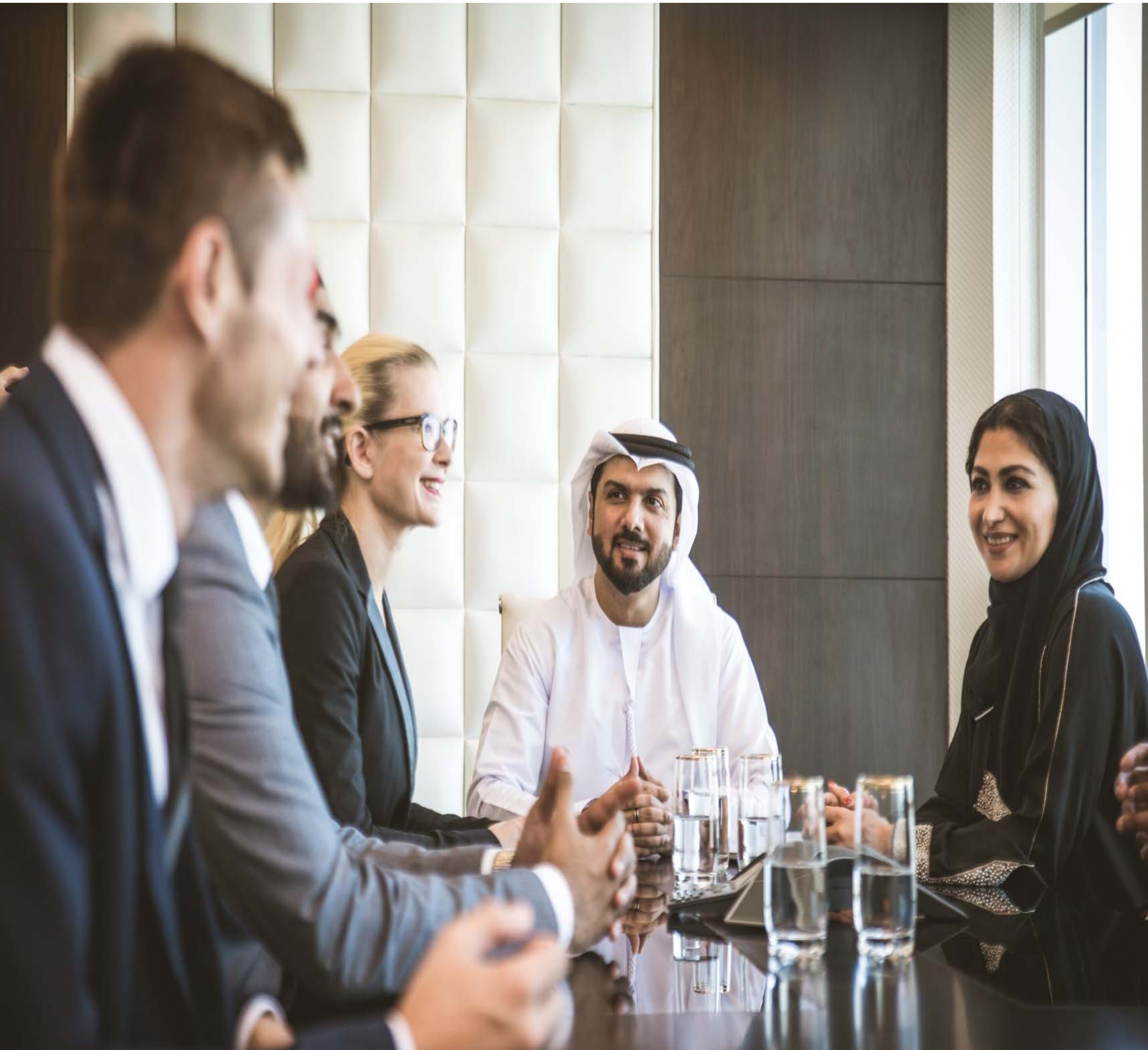
Overview on Family-Owned Companies' Law in UAE



Background of the Law

1.1. INTRODUCTION

- Family-owned businesses are crucial to growth and economic performance of the UAE economy. These businesses contribute significantly to the country's Gross Domestic Product ("GDP"). According to the United Arab Emirates ("UAE") Ministry of Economy ("MoE"), up to 90% of private companies in the UAE are family businesses which are involved in a wide array of sectors in the country, which collectively contribute approximately 70% of the country's GDP.
- One major challenge for family businesses is to ensure the continuity of such businesses across surviving generations. According to several studies, only 10 to 15% of family businesses survive up to the third generation this may be as the family members of the succeeding generation may not have the same level of business acumen and commitment as the previous generations which founded the family business. It is therefore important that the existent legal framework provides the essential environment and the necessary flexibility for family companies to ensure the succession of such companies.
- On October 10, 2022, Decree-Law No. (37) on Family Companies was issued and published in the Official Gazette with effect from three months after the date of publication, i.e., from January 10, 2023 ("Family Companies Law" or "Law"). The applicability of the Family Companies Law extends to the companies established in accordance with the provisions of the Federal Decree Law no. 32 of 2021 on Commercial Companies ("Companies Law") most of its shares are owned by persons belonging to the same family or the legislations in the free zone entity where the free zone entity are owned by the family, or relatives by descent and affinity. Under the Family Companies Law, a company loses its family company status if the members from the founding family cease to be majority shareholders, and with that the company loses its benefits as a Family Company. The law applies to all existing family companies or incorporated in the UAE hereinafter. The law does not apply to public joint stock companies and general partnerships. In this regard the law does not create a new form of company or new classification of company for the family company as family companies will still take the same forms already in place in the UAE under the Companies Law or in the free zones as per their own legislations.
- Prior to the enactment of the Family Companies Law, financial free zones such as the Dubai International Financial Centre ("DIFC") and the Abu Dhabi Global Markets ("ADGM") as well as the Ras Al Khaimah International Corporate Centre ("RAK ICC") provided legal frameworks to enable families to plan their succession in a manner that would help achieve their long-term objectives.

Factors Behind Introduction of the Law

2.1 CHALLENGES WHICH LED TO THE INTRODUCTION OF THE LEGISLATION

- The Companies Law does not entitle a mainland company, including family companies, to create different classes of shares to sub divide the total share capital in the companies.

- The Companies Law provides for statutory pre-emption rights whereby a transferring shareholder is free to dispose of his shares as he wishes if none of the existing shareholders exercise their right to acquire such shares within a thirty-day notice period. The Companies Law is also deficient in addressing the redemption rights of the family holding companies to buy back the shares from a family member.

- The Companies Law also does not provide for a suitable mechanism which is specifically designed for dispute settlement in family-owned companies.

2.2 OBJECTIVES OF THE FAMILY COMPANIES LAW

- The Law is aimed at developing a comprehensive legal framework which is adequately equipped to regulate the ownership and governance of family business in the UAE and facilitate the smooth succession of such family businesses from one generation to another.

- The Law also aims at ensuring a smooth transition in generational succession of family companies which helps in creating a long-lasting legacy for the founding families in the future generations. It also focuses on adopting a more flexible and sustainable economic model for management of family companies, which in line with best prevalent international governance practices.

- The Law also aims at supporting the continuity of the Family Companies by introducing the needed reforms in legislation through the Family Companies Law and boost the contribution of such companies to the diversification and growth of the economy of UAE.

- The Law aims at alleviating the risks of management and ownership fragmentation caused by freedom provided to minority shareholders which allows them the freedom to sell their stake to external forces. Special provisions under the Family Companies Law, focus on implementation of the necessary supplementary regulations to counter such measures and help consolidate the management and ownership of such companies.

- The Law also provides for the appropriate specific mechanism for dispute resolution of issues related to Family Companies. Such mechanism helps in better resolution of issues specific to family companies by providing the required, separate Dispute Resolution platform.

Key Highlights of the Law

3.1. CLASSES OF SHARES

- Under the Companies Law, only ordinary non-divisible shares are permitted to be issued by the Family Companies. Other types of equity or quasi-equity shares like preference shares as well as other types of supplementary equity instruments are not permitted to be issued under the currently prevalent Federal Companies Law.

- The Family Companies Law provides that a family company may issue a dual class of shares whereby:
  (i) "Class A Shares" would have a right to receive dividends and voting rights at the shareholders general assembly; and

  (ii) "Class B Shares" would have a right to receive dividends but have no voting rights.

- As noted above, this dual share class mechanism enables the separation of voting rights from ownership rights and thus, provides the family company and the family members with an important management tool to exercise their control over the management and operation in the family company, including mitigating potential risks and issues that arise as a result of an heir becoming a shareholder of the Family Company through succession.

3.2. PRE-EMPTION AND BUYBACK RIGHTS

- The Companies Law provides statutory rights of pre-emption and buy-back over the transfer of shares which cannot be waived under the provisions of the family companies' law. Tiered pre-emption rights are also not acceptable under the UAE Companies Law, as it is generally accepted that the relevant shares must be offered to all of the shareholders in accordance with pro rata to their shareholdings.

- Under the Family Companies Law, a shareholder in a Family Company may transfer or assign his share, with or without consideration, to his spouse or first-degree relative, without offering the same to the remaining partners, unless otherwise provided by articles of association of the family company. This will benefit the family companies to re-structure their shareholdings in the family company without requiring them to first offer such shares to their extended families.

- The Family Companies Law also has a specific provision allowing buy back which enables the family company to buy back any outstanding shares for sale not exceeding more than 30% of the total shares, following an offer made by any family member who is wishing to sell his shares in accordance with general pre-emption provisions designed to support the relevant system of pre-emption rights of the family.

3.3 REDEMPTION RIGHTS

- If one of the partners of the family business owns shares either amounting to no less than 90% of the family company's total shares or 95% of the voting shares of the family company, he may notify the remaining family shareholders of the intention to purchase their shares. He shall have the right to redeem the shares of the third-party partner(s) i.e., purchase the shares of the third party to the family company, who are not family members in the company at the price agreed upon between such seller of shares and the purchaser of shares, or that determined by the 'Family Business Dispute Settlement Committee'. The said third-party partners likewise will have a right to sell their shares to the 90% majority partner on the same terms regarding the purchase price.

- The Law also includes a provision that the family company may choose to purchase no more than 30% of its shares in order to achieve a reduction of its total share capital or to redeem some or all the shares of a member wishing to sell these shares in order to protect the rights of the other minority shareholders within the family company.

3.4 SETTLEMENT OF DISPUTES

- Family company governance must be devised in a manner that addresses potential conflict between family and non-family members and provides sufficient means for settlement of such disputes.

- The Family Companies Law provides that the articles of association or the Charter of the company, may include a provision whereby a number of partners, either family members or third parties, may form a council for the purpose of adjudicating disputes that may arise between shareholders and/or family members with an intention to try and attempt to reconcile their differences through an internal intervention without involving external forces. The articles or the Charter will also set out the members of such council, its powers, and mechanisms for managing its meetings as well as issuing its recommendations.

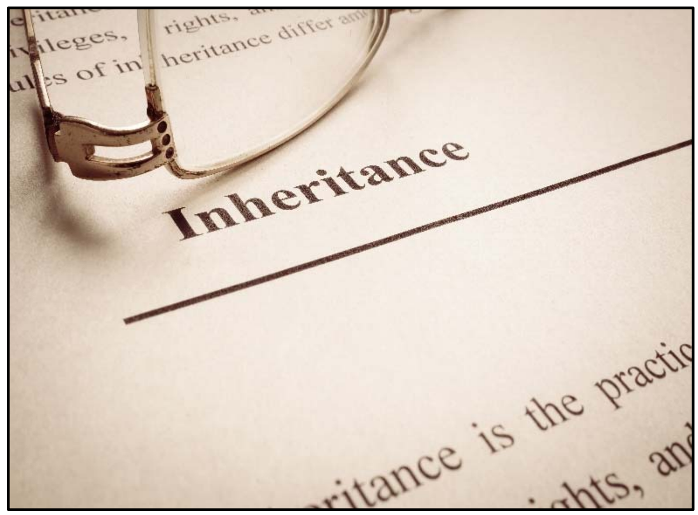
- The Family Companies Law also provides that if the articles of association or the Charter of the company does not include a provision regarding the formation of such council, or if the council has not succeeded in conciliation endeavors within a maximum period of three months from the date the dispute was presented to it, all disputes between shareholders or family members shall be referred to a Committee, to be established by the Ministry of Justice for such purpose.

- The Committee formed under such provisions shall decide on the appeal at conciliation within a maximum period of three months, which may be extended for a similar period upon a reasonable request made by the parties involved.

- Decisions rendered by the Committee shall be subject to appeal before the competent courts in the UAE. As an exception to the jurisdiction of the Committee, the relevant parties to the dispute may agree to either refer such dispute to:

  (i) arbitration (in accordance with the legislation in force in the UAE); or
  (ii) the existing courts of the DIFC or the ADGM.

3.5 INHERITANCE PROVISIONS



- Family Companies Law provides that the restructuring of the company by family members through change in the ownership of the company by transfer of their shares or assets in favor of the Family Company, whether this is affected through sale or donation shall not be considered in breach of the provisions of the UAE Personal Status Law, provided that such restructuring is carried out during the lifetime of the transferor, who is intending to transfer such assets and shares to the Family Company.

- Therefore, this specific provision of the Family Companies Law is aimed at negating the potential risk that may arise in the event that a disgruntled family member or potential heir challenges the validity of an asset transfer to the Family Company made during the lifetime of the transferor based on the UAE Personal Status Law.

3.6 FAMILY COMPANY REGISTER AND CONSTITUTION

- Family Companies Law provides that the family company may have, in addition to its memorandum and articles of association, a Charter which provides for special rules of ownership, governance, objectives, solution of family disputes and such other rules and provisions agreed upon by the shareholders and family members.

- In the event of a conflict between the memorandum of association and the 'Family Constitution', a document which may set out ownership rules, objectives, family values, etc. which shall be approved or amended by the majority of the members of the family company, the former shall take precedence.

3.7 FAMILY BUSINESS DISPUTE RESOLUTION COMMITTEE

- Family Business Law provides that a Committee shall be set up in each Emirate, called the Family Companies Disputes Resolution Committee to deal with all disputes pertaining to family companies if the memorandum of association or the constitution is silent in this regard or does not succeed in its conciliation efforts within a maximum period of 3 months from the submission date of the dispute unless otherwise agreed by the parties. It is further provided that the constitution of the Committee shall be as follows; it shall be headed by a judge with the assistance of two experts experienced and competent in the fields such as legal, financial, and family business management.

- The Committee shall decide on the dispute brought forward to it within a maximum period of 3 months, which may be extended for a similar period at a reasonable request by the concerned parties. This Committee may undertake measures it deems appropriate.

- The memorandum of association or the constitution may include a provision in which a Council of partners, family members or third party shall be formed, to consider and adjudicate the disputes that may arise among the partners themselves or between them and the other Family Members or between them and the family company. The members of the Council shall determine its powers and methods for managing its hearings and issuing its recommendations regarding the above-mentioned situations and disputes.

W&S Legal Key Takeaways

- The introduction of the Family Companies Law in UAE marks the start of a new era of organized governance and well-structured management of Family Businesses in the UAE. Companies owned and operated by generations of the same family have been historically the largest contributors to the Economic Growth in the UAE which has led to the introduction of a new legislation catering to these family-owned companies. Hence, the provision of this legislation provides for much needed additions and changes in the prevalent legislation in order to facilitate better governance and continuity of these companies.

- The introduction of a distinct dispute resolution mechanism for family companies provides for a much required detailed and structured manner of resolution of internal family disputes which have over the past led to decline of many successful family owned businesses and hence the introduction of a distinct body such as Family Business Dispute Resolution Committee ensures better management of internal disputes and disagreements to ensure longevity and continuity of such companies by introducing them to international standards of company management.

- By addressing the distinct concerns of such type of family companies through legislative measures and highlighting them through specially designed provisions under a new law for such family companies has helped place emphasis on the problems faced by family companies and introduced means for addressing those problems in a more professional and organized manner.

- This law also establishes a foundation for solidifying roots of the family businesses across the UAE region, by providing the founders of these businesses the option to pass on a solid business legacy which emphasizes cohesion instead of allowing internal conflict between family members over petty issues to fester and eventually lead to detriment of the family legacy sustained through such family companies. Thus, it will be the vision of the founders that will dictate the future potential passed on for generations to come under the provisions of the new family companies without fearing bureaucracy or old-fashioned governance which deterred the growth of these companies under the Federal Companies Law.

- At the very least, this legislation can be seen as a way to initiate family dialogue for reaching amicable solution for persistent disputes. It also facilitates adding a professional touch to an existing family constitution. For some family members it can be hard to openly question the status quo in their family business and the family companies and the new law may resolve that by giving families an opportunity to put succession and governance issues on the agenda of the family companies during meetings and better address their concerns within the family without resorting to division of the family business or adopting fragmentation measures.

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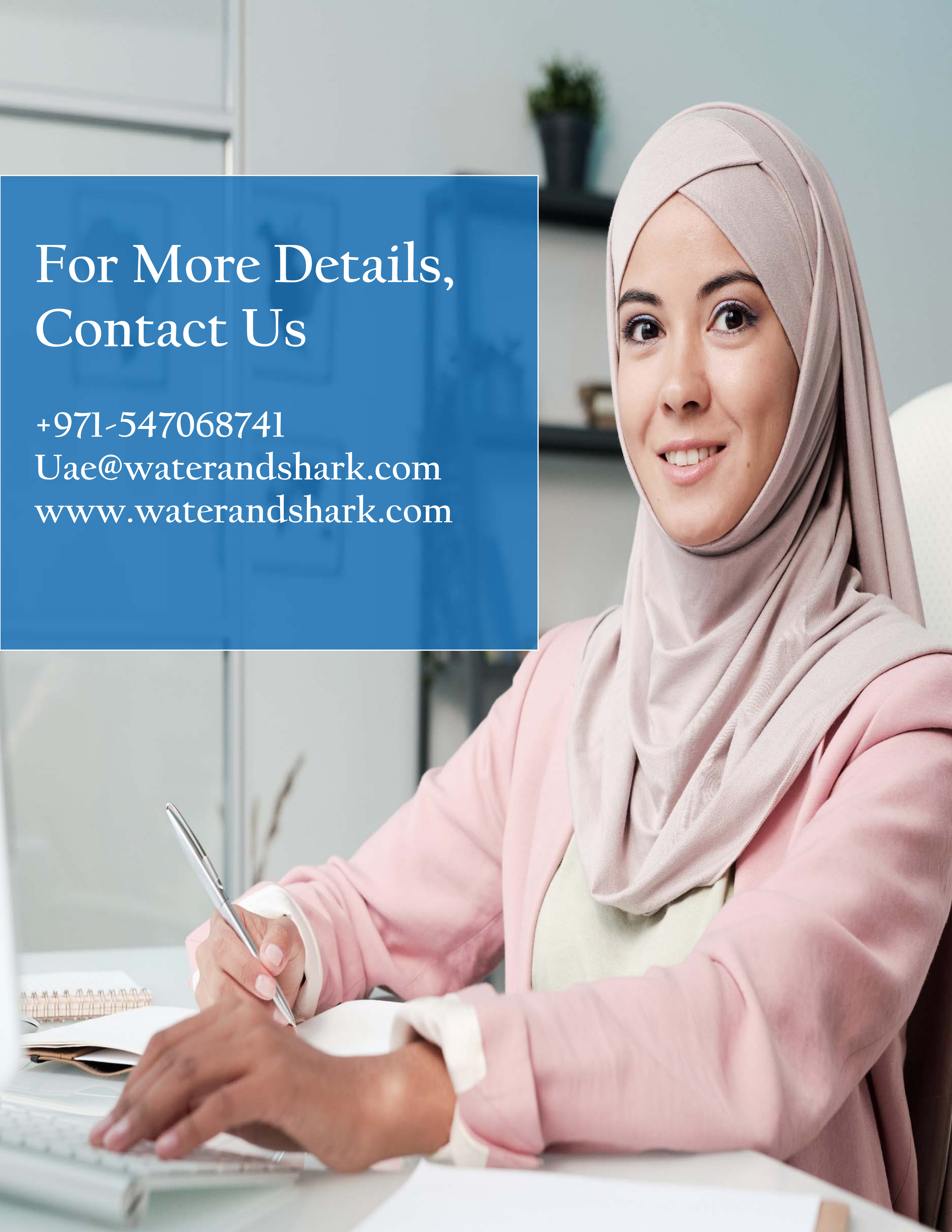

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