

## Middle East Exchange

March 2010

Welcome to this first edition of Middle East Exchange which is a new regular publication designed to address legal topics of interest in the Middle East and provide updates on some key regional legal developments.

- Protecting shareholdings in the Middle East - what can you do as the minority shareholder?
- Recent legal developments in the Middle East

### Protecting shareholdings in the Middle East - what can you do as the minority shareholder?

Many Middle East countries require that a majority of shares in companies incorporated within their jurisdiction are owned by their own nationals or (in some cases) nationals from GCC states. Investments by overseas entities are therefore usually structured as minority interests. The acquisition of a minority stake requires overseas investors to understand:

- the legal provisions that exist under the local law in order to provide protection for minority shareholders; and
- the additional legal protections that can be built into the contractual relationship among the shareholders.

Overseas investors need to devote as much attention to the structure of their ongoing relationship with the local shareholders as they do to the terms of the initial acquisition. A well drafted shareholders' agreement is an important component in providing the framework for this relationship and in protecting minority interests into the future.

#### Minority shareholder protections under the law

Generally, the company legislation in force in Middle East countries affords limited protection for minority shareholders. The provisions which are available can be categorised into two groups:

- Blocking rights – rights which provide shareholders the power to block the passing of shareholder resolutions, by virtue of the percentage of votes needed to be cast in favour of those resolutions. Blocking rights generally exist in relation to resolutions to amend the company's constitutional documents, to appoint and remove directors or managers of the company, to change the company's capital and to change the company's name.
- Positive rights – rights which provide shareholders holding a specific percentage of shares with the ability to demand certain actions be taken, such as calling a shareholders' meeting and receiving information or reports from the company's management.

The ability to block an issue of new shares by the company is key for a minority shareholder to ensure that its holding is not diluted, particularly if its percentage holding may then be reduced beneath the level at which it can block certain corporate actions or require various actions to be taken. By way of example, the company laws of Bahrain and the United Arab Emirates require that holders of 75% of the company's share capital vote in favour of an issue of new share capital. Consequently, if an overseas investor takes the maximum holding permissible under the foreign ownership rules, it will have automatic protection from dilution under the law. It should be noted that the company laws of many of the GCC countries also provide for pre-emption rights on an issue of new shares, as well as on transfer by an existing shareholder, which also affords protection against dilution.

#### Building in additional protection

There are two ways in which additional protection may be incorporated into a joint venture relationship beyond that provided under the company law:

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- amending the company's constitutional documents to include further rights for minority shareholders (such as higher percentage voting thresholds on certain resolutions and unanimity on particularly important resolutions); and
- entering into a shareholders' agreement which contains contractual rights for the minority shareholder and obligations on the majority holder.

Amending the constitutional documents is the preferred option. This is because it may be easier to obtain a local court injunction to prevent a breach of the company's constitution or other redress than it would be to enforce a shareholders' agreement.

However, it is generally the case in GCC countries that the ability of shareholders to alter the company's constitution away from the standard form document which is typically used and registered with the relevant authorities is restricted. There are limited examples in which the local company law expressly permits the shareholders to agree a different, more stringent provision. Examples under Saudi law include resolutions to issue new shares, to voluntarily wind up the company and to dispose of all or substantially all of its assets, which each require the approval of 75% of the votes attaching to all the company's shares to be cast in favour, unless the articles are amended to be more restrictive.

Therefore, it is typical for the shareholders' agreement to contain extensive provisions for the protection of the minority interests under which the parties contractually agree to extend the rights provided by law. For example, the shareholders' agreement will often provide for a list of "reserved matters" in respect of which a higher percentage of shareholder approval will be required. The shareholders' agreement will usually stipulate that the provisions of that agreement prevail over the constitutional documents of the company to the extent they contradict one another, which deals with the position in which the standard constitutional documents may not be amended by law.

Note, however, that enforcement of the rights will lie in taking action for breach of contract and consequently, the choice of governing law and jurisdiction becomes important. It is commonplace to opt for a neutral, well developed law, such as English law, and for the parties to agree to submit to arbitration in their disputes.

## Considering other structures

Given the restrictions imposed by the foreign ownership rules in the GCC countries, it may benefit investors to consider other possible options for structuring an investment. The foreign ownership rules do not apply in certain freezones across the region, although in some countries it is not possible for freezone companies to do business in that country outside the boundaries of the freezone – the UAE is one such country. Careful legal structuring may therefore need to be undertaken to achieve commercial aspirations.

*Example of UAE company law blocking rights for limited liability companies (LLCs)*

Type of resolutions	Required percentage approval
Amendments to constitution	75% (by virtue of the need to change constitution)
Change of name	75%
Removal of managers	75% (if the removal is provided for in the constitution) or 100% (if the constitution is silent)
Declare a dividend	50%
Increasing the issued share capital	75%
Reduction of share capital	75%
Increase the financial burden on Shareholders above the value of shares held	100%
Merger of the company or a sale of all or substantially all of the assets of the company	75%
Dissolution of the company	100% (subject to specific provisions in the company's constitution)

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## Recent legal developments in the Middle East

### Dubai World – government releases details of a tailor-made restructuring process

In the wake of the high profile financial problems affecting the Dubai World group, the Dubai government has announced a new reorganisation law in case that group is unable to achieve an acceptable restructuring of its debts. New legislation was needed because the status of Dubai World as a company incorporated under special legislation means that the UAE insolvency laws do not apply to it. The new legislation:

- establishes a tribunal comprising three judges taken from the courts of the Dubai International Financial Centre (the DIFC) to oversee the restructuring process; and
- creates a legal framework for the financial reorganisation based on the laws of the DIFC.

This is an interesting legal development because the laws and the legal system of the DIFC do not usually apply outside of that freezone to entities and activities carried on in the mainland UAE.

Please see the [Herbert Smith e-bulletin from December 2009](#) which discusses the role and powers of the specially constructed tribunal.

### New dispute resolution centre launched in Bahrain

The Kingdom of Bahrain has launched a new dispute resolution centre to be known as the Bahrain Centre for Dispute Resolution, in joint venture with the American Arbitration Association. The aims of the centre are to provide public and private arbitration in Bahrain for international claims as a new potential choice of forum in the Middle East. To ensure its independence from the Bahraini legal system, the BCDR has been created within an "arbitration freezone" so that awards made by a tribunal of the BCDR will be free from challenge before the Bahraini courts if the "seat" of the dispute is in another jurisdiction.

In addition, the Bahraini government has legislated to move certain high value commercial claims falling within the jurisdiction of the Bahraini courts to the BCDR for a "statutory arbitration" process, depending on the identity of the parties to the dispute. The awards made will be final and binding and deemed to be a ruling of the Bahraini courts, which follows from the majority of the judges in these cases being selected by the Supreme Judicial Council (which supervises the judiciary in Bahrain). This is a significant legal development because it imposes arbitration procedures on commercial disputes falling within the jurisdiction of the Bahraini national courts, irrespective of the intentions of the parties.

Please see the [Herbert Smith dispute resolution e-bulletin](#) for further details on the BCDR-AAA.

### Draft business laws in their final stages in the UAE

The Emirates Securities and Commodities Authority has stated that a new corporate law requiring listed companies in the UAE to exercise full transparency and making it compulsory for listed companies to abide by all ESCA rules and regulations will be introduced by April 2010. Separately, it has been reported that the UAE Minister of Justice has stated that a number of new business laws are in their final phases before being referred to the Federal National Council for discussion, including laws relating to competitiveness, bankruptcy and company law.

### New Kuwaiti private sector labour law due to come into force

A new labour law for private sector employers and employees has been approved by the Kuwaiti parliament. The new law is reported to include provisions for redundancy pay and a right of transfer between sponsors, as well as improved maternity rights and a requirement for large employers to provide childcare facilities. A mandatory three month notice period is also said to be included in the law for employers wishing to terminate employment contracts.

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