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ALERT MEMORANDUM

The UAE Issues New Foreign Direct Investment Law, Relaxes Restrictions on Foreign Ownership of Certain UAE Businesses

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Foreign investors who for many years eagerly awaited the ability to establish majority or wholly owned businesses in the United Arab Emirates ("**UAE**") outside the free zones can prepare their bait—but cannot go fishing yet.

Following an announcement made by the UAE Council of Ministers earlier this year, the long-awaited Foreign Direct Investment Law was issued in September 2018 through federal Legislative Decree No. 19 of 2018 (the "**Foreign Direct Investment Law**").

While not repealing the restrictions on foreign ownership under the federal Commercial Companies Law No. 2 of 2015 (the "**Commercial Companies Law**"), the Foreign Direct Investment Law sets forth a framework entitling foreign investors to apply for a special status for their UAE-based investment vehicles that would accord them certain derogations from the provisions of the Commercial Companies Law, including in relation to the limit on foreign ownership. The new law does *not* relax foreign ownership limitations across the board.

The promulgation of the Foreign Direct Investment Law follows a series of legislative initiatives aimed at realizing the UAE Vision 2021 and boosting investments as well as economic diversification into the non-oil sector. As such, it follows the promulgation of the 2015 Commercial Companies Law, the 2016 Pledge Law, the 2016 Bankruptcy Law and the 2018 Arbitration Law. The philosophy of encouraging foreign investments is a growing trend within the region. Kuwait and Qatar now permit up to 100 per cent foreign ownership in specific sectors, and Saudi Arabia and Oman are both considering relaxing their current restrictions on foreign investments. The UAE government believes the Foreign Direct Investment Law will increase capital inflows by as much as 20 percent in 2019.

Below, we summarize the key provisions introduced by the new Foreign Direct Investment Law and analyze the potential impact on the investment landscape in the UAE.

I. The Context: The Commercial Companies Law Restrictions on Foreign Ownership of UAE Businesses

Pursuant to Article 10 of the Commercial Companies Law, foreign ownership of companies in the UAE is generally capped at 49 per cent. This general prohibition on majority foreign ownership of companies in the UAE has given rise to a number of structures purportedly allowing foreign investors to beneficially own a higher percentage of UAE companies. These structures—despite their widespread use—often raised legal questions, in particular under the federal Anti-Concealment Law No. 17 of 2004.

By contrast, the provisions of the Commercial Companies Law, including the limit on foreign ownership, do not apply to companies established in UAE free zones. However, free zone companies are typically not permitted to operate in the UAE "onshore" (i.e., outside the free zones).

As a first step towards easing the limitation on foreign ownership of UAE companies, Article 10 of the Commercial Companies Law was amended in September 2017 to allow the UAE Council of Ministers the flexibility to permit increased levels of foreign ownership in certain companies and sectors of the economy. To our knowledge, the Council of Ministers has never exercised this authority.

II. Scope and Goals of the Foreign Direct Investment Law

The Foreign Direct Investment Law allows certain licensed foreign direct investments to benefit from specific exemptions from the Commercial Companies Law (including, potentially, foreign ownership limitations) and other federal laws. These exemptions are *not* automatic and would need to be applied for through a process set out in the Foreign Direct Investment Law. Furthermore, these exemptions are coupled with a number of obligations that are not generally applicable to companies operating in the UAE.

Positive List

The Foreign Direct Investment Law envisages a "positive list" of sectors eligible for such exemptions. The Law does not, however, specify what the said sectors are. Rather, the UAE Council of Ministers is to issue the list based upon the recommendation of a Foreign Direct Investment Committee (the "**FDI Committee**") to be chaired by the Minister of Economy.

The timing and exact content of the positive list remain unclear. Speaking at an event in Dubai, the UAE Minister of Economy said that the UAE will reveal the list of sectors in which up to 100 percent foreign ownership is allowed by Q1 2019. "Renewable energy, artificial intelligence and technology are among the sectors that are being considered," he said.[1]

In determining the positive list sectors, the Council of Ministers must take into account and fulfill the objectives of the Foreign Direct Investment Law, which include "increasing foreign direct investment flows in priority sectors so as to achieve balanced and sustainable development and employment opportunities in various areas" and "expanding the productive asset base and transferring and attracting advanced technology, know-how and training."

Rather than opening the doors wide open to foreign-investor controlled investment, the positive list is expected to promote UAE industrial policy. The UAE Council of Ministers' resolution issuing the positive list

[1] "*UAE to announce sectors eligible for full foreign ownership in early 2019*" The National, 12 November 2018.

may specify the Emirate or Emirates in which a company must operate to be eligible for the benefits of the Foreign Direct Investment Law. The resolution may allow foreign ownership of up to 100% (or any lower percentage), and may also impose conditions including minimum capitalization and minimum employment levels for Emiratis.

Negative List

By contrast, the Foreign Direct Investment Law sets out explicitly a "negative list" of sectors excluded from the Law's scope, such as oil exploration and production activities; defense and security-related activities; banking and financial activities; insurance activities; certain recruitment activities; the provision of water and electricity; fishing and related services; post, telecommunication and other audiovisual services; road and air transport; printing and publishing; commercial agency; and medical retail (including pharmacies).

The Foreign Direct Investment Law authorizes the UAE Council of Ministers to add or remove sectors on the negative list upon the recommendation of the FDI Committee.

Case-by-Case Exemption

An activity that falls in neither the positive or negative list may benefit of the Foreign Direct Investment Law if approved by the Council of Ministers pursuant to a special procedure (*See "Applying for License for Foreign Direct Investment"*).

Exclusions

The Foreign Direct Investment Law generally only applies to foreign investments established and licensed in the UAE following the law's adoption. However, the Foreign Direct Investment Law does extend the benefits and protections provided in Articles 8 and 9 of the Law, including *inter alia* the right to repatriate dividends and salaries and the protections against confiscation and expropriation, to existing investments, and does not affect advantages already enjoyed by existing foreign investments pursuant to specific laws, regulations, treaties or contracts. Further, the Foreign Direct Investment Law generally does not apply to companies incorporated in financial or non-financial free zones in the UAE.

III. Applying for License for Foreign Direct Investment

An application for a license to carry out a business activity pursuant to the Foreign Direct Investment Law must first receive the approval in principle of the relevant federal or local administrative authority having the general power over licensing the project in question (e.g., Department of Economic Development, the relevant Ministry/Department in case of activity of a special nature, etc.), following which the foreign investor must apply to the foreign direct investment authority in the relevant Emirate (the "**FDI Authority**") for approval to conduct the activity as a foreign direct investment. This requirement to obtain a license applies even if the business in question is clearly within the positive list.

If the application concerns an activity not on the positive list, the FDI Authority may either reject the application or refer it to the FDI Committee after consulting with the government of the relevant Emirate. The Minister of Economy then refers the application, together with the recommendation of the FDI Committee, to the UAE Council of Ministers for approval.

If the license application is approved, the relevant company shall be registered in the foreign direct investment register kept at a newly formed Foreign Direct Investment Unit within the Ministry of Economy. The name of the company must be followed by the words "foreign direct investment."

IV. Instrumental Role of the FDI Committee

It is evident that the FDI Committee plays an instrumental role in the implementation process of the Foreign Direct Investment Law, in particular given that the FDI Committee is charged with proposing the positive list and additional negative list sectors to the Council of Ministers.

The FDI Committee is yet to be formed. It will include representatives of the various Emirates and other relevant authorities, including FDI Authorities. In fulfilling its role, the FDI Committee is required to liaise with local governments and various federal and local authorities, including FDI Authorities. The *modus operandi* of the FDI Committee will be set out in the resolution through which it will be formed. We will therefore have to wait and see whether such *modus operandi* will include mechanisms to avoid the complexities, delays and bureaucracy that typically arise when various parties are involved in a decision-making process. This would be crucial for the FDI Committee to be able to carry out its role efficiently.

V. Guarantees of the Foreign Direct Investment

A company licensed under the Foreign Direct Investment Law (the "**FDI Company**") shall be treated as a local company to the extent permissible under the applicable UAE laws and treaties. Further, an FDI Company shall be permitted to repatriate dividends as well as the proceeds of any sale, liquidation or judgment related to the investment. Employees of the FDI Company are also entitled to repatriate their salaries and benefits. All information submitted by or on behalf of the FDI Company to the relevant authorities will be treated confidentially.

The Foreign Direct Investment Law prohibits the confiscation or expropriation of the foreign direct investment/project save for a public benefit and against the payment of just compensation. A right of use issued to the FDI Company regarding land allocated to the foreign direct investment or the underlying project may not generally be cancelled or restricted unless the FDI Company is in breach of the terms of the license. In addition, the assets of the FDI Company may only be seized or confiscated pursuant to a judicial order.

VI. Obligations of the Foreign Direct Investment Company

The FDI Company must carry out the activity specified in its license and, in doing so, must abide by applicable federal and local laws, including those relating to the protection of the environment, public health and security. In addition, the FDI Company must employ and train Emirati nationals, and must abide by the Emiratization requirements to be set out in a UAE Council of Ministers resolution adopted pursuant to the Foreign Direct Investment Law. The FDI Company must also maintain its books and records in accordance with legal requirements, appoint one or more auditors (whose mandate cannot extend beyond 6 consecutive years), and provide the information, documentation and statistical data as may be required by the relevant authorities.

The FDI Company will be permitted to add new partners or investors through capital issuances or share sales, to amend its constitutional documents or legal form and to enter into merger and acquisition transactions with other entities. However, such operations require the written approval of the relevant authorities, including the FDI Authority in the relevant Emirate and the Foreign Direct Investment Unit at the Ministry of Economy.

VII. Miscellaneous

Disputes arising from a Foreign Direct Investment may be submitted to alternative dispute resolution mechanisms.

The introduction of the FDI Law is a significant milestone towards the liberalization of certain sectors of the UAE economy in line with the government's continued efforts to attract foreign investment and achieve non-oil economic diversification. However, we will need to wait until the anticipated resolutions of the Council of Ministers are put in place, and later monitor the practice of the FDI Committee and FDI Authorities, to be able to effectively assess how far the UAE government is prepared to go in its liberalization efforts.

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