United Arab Emirates eases foreign investment restrictions

The United Arab Emirates (the UAE) has introduced long-anticipated legislation which liberalises restrictions on foreign ownership of companies incorporated “onshore” in the UAE (ie outside the free zones).

Federal Law No.19 of 2018 regarding foreign direct investment (the FDI Law) establishes a new framework for foreign ownership. Moving away from the long-standing general restriction (known as the “51/49 rule”) which requires a UAE company to have not less than 51 per cent. of its share capital owned by UAE nationals, the new regime allows foreigners to own up to 100 per cent. of the share capital in UAE companies operating in certain sectors, subject to licensing requirements. The sectors covered by the new regime will be set out in secondary legislation which is yet to be issued. Existing foreign ownership restrictions, including the 51/49 rule, will continue to apply generally for sectors not covered by the new regime, but the Cabinet of Ministers retains the ability to grant specific exemptions in relation to such sectors on a case-by-case basis.

The FDI Law does not apply to free zones or to any special arrangements relating to foreign ownership entered into with UAE government authorities. However, any existing private arrangements which do not comply with the 51/49 rule or other restrictions on foreign ownership may need to be adjusted to comply with the new regime and a licence under the FDI Law (an FDI Licence) may need to be obtained. It is uncertain when such compliance would be required, but this may be clarified in secondary legislation.

In this alert, we look at some of the key elements of the new UAE foreign investment regime.

Objectives and scope

Restrictions on the level of foreign ownership of domestic companies are common across many jurisdictions in the Middle East, where regimes favour nationals in the pursuit of commercial activities and protect strategic sectors from foreign investment. The move to attract foreign investment has been driven primarily by a desire to diversify and further develop the UAE economy. The main objectives of the FDI Law are to encourage foreign direct investment in the UAE, especially in priority sectors which will help sustainable economic development, to promote technological developments, knowhow and training and to increase employment opportunities.

The FDI Law applies to any foreign investment in the capital of legal entities established pursuant to Federal Law No.2 of 2015 regarding commercial companies (the Commercial Companies Law). This includes limited liability companies and public and private joint stock companies.

The FDI Law disapplies, in relation to sectors and activities to be specified, the prevailing requirement under the Commercial Companies Law that at least 51 per cent. of the share capital of companies established in the UAE should be held by UAE nationals. Nationals of other member states of the Gulf Co-operation Council (the GCC) (Bahrain, Kuwait, Oman, Qatar and Saudi Arabia) are generally treated as UAE nationals for the purposes of the foreign investment restrictions in the Commercial Companies Law, and we would expect the authorities to adopt a similar approach in relation to the FDI Law (although there is no official guidance on this point at this stage).
The new regime adopts a sector-based approach to regulating levels of foreign investment in domestic companies.

The Positive List: The Cabinet is expected to issue a resolution determining the sectors and activities which are open to higher levels of foreign investment. This will be known as the Positive List. These sectors will be exempt from the usual restrictions on foreign investment set out in the Commercial Companies Law. The Cabinet resolution will stipulate the permitted legal form of the entity in which the foreign investment is to be made (e.g., limited liability company, joint stock company, etc.), the percentage of foreign ownership permitted, the minimum capital of the entity, any terms and conditions attached to the foreign investment, the minimum percentage of national employees and any specific benefits that may apply to the foreign investment. The resolution may also exempt the relevant companies from certain provisions of the Commercial Companies Law and other Federal laws.

The extent to which the FDI Law will increase foreign investment will depend on how extensive the range of sectors and activities included on the Positive List is, and how onerous the conditions attached to the investment are.

The Negative List: The FDI Law specifies certain sectors and activities which will remain restricted from foreign investment. This is known as the Negative List and is described further below. While foreign investment in sectors on the Negative List is not necessarily prohibited, restrictions in sector-specific legislation rather than the FDI Law apply to those sectors.

<table>
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<th>Nature of foreign investment</th>
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<td>The foreign investor can be a natural or legal person, and the Positive List is expected to require a minimum amount of capital to be contributed by the foreign investor. For this purpose, capital would include cash, profits and returns from the foreign direct investment, certain securities and commercial instruments, fixed assets and rights such as concessions, patents, trademarks and trade names registered in the UAE.</td>
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There is some flexibility in the new framework which allows the Cabinet to amend the Negative List or to permit a specific foreign direct investment in a sector, or for an activity, which is not included in the Positive List.

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The Negative List comprises the following sectors and activities:
- exploration, drilling and production of oil
- investigations, the security and military sectors and the manufacture of weapons, explosives and military equipment, devices and clothes
- banking activities, financing, payment systems and dealing in cash
- insurance services
- pilgrimage (Hajj and Omra) services, labour and servant services and recruitment
- water and electricity services
- fishing-related services
- postal, telecommunications, audio and video services
- land and air transport services
- printing and publication services
- commercial agency services
- medical retail services (such as private pharmacies)
- toxin centres, blood banks and quarantines

The 51/49 rule

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(i) a higher level of investment is permitted under the FDI Law, in a sector on the Positive List, and an FDI Licence is obtained;

(ii) the investment is in a sector on the Negative List, in which case a different percentage would apply under specific legislation for that sector; or

(iii) a lower percentage applies by reason of other UAE laws and practices.

There is some flexibility in the new framework which allows the Cabinet to amend the Negative List or to permit a specific foreign direct investment in a sector, or for an activity, which is not included in the Positive List.

The licensing procedure

A new foreign direct investment unit (the FDI Unit) to be established within the UAE Ministry of Economy will be responsible for setting policies and procedures for licensing foreign direct investment. Where a foreign investor is seeking to invest in a UAE company operating in a sector or engaged in an activity on the Positive List, an application for an FDI Licence must be made to the authority responsible for foreign direct investment in the relevant Emirate (the Competent Authority).

It is unclear at this stage whether the Competent Authority will be an existing government body, such as the relevant Emirate’s Department of Economic Development, or a newly-established authority in each Emirate.

The FDI Law sets out a clear and relatively quick timetable for the licensing process. The Competent Authority must approve an application within five business days, otherwise the application is deemed to be rejected. If an application is rejected or deemed rejected, the applicant may file an objection with the Competent Authority within 15 business days. If the objection is rejected or not considered within 10 business days, the applicant is entitled to challenge the decision in the UAE courts within 30 business days of the rejection of the objection or the expiry of the 15 business day period (as relevant).

The Competent Authority must reject an application if the investment impacts public safety, national security, a strategic sector in the UAE, public health, social morals and values, the defence sector or the UAE’s foreign policy. The Competent Authority’s decision in such circumstances is final and not subject to objection or appeal.
**Timeline of the FDI Licence application process for sectors and activities on the Positive List**

- **Application for FDI Licence**: Within five business days
- **Application rejected or no decision made within required timeframe**: Within 15 business days
- **Applicant files objection with Competent Authority**: Within 10 business days
- **Application rejected or no decision made within required timeframe**: Within 30 business days
- **Applicant appeals to UAE courts**: No specified timeframe
- **Licence approved**
- **Application rejected**

**Benefits and protections**
UAE companies which are licensed for foreign direct investment are broadly to be treated as national companies (as if 100 per cent. owned by UAE nationals), to the extent permissible by law. Such companies may transfer returns, and their employees may remit salaries, outside of the UAE subject to applicable legislation. However, any changes to shareholdings, amendments to the memorandum or articles of association, mergers or acquisitions require the consent of the FDI Unit, the Competent Authority and the Licensing Authority.

The FDI Law provides that foreign direct investments may not be expropriated in full or in part, other than for the public interest in which case fair compensation must be paid. Any real estate rights of companies holding an FDI Licence may not be cancelled, suspended or restricted, except in the event of breach of licence conditions, and the assets and funds of such companies may not be frozen, confiscated or placed in receivership, other than by UAE court order in accordance with UAE law.

**Free zones and pre-existing arrangements**
The FDI Law does not apply to free zones or to any special arrangements relating to foreign ownership entered into with the Federal government or local authorities in the UAE.

Any pre-existing private arrangements involving foreign investment in UAE companies should enjoy the same benefits and protections set out above in relation to licensed companies, provided that such arrangements are brought into compliance with the FDI Law. As a result, any pre-existing private arrangements which do not comply with the 51/49 rule or other restrictions on foreign ownership may need to be adjusted to comply with the new regime and an FDI Licence may need to be obtained. It is uncertain when such compliance would be required, but this may be clarified in secondary legislation.

**Enforcement and sanctions**
A range of sanctions apply in the case of breach of the FDI Law or the terms of an FDI Licence. These include a warning, withdrawal of benefits granted under the FDI Law, a fine of up to AED 1m (US$270,000) or suspension of the FDI Licence. The Competent Authority may also cancel an FDI Licence in the event of repeated violations or failure to rectify a violation.

The authorities also have the power to enter the premises of companies to verify information relating to a foreign investment and to investigate potential non-compliance.

**Conclusion**
The FDI Law formalises and streamlines a historically ad hoc approach to exemptions to the foreign ownership restrictions under UAE law. The scope and impact of the new regime will largely depend on the size and shape of the Positive List, which has not yet been issued. The Federal government has stated that it aims to publish the Positive List in early 2019. The new regime offers more extensive opportunities for international entities wishing to invest in the UAE. It also presents an opportunity for foreign investors in businesses operating in sectors or activities on the Positive List to alter their existing investment and management structures, moving away from contractual side arrangements which have historically been used, and offering greater protections and control to foreign shareholders. This is a welcome change as, although there is widespread tolerance of these types of arrangements, there remained residual concerns over such arrangements as a matter of UAE law.

Looking ahead, this reform may make doing business in the UAE easier for international investors operating in the sectors on the Positive List and it is likely to increase confidence in the UAE’s business environment.
Please contact us if you would like to discuss any of the issues raised in this alert.

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