

## **Nominee Shareholder Agreement and Anti-fronting Regulations in the UAE**

There has been an extensive debate about the validity and the enforceability of so-called “Nominee Shareholder Agreements” (NSAs) in the UAE. Under an NSA, a UAE national may become a 51% shareholder in an onshore UAE Limited Liability Company (LLC) on a contractual basis that departs from the legal criteria established by the Federal Law on commercial companies No. 8/1984 as modified by Federal Law No. 2/2015 (the ‘Company law’). From a public policy perspective, the underlying issue consists in striking a balance between the need to attract foreign investors, on the one hand, and the desire to involve local operators to the national economy, on the other. Businesses and other stakeholders are increasingly concerned about how the UAE Courts interpret NSAs in light of the Company law, especially because observers expect new rules on the matter to be enacted in the imminent future. The present article examines the applicable legal provisions while taking into account recent Courts decisions in order (i) to provide an overview of the present legal situation (*de lege lata*), and (ii) to anticipate possible legislative changes (*de lege ferenda*). **What are NSAs?** NSAs are “side agreements” whereby a UAE national agrees to waive all rights (i) to receive dividends, (ii) to exercise votes in general meetings, and (iii) to receive any proceeds of the sale of the shares nominally held by the LLC. The waiver is based on the presumption that the Company law does not distinguish between beneficial and legal interests in shares of a company. In practice, a foreign minority shareholder in an LLC in the UAE (or his mother company outside the UAE) enters into an agreement with a UAE national, who is a majority shareholder of the company. Pursuant to the agreement, the UAE national is offered a loan to finance the acquisition of the majority shares, while the foreign shareholder benefits (i) from a pledge over the concerned shares in his favor, (ii) the power to be represented in general meetings, and (iii) the annual payment of a fixed fee unrelated to the financial performance of the company and to the level of dividends paid to the shareholders. In short, the provisions of the NSA circumvent the Company law in that they prevent the UAE majority shareholder from taking part in the operations of the LLC. As a result, the foreign partner is the sole beneficiary and decision maker of the company. **The Federal law No. 17/2004 concerning Anti-Fronting Law** As of the late 1990s, there was mounting criticism of this contractual setup that clearly compromised the UAE’s efforts to involve more domestic operators in the national economy. The ensuing debate led to the enactment of the Federal law No. 17/2004 concerning Anti-Fronting Law, the objective of which was to prohibit NSAs with UAE nationals. However, initially intended to occur in November 2007, the entering into force of the legislation was delayed due to the absence of the required implementing decrees. It was only the Federal law No. 2/2015 on Commercial Companies that put the ban of NSAs into effect. At present, the legislator is preparing new anti-fronting rules explicitly aimed at fighting ‘commercial dissimulation’, a notion that includes NSAs. **What is the UAE Courts’ position on this issue?** In the meantime, UAE Courts have handed down a number of decisions where an NSA was at stake. This section briefly presents four rulings that each epitomize the different approaches that the judiciary has taken on the issue thus far. The first approach is based on the rule according to which “the contract is the law of the parties”. At the same time, the Court considered the status of the shares pursuant to the NSA as being in conflict with what had been provided in the Memorandum of Association (MoA). It declared the MoA null and void (although it was compliant with the previous law on companies), while upholding the validity of the NSA. As a consequence, the judges ruled that the LLC had to be dissolved. An example of the straightforward enforcement of the parties’ contractual intent, the decision was rendered on the basis of Article 395 of Federal law No. 5/1985 (Dubai Court of Cassation - Case No. 2009/211). The second approach draws on the concept of ‘true contract’ as opposed to ‘apparent contract’. In this case, the Court found that the parties had agreed to execute an apparent but untrue transaction which concealed the true relationship between them. As a result, the judges decided that the apparent contract – the MoA – was void because they regarded the NSA as the effective arrangement and therefore as the true contract. Like the ruling illustrating the first approach, the decision was based on Article 395 of Federal law No. 5/1985 (Dubai Court of Cassation - Case No. 2008/212.) The third approach is premised on the principle

that a registered agreement shall prevail over a non-registered one. In this case, the Court decided that the MoA should take precedence over the NSA. In fact, the judges argued that the former was registered and signed before a public notary whereas the latter was unenforceable given that it had failed to comply with the notarization and registration requirements. This decision was made on the basis of Articles 8, 10 and 11 of the former companies law No. 8/1984 (Abu Dhabi Court of Appeal 300 and 301 of 2012). Fourth and finally, a more recent ruling addressed the question at issue in a very specific context. Unsatisfied with the financial performance of the company (at the time of the 2008 financial crisis), a national shareholder requested to enter into an NSA under which he would act as a sponsor of the company, thereby annually receiving a fixed remuneration but renouncing the benefit of the dividend payments. After the company's situation had improved following the recovery of the global economy, the sponsor requested the payment of dividends, in addition to the sponsor fee, for the years in which the company was making profit. After several years of litigation, the Court nullified the NSA, holding that the agreement had violated the Company Law. At the same time, the judges decided that the nullification shall have effect from the date of the court ruling and not from the date of the agreement (i.e. the nullification was not applied retroactively). Accordingly, the foreign shareholder shall be entitled to the profit in accordance with his actual shareholding (reflected in the NSA) if the national partner was receiving sponsorship fees. To sum up, the rights set out in the NSA, such as the distribution of profit, are protected notwithstanding the fact that the agreement is void (Abu Dhabi Court of Cassation and Civil Appeal 30 of 2015). This noteworthy ruling may inspire subsequent Court decisions, even though the UAE is not a common law jurisdiction, meaning that in principle each case is decided on a case-by-case basis. **What is to be expected as regards the validity of NSAs in the future?** In light of the currently applicable laws in the UAE, the Courts' relative tolerance with respect to NSAs appears to be quite remarkable. The Federal law No. 2/2015 on Commercial Companies articulates a range of criminal offenses pertaining to NSAs ('*commercial dissimulation*')

- Breach of the percentage of contributions by UAE nationals: fine from AED 20,000 to 200,000 (Art. 353);
- Providing statements in violation of the law (i.e. an NSA that is contrary to the MoA): imprisonment between 6 to 12 months and fine from AED 200,000 to 1,000,000 (Art. 361);
- Distribution of profits or interests in violation of the law: imprisonment between 6 months to 3 years and fine from AED 50,000 to 500,000 (Art. 363); and
- Criminal liability of the company shall be addressed to the legal representative (Art. 372).

Undoubtedly, these criminal remedies provide the judge with powerful tools to sanction foreign and national partners in case of serious breach of the "51/49" foreign ownership restriction that applies to LLCs, as well as of other relevant provisions of the Company Law. Moreover, the upcoming anti-fronting regulation is likely to also foresee criminal sanctions for tortfeasors, including fines, deportation and imprisonment. According to our experience, serious challenges for foreign shareholders may occur in relation to NSAs at any time. The most frequently encountered situations include those when the UAE shareholder requests an increase of his sponsorship fee; when the heirs of a late UAE shareholder claim ownership of 51% of the shares and the corresponding dividends without according some management rights; when a UAE shareholder refunds the loan and requests dividends since the incorporation of the company; or when a UAE shareholder has registered the corporate and trade names under his name and claims more remuneration. There are a range of legal and contractual venues that allow for the organization of the relationship between the foreign and the local partners in a more secure manner. The optimal solution depends on different factors, including the type of business, the existence of trade marks or patents to be protected, the provisions in the MoA in relation to negative control in general meetings or to sharing of the dividends and any ancillary contracts for the management and the sponsorship of the company. Each situation is unique and therefore calls for careful considerations, requires a long-term vision and implies a specific management of the relationship.

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