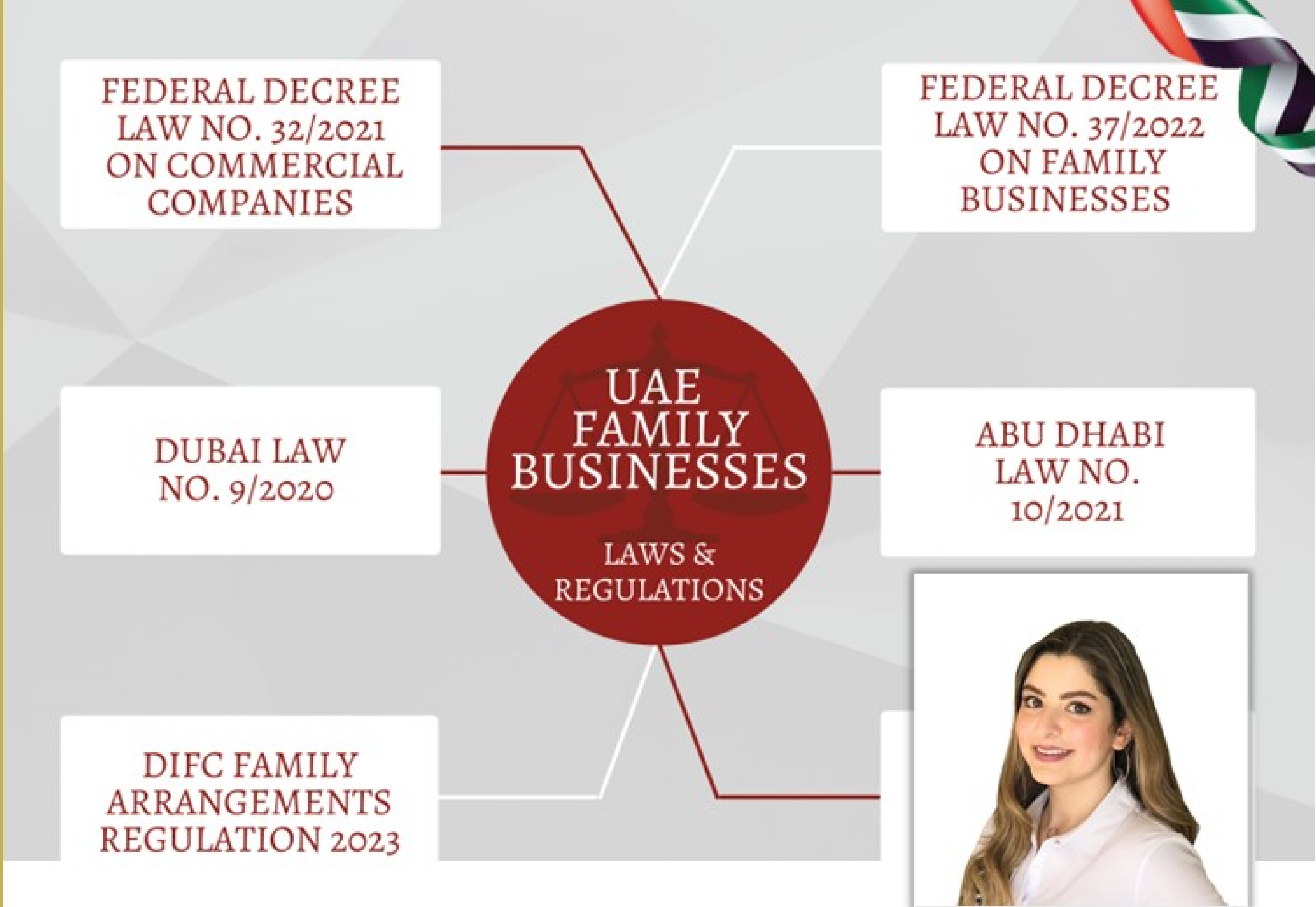

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Supporting Family Businesses in the UAE - A Legislative Revolution

30 – 03– 2023

Family-owned entities are not only the world's oldest and most dominant form of business organizations, but also an essential driver of the Middle East's economies, given the central role they play in key sectors such as banking, construction, manufacturing and retail.

In the United Arab Emirates for example, these businesses constitute 90% of private companies, and employ 80% of the nation's workforce. In fact, Abu Dhabi's entire private sector, except for several listed companies, consists of family-controlled entities[1].

Nonetheless, and as family businesses are considered "emotional ownerships", the addition of this family unit within the company could lead to numerous challenges. Conflicts around ownership and management, lack of succession planning and difficulties of recruiting nonfamily employees could not only lead to the destruction of the company in terms of reputation and structure, but also affect the harmony and relationships between family members.

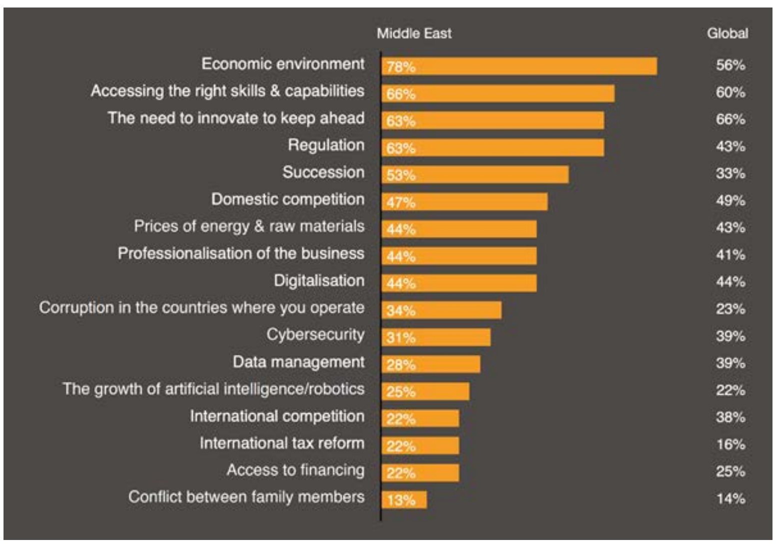

Figure 1 Key challenges Faced by Family Businesses in the Middle East
Source: PwC Middle East Family Business Survey 2019

In fact, statistics show that family companies in the Middle East who make it to the second generation do not exceed 30% of all businesses, with as low as 3% only, making it to the fourth generation[2].

Acknowledging these growing complexities, regulators across the region are developing new laws with the aim to promote the continuity of family businesses in accordance with the best practices followed globally, while also respecting the Arab culture and values.

[1] STEP Project Global Consortium and KPMG Private Enterprise, Report, The regenerative power of family businesses, United Arab Emirates edition, October 2022.

[2] Family Business Council-Gulf, The GCC Governance Code, Second Edition, 2021.

As the UAE has adopted this legislative revolution and is fully ready to ring in the changes in 2023, this article aims to demonstrate the key principles introduced under these modern legislations. In part 1, you will get to know the main insights on the Federal Decree-Law No. 37 that came into effect on January 2023. Subsequently, you will explore the different laws and regulations applicable in specific Emirates and relevant Free-Zones in part 2.

Part 1: Federal Laws

On October 10 2022, Decree-Law No. (37) on Family Businesses was issued and published in the Official Gazette, which later came into force on 10/01/2023.

The new law aims to achieve several objectives, most notably:

1- Set an inclusive and easy legal framework to regulate both ownership and governance of family companies, and facilitate their transfer among the generations;

2- Support the continuity of the family companies, support their contribution to the private sector, and therefore enhance the private sector's role in economic growth and community contribution;

3- Provide the proper mechanisms for resolving the disputes related to family companies.

We set out below certain key principles that are introduced under the new law.

Scope of Application

The provisions of the Family Companies Law are applicable to both existing family companies, as well as those registered after the enactment of the law; provided that they adopt the form of any company recognized by the Commercial Companies Law No. 32 of 2021, including the single person company and free zone companies.

However, it is important to note that a family business would be required to “opt-in” in order to be entitled to benefit from this legal framework. This would require a majority of the shareholders to pass a resolution approving the registration of the company as a family company in a special register.

Additionally, the Law is applicable in all Emirates and free zones of the UAE, unless there is local legislation or regulation governing these companies within the scope of the Emirate or the free zone *(which we will demonstrate in part 2 of this study)*. In this case, the application of the Law is limited to the areas that are not regulated or stipulated by the local laws.

Defining Family Businesses

Although there are a number of definitions used worldwide, to qualify as a "family business" in the UAE, an entity must be:

1. Incorporated in accordance with the companies' law No. 32 of 2021, but not as a public joint stock company or general partnership;
2. The majority of the stakes or shares must, at all times, be owned by persons belonging to a single family; and
3. Such entity must be registered in the unified register of family businesses.

Maximum Number of Shareholders

Under the UAE Companies Law, a maximum of fifty (50) shareholders is permitted for limited liability companies (LLCs).

As an exception to the provisions mentioned above, the family company may have any number of partners, and there is no maximum number of individuals who may become shareholders in this company.

Family Charter

In addition to the Memorandum of Association that is documented by the Federal or local government authorities, the family may have a charter, which is a written document regulating governance of family affairs related to the family company, and regulating the relationship of the family to the family company.

Considered an innovative part of the family company regime, the charter may include:

- Rules for ownership,
- Objectives and values of the family,
- Mechanisms for evaluating shares and methods of profits distribution,
- Education and qualification of the family members to work in the family company and its subsidiaries,
- Consideration of the family disputes related to the family company.

It should be noted that whenever there is a conflict between the Memorandum of Association and the charter, provisions of the Memorandum of Association shall apply, and any provision contradicting the Memorandum of Association or the Decree Law shall be repealed from the charter.

Classes of Shares and Their Transition

Under the UAE Companies Law, only ordinary non-divisible shares are permitted. Other types of shares or equity instruments (including different classes of ordinary shares with different rights attaching to them), are not permitted.

However, as families implement a succession plan, they often require the ability to benefit from certain control mechanisms pursuant to which certain family members or groups will be able to influence the corporate decision making; such control mechanisms often include granting special voting rights to these family members.

Indeed, Article 12 of the Family Companies Law specifies two basic types of shares according to the benefits granted to each type.

- **Shares (class A)**: which entitle their holders to receive profits and vote in the company's general assembly.
- **Shares (Class B)**: which entitle their holders to receive profits exclusively without the right to vote.

Moreover, the Memorandum of Association may stipulate the conditions governing conversion of shares (Class B) to shares (Class A) or vice versa, in addition to the possibility of division of shares (A) or (B) into classes according to the number of votes or the profits allocated to those votes, while the total of those shares shall be equal to the total shares of the company.

In addition, the family company's Memorandum of Association may stipulate other classes of shares differing in terms of the value, voting power, profits, priority rights and other rights or privileges, provided that the partner's liability shall be in proportion to the rights and privileges assigned to each class of such shares.

The Decree-Law also regulated how shares are transferred between members of the same family, and between them and others from outside the family, and how each partner disposes of his share. Finally, it should be noted that the business does not cease to exist due to the death, interdiction, bankruptcy or insolvency of one of the shareholders.

Family Company Management

The UAE Family Businesses law establishes a set of mechanisms for managing the family business, whether by the director or the board of directors, with specification of the most important terms of appointment, competences, obligations of the manager, and how to dismiss him.

In addition, the new law also seeks to regulate the governance of the family affairs and the legalization of the relationship between the family and the company.
This goal may be achieved through the following actions:

1. Establishing different councils and committees, such as the family assembly, the family council and the family office;
2. Educating and training family members on their work in the company and its subsidiaries, and their entrepreneurial initiatives.
3. Separating ownership and governance of the family's assets from the ownership and governance of the family company;
4. Supervising the family's investments and organizing the family charitable works and community contribution initiatives.

Settlement of Disputes

The blurred boundary between family life and work life can often cause conflicts difficult to resolve with emotional family connections at play.
According to Harvard Business Review, major fights in family businesses often follow a pattern called a conflict spiral. As illustrated below, this spiral consists of seven stages moving in a gravitational pull.

Figure 2 The Conflict Spiral
Source: Harvard Business Review Family Business Handbook by Josh Baron and Rob Lachenauer. Page 225

UAE's new Family Companies Law stipulates that the mechanism for settling disputes of family companies is to be established in the memorandum of association through the formation of a council that includes partners, family members, or third parties. The purpose of this council is to consider disputes that may arise between partners, between them and family members and between them and the family company, and to try to reconcile them.

In addition, The Decree-Law also provides for the establishment of a committee in each Emirate called the "Committee for the Resolution of Family Business Disputes", chaired by a judge and assisted by two experienced and competent persons in the legal, financial, and family business management fields.

Part 2: Local Legislations

Aside from the above-mentioned Federal Decree-Law No. 37, Emirates are also promoting ownership and succession among family businesses, most notably by enacting family business-specific legislations such as Law No. 9/2020 Regulating Family Ownership in the Emirate of Dubai, and Law No. 10/2021 on the Governance of Family Businesses in the Emirate of Abu Dhabi.

In addition, and as is well known that the UAE offers investors more than 40 multidisciplinary free zones in which expatriates and foreign investors can have full ownership of companies; these free-zones are also laying down the necessary legal framework for family businesses through the enactment of new arrangement regulations.

A- Legislations in Dubai and the DIFC

DUBAI

On the 13th of August 2020, his Highness Sheikh Mohammed bin Rashid Al Maktoum, Ruler of Dubai, issued Law No. (9) of 2020 regulating family-owned businesses in the Emirate of Dubai.

Under the said law, family members who are bound by common ownership of movable or immovable property may opt to enter into a legally binding and notarized family ownership contract, to regulate Family Property that is co-owned by them in undivided shares and determine the method of management of such property of the family members and their successors.

While the law defines "family" as the spouse, and the blood relatives and in-laws up to the fourth degree, it covers new and existing common ownership of most forms of movable and immovable property such as:

- Shares and stocks in commercial and civil companies and assets of sole proprietorships (excluding shares and stocks in public joint stock companies);
- Trademarks, Copyright and Related Rights;
- Industrial Property Rights of Patents, Drawings, and Industrial Designs.

In addition, the law facilitates the transfer of family property to successive generations, through regulating the articles of the Family Ownership Contract with respect to the disposition of shares, formation of board of directors, appointment of a manager to manage the family property and specification of the functions and obligations thereof.

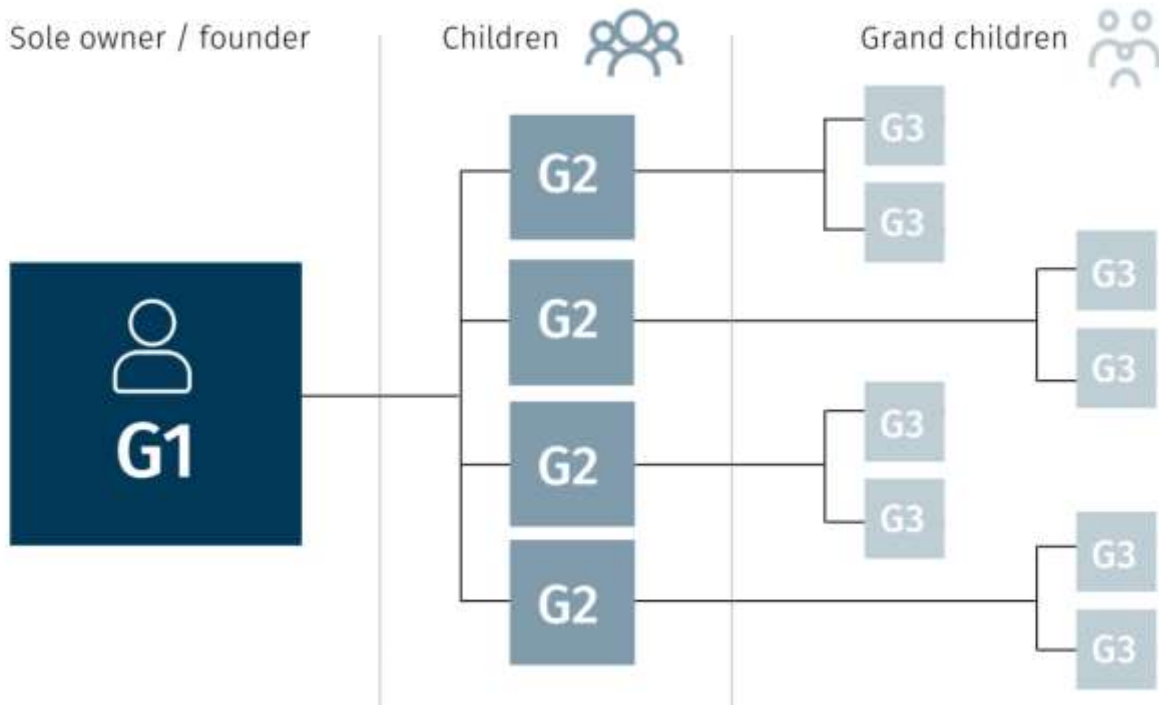

Figure 3 Family Businesses Succession Across Generations.
Source: FBCG, Dubai Chambers, Al Tamimi & Co., White Paper, The future of UAE family businesses, February 2023.

In addition, the law regulates provisions related to bankruptcy, Death, Missing Status, and Lack of Capacity of Partners, and further provides that any dispute arising from a Family Property Contract shall be settled by a special judicial committee comprised of experts in legal, financial and family management matters, ensuring the confidentiality and privacy of any dispute as well as time efficient procedures for their resolution.

Lastly, it is worth noting that Family Property Contracts that meet the legal requirements will have the same evidential value of the official documents attested by Notaries Public, as against other Partners, their universal or particular successors, and third parties.

DIFC

The Dubai International Financial Centre (DIFC) witnessed a strong performance in 2022, with the total number of registered companies growing from 3,297 to 4,031, marking a 22 per cent year-on-year growth.

For the purpose of providing guidelines for family businesses and entities controlled by families holding assets and operating in or from the DIFC, the center replaced the previous Single-Family Office regime with new Family Arrangements Regulations, effective as of 31 January 2023.

The regulations enable families to manage their businesses and preserve wealth through succession and legacy planning within the DIFC, and establish certification and accreditation programmes for family businesses and their advisors.

The 2023 regulations provide a foundation for the new DIFC family wealth centre, established as a hub for global and regional family-owned businesses, officially launched on the 1st of September 2022. The centre's offering provides a range of services to family-owned businesses to assist them in all aspects of their legacy and succession planning such as advisory, education services and networking events.

B- Legislations in Abu- Dhabi and ADGM

ABU-DHABI

In his capacity as the Ruler of the Emirate of Abu Dhabi, President His Highness Sheikh Khalifa bin Zayed Al Nahyan has issued Law No. 10 of 2021 regarding the governance of family business in the Emirate of Abu Dhabi.

Whereas the term "Family" was defined according to the aforementioned law as the husband and relatives by blood or lineage up to the fourth degree, a company shall be considered a Family-owned company, whatever its legal form, in any of the following cases:

1. The members of one Family own the entire capital of the company;
2. The members of one Family own a company that is owned by several legal persons wholly owned by the members of such Family;
3. The Founder alone owns the one-person company, and he allocates all or some of its benefits to his Family members;
4. The Family owns the majority of the company's capital or retains the majority of the votes;
5. The Family-owned company allocates a portion of its profits to the Beneficiaries, according to what is decided by the Founders or the company's regulations.

In contrast, the family-owned company shall lose its characteristics and privileges if the share of new partners from outside the Family exceeds forty percent (40%).

Moreover, the Abu Dhabi law of 2021 stipulates the privileges and advantages of family-owned companies as follows:

a. The Founders have the right to stipulate in the memorandum of association that it is prohibited to sell shares or stocks to any natural or legal person outside the Family, or to specify the degree of kinship that allows the trading of shares and stocks.

b. The Founders also have the right to issue their own Shares or Stocks with Double Vote. These votes are counted in the meetings of the general assembly, but not counted as double for the purposes of fulfilling the quorum of the meeting. This privilege can also be transferred with the share or stock in case of inheritance.

c. If the Family-owned company takes the form of a public or private joint stock company, it may issue preference shares without voting rights or redeemable shares, with specification of the privileges of these shares concerning the distribution of profits.

ADGM

Abu Dhabi Global Market (ADGM) offers a broad range of structures and solutions that can be used to optimize family wealth planning and organize family businesses, whether assets and subsidiaries are held in ADGM, UAE or overseas.

Whilst some jurisdictions will offer specific regulations around the family office, the ADGM -similar to the UK- offers a holistic platform with a range of regulations (including the ADGM Companies Regulations of 2020) and services to provide sufficient flexibility when managing personal and family wealth through direct incorporation of English law.

Interestingly, there is no obligatory structure for a single-family office in the ADGM. The term refers more to a concept including a variety of structures established to manage family wealth, and in each case a bespoke solution can be applied.

Final Thoughts

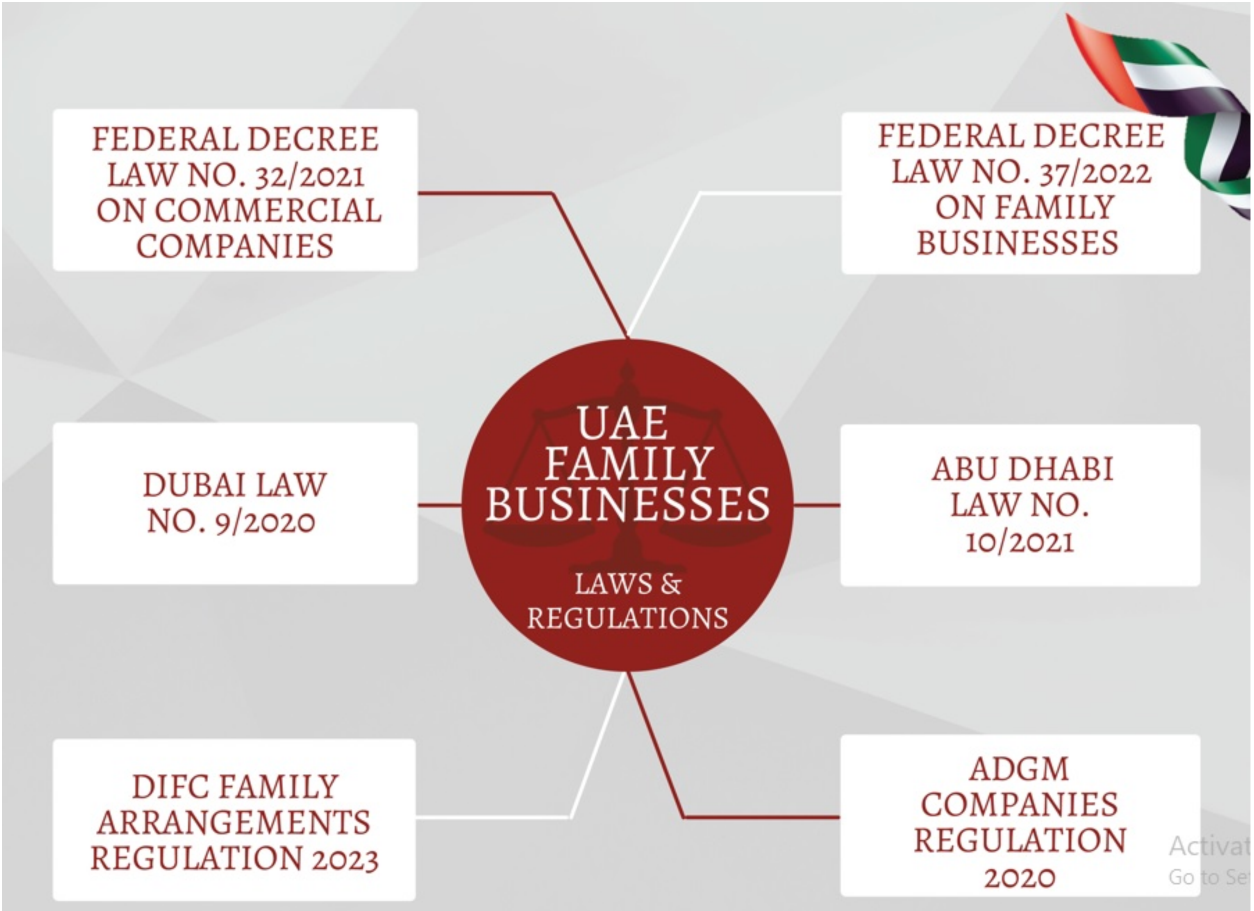

Figure 4 Recent Laws and Regulations Related to Family Businesses in the UAE

Sometimes, family businesses don't realize that their governance structure is lacking, until they encounter significant problems with decision making.

The enactment of new family business-related laws as portrayed above, and whether federal, local laws, or free-zones regulations, constitutes a major step forward that supports these entities in overcoming challenges when planning succession, resolving their disputes, and adhering to principles of good conduct and governance. Hence, this legislative support for the long-term growth of family businesses as one of the main pillars of the UAE's new economic model, will in turn contribute to enhancing the global competitiveness of the UAE national economy and create new and promising opportunities.

List of References:

I. Laws and Legislations

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