# My Space

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# Side Agreements with national Sponsors in Dubai-Myth or Reality

In the UAE, a foreign shareholder can own a Limited Liability Company only if a minimum 51% of the shares in such companies are owned by UAE nationals. The companies are established by way of registration of a basic memorandum of association, where, the shareholding of each shareholder, including the 51% shareholding of the UAE national is confirmed. In view of such requirement, the foreign shareholders often enter into a "side agreement" with the UAE shareholder, which underlines certain basic protections for the foreign shareholder.

The side agreement usually provides for the following:

- Only the foreign shareholder has contributed to the share capital of the company and accordingly owns all the share capital of the company.
- The foreign shareholder is the sole owner of all the assets and the trade name of the company and is the actual agent with respect to distribution agreements and commercial agencies of the company.
- The UAE shareholder acts only as the 'sponsor' and is the custodian, nominee and trustee with regard to the 51% shares registered in his name.
- The UAE shareholder will waive/give up any shares held by him in the share capital of the company in case of liquidation of the company (whether in the form of in kind dividends or public auction proceedings or amicably).
- The entire profits and losses in the company will be earned/borne by the foreign shareholder except for an agreed percentage of the net profits of the company (agreed percentage).
- The UAE shareholder will not claim any right to the profits generated by the company except for the agreed percentage.
- The UAE shareholder acts only as the local sponsor for the company to obtain and renew the licenses, visas and work permits relating to the company and its employees, represent the company before government authorities and so on, for which he is entitled to a fixed annual fee.
- The UAE national generally appoints the foreign national as his attorney to manage the company and the foreign national is also appointed as the Manager.
- The side agreement applies to the UAE national and its legal heirs.

However, time and again, foreign businesses operating in the UAE have raised a concern over the sanctity and enforceability of such 'side agreements'. In view of such concerns, it is pertinent to mention that there have been several precedents, where UAE courts have recognized the existence of such side agreements, taking into consideration the language and structure of such agreements, and other circumstantial evidence including the degree of participation by the local national sponsor, his annual payment of fixed fee and receipts of such fixed fee and testimonials from persons involved in the business.

In a recent judgment, where a UAE shareholder of an existing LLC brought a claim, requesting the court to confirm his title to the 51% of the profits according the memorandum of association. The court, in its final decision, dismissed the UAE national's claim over the 51% shareholding as the court concluded that there was sufficient evidence to establish the existence of a side agreement where the UAE national agreed to a lesser de-facto shareholding of 37.5%.

There have been several similar instances where courts have decided against such claims brought by UAE nationals, which proves the fact that the UAE courts want to protect the interest of the foreign nationals who have invested their money and skills in the UAE economy. Such decisions by the courts go on to prove that the UAE courts and judiciary does not want to harm the investor confidence in any way.

Nevertheless, in the absence of any written mechanism, rules or law, the matter of enforceability of side agreements remains uncertain. But in view of various legal developments that have been brought about in recent past, businesses are still hopeful that such side agreements will perhaps get a legal authentication in the form of some amendments to the existing laws and rules.