A legacy of resilience

In a landmark move, Law No. (9) of 2020 regulating family-owned businesses in Dubai was issued last month. The original bill was prepared by Fadi Hammadeh of Al Futtaim Group in 2013. In an exclusive to *the Oath*, the general counsel provides a comprehensive overview of the new legal framework and how it facilitates protection, expansion and successful transition of family firms.

Family firms are instrumental to the region's economic prosperity and social stability. That said, very few examples of successful family business succession planning have emerged in the GCC over the years. This could be attributed to the proliferation of poor internal governance models, lack of education amongst decisions makers about the risks of poor planning, and absence of impenetrable legal solutions that could promote inter-generational management and ownership continuity. This has led many family firms in the region to place their destinies in the hands of Sharia'a-forced heirship rules as the default option for organising the inheritance and ownership of their family business assets. This lack of preparedness has proved costly to many regional family firms as it has invariably led to business decision-making paralysis and ownership fragmentation at best, and festering family court disputes and the demise of the family business at worst.

FAMILY OWNERSHIP LAW (9) FOR 2020

The recent promulgation of the new Family Ownership Law in Dubai (the "Law") could be seen as the culmination of a legislative revolution that took place over the past decade, promoting family succession planning and wealth management in the United Arab Emirates and the GCC region. This movement has started in earnest with the issuance of the trust and foundations legislations and the enactment of the system of wills for non-Muslims in the financial free zones, namely DIFC and ADGM. It continued with the issuance of *Waqf* laws in the Emirates of Sharjah in 2018 and Dubai in 2017. In 2018, the federal *Waqf* Law No. 5 was promulgated, which contained for the first time-specific modern provisions organising *waqf*s for family businesses. Moreover, the new federal company law No. 2/2015 included provisions reducing the minimum shares to be floated by promoters to only 30 per cent of capital, thereby encouraging more family firms to float. More recently, the amendments to the federal commercial agency laws also allowed listed family firms to register and manage commercial agencies in the UAE, even where they are not 100 per cent owned by UAE nationals.

The Origins

The draft of the new Family Ownership Law was originally prepared by the author of this article back in 2013 under the auspices of the Family Business Council-Gulf (FBCG) following its establishment in Dubai in 2012The draft law was discussed with a number of local family businesses and public stakeholders before it was passed on to the Supreme Legislative Council of Dubai upon its creation in 2014. The draft law underwent lengthy consultations and debates until it was recently issued by HRH the Ruler of Dubai.

The concept of Family Ownership originated in Swiss and Italian civil laws in the 19th century. In the mid-20th century, the Egyptian legislature borrowed the principle and incorporated it into its civil code. It was later incorporated into the UAE Civil Transactions Law of 1985, and thereafter found its way to other Middle Eastern countries. The concept builds upon the principle of common ownership and the delegation of authority to devise a strategy for maintaining the economic unity of family assets in a manner that serves a united family's best interests. It differs primarily from the general principles that govern other common ownership in that this familial form of common ownership is optional, not mandatory. Moreover, the rights and obligations associated with such common ownership stem primarily from the family ownership contract to be drawn between the family members.

THE SIX PILLARS OF THE FAMILY OWNERSHIP LAW

Clarity of objectives

The Law's objective is to facilitate the successful generational transition of family firms. The Law contains appropriate provisions to mitigate the risks of management and ownership fragmentation as the family business transitions between generations. It is important to note that the proposed law is not mandatory. Regional family firms may choose to opt in or out, especially since not every family business has the explicit intention to continue over the long term. Some companies begin as start-ups with the objective of attaining preliminary success and critical mass and then consequently getting sold (privately or publicly). Others may simply prefer to allow future heirs to cash in and opt out of the family firm. These businesses may not need to be locked into a structure that would stop them from selling their future inheritance to third parties.

Family ownership as a contract

Family ownership is a written contract entered into by family members fueled by a common economic interest. Here are the main characteristics of this contract:

» The family ownership existence depends on drafting and executing a written instrument, the lack of which will automatically nullify its existence. The contract must be executed before a notary public to mitigate against the risk of forgery, especially if challenges are raised years after the agreement's creation and the original signees' demise. The fundamental changes to the nature of ownership—transitioning from segregated to common—require that the family ownership be publicised so that everyone is made aware of the new limitations affecting the co-owned assets. For example, if a family ownership consisted of shares in various companies, the company registry, upon the request of the family ownership manager, must bring about the necessary amendments to note the changes to the shares' ownership to comply with the Law. Similar amendments must also take place in the land department registry concerning real estate assets.

» Parties must be members of the same family. The Law provides an extended definition of "family" to be compatible with modern economic realities. Spouses of family members are therefore included, as it appears illogical to include cousins yet exclude spouses, given that many businesses are forged by husbands and wives.

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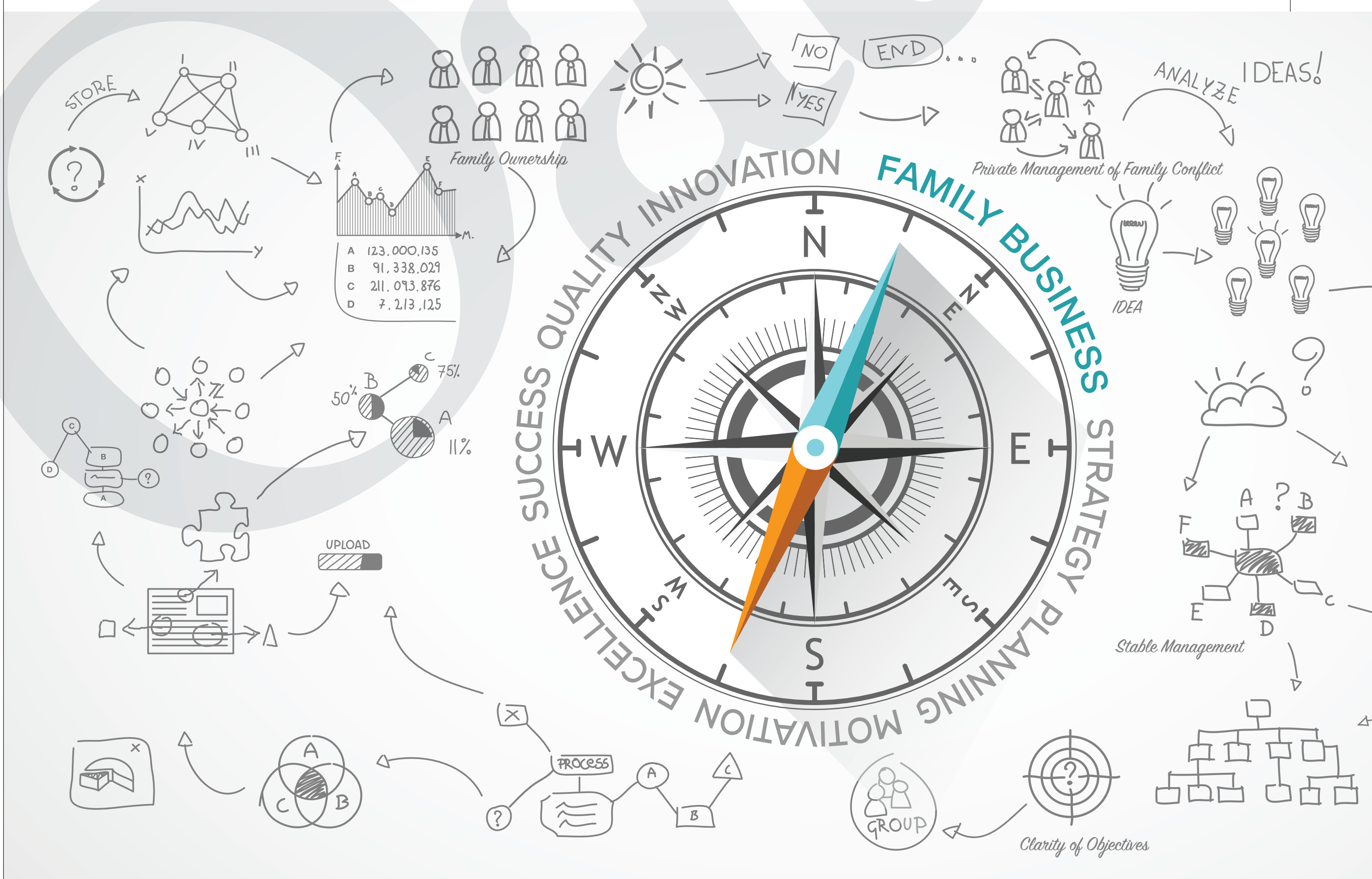
» Partners must be bound together by a common economic interest, whether these are company shares,an operating factory or other properties that they may have been collectively inherited.
» Parties must possess the necessary legal capacity to enter into a binding family ownership contract, a key element in avoiding future disputes. Family members who are minors when they become owners by inheritance must be properly represented by a parent or court-appointed custodian.
» If the assets under family ownership are comprised of shares in a company, these shares cannot be in a listed joint stock or publicly traded company.
» The duration of the contract is limited to 15 years. The relatively short term in the context of family business lifecycle was necessary to ensure the Law's compliance with the provisions of the UAE federal Civil Law. To compensate, the Law allowed for the possibility of extending the family ownership by unanimous agreement of the co-owners upon its expiry.
» With the approval of at least a 75 per cent of the family owners, the family ownership contract can be amended at any time. This freedom to change is invaluable, allowing subsequent generations to upgrade, modify, and otherwise improve on the legacy of their ancestors.
» Founders may agree that the contract may only take effect after their demise. In this case, and to the extent that the family is bound by applicable forced heirship rules, the future family owners and their consequent ownership percentages will then be determined by Sharia'a.

Economic unity by common ownership

The Law organises the assets in the family ownership as commonly-owned. The most obvious difference between family ownership and other forms of common ownership is the relative longer duration of the former, designed to ensure stability. During this period, no family owner is permitted to dispose of its shares in the



common ownership to third parties outside of the family ownership without the other owners' consent. This limitation includes the prohibition to mortgage, pledge, or otherwise encumber the family assets.

The four permitted exceptions to the above restriction can occur in the following scenarios:

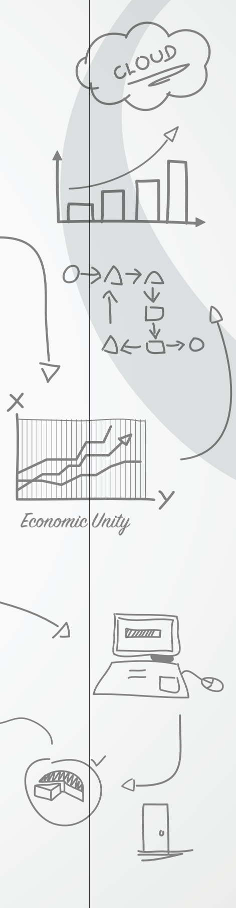
❶ The owner who wishes to sell or dispose of his share obtains approval of at least 51 per cent of the family ownership.

❷ The owner selling or disposing of his shares to other family co-owners.

❸ An owner who may transfer to his own children, spouse or first-degree relatives.

❹ The designated dispute committee permitting such transfer for 'compelling reasons'.

The Law also contains provisions that organise the recovery of family ownership assets if they end up in the hands of outsiders against the desire of the founding members. This may happen, for instance, in the case of inheritance by will or bankruptcy of a family owner.



Stable management

A family ownership structure may support the family business business continuity by promoting operational management stability. The selected manager may be a family owner, an outside professional, or a management company. The primary objective is to provide the family ownership members with the maximum discretion to choose their manager based on skills and temperament. In theory, the manager of the family ownership has extensive authority to manage the assets in whatever manner he or she deems appropriate, if their actions are aligned at all times with the best interests of the family. This extensive authority exceeds what is typically allotted for the management of a normal common ownership. The family business manager may go so far as changing the intended use of the assets under common family ownership, for instance. That said, having extensive authorities doesn't mean that managers are free to do whatever they wish. The Law is founded upon the principle that great authority is paired with great responsibility. A family ownership manager must abide by the family ownership contract and will be responsible otherwise.

The Law states that the manager can only be removed in the same manner and with the same majority that appointed him, in order to ensure management stability and reduce the odds for undue challenge or opposition. The manager must provide financial and management reports to the family owners on regular basis and be held accountable for any damages arising out of his negligence, breach of contract or violation of the Law.

The Law contains provisions for the creation of a board of directors. The family ownership contract will determine the necessary qualifications required for the appointment of the board members, including their education level, professional experience, temperament, independence prerequisites, or any other quality deemed necessary by the contract.

Finally, the Law seeks to separate the business governance from family governance, while reinforcing the need to strengthen constructive communication and positive cooperation among family members. The Law therefore permits the creation of a family council, detailing its terms of reference, management, authorities, membership, financial and administrative structures. This is essential in encouraging family owners to unite their efforts, manage the expectations of other family members (particularly regarding employment and education), mitigate the risk of conflict, and promote their amicable resolution in a private and peaceful manner.

Family ownership termination

The primary objective of the Law is to prolong the life of the family business as long as it remains in the best interests of its shareholders and stakeholders to do so. There may come a time, however, when it becomes necessary to end the business, whether due to economic hardship that may render the family firm commercially unviable, internal conflict, poor management or bleak markets future.

When the family firm reaches the end of the road, the family may either wish to shut down the business or, if the business retains value, sell it to a third party (either privately or as part of a public offering). Envisaging these eventualities, the Law permits the end of the family ownership if not renewed at its expiry, or prematurely with the affirmative approval of the simple majority of its co-owners, unless the contract stipulates a higher majority.

The end of the family ownership will cause any remaining assets to be distributed between the then family owners, each in proportion to their common ownership. In this case, the family owners will need to ensure that the legal records organising the common ownership of the family assets are duly amended to reflect the new ownership.

Private management of family conflict

The Law advocates the formation of a special judicial committee to be subsequently established by HRH tasked with overseeing the resolution of disputes that may arise out of the family ownership contract, its validity, formation, operation, management, or expiry. The selected members are expected to be professionals with the relevant legal, financial, and—most importantly—family business expertise. The ultimate objective is to provide family firms with the confidentiality, speed and expertise they needto settle their disputes if they arise.

ADVANTAGES OF CREATING A FAMILY OWNERSHIP UNDER THE NEW LAW

In summary, the new Law provides family firms in the region with yet another tool to manage the precarious process of generational transition. Families that are currently reviewing available succession planning options can consider the following benefits of this Law:

» **Ease of implementation**. Family ownership can be easily implemented as a succession structure. It does not require complex formalities, with the only prerequisite being a written and notarised contract. Family ownership can also help to circumvent limitations placed in many regional company laws regarding the maximum number of partners in limited liability companies.

» **A window of security**. By creating a "cooling-off period" of safe common ownership sphere after the demise of a family owner, the family ownership structure limits the temptation of heirs to squander the family wealth. It gives them a valuable time to consider the value of maintaining the family business legacy for their collective benefit.

» **Pre-selected leadership**. Family ownership contract enables the family founder or owner to pre-select the family business leader and vest extensive authorities in that person.

» **Accessible governance**. The law contains comprehensive provisions that regulate the establishment and authorities of different governance bodies to oversee the family business and also ensure separation between the family and the business, whilst at the same time unlock their potential synergistic powers.

» **Compatible and compliant**. The family ownership structure is embedded in the Civil Law of the UAE; as such, it is compatible with the mandatory heirship rules contained in personal status laws. It is a sturdy onshore concept that is less likely than other available structures to be challenged for inconsistency with Sharia'a.

The challenges facing continuity of family firms in our region are manifold and may seem daunting. However, with many new structures and legal innovations becoming available, now is the time for visionary family firms to embark on their succession planning journey with a healthy dose of determination and education. Founders of family business in the region can leave behind either a legacy of togetherness and harmonious growth or one of fragmentation and festering conflict; their foresight and wisdom will be the ultimate decider.

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