DUBAI REINVENTED

HAS IT LEARNT ITS LESSON?

BY **SHAHEEN PASHA**

REUTERS/Stringer

As the growing shadow of a double dip recession spreads through Europe and the United States, global investors are increasingly turning their gaze towards the East in the search for new opportunities. While China and India are the first names to come to mind in this Eastward financial migration, another player is setting the groundwork to re-emerge as a financial powerhouse in the Middle East, provided it manages to shake off the ghosts of its past.

The United Arab Emirates, which gained notoriety through the meteoric rise and subsequent humbling of its glitzy emirate Dubai, is now seeking to draw global investment once again through a legislative overhaul. It is an ambitious endeavour that the country hopes will set it apart from its neighbours in the Gulf. But for the UAE, and Dubai in particular, reinventing itself as a hub for regulatory excellence following its recent high-profile restructurings and fall from grace may prove to be an uphill battle.

"In the UAE, there is a mindset in the government that the market economy is top priority," said Faraj Ahnish, managing partner of law firm Hadef & Partners' Abu Dhabi office. "If you want to attract international investors, you have to have regulations in place. That means laying the groundwork. You don't have to be comprehensive from day one, but you need to start the process."

It is a process that has been late in the coming. During the boom years, when real estate was king and money was easy to come by, Dubai overshadowed its more conservative neighbour, Abu Dhabi, to make itself the centre of financial wheelings and dealings in the UAE. Best known for housing the largest skyscraper in the world as well as its ambitious real estate development projects, including man-made islands shaped like a map of the world, Dubai appeared invincible. Deals were abundant, credit was easy, and little thought was given to what would happen if the bubble burst.

DUBAI WORLD FALLOUT

Then came investment company Dubai World's debt crisis in 2009.


REUTERS/Ahmed Jadallah

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Suddenly, Dubai was faced with a $25 billion debt restructuring and creditors realised that they had little legal recourse to recover billions of dollars in investment. As investments dried up and projects were shuttered, leaving ghost towns in the once vibrant emirate, the government realised that aggressive action would have to be taken to convince global players that the UAE and its flagship Dubai were still a good place to conduct business.

"The international community just wasn't buying it," said a partner at an international law firm. "Dubai World's restructuring painted the UAE in a bad light, especially since the deals that had gone south were seen as having implicit guarantees by Dubai's government backing them. The insolvency law was outdated, no one had faith in the civil courts, and it seemed that the legislative environment worked against the business community."

The UAE's economy contracted 1.6 percent on the back of the global financial turmoil in 2009, as oil prices plunged and a local property bubble burst, straining banks in the fourth-largest crude oil exporter in the world. Gross domestic product expanded by 1.4 percent in 2010, and is estimated to have grown by 3.9 percent in 2011, largely driven by an increase in petroleum prices according to a Reuters poll. The poll, however, indicated that the overall UAE economy is expected to slow down this year, expanding only by 3.1 percent in 2012.

Dubai, which accounts for 28 percent of the UAE's economy, shrank by 2.4 percent in 2009 but rebounded to expand by 2.8 percent in 2010. The GDP for 2011 was estimated to have grown by 3 percent, according to the Dubai Economic Council.

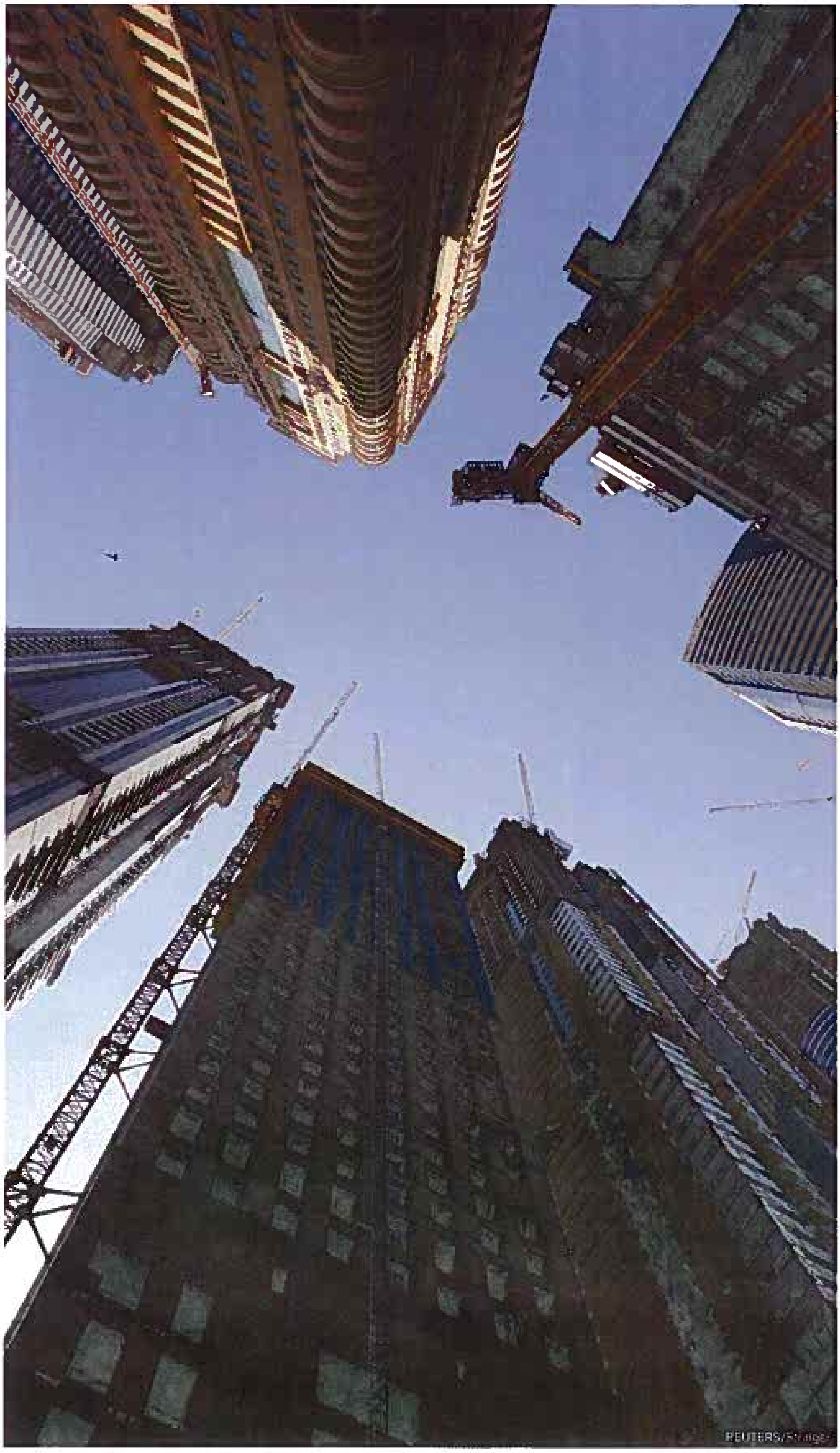
In the quest to reassure the financial community that the UAE had learnt its lessons from the debt crisis, the government has spearheaded a movement to revamp outdated laws. The goal is to make the legislative landscape more inviting to international players, thus spurring economic growth for the country.

Legal observers say there is a wide swath of legislations that needs review starting from legal procedural law to shipping and marine laws. Yet, it is the Commercial Companies Law and the insolvency law which have garnered the most attention in recent days, and are expected to have the most impact on businesses going forward. Both laws are currently in the draft stage, and are awaiting the UAE government's final approval. But legal experts fear that the new laws, which have been touted as major overhauls of the current legislation, may not actually have enough bite to appease the financial community.

Investors are keeping a close eye on the Companies Law in particular. The draft of the law, which was approved by the UAE cabinet in December 2011, will allow business ventures, especially small enterprises, to forgo the 150,000 dirham minimum capital requirement under the old Companies Law passed in 1984. It will also address issues of corporate governance by increasing transparency through the disclosure of financial statements, and is expected to provide a set of unified accounting standards based on international best practices.

But perhaps the most anticipated change revolves around the issue of foreign ownership. Under the current legislation, foreign owners are restricted from owning more than 49 percent of a limited liability company, while a local partner must hold the rest. The new Companies Law would give the UAE cabinet the authority to raise that ceiling of ownership for foreign owners in certain sectors and industries.

Some, however, say that the law does not go far enough. Abdul Kadir Hussain, chief executive of Mashreq Capital, said he is skeptical that the new Companies Law will have any major impact. "We're not expecting a huge amount of change there despite all of the talk," he said, adding that while there may be some benefit in issues of trans-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parency or governance, major issues such as ownership restrictions are unlikely to see much reform ultimately.

Essam Al Tamimi, founder of law firm Tamimi & Co agrees. According to him, the Companies Law does not stray far enough from the original law to truly benefit the business community. "The law introduced one or two procedural issues, certain corporate governance on companies, (introduced) certain regulatory works on supervision and transparencies. But the law has missed out on a lot of ideas that could help businesses to grow," he said.

Al Tamimi added that the decision to only provide exemptions to the 51 to 49 percent foreign ownership rules in select cases, rather than change the law altogether to accommodate 100 percent ownership by foreigners, may turn off some investors that are eagerly awaiting a firmer stance on the issue.

A FINE BALANCE

It is a fine balance for the UAE where implementing regulatory change is concerned. On one hand, the country needs to diversify its economy beyond the oil wealth that is mainly prevalent in the capital city of Abu Dhabi. In Dubai, for instance, the main contributors to the city's gross domestic product are the economically sensitive tourism, financial and trade sectors – all areas that have traditionally fallen under the umbrella of the expatriate population, and have been hit hard with the onset of the global financial crisis. Dubai's financial woes resulted in a brain drain with foreigners either returning to their home countries to set up shop, or looking further East. Thoroughly revamping laws, such as the Companies Law, in the UAE would help bring back some of the foreign investment which could bolster the economy.

But the UAE must also take into account the needs of its own population. In a country of about five million people, local Emiratis only make up 19 percent of the population. Opening the doors completely for foreign ownership may marginalise the local population that is looking to compete within its borders.

"While the country is looking to encourage foreign investment, there are other various

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socio-economic factors that must be kept in mind," said Hadef's Ahnish. "The UAE is one of the only stable countries in the region at this time, and opening it up too much risks floods of people coming in. Consideration has to be given to the risks and benefits of this to the national citizens of the country."

A law passed late last year has already stirred up some controversy among local Emirati lawyers who fear that their business may be under attack. In October, Dubai's ruler passed Decree 16, opening up the jurisdiction of the Dubai International Financial Centre (DIFC) Courts – an English-language judicial body governed by British common law. While a special tribunal had been created at the DIFC Courts to oversee legal cases relating to Dubai World, prior to Decree 16, local and international businesses that were not registered with the free zone were only permitted to file claims in the Arabic-language civil courts. The move was hailed enthusiastically as a step forward for international business.

"Without a shadow of a doubt, a CEO's decision to invest is linked to legal and regulatory risk," said Mark Beer, registrar at the DIFC Courts. "When you combine the legal infrastructure with the commitment of Dubai to free and open trade, it makes a compelling business case for investment in Dubai. I think this will spur quite significant investment. Dubai is definitely back on the list."

But local lawyers worry that there may be an exodus of cases from the Arabic-language courts to the DIFC Courts. That would leave them with little business and a tough time in court while competing with foreign litigators who are far more well-versed in common law. The law also raises questions of enforceability and scope, which some legal experts say need to be tested.

Melissa Forbes, an associate at Taylor Wessing in Dubai, said it remains unclear whether the DIFC Courts' judgments will be accepted across the board, especially in cases that may be deemed as matters of public policy. "There is a lot of excitement about this law, but it's not a black and white issue. It is untested in how it will be actually implemented, and whether it will be a streamline process," she said.

DIFC Courts judge Shamlan Al Sawalehi said at an event in February this year that the court has signed memoranda of understanding with the Dubai civil courts, the court in Ras al-Khaimah, and the federal Ministry of Justice in the United Arab Emirates. He said the court is in discussions with the Abu Dhabi courts to pass a similar MOU guaranteeing that any rulings made by the DIFC Courts will be enforced in the capital.

But until such an MOU is signed or there is evidence of any other regional courts upholding a DIFC courts verdict, legal observers say there are still questions over the efficacy of Decree 16. In the meantime, it can be seen as a way to promote a positive image of Dubai as it comes out of the financial crisis, they said.

"One thing I've learned about Dubai is that it is the best at reinventing itself," said a lawyer at an international law firm. "When the (debt) troubles happened and the real estate market went down and all of a sudden it found itself faced with a number of disputes, it suddenly decided to put a better light on it by saying 'let's be a hub for better dispute resolution.' Dubai is doing what it does best."

EYEING INSOLVENCY LAWS

Open jurisdictions and increased foreign ownership ceilings may go a long way in attracting foreign investment. But until the country overhauls its insolvency laws, the global market will continue to view the emirates with some skepticism. In the wake of the Dubai World scandal, corporations are now faced with a law that is just not applicable to the breadth and scale of businesses.

Under the proposed draft of the new insolvency law, which was submitted to representatives of the seven emirates and the Ministry of Finance late last year, bankruptcy procedures are expected to be more clearly defined. For instance, some aspects of the new law will mirror parts of the United States' Chapter 11 rules. Under the current law, individuals in charge of businesses in default can face stiff penalties and imprisonment if they do not repay their debts. The new law would create a commission to help debtors and creditors reach an out-of-court settlement. The new law would also provide insolvent businesses that are still considered to be viable with help in reorganising their operations to avoid having to shut down completely.

"Anything that establishes more transparency and a defined process will be welcome by the business community," said Mashreq Capital's Hussain. "Precedence would be established, and essentially in the long run, you will reduce your own business costs. As long as an actual process is put into place, businesses can make informed decisions, which should spur investment."

But Hussain is wary of viewing the UAE as a legislative hub in the near future until there is more evidence of actual reform. Hussain said he hopes that the UAE will follow the path taken by markets following the Asian financial crisis in the late 1990s. Asian governments, such as Thailand and Indonesia, were forced to reform their insolvency systems and introduce new laws – a move that has helped the Asian markets recover and draw more international interest. "Hopefully, we'll see the same sort of trend here," he said.