ALERT MEMORANDUM

While Others Increase Scrutiny of FDI, the UAE Takes Another Step Towards Relaxation of Foreign Ownership Restrictions

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The United Arab Emirates ("**UAE**") has taken another step along the path towards becoming one of the most friendly jurisdictions for foreign investment. On July 2, 2019, the UAE Council of Ministers announced that it had approved a list of sectors and economic activities eligible for up to 100% foreign ownership in the UAE (the "**Cabinet Decision**"). The Cabinet Decision was finally issued on March 17, 2020 and published in the UAE Official Gazette on March 31, 2020.

The Cabinet Decision follows the adoption of the Foreign Direct Investment Law in September 2018 through Federal Legislative Decree No. 19 of 2018 (the "**FDI Law**"). The FDI Law set forth a framework enabling foreign investors to apply for a special status for their UAE-based investment vehicles that would grant them certain derogations from the provisions of the federal Commercial Companies Law No. 2 of 2015 (the "**Commercial Companies Law**"), including in relation to the restrictions on foreign ownership. The Cabinet Decision provided long-awaited details that the FDI Law intended to be determined at a later stage, but the picture still needs to be completed by a series of decisions at the level of each Emirate, the timing of which is unclear.

The FDI Law and, more recently, Cabinet Decision are the latest in 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. The publication of the 2015 Commercial Companies Law, the 2016 Pledge Law, the 2016 Bankruptcy Law and the 2018 Arbitration Law are further examples of the UAE's commitment to creating a modern, robust and investor-friendly legislative framework as the foundation of wider efforts towards economic diversification.

Below, we summarize the legal framework for foreign investors in the UAE prior to the adoption of the FDI Law and the key provisions introduced by the FDI Law and the Cabinet Decision. We also analyse the potential impact of this new regime on the investment landscape in the UAE and compare it with the equivalent rules adopted in neighbouring members of the Gulf Cooperation Council ("**GCC**").

I. The Historical 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%. Although 100% foreign ownership of companies is allowed in designated free trade zones in the UAE, free zone companies are typically not permitted to operate in the UAE "onshore" (i.e., outside the free zones). To operate onshore, foreign investors have to either (i) incorporate a company onshore and partner with a UAE investor who would hold the remaining 51% stake in such company; or (ii) incorporate a fully owned company in a free zone, establish a branch onshore under the same name and appoint a local service agent who will have no civil responsibility, financial obligations or managerial involvement with respect to the business but whose sole function is to ensure that the branch conducts its business onshore.

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. Note that this flexibility is separate from the FDI Law but, to our knowledge, the Council of Ministers has never exercised this authority.

Mitigation of Restrictions on Foreign Ownership

The general prohibition on majority foreign ownership in the UAE gave rise to a number of structures designed to allow foreign investors to own a higher percentage, in economic terms, of UAE companies. Attempts at mitigating restrictions on foreign ownership include the use of side letters, nominee shareholder arrangements or trust structures.

A nominee arrangement typically involves the designation of a UAE nominee shareholder who would hold the majority of shares in a company on behalf of a foreign investor, but surrender the management, control and profit entitlement in the company in exchange for a fixed annual fee. This suited UAE partners who preferred not to be actively involved in the business dealings of the company. Several companies provide services related to nominee arrangements such as acting as nominee shareholder (and are in this case owned by UAE partners), recommending local nominee shareholders to foreign investors or setting up the required nominee structure.

These structures—despite their widespread use—often raised legal questions, in particular under the federal Anti-Concealment Law No. 17 of 2004 (the "**Anti-Fronting Law**") which, when enacted, was intended to prohibit the use of side contracts or nominee agreements with UAE nationals. Sanctions for violating the Anti-Fronting Law include both civil and criminal penalties and extend to all parties concerned, with the possibility of a deregistration from the commercial registry and a revocation of the license with respect to the company subject of such arrangements. Although the implementation of the Anti-Fronting Law was subsequently delayed and the law is currently not demonstrably enforced in practice, some foreign investors have shied away from using nominee arrangements in fear that this situation could change at any time and many others have reluctantly concluded that they must use these structures but remain concerned about the legal risks associated with them. Such structures have come under renewed scrutiny recently, as developments at NMC Health and related companies have led to questions around their ownership structures.

Nominee arrangements have both been upheld and struck down by UAE courts, which led to legal uncertainty surrounding their validity. Further, certain common law concepts (e.g., trusts or beneficial interests) are not generally recognized in civil law jurisdictions such as the UAE. For this reason, some investors have structured their onshore investments through the ADGM free zone, which does recognize English law trust structures.

While UAE courts may have upheld such side arrangements in the past, there is no guarantee they will continue to do so. As such, foreign investors remain dependent on the willingness of their UAE partner to abide by the terms of their arrangement and face significant risk in the event the relationship with this UAE partner becomes strained. Such risk could typically arise in the context of a drag-along sale where the UAE partner could refuse to participate in the sale and hold the transaction ransom in order to negotiate a higher financial return in exchange for his involvement in the structure. Other examples of practical risks of such structures are the risk that a passive owner alongside a private equity investor suddenly wishes to become actively involved in the management of the company or simply the risk that the local partner passes away and the business cannot be operated lawfully until he is replaced. Having a corporate service provider instead of an individual local partner as the nominee mitigates some of the practical risks but does not eliminate all of the legal risks.

In this context, the FDI Law and the Cabinet Decision are in line with the UAE's aim to increase capital inflow and create growth, by providing a transparent legal framework within which foreign investors can invest directly, without needing to find a local partner or set up convoluted legal structures.

II. Scope and Goals of the Foreign Direct Investment Law

The FDI 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 will need to be applied for through a process set out in the FDI 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 FDI Law envisaged a "positive list" of sectors eligible for such exemptions but did not specify what the said sectors are. Rather, the FDI Law envisaged that the UAE Council of Ministers would issue the list based upon the recommendation of a Foreign Direct Investment Committee (the "**FDI Committee**") to be chaired by the Minister of Economy. This is the void the Cabinet Decision has filled.

The announcement of the Cabinet Decision in July 2019 specified a total of 122 economic activities across 13 sectors eligible for up to 100% foreign ownership. These sectors are: (i) renewable energy; (ii) space; (iii) agriculture and manufacturing; (iv) transport and storage; (v) hospitality and food services; (vi) information and communications;(vii) professional, scientific and technical activities; (viii) administrative services; (ix) support services; (x) educational activities; (xi) healthcare; (xii) art and entertainment; and (xiii) construction. The final published Cabinet Decision groups these 122 economic activities into 3 broader categories: agriculture, industry, and services.

In determining the positive list of sectors, the UAE Council of Ministers had to take into account the objectives of the FDI 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 throwing the doors wide open to foreign-investor controlled investment, the positive list seems to have been carefully tailored to promote UAE industrial policy.

The Cabinet Decision provides that an eligible activity must be carried out under the legal form of a limited liability company or a private joint stock company, either of which can be a one person company, and excludes the requirement under the Commercial Companies Law that the chairman and the majority of board members of such companies be UAE nationals. The Cabinet Decision also specifies the minimum capital as well as other terms and conditions applicable with respect to each eligible activity in addition to terms and conditions imposed by regulators or applicable legislation.

However, the Cabinet Decision still needs to be reinforced and clarified by a series of decisions at the level of each Emirate specifying the formal procedure a company must follow in order to apply for exemptions under the FDI Law.

Negative List

By contrast, the FDI Law also explicitly set out a "negative list" of sectors excluded from the Law's scope, including: (i) oil exploration and production activities; (ii) defence and security-related activities; (iii) banking and financial activities; (iv) insurance activities; (v) certain recruitment activities; (vi) the provision of water and electricity; (vii) fishing and related services; (viii) post, telecommunication and other audio-visual services; (ix) road and air transport; (x) printing and publishing; (xi) commercial agency; and (xii) medical retail (including pharmacies). The choice of sectors seems to be driven by a combination of reasons, such as the strategic importance of these sectors or the desire to protect strong local interests. The UAE Council of Ministers clearly considered that the economy and the local public opinion was not ready to welcome a significant liberalization of foreign investment restrictions in these specific sectors.

The FDI 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 nor the negative list may benefit from the FDI Law if approved by the Council of Ministers pursuant to a special procedure (*See "Applying for License for Foreign Direct Investment"*). We are aware that Dubai has begun to accept applications by foreign investors pursuant to this process.

Exclusions

The FDI Law generally only applies to foreign investments established and licensed in the UAE after the date of the law's adoption. However, the FDI Law does extend the benefits and protections provided within Articles 8 and 9 of the law, including the right to repatriate dividends and salaries and the protections against confiscation and expropriation, to existing investments, without affecting the advantages already enjoyed by existing foreign investments pursuant to specific laws, regulations, treaties or contracts. Further, the FDI Law generally does not apply to companies incorporated in financial or non-financial free zones in the UAE. Foreign investors who had the foresight of inserting appropriate termination clauses in their nominee arrangements should be able to untangle themselves from their UAE partners in order to benefit from the exemptions of the FDI Law relating to foreign ownership.

III. Applying for License for Foreign Direct Investment

As explained above, where an activity does not fall within either the positive list or the negative list, majority foreign ownership may be permitted if a specific license is obtained. However, the requirement to obtain a license also applies even if the business in question is clearly within the positive list. An application for a license to carry out a business activity pursuant to the FDI Law must first receive the approval in principle of the relevant federal or local administrative authority having the general power over licensing the project[1] in question (e.g., Department of Economic Development, the relevant Ministry/Department in the case of an activity of a special nature, etc.). Following this initial approval, the foreign investor must then apply to the foreign direct investment authority in the relevant Emirate (the "**Emirate FDI Authority**") for approval to conduct the activity as a foreign direct investment. The government of each Emirate will need to specify the details of the formal procedure a company must follow to apply for such license.

If the application concerns an activity not on the positive list, the Emirate 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 will then refer the

[1] Note that the law specifically uses the term "project" so it is unclear whether this procedure is available to exempt a general investment vehicle that has not been established to implement a particular project.

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. Benefits of the Foreign Direct Investment Law

The obvious benefit available to foreign investors in the relevant business activities is the ability to legally own a majority of the investment. A number of other benefits apply.

A company licensed under the FDI 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. The FDI Law specifies that all information submitted by or on behalf of the FDI Company to the relevant authorities will be treated confidentially. In addition, the Cabinet Decision provides that an Emirate FDI Authority may grant additional benefits to an FDI Company.

Prior to the FDI Law, the UAE did not have any domestic laws to protect foreign investors from nationalization or expropriation. Foreign investors had to rely on the protections granted under bilateral investment treaties and other international conventions to which the UAE is signatory, as well as on general local law principles protecting private property, including Article 21 of the UAE Constitution, which established a general protection of private property “except in circumstances dictated by the public interest in accordance with the provisions of the law, and on payment of fair compensation.”. The FDI Law provides additional guarantees to foreign investors by specifically prohibiting the confiscation or expropriation of the foreign direct investment/project, except if such confiscation or expropriation is undertaken for the public benefit and in exchange for 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.

Further, the FDI Law provides that disputes arising from a foreign direct investment may be submitted to alternative dispute resolution mechanisms, and those submitted in front of competent courts in the UAE will be heard expeditiously. While the FDI Law has the benefit of providing foreign investors a choice with respect to forums or mechanisms in order to deal with disputes, it does not elaborate a particular default process in the event that parties involved in a foreign direct investment fail to agree on the terms governing the resolutions of their disputes. The law is also vague in referring to “disputes arising from a foreign direct investment”, and it is unclear what constitutes such types of disputes.

V. 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 applicable Emiratisation requirements. The Cabinet Decision has delegated the task of defining the minimum employment levels for Emiratis to the Ministry of Human Resources and Emiratisation. 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 such information, documentation and statistical data as may be required by the relevant authorities. These requirements are similar to those that apply to any UAE company, but are in some cases slightly less onerous.

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 Emirate FDI Authority and the Foreign Direct Investment Unit at the Ministry of Economy. This significant limitation on the possibility of foreign investors to expand or exit their investments reveals the UAE's desire to keep a watchful eye on the identities of the foreign investors benefiting from the FDI Law and the economic activities they undertake. This limitation could also have a counterproductive effect on the UAE's asserted objective to attract capital inflows by discouraging foreign investors from applying to benefit from the FDI Law and leading them to revert to the old structures the FDI Law was supposed to make redundant.

VI. Similar Developments in Neighbouring Jurisdictions; Opposite Trend Further Afield

Historically, GCC countries have been more open to trade than to foreign direct investments but there has been a significant shift towards FDI over the past 5-10 years.

The GCC and the MENA region seem to be headed in the opposite direction to many countries, given recent developments in CFIUS rules[2], the strengthening of FDI review regimes in China[3], the UK and other European countries[4], and ongoing efforts to introduce a common framework or harmonisation across the EU, which have been thrown into renewed focus due to the COVID-19 pandemic[5]. Yet, within the GCC and wider MENA region, the philosophy of encouraging foreign investments is a growing trend, as calls to reduce exposure to volatility and uncertainty in the global oil market, create private sector jobs, and increase productivity and sustainable growth became louder following a sharp decline in oil prices in 2014. Arguably, the current COVID-19 pandemic and ongoing volatility in the oil price make this task more urgent still.

GCC countries have recently been focusing on implementing reforms in an effort to diversify their economies and in order to attract foreign direct investment in the wake of weakening capital inflows in recent years. These countries have adopted a similar approach to relaxing foreign ownership restrictions, for example by listing sectors to be excluded from the scope of foreign investment law and requiring foreign investors to apply for an exemption from restrictions on foreign ownership. Kuwait, Qatar, Saudi Arabia and Oman now permit up to 100% foreign ownership in specific sectors. However, with the exception of Bahrain, restrictions on foreign ownership remain the default in GCC countries, and foreign investment legislations provide the possibility of a derogation from the standard restrictions.

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[2] For further information on recent CFIUS developments, see our memorandum published on 22 January 2020: https://www.clearygottlieb.com/-/media/files/alert-memos-2020/cfius-releases-final-firrma-regulations.pdf.

[3] For further information on recent FDI developments in China, see our memorandum published on 11 April 2019: https://www.clearymawatch.com/2019/04/the-new-foreign-investment-law-ushers-in-new-regime-for-foreign-investments-in-china/.

[4] For further information on recent FDI developments in France, see our memorandum published on 9 March 2020: https://www.clearytradewatch.com/2020/03/french-foreign-investment-control-new-rules-applicable-as-from-april-1st-2020/. For further information on recent FDI developments in Germany, see our memorandum published on 10 March 2020: https://www.clearytradewatch.com/2020/03/upcoming-changes-to-the-german-foreign-direct-investment-control-regime/.

[5] For further information on the recent European Commission communication on screening of FDI in the context of the COVID-19 pandemic, see our memorandum published on 2 April 2020: https://www.clearygottlieb.com/-/media/files/alert-memos-2020/european-commission-urges-member-states-to-protect-suppliers-pdf.pdf.

In Saudi Arabia, foreign direct investment is regulated by the Saudi Arabian General Investment Authority ("**SAGIA**") whose main functions are to attract and retain foreign investors in the country, and to oversee the liberalization and diversification process of the Saudi economy. SAGIA also issues licenses for any type of foreign investment in a permitted activity in Saudi Arabia, irrespective of the foreign investor's ownership percentage. SAGIA also has the authority to take action against violations of foreign investment rules by foreign investors. In comparison with the framework adopted in the UAE, SAGIA's role and authority extends much further than those given to the FDI Committee or the Emirate FDI Authorities. Saudi Arabia currently allows for 100% foreign ownership in certain activities such as wholesale and retail trade or engineering, although this remains subject to certain conditions. In addition, the Saudi Arabian Capital Markets Authority has recently relaxed the additional 49% foreign ownership limitation on companies listed on Riyadh's Tadawul stock exchange by allowing foreign strategic investors to take controlling stakes in such companies.

In Oman, foreign investors were limited to 49%-70% ownership, depending on the sector, while US firms have been permitted since 2009 to own up to 100% of their investments under a bilateral treaty. On July 1, 2019, Oman adopted a new law allowing for 100% ownership to all foreign investors. However, the executive regulation and decisions necessary for the implementation of this law still need to be issued by the relevant authorities. The law became effective 6 months following its adoption. It remains to be seen how it will be implemented.

Qatar adopted a new law regulating foreign investments on January 7, 2019. The new law set out a framework similar to the one established by the UAE's FDI Law by specifying a number of activities that remain excluded from the scope of the law (such as banking and insurance activities or commercial agencies), and requiring that foreign investors seek the approval of the Ministry of Commerce and Industry in order to benefit from exemptions from restrictions on foreign ownership.

Bahrain is currently the most permissive GCC jurisdiction in terms of the extent to which full onshore foreign ownership is permitted and exists in practice. It first granted US nationals GCC recognition for investment purposes decades ago, thereby allowing them to invest in activities otherwise restricted to foreign investors. Then, in 2014, Bahrain removed from its Commercial Companies Law the requirement that all shareholders in a public joint stock company shall be of Bahraini nationality, whilst giving competent authorities the power to impose foreign ownership restrictions in certain economic sectors or activities. In 2016, majority foreign ownership was further extended to the tourism and mining sectors, and restrictions on foreign ownership in Bahrain remain only in a few activities such as media or workforce agencies. Kuwait also started to liberalize investment regulation early on and adopted a law in 2014 allowing for 100% foreign owned investments in various sectors such as infrastructure, tourism, IT and housing.

Other countries in the wider region are taking a similar approach to opening up for investment – a recent example being Algeria. The Algerian 2020 finance law provides for the removal of the 49% foreign ownership cap in Algerian companies, although the cap will be maintained in certain strategic sectors that will be determined by regulation. Such sectors are expected to include hydrocarbons, banking, insurance and telecommunications. The law also removes the local financing obligation under the previous foreign direct investment regime and allows for the financing of certain projects by international development financial institutions, subject to the consultation of the competent local authorities. We will have to wait for the publication of the relevant regulations in order to confirm the scale of the liberalization measures in Algeria.

VII. Conclusion

The Cabinet Decision is another indication of the UAE's commitment and continued efforts to attract foreign investment and achieve non-oil economic diversification. However, now that the positive list of sectors has been set out and brought into force, we will need to wait for decisions to be taken at the level of each Emirate to understand the full details of the new regime. We will also need to monitor the practice of the FDI Committee and the respective Emirate FDI Authorities in the future in order to effectively assess whether the UAE government was successful in its liberalization efforts.

The regime that the UAE has decided to adopt is not the wholescale liberalization that some had been hoping for. Foreign investors will still have to go through a process of seeking the written approval of local authorities in order to benefit from the FDI Law and the requirement for government approval over M&A activity, share issuances and amending by-laws may put some off. Time will tell to what extent the FDI Law and Cabinet Decision really has the desired effect of encouraging greater foreign investment and thus helping to diversify the UAE economy. But ultimately, foreign investors themselves will likely have the last word as to whether the new foreign investment regime is as attractive as the UAE has intended it to be.

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