

The New UAE Law on Family Businesses

| | |
|-------------------------|--|
| <i>Type</i> | E-journal |
| <i>Date</i> | 10 Oct 2022 |
| <i>Jurisdiction</i> | United Arab Emirates |
| <i>Copyright</i> | LexisNexis |
| <i>Legal reference</i> | Federal Decree-Law No. 37/2022 On Family Businesses, Federal Decree-Law No. 32/2021 On Commercial Companies, Federal Law No. 28/2005 On Personal Status, Abu Dhabi No. 9/2021 for Family Business Ownership Governance, Dubai Law No. 9/2020 Regulating Family Ownership in the Emirate of Dubai |
| <i>Relevant company</i> | Diana Hamade Attorneys at Law |

Document link: https://www.lexismiddleeast.com/eJournal/2023-02-10_13



Table of contents

| | |
|---|---|
| Introduction | 3 |
| Scope of application | 3 |
| Circumventing Sharia in inheritance | 3 |
| Difference between “family” & “family business” | 3 |
| Family member shareholders | 3 |
| Family charter/constitution | 4 |
| Registration | 4 |
| Valuation of shares | 4 |
| Articles of Association | 4 |
| Transfer of shares | 5 |
| Dividends distribution | 5 |
| Family business shares buyback rights | 5 |
| Board of directors | 5 |
| Management, managers powers & responsibilities | 6 |
| Family governance | 6 |
| Dispute resolution | 6 |
| Conclusion | 7 |
| Authors | 7 |

Introduction

It was not long after the relatively recently promulgated laws of Abu Dhabi No. 9/2021 for Family Business Ownership Governance & Dubai Law No. 9/2020 Regulating Family Ownership in the Emirate of Dubai, were issued that the much-anticipated Federal Decree-Law No. 37/2022 On Family Businesses. Federal Decree-Law No. 37/2022 was issued on 10 October 2022, and came into effect on 10 January 2023, to take centre-stage as the more enhanced federal, accessible and implementable legislation to be sought by resident and local family businesses to enhance their chances of surviving into the next generation, avoiding the number of constraints and limitations of the inheritance provisions in Federal Law No. 28/2005, based on Islamic Sharia, and the said emirate laws, and many uncertainties of the other existing legislations.

Until recently, many families with younger generations participating in the company and family office sought the offshore jurisdictions of Dubai, Abu Dhabi & Ras Al Khaimah, namely, Dubai International Financial Centre (DIFC) and Abu Dhabi Global Market (ADGM) & RAK ICC with structures like trusts and foundations, holding companies, and family office businesses, to avoid the onshore sharia based inheritance law. Mainly to assure continuity of family company and legal enforcement of additional purpose of the company, such as, charitable aims, impact investments, and venture capital investments by succeeding generations etc. However these structures lack the ultimate goal of family businesses, which is to properly structure and administer the family governance, and ensure sustainability.

Dubai Law No. 9/2020 was enacted as a "family property contract" to enable family members to sign into a legally binding and notarized agreement that permits the collective ownership and management of family-owned property for the benefit of the family members and their heirs. Dubai Law No. 9/2020 covers both new and existing family businesses, including sole proprietorships and corporation stock shares. Dubai Law No. 9/2020 does however exclude family ownership of real estate, moveable and immovable property, and publicly listed joint stock enterprises.

Abu Dhabi Law No. 9/ 2021, empowers owners of family business to prevent selling of shares or dividends to individuals or companies outside the family, and to require prior approval from family partners before a shareholder sells her/his respective equity stake to a non-family member. Abu Dhabi Law No. 9/ 2021 also specifies that its provisions are not applicable to family-owned businesses where non-family members own more than 40% of shares, in order to prevent non-family members from owning more than 40 % of equity, to avoid family ownership of the business coming under threat.

Scope of application

Article 3(4) of Federal Decree-Law No. 37/2022 applies to onshore and article 3(3) of Federal Decree-Law No. 37/2022 applies to free zones in all emirates, including the DIFC and ADGM, but remains subject to the relevant companies' laws in force therein (to the extent that such matters are not set out in Federal Decree-Law No. 37/2022). This means that family businesses in Dubai & Abu Dhabi may also opt to the promulgated laws of Abu Dhabi No. 9/2021 or Dubai Law No. 9/ 2020, which may ultimately cause a constitutional matter if any disputes arise between family business shareholders over which law to opt to.

Circumventing Sharia in inheritance

Article 24 of Federal Decree-Law No. 37/2022 states that the family members' structuring of the ownership and transfer provisions of the shares or assets of the family business, whether achieved through sale, donation, or usufruct, is not in violation of the provisions of Federal Law No. 28/2005 On Personal Status, provided that it was completed during the lifetime of the disposing partner, giving families the opportunity to arrange their assets outside of the rules and restrictions of Federal Law No. 28/2005. It is critical to note that by introducing article 24 of Federal Decree-Law No. 37/2022, the legislator provided the certainty sought by family businesses, that article 361 of Federal Law No. 28/2005 does not apply to family businesses and reduces any arising risks of any invalidation attempts by a dissatisfied heir of an asset transfer made to the family business while the disposing partner was still alive under article 361 of Federal Law No. 28/2005.

The articles of association give the board of directors or the director the authority to act as a trustee under Federal Decree-Law No. 37/2022 for the shares of a deceased partner, directing the transfer of the relevant shares to the heirs and taking the required actions to reflect this in the articles of association after the obligations or rights related to these shares have been settled.

Difference between “family” & “family business”

Article 1 of Federal Decree-Law No. 37/2022 refers to "family" as relatives by kin or marriage. Article 1 further specifies to qualify as a "family business" an entity can be owned by any number of partners, but must be incorporated in accordance with the relevant companies' law (Federal Decree-Law No. 32/2021), but not as a public joint stock company or general partnership); the majority of the shares in such entity must, at all times, be owned by persons belonging to a single family. The council of ministers shall, upon the recommendation of the minister, issue a decision specifying what is meant by the term "single family."

It is possible the cabinet resolution will apply the DIFC Family Office Regulations in defining a "single family" under regulation 2.3.1 which states "a family constitutes a Single Family where it comprises one (1) or more individuals limited to the descendants of a common ancestor and their spouses (including widows and widowers, whether or not remarried)". However, it is worth noting that though Federal Decree-Law No. 37/2022 includes free zone established companies, the way the law defines "family business" seems to cover only companies established in conformity with Federal Decree-Law No. 32 /2021.

Family member shareholders

According to article 7 of Federal Decree-Law No. 37/2022, a family business may be owned by any number of partners, unless otherwise stated by Federal Decree-Law No. 32/2021 or in the free zones' laws. Limited liability corporations in the UAE are limited to having no more than 50 shareholders as legislated under article 71 of Federal Decree-Law No. 32/2021.

As per Federal Law No. 28/2005, compulsory heirship restrictions may be applied when ownership is transferred from one generation to the other, this limit on shareholders is of relevance to family businesses that include individual family members as direct shareholders of the family holding company. It is encouraged for families to create a structure for indirect share ownership of family members in the family business through investment vehicles like trusts, foundations, or corporate organizations.

Family charter/constitution

The family charter is a written document organizing the governance of the affairs of the family relevant to the family company, and the relationship between the family and the family company. Under article 6 of Federal Decree-Law No. 37/2022, a family may have a charter that specifies guidelines for ownership, the family's goals and values, how shares are valued, how profits are distributed, how family members are educated and qualified to work in the family business and its subsidiaries, how family disputes involving the family business are handled, and other guidelines. The family business may register a copy of the charter, and the minister's decision will specify the procedure, restrictions, and requirements for doing so.

The majority of the members of the family assembly, or, in the absence of the assembly, the majority of the partners of the family business, must adopt or change the family charter.

The articles of association's provisions should take precedence over the charter in the event of a disagreement or dispute. Any clause in the charter that is in conflict with the articles of association or Federal Decree-Law No. 37/2022 must also be repealed.

Registration

A family business must be registered in the unified register of family businesses prepared by the ministry in coordination with the competent authority as per article 4 of Federal Decree-Law No. 37/2022. Such register is to be established by Federal Decree-Law No. 37/2022.

A family business shall take any form of companies stipulated in the Federal Decree-Law No. 32/2021, including the sole proprietorship, or the legislation in force in the free zones, as per article 3(1) of Federal Decree-Law No. 37/2022. However, the family business is excluded from taking the form of public joint stock companies and general partnerships as per article 3(2) of Federal Decree-Law No. 37/2022.

The company forms that are stipulated in article 9 of Federal Decree-Law No.32/2021:

- Joint Liability Company,
- Limited Partnership Company,
- Limited Liability Company,
- Public Joint Stock Company, and,
- Private Joint Stock Company.

Valuation of shares

Article 208 of Federal Decree-Law No. 32/2021 only permits for ordinary non-divisible shares. Any other forms of shares, including different classes of ordinary shares, or equity instruments are not permissible. However, families usually seek to be able to gain advantage over certain control mechanisms as part of succession planning, and these control mechanisms frequently entail providing these family members preferential voting rights.

Article 12 of Federal Decree-Law No. 37/2022 provides family businesses the right to issue different classes of shares, including voting and profit bearing shares, and non-voting, profit bearing shares and other shares that differ in value, voting power, profits and priority. More specifically, the family business can issue a dual class of shares through which "Class A Shares" would be qualified to participate in dividend payments and voting at the annual shareholders meeting; and "Class B Shares" would be entitled to dividends but not voting rights.

The ability to issue these shares under article 12 of Federal Decree-Law No. 37/2022 which permits for the split of ownership rights and voting rights enhances the family's capacity to take further control over the family business' governance and operation procedures, including taking precautionary measures to avoid issues arising from an heir becoming a shareholder of the family business.

Article 12 of Federal Decree-Law No. 37/2022 further stipulates that other kinds of shares with varying values, voting rights, priority rights, and other rights and benefits may be included in the family business' articles of association. The flexibility of Federal Decree-Law No. 37/2022 can be seen through the new ability of class share diversification and other voting rights in relation to specific things, such as the selection of the members of the board of directors, even though the default position is one vote per share.

Articles of Association

A family business shall have a memorandum of association, which must be drafted in compliance with Federal Decree-Law No. 37/2022, Federal Decree-Law No. 32/2021 or the legislation in force in the free zones. A reference memorandum of association is prepared by the ministry as guidance for registered family businesses as stated in article 5 of Federal Decree-Law No. 37/2022.

The family business' articles of association can determine the rights attaching to the different classes of shares and any conditions of transferring voting shares to non-voting shares and vice versa (subject to further regulations to be issued in due course).

Transfer of shares

There exist statutory pre-emption rights over share transference under Federal Decree-Law No. 32/2021. These rights may not be subject to waiver, as is the same for tiered pre-emption rights. Therefore, these rights may not be included in the articles of association and can only be contained within private agreements between parties. This is due to the common practice that relevant shares must be issued to all the shareholders in equal portions to their shareholdings.

However, unless otherwise specified by the articles of association of the family business, a partner may now transfer and assign his share, with or without compensation, to his spouse or first-degree relative without proposing the same to the remaining partners under article 8(1) of Federal Decree-Law No. 37/2022. This shall allow some family members to reorganize their ownership of the family business without first having to give those shares to the broader family.

Any transfer to a third party or non-member of the family business must be approved by partners representing at least 75% of the share capital as per article 8(2) of Federal Decree-Law No. 37/2022. This is to protect the family business against possible hostile or unforeseen disagreements that can have a detrimental effect on its operations and the family members with shares in such company.

Dividends distribution

Federal Decree-Law No. 37/2022 differs from Federal Decree-Law No.32/2021 as it provides under article 9 of Federal Decree-Law No. 37/2022 that where one partners attains ownership that is no less than that of:

- 90% of the voting shares of the family business, he may notify the remaining non-family shareholders of his desire to purchase their shares; or
- 95% of the voting shares of the family business, he may notify the remaining family shareholders of his desire to acquire their shares;

In the latter case, they are obligated to sell to him upon the request of any of them either at a price to be agreed upon between them or at a price determined by the Family Business Committee.

Family business shares buyback rights

Article 11 of Federal Decree-Law No. 37/2022 permits a family business to repurchase shares of its own up to a maximum of 30%, to achieve capital reduction or for the buying-back or redemption of a shareholder's shares where such shareholder intends to sell or is bankrupt or insolvent with no buyers for his shares, in line with general pre-emption clauses designed to support the family's preferred pre-emption scheme.

Where a partner in the family business files for bankruptcy or insolvency, Federal Decree-Law No. 19/2019 On Insolvency and Federal Decree-Law No. 9/2016 On Bankruptcy shall apply, with the caveat that any other partner will have a priority right to purchase that partner's share at the price and for the duration set by the court hearing the bankruptcy or insolvency. These laws shall also apply where the partners are unable to purchase the share of the partner who has declared bankruptcy as per article 10 of Federal Decree-Law No. 37/2022.

Board of directors

Family businesses are able to run their own internal affairs, including the ability to allow directors to distribute profits and choose how to set up the entity's governance and committees under article 14 of Federal Decree-Law No. 37/2022. The board of directors is vital to any company's governance structure, including that of a family business. It oversees and monitors the company's management and provides expertise to assist in that function.

Federal Decree-Law No. 37/2022 stipulates that the family business may be run by a board of directors, as in Federal Decree-Law No.32/2021; however:

- The articles of association must list the members of the board of directors;
- Unless the articles of association provide otherwise, a chairman must be proposed and chosen who has the required power to represent the board of directors;
- With the exception of the chairman, the board members may also serve as managers;
- A director may be a legal entity, but at least one person must also be a member of the board of directors;

- A director must have the skills and background that are typically anticipated of someone in the same position; it is possible for a young family member to be appointed as a director of the family business, but must to possess the skills and knowledge required to exercise his fiduciary duties.
- An annual report on the management of the family business and its enterprises shall be sent to the shareholders by the board of directors or the single director, as applicable;
- Except as provided in the articles of association, neither the board of directors nor the single director may dispose of the assets of the family business.

Succession often poses difficulties for families and family businesses. Therefore, it is of great importance to guarantee that a competent corporate governance structure is put in place, which will include procedures that enable good decision-making and the implementation of policies pertaining to the administration of the family business.

Management, managers powers & responsibilities

Under article 14 of Federal Decree-Law No. 37/2022, if there are no appointing provisions in the articles of association, the partners who own at least 51% of the shares may appoint the manager of the family business. Any number of people, including legal entities and members of the partners' own families, may serve as the manager as long as at least one manager is a natural person. Under article 15 and 16 of Federal Decree-Law No. 37/2022, the manager may exercise the authorities and responsibilities required for managing the family business, including the following:

- assuming executive management of the family business;
- distributing the family business's profits in accordance with the articles of association and Federal Decree-Law No. 37/2022;
- the manager shall take special care in managing the family business to be equitable in dealing with all partners and not giving one partner's interest precedence over another; and shall deduct from profits or benefits payable to any partner the amounts that this partner may be owed by the family business;
- advocating for the family business before the committee, courts, and other parties;
- seeking the best interests of the family business with special care;
- present an annual report to the partners on the administration of the family business;
- refrain from taking out personal loans backed by the family business's assets;
- not sell the family business's assets unless doing so advances the company's goals and is authorized by the articles of association;
- the manager must not acquire for his or her own account or for the account of third parties, any economic activity that competes with the activity of the Family Business or its subsidiaries; and;
- be independent in opinion, free from bias and personal interests, and giving the family business' interest precedence over any other consideration.

In the event that a partner passes away, the manager of the company, unless the articles of association provide otherwise, shall act as trustee over the deceased partner's shares, oversee the processes for transferring ownership to each heir in accordance with their legal share, and take the procedures for amending the memorandum of association, after resolving any rights or debts that may be related to these shares in favour of the family business or third parties.

Family governance

Under article 18 of Federal Decree-Law No. 37/2022, governance of family businesses and their affairs can be achieved through regulating the work of councils and committees in their tasks. Some of which include:

- the education and training of its members and their work in the family business;
- separating the ownership and management of the family's assets from that of the family business;
- monitoring the family's investments, planning charitable endeavours and its community involvement programs;
- helping to manage conflicts of interest, and balancing points of view in disagreements that may occur between family members as well as between them and the Partners.

Dispute resolution

Conflicts that may develop between family members are one of the main problems for family companies. These disputes can affect the operation and administration of the business since they might arise from within the company or from interpersonal interactions. The family can also choose how to deal with the settlement of disputes, such as reconciliation through a committee formed by the family. Whilst this has not yet been tested, Federal Decree-Law No. 37/2022 has afforded family businesses a framework within which they can structure the management of their assets and entities, whilst remaining true to the nature of family businesses and their nuances compared to other business structures.

According to article 19 of Federal Decree-Law No. 37/2022, articles of association or the charter may contain language allowing a council to be formed by a number of partners, family members, or outside parties to discuss and attempt to resolve any disputes that may arise between shareholders and/or family members regarding the family business. The members of such a council, its authority, and the procedures for running its meetings and delivering its recommendations will all be outlined in the articles of association or the charter.

In addition, article 19 of Federal Decree-Law No. 37/2022 states that all disputes between shareholders and/or family members regarding the family business, that result from the articles of association or the management or ownership of the family business, that may arise if the charter or articles of association do not contain a provision regarding the formation of such council, or if the council has not succeeded in its conciliation efforts within a maximum period of three months from the date the dispute was presented to it, shall be resolved by arbitration.

Decisions made by the committee may be challenged before the UAE's competent court. The relevant parties to the dispute may agree to refer it to one of the following organizations as an exception to the committee's jurisdiction:

- Arbitration (in conformity with the UAE law currently in effect);
- DIFC's or ADGM's current courts.

Conclusion

The progressive approach of Federal Decree-Law No. 37/2022 to the way a family can manage its wealth and sustain it, is what family businesses should consider, especially where they shall benefit from the provisions of the law which were included in order to mitigate potential risks and issues that may cause disruption to their business in the context of succession. By introducing the first law on family business, the UAE legislator succeeded at preventing the uncertainties caused by many legislations introduced earlier, to support the sustainability, growth and development of family businesses and add regulation to ensure their societal contribution can continue. The objectives defined in article 2 of Federal Decree-Law No. 37/2022 thereof aim to regulate the ownership and management of family businesses in the UAE and to ease the transfer of these businesses across generations; support the continuation of family businesses and strengthen the private sector's contribution to community development and economic success in the UAE; establish suitable channels for dispute settlement involving family businesses; and enhance the role that family businesses play in the UAE's economy and competitiveness.

Authors

Diana Hamade, Founder & Managing Partner, Diana Hamade Attorneys at Law (Dubai, UAE)

Khulud Jarrar, Associate, Diana Hamade Attorneys at Law (Dubai, UAE)