

Structuring investments in the Middle East

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Overview

The countries in the Middle East are among the fastest growing economies in the world as some have shown outstanding GDP growth rates over the past 10 years. Notwithstanding some of the political instability in the region, revenues generated by oil and gas trade and the resulting accumulation of wealth and a growing middle class open a number of opportunities for Canadian businesses as these governments are looking to attract foreign direct investment and expertise from the around the world in various sectors, including, construction, education, healthcare and infrastructure.

This article provides a brief overview of some the legal issues which should be considered by Canadian companies when establishing a business and making investments in the Middle East, with references (where appropriate) to the United Arab Emirates (“UAE”) (rather than covering the entire Gulf Co-operation Council (the “GCC”) which includes Bahrain, the Kingdom of Saudi Arabia, Kuwait, Oman and Qatar) as the UAE represents an obvious hub through which Canadian businesses can run their regional operations and make investments in the Middle East and the UAE has historically accounted for most of Canada’s trading activity in the GCC.

Structuring Investments and Key Issues

Local Ownership Restrictions

Many of the Middle Eastern jurisdictions impose requirements under their local company laws which restrict the level of foreign ownership of companies established within. For example, generally every company incorporated in the UAE under local law must have at least one or more UAE nationals as a shareholder whose shareholding in the capital of the company must not be less than 51%.

As a result of these restrictions in the UAE and comparable restrictions in other Middle Eastern jurisdictions, investments by foreign entities in the Middle East are typically structured as minority investments. This raises a number of issues in terms of structuring an investment to address the legal risks associated with minority ownership and highlights the importance of Canadian businesses understanding:

- (1) what legal provisions exist under local law in the Middle East which provide for the protection of minority shareholders; and
- (2) what additional protections can be incorporated into the legal documentation governing the relationship between Canadian investors and their local partners.

Key Document Protections and Alternative Contractual Arrangements

In respect of item (2), above, these comprehensive protections will typically be incorporated into a shareholders agreement or a similar

document (i.e. an investment agreement, joint venture agreement, etc.) and the constating documents of the local company. These protections would include (among others) comprehensive veto rights, clearly defined information rights, higher percentage voting thresholds for certain resolutions and a governing law of an acceptable jurisdiction.

In order to deal with the restrictions imposed on foreign ownership in the Middle East, there has evolved over the years a market practice for foreign investors to enter into additional contractual arrangements (e.g. trust arrangements, nominee agreements, powers of attorney, license agreements, etc.) with the objective of giving the foreign investor sole control over the local company at both the management and shareholder level.

A key risk associated with these arrangements is that they would likely contravene the concealment laws in place in most Middle Eastern jurisdictions which prohibit such arrangements. That being said, there is some uncertainty as to whether the competent authorities would actually choose to enforce these laws given that these arrangements are common practice in most Middle Eastern jurisdictions and have been a key factor to attracting foreign investment to those jurisdictions. For example, in the UAE, a concealment law has been passed but the enforcement of the law is currently, suspended.

Free-Zone and Offshore Companies

In light of the ownership restrictions under local laws in the Middle East, some foreign entities have opted to establish their operations and make investments in certain designated "free-zones" which exist in some GCC countries, as they generally permit 100% foreign ownership. However, incorporating in a free-zone may be problematic in that some of these free-zones preclude entities established and/or licensed within their free-zones from conducting business and having operations outside of these areas. Accordingly, Canadian businesses exploring the feasibility of establishing a presence in a free-zone need to be mindful of what restrictions exist in these free-zones in view of their proposed business activities.

A key point for Canadian investors to keep in mind is that the relevant legal protections which they have as investors are determined by the law of the jurisdiction pursuant to which the company they invest in is established. In this respect, a number of private equity investments in the Middle East have been structured, when possible, through the use of an offshore company (i.e. British Virgin islands, Cayman Islands, etc.) with the result that they have not invested directly into the operating businesses which were established under local law. These steps have been taken on the basis that the private equity investor would avail themselves of the benefit of a legal regime which (i) provides them with rights as shareholders which are more analogous to the rights they would have under the laws of certain Western European and North American jurisdictions in which they are accustomed to doing business, and (ii) provides these investors with more certainty in terms of how the law will be interpreted and applied by the courts or other competent authorities.

Directors' Duties and Liabilities

Canadian businesses which appoint directors to the boards of Middle Eastern companies need to understand that they are subject to regimes which do not necessarily have comparable sets of directors' duties to those that exist in Canada, and therefore this may expose directors of Middle Eastern companies to personal liabilities and possibly even criminal sanctions including imprisonment. Therefore, it is crucial for Canadian businesses contemplating appointing a director to a local company in the Middle East to comprehend the scope of the responsibilities of a director under local law.

Summary

Prior to making investments and establishing a presence in the Middle East, Canadian businesses will need to invest time to not only understand the local legal framework, but also understand what are acceptable market practices in these jurisdictions and what it is practical for foreign investors to do in order to address various requirements under Middle Eastern laws.

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