements

Disagreements between shareholders are not unusual, not least in regards to requirements on a country's ownership structure. For example, if the *nominee shareholder* (the majority owner) wish to enhance his share of the economic interests, or increase his participation in the company's operations.[119] To provide a clearer understanding, I have looked into typical fractions behind such conflicts, where Sameer Huda (Hadef & Partners)[120]

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[117] Azzam and Rettab (2011) p 17.
[118] Asiedu and Esfahani (1998) p 659.
[119] Hadef & Partners (2010).
[120] Huda (2013).

and Samer Qudah (Al Tamimi & Company)[121] have assisted with examples of situations.

One of the most common indications of conflict, according to Huda, appears when the UAE shareholder has requested an increase in his or her annual "sponsorship fee".[122] In such a case, the UAE shareholder probably wants to review the financial statements to find out whether he or she might be entitled to a higher cut. Huda further indicates that disagreements are common if the UAE shareholder finds out that the foreign investor is considering replacing him or her with another shareholder, which could be a result from the local partner's laziness and unwillingness to cooperate.[123]

Qudah, meanwhile, refers to a recent case where the majority owner (UAE shareholder) unexpectedly passed away. The heirs of the dead owner claimed ownership of the 51% shares as well as a share of the profits and management rights of the company, which they had rights to according to Articles 233, 283 and 22 in the CCL. This situation typically brings conflict to the surface, as the foreign owner does not expect a third party to inherit these rights nor to become his new partner. Many times, foreign investors are not aware of such rules prior to entering a partnership agreement. Instead, foreign shareholders are often too attracted by the business friendly and tax-free environment offered in the UAE, and thus end up in problematic situations that could have been avoidable.[124]

Additionally, St Valery at the Links group has stated the following scenario: "There have been instances that we have dealt with where a business has been successfully built up by a foreign party with no interference from the local partner over a three-to four-year period," he says. "Then the local partner has come in and said, 'Thank you for running my business, you can go now, I am getting another partner.' Literally as quickly as that, because the right documentation had not been put in place. If you are cutting corners in the beginning, these things can go horribly wrong if you are not well-protected."[125]

Other situations indicating conflicts can additionally be attached to routine corporate requirements, for example, renewal of trade licenses or renewal of residency visas.[126]

In the demonstrated scenarios, we can conclude that the matter of ownership structure is constantly present and somewhat outlines the source of each conflict; whether it concerns the sponsorship arrangement, the replacement

[121] Qudah (2013).
[122] *In order for a foreign shareholder to even reside in the UAE, a local sponsor must provide him or her allowance to register with the authorities. In a corporation's agreement between a national shareholder and a foreign shareholder, the sponsor normally represents the local shareholder acting as the employer of the firm,* Ministry of Labour and Social Affairs.
[123] Huda (2013).
[124] Qudah (2013).
[125] MEED (2011).
[126] Qudah (2013).

of a partner, third parties rights and more. When resolving shareholders disagreements, it will correspondingly be a matter of restructuring or renegotiating the company's ownership arrangement.

3.2.4 Strategies Resolving Disagreements

According to Hadef & Partners, there are three primary ways to prevent conflicts: through friendly settlements, negotiations, or by filing a case with the court.

First and foremost, the foreign investor should focus on establishing and maintaining "friendly settlements." For example, if the foreign investor is satisfied in his or her partnership and wishes to continue operating with his existing UAE shareholder, the foreign investor should consider to regularly *renegotiate* existing contractual terms. By amending the notarized Memorandum and Articles of Association on a regular basis, chances that both parties are satisfied with terms and conditions of their contract and each other will increase. Another friendly settlement could be to notarize a *power of attorney* where the UAE shareholder bestows execution rights upon the foreign partner.[127] However, there is a risk that the UAE shareholder could cancel such a power of attorney, as the concept of a binding power of attorney is not yet recognized under UAE law.[128]

Side agreements represent an additional option to reach a friendly settlement. It may for example contain provisions where the UAE shareholder approves that he did not contribute with financing the share capital of the company and thus have no right to claim profits, trade name, assets, or other benefits of the company.[129]

If a friendly settlement is not an option, a dispute can be resolved through "negotiation" with the UAE shareholder on mutually agreed lump sum compensation. The foreign investor typically does this to encourage the local shareholder to transfer his 51% of shares to a new local shareholder.[130]

In case all friendly and negotiable settlements eventually reaches a dead-end, the foreign shareholder could consider filing a case with the court to request *involuntary liquidation*. Such liquidation is only possible if the company has suffered losses up to at least 75% of its capital, or, if the disagreement between shareholders makes it unmanageable to carry out the business and thus comply with the company's objectives.[131]

Shareholders disagreement must be managed accurately, preferably not only

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[127] Hadef & Partners. (2010).
[128] *The UAE law contains no provisions, like in other legal systems, whereby a party contracting with a company in good faith is allowed to assume that the contract is validly completed, and thus a person who signs a contract must prove that he is entitled to do so,* Brawn (2013).
[129] Arab Center for the Development of the Rule of Law and Integrity (2008) p 38.
[130] Hadef & Partners. (2010).
[131] Articles 281, 289 CCL; Hadef & Partners. (2010).

after a dispute has arisen but also preventively. Huda insists that foreign investors should appoint a legal advisor when arranging any additional contract to the MOA, e.g. if initiating a side agreement. A difficult barrier could otherwise be the Arabic language, especially since translation from national law normally is necessary.[132] According to St Valery, "We have had instances where the Arabic text does not concur with the English text. When it comes to payment terms, the duration of the agreement, or termination clauses, Arabic text will always take precedence in court if there is a dispute. Sometimes foreign parties have just read the English text and are happy with it, but the fact the terms are completely different on the Arabic side has landed them in hot water."[133]

Accordingly, disagreements between shareholders may refer to vast different situations, but as demonstrated above, they usually origin in the ownership structure. Next we will investigate the "friendly settlement"; *side agreement*, which is the arrangement foreign investors typically apply in order to avoid the 49/51 rule.[134]

3.3 Side Agreeements

It is not a secret that side agreements represent a crucial structure for many foreign investors operating in the UAE. Some unofficial findings indicate that around 80% of all LLCs in the UAE have a form of nominee arrangement in place.[135] Other estimations confirm that up to 85% of the foreign owned LLCs in mainland are operating on the basis of the same.[136]

Typically the Emirati shareholder prefers to take less responsibility in the company and sometimes only acts as the sponsor for the foreign investor (against a sponsor fee). Meanwhile, the foreign investor desires to own a larger amount of shares and to assume managerial control of the company. Consequently, many local partnerships have established side agreements as a way of evading the restrictions on foreign ownership. Hence, side agreements usually specify that the UAE shareholder is not in fact the real owner of 51% share capital.[137] Instead, such arrangements limit or remove the powers and rights of the national shareholder, leaving the foreign party as the 'real' owner of the entity in question.[138]

As demonstrated by Dark, side agreements usually provide the following conditions:

- *"Only the foreign shareholder has contributed to the share capital of*

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[132] Huda (2013).
[133] MEED (2011).
[134] Hadef & Partners. (2010).
[135] Khodeir and Wallaman (2010).
[136] Smith (2010).
[137] Khodeir and Wallaman (2010).
[138] Smith (2010).

the company and accordingly owns all the share capital of the company.

- *The foreign shareholder is the sole owner of all the assets and the trade name of the company and is the actual agent with respect to distribution agreements and commercial agencies of the company.*
- *The UAE shareholder is the custodian and trustee with regard to the 51% shares registered in his name.*
- *The UAE shareholder will waive/give up any shares held by him in the share capital of the company in case of liquidation of the company (whether in the form of in kind dividends or public auction proceedings or amicably).*
- *The entire profits and losses in the company will be earned/borne by the foreign shareholder except for an agreed percentage of the net profits of the company (agreed percentage).*
- *The UAE shareholder will not claim any right to the profits generated by the company except for the agreed percentage.*
- *The UAE shareholder acts only as the local sponsor for the company to obtain and renew the licences, visas and work permits relating to the company and its employees.*
- *The UAE shareholder is entitled to an annual fixed fee (fixed fee) at the beginning of each financial year for acting as the local sponsor for the company in addition to the agreed percentage.*
- *The UAE shareholder is entitled to 10% interest on undistributed amounts of the agreed percentage at the end of the financial year, to the extent that the company did not distribute profits in the relevant financial year.*
- *The foreign shareholder, represented by an individual, is appointed as the manager of the company."*[139]

3.3.1 Distinguishing Ownership

The CCL distinguish between *registered ownership* (requiring the 49/51 division) and *economical/beneficial ownership*. The registered ownership of shares is explicitly stipulated in the CCL and listed in the MOA of a company, whereas the economical/beneficial ownership typically is stated in the side agreement, which we know usually provides a larger shareholding to the foreign owner.[140]

In contrast to the CCL, the Civil Code, which only applies in situations where the CCL is silent on a matter of issue,[141] does not explicitly distinguish between registered ownership and economic/beneficial ownership (Article 394). Nowhere does it either require the majority ownership in a UAE company to be held by a UAE national.[142]

[139] Dark (2009).
[140] Khodeir and Wallaman (2010).
[141] Lester and O'Keefe (2011) p 2-3.
[142] Federal Law No. (5) of 1985.

Article 394, Civil Code:

(1) If a sham contract is made, the obligees of the contracting parties, and special successors, may, if they are acting in good faith, rely on the sham contract and also rely on the hidden contract, and prove by all means the sham nature of the contract by which they are prejudiced.

(2) If there is a conflict of interest between the parties concerned and some of them rely on the apparent contract and others on the hidden contract, the former shall take precedence.

Article 395, Civil Code:

If the contracting parties conceal a true contract with an apparent contract, the true contract will be the effective one as between the contracting parties and a special successor.

The Civil Code refers to the "true contract" as the binding agreement. As the law does not mention if the "true contract" is also the one registered, one can assume that the validity of the contract has no impact whether it has been registered in the company's MOA or through a side agreement.

The question is how the CCL agrees to the *binding agreement*? Even if Article 22 provides that 51% of all shares in an LLC in mainland must be dedicated a UAE national,[143] it does not explicitly prohibit side agreements. In fact, the CCL does not even mention side agreements. What the CCL stipulate is the distinction between registered ownership and financial/economic ownership:[144]

Article 227, CCL:

"Unless otherwise stipulated in the Memorandum of Association. Profit and loss shall be divided equally between shareholders."

That said, both the CCL and the Civil Code do not prohibit side agreements. The major difference is that the CCL automatically presumes that the registered agreement is the valid contract (Article 22), whereas the Civil Code does not make a judgment regarding this. This means that side agreements have no legal acknowledgement in the CCL. As a result, it could be presumable that the Civil Code, which applies in situations where the CCL is silent, could justify side agreements by relying on the "true contract"? There are currently no reflections on this matter, although if this is a way to circumvent the registered ownership (MOA), it is definitely an interesting reflection. Later we will find this consideration again in regards to Case X.

With no clear standpoint whether side agreements are valid, the need for legislation (e.g. Anti-Fronting Law) is crucial. Until that happens, or if it will occur, our guideline will be the courts' rulings on side agreements.

[143] Zurich General Insurance (2013) p 786.
[144] Khodeir and Wallaman (2010).

Initially we will pass through three cases from the Dubai Court of Cassation, and thereafter a recently ruled case from the Federal Supreme Court, which completely turn down the former rulings.

3.3.2 "True Intent of the Parties"

These first three cases presented verify that the actual agreement refers to the contract with the "true intent of the parties" and that it must be written in order to be valid and prioritized in a dispute. In other words, they confirm that side agreements are accepted if they are documented and reflect the true intent of the parties.[145]

In the civil Case No. 2009/211 the Dubai Court of Cassation made an important statement in respect to "actual agreements."[146] The court ruled in favor of the principal (foreign shareholder) giving him the rights of financial interest in nominee shares. In its judgment, the court reflected on the "true intent of the parties" on top of the covering (registered) agreement. Mr. Khodeir and Mr. Wallman believe "this judgment implicitly gave grounds to distinguish between registered ownership and economic/beneficial ownership as well as provided the grounds for honoring side agreements," even though it is not inscribed in the UAE Civil Transactions Code. Another important consequence of the case is that side agreements must be written form to conform to the laws of evidence.[147]

The Dubai Court of Cassation again acknowledged the phenomenon "actual agreement" in the *commercial* Case No. 2008/212 of 27 in January 2009. The court stressed that the actual agreement must be documented to be fully accepted.[148] This judgment is in compliance with Article 10 of the CCL. According to the Article, *unwritten* testimonies are prohibited in the case of a dispute between a company's partners trying to demonstrate an arrangement contrary to what is exposed in the Articles of Association.[149]

The third case to be presented (Case No. 2009/17) excelled from the previous two cases. It emphasized the Articles 322 and 323 of the CCL, which belong to the "Fronting Restriction Regime"[150]. Relevant parts of Articles 322 and 323 provide sanctions on parties intentionally misleading information on the Articles of Association of a company:

Article 322, CCL:

"Without prejudice to a more severe punishment prescribed in any other law, he shall be imprisoned for a minimum period of three months and a

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[145] Khodeir and Wallaman (2010).
[146] Case No. 2009/211.
[147] Khodeir and Wallaman (2010).
[148] Case No. 2008/212.
[149] Article 10 CCL.
[150] *The implications of the Fronting Restriction Regime are perceived restrictive in terms of entering into nominee or side agreements and inter alia The Anti-Fronting Law (Federal Law No. 17 of 2004),* Khodeir and Wallaman (2010).

maximum of two years and fined a minimum of ten thousand Dirhams and a maximum of one hundred thousand Dirhams and a maximum of one hundred thousand Dirhams or by either penalty"

1. "Any one who willfully enters false information or details inconsistent with the provisions of this law in the company memorandum or Articles of Association or in any other company documents and so too shall be any one who knowingly signs or distributes any such documents."

Article 323, CCL:

"Without prejudice to a more severe punishment prescribed in any other law, he shall be punished with a fine of not less that ten thousand Dirhams and not more than one hundred thousand Dirhams"

4. "Any company who violates the provisions concerning the established portion of the U.A.E nationals in the company capital share or the manager or Chairman of the board of directors therein."

Despite these Articles, the judgment once again honored side agreements, even after it had recognized the implications of Article 322 and 323 of the CCL. The Dubai Court of Cassation ordered the relationship between the partners of the company to be governed by the side agreement as the de-facto company.[151]

Even though the aforementioned cases acknowledged side agreements, the Supreme Court in its latest judgment ("Case X") unexpectedly ruled in contrast to the Dubai Court of Cassation.

3.3.3 Supreme Court Rejects Side Agreement

This case, which got its final judgment by the Supreme Court this year (2013), demonstrates a unique position on the issue of proof in respect to side agreements. It further highlights the possibility to remove a shareholder from the company.[152] However, our focus now lays entirely on the issue of side agreements, while the concern on removal of a shareholder will be discussed in chapter 5.

A conflict arose in an Abu Dhabi based LLC between a UAE shareholder (owning 51% of the shares), an Omani shareholder (owning 24% of the shares) and a US company (owning 25%). The UAE shareholder had requested approval of his right to 51% of the profits in accordance with the registered contract. The Omani shareholder countered and claimed that a side agreement had been established whereby the UAE partner and the Omani partner each owned 37.5% of the shares and the US Company owned 25% of the shares.[153]

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[151] Case No. 2009/17.
[152] Noor and Anani (2012b).
[153] Noor and Anani (2012a); Noor and Anani (2012b).

The Court of First Instance issued the judgment in favor of the UAE partner on the basis of the official documents (the MOA). The case was appealed to the Federal Court of Appeal, which upheld the lower judgment. When it arrived in the Federal Supreme Court, an important issue arose: according to the general principle in UAE Evidence law,[154] written contracts may only be contradicted by written evidence (see Case No. 2008/212). However, *exceptions are permitted* if (1) if the opponent ignores his or her right to documentary evidence, or (2) if there is an agreement to defraud the law. If the fraud exception applies, the party against whom the fraud was made can use *all kinds of evidence* including testimony of witnesses to prove that the official agreement is not an honest side agreement. The Federal Supreme Court overruled the lower instances and remanded the case back to the Court of Appeal.[155]

Lack of evidence made the Court of Appeal dismiss the case once again, i.e. the UAE partner was considered the majority shareholder. This was not accepted by the Supreme Court, which stated that the Court of Appeal had not addressed the side agreement's crucial clause (Article 20). This Article states: "Each of the parties acknowledges that they hold shares equally in the company." This was sufficient evidence that the profits and losses were distributed equally and not based on the official 51/49-rule of the UAE Company.[156] Back to the Court of Appeal (for the third time), sufficient evidence could finally prove that the shares were distributed on the basis of 37.5% to the UAE and Omani partners and 25% to the US Company, and the Court of Appeal could finally confirm the existence of the side agreements.[157]

Unhappy with the judgment, the UAE investor appealed for a third time to the Supreme Court, contesting the validity of the side agreement.[158] This time, the Supreme Court ruled differently and declared that the official MOA, registered with the authorities, was the actual agreement governing the relationship between the parties. The Supreme Court relied on Articles 8, 10 and 11 of the CCL and held that all agreements should be in writing, notarized and registered in the Companies Commercial Register, in order to comply with the requirements of the CCL. It further held that all amendments to the company documents (MOA) must be notarized and registered in the same manner as the MOA.[159]

This ruling took a completely different turn as the requirement on side agreements raised radically. The problem with this ruling though is that side agreements are not official agreements. They cannot be notarized or registered in the Commercial Register and therefore they can never overcome the registration requirements.[160] In fact, the purpose of the side

[154] Federal Law no 10 of 1992.
[155] Appeal Judgments Numbered 539, 540 & 546 of 2009.
[156] Appeals No 199, 200 and 201 of 2011.
[157] Noor and Anani (2012a).
[158] Appeals 300 and 301 of 2012.
[159] Noor and Anani (2012b).
[160] Hadef & Partners (2010).

agreement is that it binds the two concerned parties and is concealed from the Commercial Register.[161] This purpose will not be achieved if there is a requirement to notarize it or file it with the Commercial Register. In addition, side agreements include provisions that cannot be notarized or accepted by the official authorities, such as the shareholding percentage, which is usually different from the official documents.[162]

It should further be noted that the judgment did not address the effect of Article 395 of the Civil Code stating that, "*if the contracting parties conceal a true contract with an apparent contract, the true contract will be the effective one as between the contracting parties and a special successor",* which possibly would have produced a different result if addressed. See previous reflection whether the Civil Code possibly could cover up for the CCL (3.2.2).

In the light of above rulings we can conclude that the courts in future cases will necessarily not decide that all side agreements are null and void as a result from Case X. Each conflict will instead be judged on a case-by-case basis,[163] which unfortunately leaves side agreements' validity continuously vague.

The discussion to eliminate side agreements by legislation has been in the frontline for several years.[164] In 2004, the Federal Council of the UAE tried to restrain side agreements by passing the Anti-Fronting Law.[165] However, pending the completion of a New CCL, which purpose has to relax foreign ownership restrictions, has put off a final affirmation of the Anti-Fronting Law.[166] Consequently, the UAE's modification of laws in terms of foreign ownership structure will probably face a conflicting period while deciding in which direction to move. Should the government relax foreign ownership rights, or should it stringent it by prohibiting side agreements? What happens if both laws become adopted? These are questions that face the UAE lawmakers and that we will try to address in the forthcoming sections.

[161] Noor and Anani (2012b).
[162] Article 22 CCL.
[163] Noor and Anani (2012b).
[164] Dark (2009).
[165] Federal Law No 17 of 2004.
[166] Smith (2010).

4 Relax or Constrain?

4.1 Legal Development

Among the UAE's business-related laws, the existing CCL create a source of discouragement in foreign investors. Naturally, these investors have always been eager to benefit from UAE's rapid economic growth, but have, at the same time, shown a tendency to hold back or invest with fear due to the absence of security that relates to the 49/51 rule.[167] This has inhibited potential foreign entrepreneurs who are wary of spending millions without having transparent exit strategies.[168]

Mr. Philip O'Riordan, corporate partner at Clyde & Co, states, "At one level, the UAE already has a reputation as being quite investor-friendly. It's the Switzerland of the Middle East and since the Arab Spring that position has really grown. But it has been apparent for a number of years that both the companies law and the existing laws around insolvency have been out of date." The Managing Partner at Eversheds Dubai, Mr. Nasser Ali Khasawneh continues, "The UAE's old companies law dates back to the 1980s and there was the desire for a new law that upgrades the legal provisions in this regard."[169]

The UAE authorities have recognized this issue and thus the New CCL is expected to instill confidence in foreign investors to attract new FDI and enhance the security for existing foreign investments in the UAE.[170] This chapter will guide us through the New CCL as well as through the Anti-Fronting Law, concluding with balancing these legal reforms with the country's interests of national independence.

4.1.1 The New Companies Law

Discussions and preparations on the New CCL have been worked on since 2006,[171] but the council of ministers did not approve the draft law until 2011.[172] According to an announcement on 28 May 2013, the Federal National Council has also approved it and the New CCL is expected to come into full force in the final quarter of 2013. The only thing remaining is that the Supreme Council ratifies it and that the President signs it before publishing it in the UAE Federal Official Gazette.[173]

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[167] Ahnish (2012).
[168] Hatoum (2013).
[169] Swift (2012).
[170] Arab Center for the Development of the Rule of Law and Integrity (2008) p 76.
[171] The "New CCL" is an amendment to the existing CCL (UAE Federal Law No. 8 of 1994).
[172] Swift (2012).
[173] Al-Shukairy (2013).

Earlier efforts to adjust the CCL have failed despite years of negotiation since the economic committees from the different Emirates saw no benefits for UAE nationals. As a result, the New CCL is supposed to be more advantageous for local citizens. According to the Minister of Economy, Mr. Sultan Al Mansouri, the new CCL will include: "some conditions that serve the economy of UAE and introduce job opportunities and serve certain industries, such as the aluminum sector."[174] Nonetheless, the principal changes reflected in the New CCL are expected to increase confidence in foreign investors and thus attract FDI.[175]

The most eagerly anticipated and talked about change in the new law is the relaxation of the 49/51 rule on certain categories of company. The new law will not eradicate this ration completely, but there will be exemptions on a sector-by-sector basis.[176] It is not official in which sectors these exceptions will be and by what percentage, but according to previous discussions, we can presume that strategic' or 'sensitive' sectors to the UAE's economic growth and national security will be restricted (e.g. the oil industry, infrastructure and defense sectors).[177] Service sectors such as electricity, telecommunication, transportation and financial services, are also likely to be restricted.[178] More relaxed sectors could possibly be connected with trading, such as the retail sector.[179] However, the changes will not apply on joint liability companies or simple commandite companies, where all partners are required to be UAE nationals.[180] "The full details have not yet been released," says Hardeep Plahe, counsel at law firm Linklaters in Dubai. "However, I expect the companies law to say that foreigners will continue to be limited to owning 49 per cent or less of all UAE incorporated companies, except in those cases where the cabinet decides otherwise."[181]

Under the existing CCL, a company must be founded by at least two shareholders. The New CCL upholds this, but additionally permits for one natural or juridical person to incorporate and own all the shares.[182] This will apply for LLCs as well as for Private Joint Stock Companies. We have no clearance whether this will favor foreign investors or not. In addition, the limited number of shareholders in an LLC will increase to 75, which should provide companies with greater opportunities to increase capital comparing to the current limitation of 50 shareholders.

The New CCL will furthermore allow shareholders to pledge their shares in an LLC to another shareholder or to a third party in accordance with the articles of incorporation of the company. The pledge will be deemed valid against the company and third parties upon its registration in the

[174] Hatoum (2013).
[175] Constance (2012).
[176] Golub (2003) p 25.
[177] Asiedu and Esfahani (1998) p 647 ff.; Azzam and Rettab (2011) p 2.
[178] Golub (2003) p 17.
[179] Asiedu and Esfahani (1998) p 647 ff.; Azzam and Rettab (2011) p 2.
[180] Swift (2012).
[181] Melly (2012).
[182] Swift (2012).

Commercial Registry of the relevant authority of each Emirate.[183] This will provide investors with better flexibility to decide their activity level in a company.

Companies will also be permitted mortgages over the shares of LLCs.[184] The current provisions are rather confusing on this matter and have resulted in disagreement amongst legal experts and authorities.[185] The New CCL sets out the process and require a mortgage to be arranged in an official document notarized in agreement with UAE law. As a result, additional foreign investors will be able to invest, or increase their current investment.

All in all, the amendments, still not enshrined in Articles,[186] seem to provide a friendlier business environment for foreign investors. The draft of the New CCL does not change things radically, and it will probably not move as far as people have hoped for (as suggested by Mr. Nasser Ali Khasawneh). In fact, the result of foreign ownership restrictions has resulted in local actors making a lot of money from acting as their sponsors. In response to this, local actors have lobbied heavily to keep the existing legislation in their favour, as local stakeholders are used to being protected from international competition.[187] For example, the UAE still has no competition law in force: however, the authorities have recently agreed upon a new framework to enforce a new competition law. The new law, which reflects many elements of EU law and international norms, is planned to be adopted in September this year (2013).[188]

In terms of side agreements, the New CCL will most likely have an impact of easing up and eliminating such arrangements as foreign investors no longer, at least in some sectors, will need to circumvent the 49/51 rule. However, the proportion to be dedicated foreign investors vis-à-vis the local party as well as the division of sectors, is still not official, which means that the New CCL's actual affect on side agreements is unclear. Yet, the UAE government finds it very important to reduce side agreements, for instance to encourage the "Emiratization programme." Consequently, the aforementioned Anti-Fronting Law has been developed, which leads us to our next discussion.[189]

4.1.2 The Anti-Fronting Law

In the previous chapters on side agreements, we stated that the Anti-Fronting Law seeks to eliminate the use of such provisions. In this chapter we will first take a broader look at the purpose of this law, and then discuss the findings in regards to eliminate side agreements.

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[183] El Ghul and Sadek (2012).
[184] Ahnish (2012).
[185] Articles 103, 168 CCL.
[186] Ahnish (2012).
[187] Swift (2012).
[188] Freshfields Bruckhaus Deringer (2013) p 2.
[189] Federal law No.17 of 2004.

While many local partners prefer not to be involved in the foreign company's day-to-day operation (i.e. they act as "sleeping partners"), foreign investors desire to have full managerial control of the company.[190] Consequently, side agreements are being carried out and the local UAE investor remain with little insight in the foreign management's business dealings as well as little awareness of possible illegal practices.[191]

In order to undermine the practice of the so-called sleeping partners, the UAE authorities have passed the Anti-Fronting Law (also referred to as the Concealment Law[192]) to indirectly force local partners to take an active role in the businesses.[193] After its enactment in 2004, the Concealment Law was first postponed until late 2007 and then until late 2009.[194] It is still put on hold and the uncertainty of it implementation is due to circumstances like the New CCL.[195]

The key provisions prohibit "fronting" (or concealing) agreements, as outlined below:

Article 1:

"Concealment: to enable the foreigner – whether natural or juristic person – to practice any economic or professional activity that is not permissible for him/it to be practiced in accordance with the law and decrees of United Arab Emirates, whether for his/its account or in participation with others, or to enable him/it to evade all liabilities entailed on him/it."

"Concealer: any natural or juristic person that enables the foreigner – whether a natural or juristic person – to practice any economic or professional activity which is not permissible for him/it to practice within United Arab Emirates."

"Concealed Person: any foreigner, whether a natural or a juristic person, practicing with the assistance of the concealer any economic or professional activity that is not permissible for him/it to practice within United Arab Emirates."

Article 2:

"It shall not be permissible to cover up any foreigner, whether a natural or a juristic person, whether by using the name of the concealer or his permit or his commercial register or through any other method, in light of the definition of concealment stipulated in Article 1."[196]

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[190] Khodeir and Wallaman (2010).
[191] Urbach Hacker Young International Limited. (2012).
[192] Khodeir and Wallaman (2010).
[193] Urbach Hacker Young International Limited. (2012).
[194] Khodeir and Wallaman (2010).
[195] Hadef & Partners (2010).
[196] Khodeir and Wallaman (2010).

When studying Articles 1 and 2, the issue arise if entering a side agreement in the context of an LLC is classified as "any economic or professional activity, which is not permissible for him/it to practice within United Arab Emirates"? For instance, under the 49/51 rule in the CCL, it is permissible for foreigners to participate in UAE companies, but it is not clearly defined what the foreign partner can or cannot do, neither do the definitions in the Concealment Law shed light on this problem. As studied before, the CCL does not explicitly prohibit side agreements, i.e. it does not prohibit an arrangement not consistent with the 49/51 rule, even though this rule is the presumed ownership structure to be followed.

For example, if a UAE company (LLC) undertakes activities considered to fall under the Concealment Law, it can be argued that agreements reflecting legitimate commercial arrangements between a foreign party and a local company would not constitute a prohibited concealment arrangement. To clarify the matter, agreements that are not in accordance with the 49/51 rule do not necessarily need to fall under the scope of the Concealment Law, e.g. well-documented agreements that reflect a company's actual ownership should not be considered as fronting or concealing agreements (Case No. 2008/212, No. 2009/211 and No. 2009/17).[197] On the other hand, the Supreme Court decided in Case X to dismiss side agreements that are not notarized or registered, even though they were documented.[198] The confusing part with this ruling is that we still do not know what the requirements are to justify an agreement with a different structure from the 49/51 rule.

If the Concealment Law is implemented, it will engage to inhibit agreements considered "concealed". In order to actually constrain such arrangements, the law needs to be clearer and describe what *concealed* activities exactly refer to. As it seems today, side agreements do not necessarily fall under "any economic or professional activity, which is not permissible for him/it to practice within United Arab Emirates" (Article 1). If the law will not be identified more precisely, side agreements circumventing the 49/51 rule can probably go on being contracted between local and foreign shareholders, and we will be back on square one where the validity of an agreement will be decided on a case-by-case basis (Case X).

It is further difficult to imagine that the Concealment Law would take away a contract's obligations, i.e. moral weight, towards the nominee UAE shareholders, their respective heirs, and to third parties (e.g. banks, creditors, etc.).[199] That would just awake a chain of actors growing such cases unnecessarily large and expensive to investigate. Most common is though that heirs and other third parties are not aware of the existence of such arrangements and therefore are not bound by their terms and conditions.[200] Nevertheless, the heirs have the right to claim ownership of

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[197] See further Article 395 of the Civil Code.
[198] Noor and Anani (2012b).
[199] Dark (2009).
[200] Qudah (2013).

the 51% shares as well as a share of the profits and management rights of the company.[201]

We can conclude that the Concealment Law is far from ready of becoming implemented. It is too ambiguous for judging in which cases should fall under Article 1, and there is a moral weight that is not easily ignored. Speculations are even indicating that the Concealment Law might be a part of the New CCL, hence, that the amendments on CCL could be enough.[202] However, it is crucial for entities aiming to go through with side agreements to do so in the light of the Concealment Law, as this will help to avoid surprises when, and if, the law will be fully implemented.[203] If a company falls under this law, that entity will be imposed fines and imprisonment penalties. The local as well as the foreign partners would have to pay fines up to AED 100,000 and face deregistration from the commercial register. In addition, the foreign investor and his employees can be deported.[204]

Having absorbed the Concealment Law as well as the New CCL, the pattern seems sharper: the UAE try to increase their influence in the international community while foreign entities are awaiting new legislation to ease the procedure and security of conducting business in the country. In order to provide this legal progression, there must be an established balance between the two laws and the UAE's strategic objectives of a more diversified and sustainable economy.[205]

4.1.3 Balancing the Legal Development

In terms of the New CCL, the federal authorities see the relaxation of ownership rules as a question of pragmatism rather than of ideology. The move is necessary to find a balance between the country's intentions of attracting international capital whilst ensuring a central role for UAE nationals in the domestic economy. For instance, business sectors that the authorities do not view as strategic to their own economic growth will be less legislated. In contrast, sectors such as the oil industry will more or less remain entirely under Emirati control.[206] This means that foreign ownership will be constrained in sectors strategically prioritized by the authorities.

Ensuring a central role for UAE nationals also goes hand in hand with the Concealment Law, which has the intention to force national citizens to take larger responsibilities and thus develop know-how and contribute to the country. The problem is that no relevant laws, including the Concealment Law, justify the prohibition of side agreements that circumvent the 49/51 rule (Article 1 in the Concealment Law). To cover this cap, the prohibition could be implemented in the New CCL. As a result, Article 1 in the

[201] Articles 233, 283 CCL.
[202] Hadef & Partners (2010).
[203] Khodeir and Wallaman (2010).
[204] Urbach Hacker Young International Limited. (2012).
[205] Dubai Strategic Plan 2015; Abu Dhabi Economic Vision 2030.
[206] Melly (2012).

Concealment Law could lean its ban directly on the New CCL, and the gap would be covered. An easier solution is to install the prohibition directly in the Concealment Law. The only thing speaking against the latter is the insecurity whether the Concealment Law will ever be adopted.

Hence, if the Concealment Law and the New CCL are not considered in harmony, gaps and barriers may potentially appear. If the Concealment Law will not be implemented at all, its objectives should be considered in the amended CCL.

4.1.4 Barriers

Other barriers that might appear once the New CCL is in place are speculated to be sector regulation and the constitutions of individual companies.[207] Sector regulations are nothing new and already exist in several fields, especially within the banking sector. The procedure to transform companies' regulations into new percentages of foreign ownership will therefore be demanding in organizations where it has already been implemented.[208]

According to Hardeep Plahe (Linklaters), "In commercial agency, the law permits no foreign ownership, while in insurance, foreign shareholdings are limited to 25 per cent"…"The articles of association of some individual entities set higher foreign ownership limits.[209] For example, the bank "Emirates NBD" limits foreign ownership to 5 per cent and it is not alone in this. Of course, some businesses may decide that it is in their interest to relax these rules." Furthermore, First Gulf Bank announced in November 2012 it was raising the ceiling on foreigners share ownership to 25% from the bank's former 15% ceiling. During this time, non-Emiratis were holding 14.03% of the stock (counting 9.05% non-Arabs).[210]

Another obstacle for the New CCL could potentially be the Concealment Law itself: It would be somewhat foolhardy to implement the Concealment Law before implementing the New CCL. If that would occur, several foreign companies that are relying on side agreements would need to completely reconstruct their ownership structure. Hence, they might have reconstructed and invested in a new corporation form, only to satisfy the Concealment Law, but later to be legally firm in line with the New CCL. Such reconstructions are time consuming, costly and exposed to risk, e.g. being unable to produce or operate during a period of time and consequently lose customers. It should therefore be crucial for the Concealment Law to be implemented after and in accordance with the New CCL, or otherwise, as a

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[207] National Investment Reform Agendas (2007) p 11-12.
[208] Hermansson (2013).
[209] Melly (2012).
[210] *In contrast, neither the Abu Dhabi Securities Exchange nor the Dubai Financial Market have any percentage ownership ceiling and will therefore easily adapt to the new regime,* Melly (2012).

part of the New CCL.[211]

Eventually, it is critical that the government provides clear guidelines confirming that liberalization is definitive and that new rules are not just temporary. In respect to the New CCL, the law firm *Baker Botts* advice that uncertainty could be yet another, unnecessary, barrier: "It is unknown whether, once the threshold has been increased, it can be lowered again and, if so, what is the mechanism for doing so. If the threshold can be easily lowered, this would adversely affect the effectiveness of the new law and therefore the willingness of companies to rely on it to increase their investments in the UAE."[212] In other words, there is a risk that foreign investors will be dissuaded from investing in the UAE without having full commitment that liberalization is definitive.

Until now, we have learned about the incorporation process of companies in the UAE. With a clear focus on LLCs, we have looked into foreign ownership structures and thereof restrictions, potential conflicts and solutions. We have also discussed the legal developments in respect to side agreements and foreign ownership restrictions (i.e. 49/51 rule). Before analyzing and making conclusions, another situation is to be examined: the possibility to remove a shareholder from a company in which the parties have entered a side agreement.

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[211] Hadef & Partners (2010).
[212] Melly (2012).

5 The Effect on Minorities

5.1 Introduction

This chapter refers to the previous discussion on shareholders' disagreement (chapter 3). In this section, we will highlight the possibility to remove a shareholder from a company as because of shareholders' disagreement. By investigating this question, we will understand to what extent minority shareholders are protected by side agreements, and thus what the Concealment Law would mean to minority shareholders if it were implemented. It is important to know that the withdrawal of a partner has not been discussed on a large-scale in the UAE. That is why Case X, as one of the very few judgments in this regard, is critical for this discussion.

For example, if two shareholders of an LLC, have entered a side agreement where the foreign shareholder controls 75% and the Emirati partner 25% of the shares, then it will be a matter of who holds the majority of the shares in case the Emirati partner wants to remove the foreign investor (Articles 37, 47 and 63 of the CCL). The UAE shareholder will undoubtedly refer to the registered ownership, as outlined in the MOA, claiming that he is the majority owner, whilst the foreign shareholder will refer to the side agreement.[213] This leaves us with the fundamental question: which contract represents the "actual agreement?" Is it the registered contract (MOA) or the side agreement? As we learned from Case X, the appraisal is decided on a case-by-case basis.

5.2 Case X

This recent judgment (2013) by the Federal Supreme Court, which identifies the validity and enforceability of side agreements, also addresses the issue on whether the majority shareholder can request the court to remove a minority shareholder in the same company.[214]

Based on its 51% shareholding majority, the UAE investor requested the court to remove the Omani shareholder because the Omani shareholder had not been cooperative and as a result caused a loss to the company. The Omani shareholder argued that the partners in the company had signed a side agreement where the Emirati shareholder and the Omani shareholder each owned 37.5 % of the shares, and the American partner 25%.

The Court of First Instance refused to accept the UAE shareholder's request

[213] Khodeir and Wallaman (2010).
[214] The dispute was between a UAE shareholder (owning 51 % of the shares), an Omani shareholder (24 %) and a US company (25 %), in accordance with the company's MOA, Case X.

on the basis of Articles 37, 47 and 63 of the CCL. These articles require a *numerical* majority, and in this situation only one out of three shareholders requested the dismissal. The Court of Appeal consequently upheld this.[215]

Article 37, CCL

Unless the Memorandum of Association allows for a majority of votes, general partnerships shall adopt resolutions made by unanimous voted the partners' unanimous votes, and unless otherwise stipulated in the Memorandum of Association, "majority" shall mean numerical majority of votes,

Article 47, CCL

A commandite is a company comprising one or more jointly associated partners liable for the company's obligations to the extent of all their assets together with one or more silent partner(s) liable for the company's obligations only to the extent of their respective shares in the capital,

Article 63, CCL

Provisions of Article (37) of this Law shall apply to joint ventures.

The Emirati shareholder appealed to the Federal Supreme Court,[216] which overturned the rulings of the lower instances and required the "majority" to refer to the majority of *shares*, not to the majority of the partners. The Supreme Court stated that only one shareholder owning a majority of the shares could request the court to dismiss a partner based on sufficient reasons to justify his appeal. As the UAE shareholder, according to the registered MOA, owned 51% of the shares, he could appeal the dismissal of the Omani shareholder on the basis of the following articles:[217]

Article 677, Civil Code:

(*1) It shall be permissible for a majority of the partners to apply for a judicial order dismissing any partner if they adduce serious reasons justifying the dismissal.*

(2) It shall likewise be permissible for any partner to apply for a judicial order that he cease to be a partner in the company if the company is of defined duration, and he provides reasonable grounds for such application.

(3) In both of the foregoing events the provisions of Article 675 (2) shall apply to the share of the dismissed or withdrawing partner, and such share shall be assessed in accordance with its value on the date the claim was brought.

Article 675 (2) 'It shall likewise be permissible for an agreement to be made to continue the company as between the remainder of the partners if one of

[215] Noor and Anani (2012a).
[216] Appeal Judgments Numbered 539, 540 & 546 of 2009.
[217] Noor and Anani (2012a).

them dies or is placed under a legal restriction or becomes bankrupt or withdraws, and in those events such partner or his heirs shall be entitled only to his share in the assets of the company…'

In light of the above, the Federal Supreme Court remanded the case to the Court of Appeal to consider the directions of the Supreme Court.[218] As the requirement now was a matter of who held the majority of *shares*, the problem was to decide which agreement that was binding. The only chance for the Omani shareholder to avoid being ejected from the company was if the side agreement was considered the binding contract.

As we already clarified when studying this case in chapter 3, the side agreement was firstly approved because it was documented (in writing), and because all three parties signed it. Article 20 in the side agreement states, "Each of the parties acknowledges that they hold shares equally in the company." In addition to other documents, this supported that the profits and losses were distributed equally between the two shareholders and not based upon the official 51/49 rule.[219] But as the case took a different turn in the final judgment by the Federal Supreme Court,[220] the rights dedicated the minority shareholder (the Omani partner) went straight to the UAE shareholder. After the Supreme Court's ruling that the registered contract was the one to be considered valid, the UAE partner could account for his part of the company in accordance with the 49/51 rule.[221]

This final judgment did not address the issue whether the rights of the parties under the MOA should be liquidated as a result of the invalid side agreement. In other words, we still do not know if the Omani partner will be removed from the company, we only know which ownership structure the Court decided to rely on.[222] What we may conclude; however, is that this ruling noticeably causes an insecure environment among foreign investors. Not only in regards to the validity of side agreements, but also in respect to the affect that *one* single shareholder may have on minority shareholders. If there are no circumventions to the 49/51 rule, foreign investors in LLCs will always face the risk to be removed from the company.

[218] Appeals No 199, 200 and 201 of 2011.
[219] Noor and Anani (2012a).
[220] Appeals 300 and 301 of 2012.
[221] Noor and Anani (2012a).
[222] Noor and Anani (2012b).

6 Analysis

6.1 Introduction

It is clear that the UAE's economic growth has attracted international enterprises to the country. It is also clear that the Emirati jurisdiction, providing for instance no corporate tax rate and free zones, is a major reason why foreign corporations choose to establish there. However, this rather "optimistic" interpretation of being business-friendly towards foreign investors is not always realistic.

The UAE has strict laws in respect to foreign ownership rights if the company does not incorporate in a free zone, which has been demonstrated in this study and which I am about to analyze further throughout three sections: First we will estimate the advantages/disadvantages with side agreements to realize whether such arrangements should be recognized in the UAE. Afterwards we will analyze the balance between the government's desires to activate local Emiratis in the national economy whilst attracting FDI. Lastly, we determine whether the UAE should relax or constrain foreign ownership rights based on the relevant legal developments.

6.2 Recognizing Side Agreements

Establishing in a free zone will avoid conflicts as the ownership structure can be attributed to only *one* shareholder, whereas companies in mainland are required to have at least two.[223] As a result, foreign ownership restrictions in LLCs often lead to disputes between shareholders. In this paper we have looked at different sources of conflict, such as when the foreign shareholder wants to exchange his local partner, or when the local shareholder, acting as a sleeping partner accordingly with a side agreement, suddenly claims the 49/51 structure in order to take control over the company's financing and management.

Normally when a dispute arises between a foreign and a local shareholder, it is related to the company's ownership structure. If a different structure apart from the 49/51 rule has been conducted (i.e. side agreement), the source of the problem tend to focus on which agreement that is *valid*. Thus, as side agreements typically provide a larger share to the foreign investor, such arrangements noticeably collapse with the CCL's required 49/51 rule. The solution to the problem will therefore be for the courts to investigate which ownership structure that a company is built upon (the "true contract"). This is supported from case law; where disputes usually result in the argument of which contract is *valid.* The foreign shareholder naturally claims the side agreement while the UAE shareholder claims the 49/51 rule.

[223] Zurich General Insurance (2013) p 786.

According to Case No. 2008/211, No. 2009/17 and No. 2008/212, shareholders may structure their company based on side agreements if they are well documented. But since the ruling of Case X (2013), where the Supreme Court decided that written evidence is not enough and that side agreements must be notarized or registered in the Commercial Register, this pattern was suddenly interrupted. As a result, case law conflicts with each other, which provides an insecure environment among foreign investors. In this sense, the UAE judicial system is flawed, as it does not clearly state whether it accepts side agreements or not. In Case X, the Supreme Court ruled that side agreements should be judged on a "case-by-case ruling". By stating so, the court has indeed confirmed that they have no sharp position towards side agreements: on the one hand, the court concedes it is enough if the side agreement is documented, but on the other hand, the court claims the side agreement is "null and void" if not notarized or registered.

Another interesting aspect of Case X is that side agreements are independent non-official arrangements that only bind concerned parties. They usually include provisions that cannot be accepted by the official authorities (i.e. the shareholding percentage), which makes the agreement impossible to register. Correspondingly, this creates a rather unserious picture of the Federal Supreme Court as the demands are impossible to follow, since side agreements are not official agreements and can therefore not be notarized or registered in the Commercial Companies Register. If this case would be precedential, side agreements would never gain support over the 49/51 rule and thus all future cases would already be decided before trial.

Case X confirms the negative aspect of entering into side agreements as it could provide harsh consequences for the foreign investor. Even for foreign shareholders who are being accurate by writing, signing and stamping the side agreement, it is possible that their actions are not adequate in a court of law. Thus, the lesson from this ruling is the importance of being aware of the uncertainty with side agreements. Foreign investors who enter such agreement with a local shareholder should *in advance* consider strategies to prevent and eliminate disagreements. For example, by regularly renegotiating the existing contractual terms to make sure that all parties are satisfied, by notarizing a power of attorney where the UAE shareholder bestows execution rights upon the foreign partner, or, by reaching a settlement through a side agreement, e.g. where the UAE shareholder confirms that he or she did not participate in financing the share capital of the company and thus have no right to claim profits. However, these solutions are not resolving the long-term problematic with side agreements, but rather inhibiting disagreements before they arise.

The positive view on side agreements is that they represent the true proportion of a company's ownership structure between shareholders. Therefore, it seems wise, and fair, to contract side agreements in order to reflect the "true" division among shares and management in a corporation, and rather unfair not to conduct such arrangements if the registered MOA does not reflect the actual division of workload, capital and engagement.

This conclusion provides that regulation in the field is significant to prevent anxiety among international investors and to eliminate the risk of scaring away already established companies. The regulation does not necessary need to prohibit side agreements, as suggested in the Concealment Law, but rather outline a framework and legalize it as an option to the CCL's 49/51 rule.

In fact, implementing the Concealment Law may have a negative approach on minority shareholders, as they would be far less protected because of such agreements being invalid and always lay behind the local shareholder in any dispute referring to ownership structure. In addition, there will most likely be situations where the foreign owner contributes more to the company than he can ever be legally recognized for. There is also the challenge for foreign investors to rely upon UAE nationals taking an active responsibility for 51% of the shares, as many local owners presently are not accustomed to such engagements as a result of the traditional sponsorship arrangements.

Even if the Concealment Law would be adopted, we will probably continue facing side agreements, and shareholders will continue circumventing Article 22 of the CCL. As seen in this study, the match between the local shareholder and the foreign shareholder seem too beneficial and satisfying for both parties to ignore: the foreign investor can assume managerial control of the company whilst the Emirati shareholder acts as the sponsor (against a sponsor fee). If such side agreements will be prohibited, they might still be conducted, but in secrecy. As a result, the surface of a company will mirror a company's structure incorrectly, which further could lead to authorities losing control over individual companies by simply having a register non-uniform with reality.

If the Concealment Law will not come into force and side agreements will not be invalid, investors should still think carefully before entering such arrangements, as these will continue to be judged on a case-by-case basis. The right documentation must be put in place, and preferably signed by all concerned parties. It is further crucial paying attention to contractual differences between languages. When the *Arabic* text does not concur with the *English* text and there is a dispute in terms of payment terms, the duration of the agreement, or termination clauses, the Arabic text always take precedence in court. Appointing local legal advice is therefore central to eliminate unnecessary language misunderstandings.

Irrespective of the outcome of the Concealment Law, the adoption of the New CCL (end 2013) will most likely reduce side agreements due to the relaxation of foreign ownership restrictions in certain sectors. Yet, there will always be an interest among shareholders to conduct side agreements in other sectors that are not affected by the amendments to the CCL. Therefore, the New CCL should not be considered part of a solution at this stage, as we still do not know in which sectors a relaxation will be enforced and to what extent.

In light of the above, we can conclude that side agreements are an impartial way of estimating the actual ownership structure. Side agreements are good if it keeps all parties satisfied and reflects the true agreement, or at least if it is closer the true agreement than the registered one. But we should also determine that side agreements are unreliable tools and can affect foreign investors negatively (Case X). If side agreements become legally recognized, conflicts leaning on the validity of contracts would be less confusing. Such arrangements can help the UAE towards economic growth by not scaring off foreign corporations from establishing in the country.

6.3 Nationalized whilst Attracting FDI

My interpretation is that the debate weather side agreements should be illegal is grounded in a fear of being less "Emirati." By letting control pass from the UAE's citizens to the foreign investors, the country loses control of its domestic economy. The government's desire is to see the country grow on its own and not to be dependent on foreign know-how.

Efforts by the UAE government to motivate the citizens and to increase their involvement in the private sector (e.g. the Emiratization programme) also include the reduction of side agreements. This forces the UAE nationals to take an active role in the private sector since they no longer can be sleeping partners to foreign companies. A potential consequence could be that Emirati nationals, who are looking for a partner, avoid investing or sponsoring foreign entities. Indeed, some of the local firms probably want to pertain their registered shareholding within the company, while other local firms or UAE nationals prefer being inactive. However the relationship turns out, the option should lie on the involved partners. After all, circumventing the 49/51 rule must be based on the will of all involved parties.

Although, if there is a desire to reduce national dependence on international professionals, UAE's initiative to activate local citizens is a good course of action to diversify the domestic economy. The fact that Emiratis often enter the world with no conscience regarding wealth makes it difficult to create a hard-working environment without clear guidelines.[224] On the other hand, the UAE aim to be an international trade and investment hub. From this perspective, the country depends on FDI.

This balance is complicated because the government seeks to relax foreign ownership restrictions (the New CCL), and at the same time to restrict side agreements that circumvent such constraints (The Concealment Law). There is no clear answer when these two fairly connected laws will be adopted, or even if both will come into force. Experts are even indicating that the Concealment Law might be a part of the New CCL, hence, that the amendments on CCL could be enough to cover both laws. Overviewing the

[224] Jane Williams (2011).

Concealment Law's Article 1 and 2, it does seem far from finalized as the prohibition to circumvent the 49/51 rule is not specified. However, it is crucial for entities aiming to conduct side agreements to do so in the light of the Concealment Law, as this will help to avoid conflicts when, and if, the law will be fully implemented.

A negative consequence of the legal uncertainty is that foreign investors might avoid investing in the UAE. For example, if a foreign company that seeks to incorporate an LLC in Dubai finds a local investor who is only interested in being a sponsor and not to partake in the company's day-to-day operations or invest any capital in the LLC; that company deserves to know if entering a side agreement is illegal. If the Concealment Law is implemented, side agreements are made illegal and the foreign investor would need to find another local investor. If the New CCL was adopted, the sector in which the company is licensed to work could possibly allow the foreign investor a larger shareholding without the need of issuing a side agreement.

There is also a risk that foreign investors will be dissuaded from investing in the UAE without having full commitment that liberalization is definitive, as suggested by Baker Botts.[225] Therefore, these legal amendments should provide a clear standpoint as soon as possible to facilitate the business environment.

The approval of the New CCL will be a major step towards lifting the ban on non-Emirati corporate control of firms outside free zones. According to the GAO study, it will help the country to attract a wider range of international portfolio investors due to an increased confidence in foreign financiers. It is further declared that superior productivity of foreign-owned firms over locally owned firms is a major benefit of FDI (i.e. the *general theory of internationalism*),[226] and that companies limited from foreign ownership (e.g. the 49/51 rule) are less productive.

The natural result from these arguments is that relaxation on foreign ownership is good, productive and beneficial. In a broader perspective though, it seems as if the matter of restrictions on foreign ownership is rather insignificant when also considering e.g. sectorial differences, co-existence of free zones and customs territory, which is confirmed by Azzam. He demonstrates that foreign ownership as such is not necessarily the most important determination of productivity gaps between locally owned and foreign owned firms in the UAE.[227] Asiedu and Esfahani also support this by showing that ownership structure depends on the productivities of the investing transnational enterprise's assets, local entrepreneurs' capabilities and the host country's infrastructure, and thus not only by relaxing foreign ownership restrictions as such.[228]

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[225] Melly (2012).
[226] Karpaty (2007) p 242.
[227] Azzam and Rettab (2011) p 17.
[228] Asiedu and Esfahani (1998) p 659.

That said, we can determine that mixing foreign and local ownership is positive if the company can access otherwise inaccessible local resources, but it does not necessarily mean that relaxing foreign ownership restrictions will contribute to the country's goal to attract FDI. The view may also be negative if problem arises as a result of the partners' contributions not being fully contractible and thus leads to shareholders disagreements. Finally, we can state that the legislation must be clearer and provide a fixed position on the issue of foreign ownership rights.

6.4 Relax Foreign Ownership with Caution

It can be determined that the New CCL's positive implications surpass the negative aspects. Relaxing ownership restrictions will create confidence in foreign investors, which will turn the UAE to an even more attractive business hub. By doing so in a sectorial basis, the UAE will be able to remain in control over the domestic economy and strategically prioritize which sectors to be constrained. Awaiting such legislation would rather seem uncompromising towards FDI, despite the aforementioned studies suggesting that relaxation on foreign ownership restrictions is inefficient for companies' productivity.

Nevertheless, the willingness to reduce the dependence on foreign knowledge is reasonable from the UAE's perspective. If the local population is not active, as we can understand by the number of agreements opposed to the required company structure (80% or more, see chapter 3.3), constraints on foreign ownership rights might be necessary. Thus, for the UAE to develop local know-how and minimize their international dependency, it is crucial with more drastic regulations, for example, to forbid sleeping partners.

From another perspective, side agreements can be established as valuable tools for foreign investors, if it keeps all parties satisfied and reflects the true agreement. It can further help the UAE towards economic growth by not scaring off foreign corporations from establishing inside the country. The most obvious obstacle though is that they are not legally recognized. Therefore, the Concealment Law should not be implemented. Although, there should be regulations acknowledging side agreements, for example as an addition to 49/51 rule in the New CCL.

In case both the New CCL and the Concealment Law are to be implemented, it is unwise to adopt the Concealment Law first. For example, if a company first is legally forbidden to circumvent the 49/51 rule and later allowed to be the majority owner, the first ownership structure is unnecessary and result in a company's loss of time and capital.

All in all, with respect to the UAE's infancy and small population, letting foreign investors contribute seems as the most beneficial way for the nation to achieve its visions. However, since local organizations are resisting the

amendments (as used to protection from international competition), the authorities will be unwilling to allow amendments in a too large scale and it will be a long and time-consuming process.

7 Conclusion

The New CCL will most likely be affecting companies in a step-by-step process in respect to the UAE nationals. Nevertheless, relaxing foreign ownership rights is a crucial and productive way to optimize and attract a wider range of international portfolio investors. However, there is the possibility that the New CCL will not be adopted on large foreign firms in order not to lose corporations with influence and power from having national majority.

If the Concealment Law comes into force, it is unlikely that the country would shut down partnerships and establishments that are relying on foreign investment. The key is to inaugurate a suitable set of agreements and create a structure in line with the New CCL through a legal practice that does not violate other UAE laws. This said, if the Concealment law would be implemented, it should be so in accordance with the New CCL. This requires an in depth knowledge of local training and customs as well as a thorough analysis of court precedents for guidance, given that the UAE is a Civil Code regime and not a common law jurisdiction.

The interpretation of the concealment regime may suggest that foreign investors should not enter into side agreements. Although, we believe that the prohibition of side agreements is interfering with one of the country's most prominent resources, i.e. foreign investors, giving consideration to the economic circumstances and the practical reality supported by available legal arguments.

In light of the above, there should be no adoption of the Anti-fronting Law. Focus should lie on the New CCL, providing relaxed ownership structure for foreign investors. Side agreement should instead be acknowledged along with the 49/51 rule in the New CCL, providing that they are legally accepted if certain elements have been achieved. Since studies have demonstrated that a company's productivity is relatively unrelated to its foreign equity stake, the reform of the 49/51 rule should be made in sector specific areas where productivity will actually make a difference, and not in strategic sectors defined as secure and sensitive.

Appendix A

Company type	Ownership Structure	UAE Nationality Requirements
General partnership	Two or more partners who owe joint and unlimited liabilities. Partnership companies are confined to UAE nationals only.[229]	All the partners.
Simple limited partnership	One or more general partners who owe joint and unlimited liabilities & one or more limited partners who owe limited liabilities. All general partners should be UAE nationals and the limited partners may not interfere in management functions involving third parties even with the approval to do so.[230]	All the general partners.
Joint venture company / joint participation	Two or more partners among whom only a trading partner owes unlimited liability in relation to the counterparty and the other partners owe no liabilities. The contract regulates rights and obligations of the partners and the distribution of profits/losses, which will be carried on in the name of one of the partners. This contract will neither be registered in the commercial register nor is to be declared.[231]	UAE Nationals should constitute at least 51% of the capital.
Public joint stock company	Ten or more shareholders who owe limited liabilities.[232] The Public Joint Stock Company shall be managed by a Board of Directors.[233] The chairman and majority of the members of the Board of Directors must be U.A.E. nationals.[234]	Shareholders having a 51% share or more in the capital; the majority of the board of directors and the Chairman of the board of directors.
Private joint stock company	Three or more shareholders who owe limited liabilities. Shares may not be floated to public subscription and founder members are to fully subscribe the capital.[235] Except the provisions concerning public subscription, all provisions concerning public joint stock companies applies to private joint stock companies.[236] CCL further permit a joint stock company to be converted to a public joint stock company.[237]	Shareholders having a 51% or more share in the capital; majority of the members in the board of directors and the Chairman of the board of directors.

[229] Article 25 CCL.
[230] Articles 48, 53 CCL.
[231] Articles 56, 57 CCL.
[232] Article 70 CCL.
[233] Article 95 CCL.
[234] Articles 99, 100 CCL.
[235] Article 215 CCL.
[236] Article 216 CCL.
[237] Article 217 CCL.

Limited liability company	Two to fifty partners who owe limited liabilities.	Partners having a 51% share or more in the capital. A foreigner can be the manager of the company.
Partnership limited by shares	General partners who owe joint and unlimited liabilities & limited partners who owe limited liabilities to the extent of their share in the partnership. All general partners should be holders of the UAE nationality.[238]	All the general partners.
Branch or representative office[239]	A branch may exercise *freely* the activities for which it is licensed. A representative office can only practice promotional business for the products and services provided by the parent company.	Service agent must be UAE national or a company wholly owned by UAE nationals.

[238] Article 256 CCL.
[239] *A foreign branch office remains 100% owned by the international organization. Branch offices must employ a local "service agent", which duties are restricted to providing services required by the principal with no right to interfere in the management of the branch office. For example, the service agent arrange with entry of residence permits, acquiring necessary licenses and facilitating relations and thus transactions with authorities. In regards to representative offices, they are even more limited towards which activities can be undertaken: only promotion activities of the parent company is allowed*, Lester and O'Keefe (2011) p 9; Arab Center for the Development of the Rule of Law and Integrity (2008) p 43-45.

Appendix B

Free zones in the UAE[240]

- Masdar City
- Abu Dhabi Airport Free Zone
- Khalifa Industrial Zone
- twofour54
- Dubai Airport Freezone
- Dubai Silicon Oasis
- Jebel Ali Free Zone
- Dubai Multi Commodities Center
- Dubai Internet City
- Dubai Media City
- Dubai Studio City
- Dubai Academic City
- Dubai Knowledge Village
- Dubai Outsource Zone
- Enpark
- Intl Media Production Zone
- Dubai Biotech Research Park
- Dubai Auto Zone
- Gold and Diamond Park
- Dubai Healthcare City
- Dubai Intl Financial Center (DIFC): the only free zone in the UAE with its own civil, labor and commercial laws.
- Dubai Logistics City
- Dubai Maritime City
- Dubai Flower Centre
- Intl Humanitarian City
- Sharjah Airport Free Zone
- Hamriyah Free Zone

[240] Arab Center for the Development of the Rule of Law and Integrity (2008) p 54.

- Ahmed Bin Rashid FZ
- Ajman Free Zone
- RAK Free Zone
- RAK Maritime City
- Fujairah Free Zone
- Fujairah Creative City

Appendix C

Mail conversation requesting for Case X's case number.

Hello Anna,

Thank you for your email. I am not permitted to provide the judgment for confidentiality reasons. In most cases I can provide judgments but the client in this case said no. Please see the case citations below:
Appeal Judgments Numbered 539, 540 & 546 of 2009 provides a unique position on the issue of side agreements. The Supreme Court held that the side agreement can be established by any means of evidence and allowed the parties to hear testimony of witnesses.
When the Court of Appeal heard witnesses and rejected the claim, the parties appealed again to the Supreme Court under Appeals No 199,200 and 201 of 2011 whereby the Supreme Court considered the evidence submitted and decided that there was enough evidence to prove the existence of the side agreement and subsequently directed the Court of Appeal to look into this, after which the Court of Appeal issued its judgment in the appeals No 324,336 of 2008 confirming the existence of the side agreement.

The Supreme Court ruled for the third time (Appeals 300 and 301 of 2012)! In this latest and unusual judgment, the Supreme Court ruled very differently to the last decision and ignored the issue of the side agreement. The Supreme Court relied on Article 8, 10 and 11 of the Commercial Companies Law (CCL) and held that it was imperative for all agreements to be in writing, comply with the requirements of the CCL (i.e. that the UAE national holds the majority of the capital) and that all amendments to the company documents (i.e. Memorandum of Association) including the side agreement, must be duly notarized.

Kind regards,
Arabella Zane Anani
Associate
Al Tamimi & Company
Dubai International Financial Centre
Registered with the DFSA
www.tamimi.com

From: Anna Wallander [mailto:a.wallander87@gmail.com] **Sent:** Tuesday, July 09, 2013 4:01 PM **To:** Zane Anani; e.noor@tamimi.com
Subject: Fwd: Regarding a case

Dear,
I am a law student from Sweden about to finalize my Master Thesis before graduating from law school. I have studied foreign ownership structure in the light of side agreements (UAE) and discovered your article where a highly relevant case is being analyzed.
http://www.tamimi.com/en/magazine/law-update-magazine/section-6/july-august-1/the-courts-approach-side-agreements-and-their-enforceability.html
I would be thrilled if you could possible let me know the case number of that ruling as it would be a very good complementary to my study.
Moreover, is this article referring to the same case as the aforesaid? http://www.tamimi.com/en/magazine/law-update/section-5/june-issue/supreme-court-judgment-new-approach-on-the-issue-of-side-agreements.html

I appreciate your help very much!
Kind Regards,
Anna Wallander

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