MAYER • BROWN

The Improving Case for Joint Ventures in the Middle East: KSA and UAE

Charles Hallab

Co-lead, Joint Venture Practice

Chair, Middle East Practice

challab@mayerbrown.com

Tahan (Tom) Thraya

Partner-in-Charge of Dubai Office

Head, Middle East Corporate Practice

tthraya@mayerbrown.com

July 27, 2017

KSA: Positive Legal Developments

- **New 2015 Companies Law**
  - LLCs can now be formed with a single member (no longer a minimum requirement of two members) - deadlock and foreign JV implications with local holding company
  - Members in LLCs are no longer jointly liable for the debts of an LLC in certain cases – bad actor implications
- **Relaxed Local Ownership and Capital Requirements**
  - Non-Saudi investors in KSA now have the flexibility to structure their company more effectively to benefit from opportunities in the Saudi market, namely, by seeking up to 100% ownership or operating through a joint venture
    - ➢ This is an increase from the previously imposed 75% limit on foreign ownership in trading companies
  - Relaxed minimum capital requirements for LLCs , the most common vehicle for JVs (used to be SAR500,000 - approximately US$135,000)
    - ➢ Although the industrial sector requires a minimum capital requirement of SAR10 million (approximately US$2.7 million)

KSA: Positive Legal Developments (cont.)

- **More Efficient Government Investment Services**
  - Up until recently, it took months to obtain an investment license from SAGIA - it now generally takes 30 days
  - SAGIA has now merged with the Saudi Ministry of Commerce and Investment (MOCI) to become a "one-stop-shop" for investment approvals and services
- **Tax Incentives**
  - 20% tax on corporate profits (losses are carried forward indefinitely to offset future taxes)
  - Companies are permitted to fully repatriate capital, profit and dividends (subject to a 5% withholding tax)
  - Earnings from exports are tax exempt
  - Companies making R&D investments are eligible for tax credits

KSA: Positive Legal Developments (cont.)

- **Other Legal Aspects of Saudi Arabia's JV Landscape**
  - Saudi Arabia has relaxed its restrictions on real estate investment for non-Saudis. Non-Saudis are now able to invest in real estate in certain parts of the Kingdom
  - Licensed companies can serve as immigration sponsors for their investors and its non-Saudi employees without the need for a local partner (used to be that local partner was required for such sponsorships)
  - New local manufacturing requirements have been introduced - e.g., half of the Saudi military's equipment must be manufactured locally
  - Despite recent updates to the legal system, guidance on the mechanics of exiting a JV in Saudi Arabia are still vague. The consensus among JV practitioners in the region is that unilateral termination is not permitted

KSA: Non-Legal Factors

- **Saudi 2030 Vision**: The Vision aims to spur economic diversity and sustainability, with the specific long-term goal of reducing Saudi Arabia's reliance on oil. It has allowed for the following :
  - **The Human Resources Development Fund**
    - provides investors with tools and guidance to qualify, train and recruit Saudi workers
  - **Saudi Industrial Development Fund**
    - Loans are now more easily obtained from the Saudi Industrial Development Fund and from other different regional funds

KSA: Non-Legal Factors (cont.)

- **MODON (Saudi Industrial Property Authority)**
  - responsible for developing industrial cities in the Kingdom
  - 34 cities in the Kingdom, more than 5,800 factories and more than 480,000 employees
  - Private Industrial Cities: Six unique cities for industries with high global standards and specifications. Advantages and incentives include:
    - Annual rent rates start at 1 SAR (US$ 0.26) per square meter
    - 75% of an Industrial City company's operating capital can be obtained in the form of a loan from the government or from regional banks, generally with an obligation to be repaid within twenty years

- **Anecdotally....**

UAE: Positive Legal Developments

Why Joint Ventures in the First Place?

1. Natural progression of the business from a purely commercial agency arrangement (i.e., direct client interface, better brand recognition, direct employee sponsorship, etc.)
2. Avoiding the significant legal pitfalls of a registered commercial agency (i.e., restrictions on termination, importation/business band, etc.)
3. Consolidation considerations
4. A show of greater local investment (especially in regards to governmental entities/RFPs)
5. Greater management control and greater claim to profits

Traditional JV Issues and Recent Legal Developments

Prior Positions	Current Positions/Amendments in Law and Practice
1. 51% Local Ownership Rule: • Emirati shareholder required to hold at least 51% of the shares • Difficulty in guaranteeing that local shareholder will honor terms	• Free zone options • Pledging of shares now permitted based on new Companies Law Amendments in 2015
2. Nominee Shareholder Issues: • No legal recognition of trust agreements in the UAE • Nominee agreements generally untested and viewed as likely unenforceable by UAE Courts	• Introduction of Corporate Nominee Companies into the UAE market • DIFC Trust arrangements governed by English law • Powers of Attorney for the unilateral transfer of shares/voting, etc. • Arrangements removing Shariah inheritance risk

Prior Positions	Current Positions/Amendments in Law and Practice
3. <u>Management Control</u>: • No "silent" local partner permitted • Risk of local partner receiving immunity from liability of the JV	• Greater management control afforded to foreign shareholder while balancing local partner involvement • Minimizing risk of detention for general manager appointed by foreign shareholder
4. <u>Wind-up/Dissolution Issues</u>: • No dissolution except by mutual agreement and involvement of local partner • Implicit exclusivity rights in favor of local partner	• Dissolution by one party streamlined through involving the Chamber of Commerce • Valuation process through the Chamber of Commerce
5. <u>Enforcement of Shareholder Rights</u>: • Limited enforcement by UAE courts of many standard shareholder agreement provisions (i.e., call/put options, deadlock, etc.)	• English law more common with enforcement before the DIFC Courts (English courts in Dubai; judgments of the DIFC Courts essentially equal to judgments of UAE Courts)

Thank you.