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AL TAMIMI & CO.

A PUBLICATION BY AL TAMIMI & COMPANY

VENTURE CAPITAL

& EMERGING COMPANIES LAW REVIEW

2021 ISSUE

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FOREWORD

While tech start-ups in the Middle East have been around for a few years now, the explosion of growth in both the entrepreneurship and venture capital ecosystems in the past couple of years has been truly impressive. Our time has come. The disruptive mindset has taken root. The desire to build innovative solutions to old-economy problems has given birth to a generation of pioneers and entrepreneurs ready to make a mark. Most importantly, the capital has become available to fund innovation and disruption. And the sums of money available and the value - beyond mere cash - investors are bringing to the table is driving the development of the ecosystem at pace.

With the ever-developing track record of regional success stories (think Zawya, Maktoob, Souq.com, Careem, Instashop, Fawri, Anghami, and many others), the opportunities for venture investors have become clear. Yet only two years ago, the venture capital landscape in the region was made up of a handful of dominant GPs chasing the best opportunities in a nascent emerging companies scene. But this has changed and, in the last 24 months alone, the pool of available capital and investment managers has mushroomed and the MENA region is poised to become a global focal point for investors interested in the enormous unlocked value across our region along with the multiple and diverse markets of Africa, South Asia and Turkey.

My decision to build out a Venture Capital & Emerging Companies team two years ago was borne out of the opportunity this rapidly growing ecosystem presented. And in that time, we have now built the largest team of dedicated venture capital lawyers in the region. Our venture capital lawyers have been admitted to numerous bar associations including the UK, California, UAE, Egypt and Jordan have an impressive deal list including many deals across the MENA region in addition to venture deals in Silicon Valley, New York, London, Paris and elsewhere. I am immensely proud to say that since establishing the practice we have been retained by some of the best-known VC funds, corporate venture funds, sovereign investors and family offices and have closed more than 50 financing rounds from convertible seed rounds to to priced Series A, Series B and Series C rounds in addition to less typical deals such as the region's first 'pay to play' down-round allowing an insolvent technology company to be rescued by its venture backers and re-structured by a specialist team to fight another day.

We have also forged partnerships with the Middle East Venture Capital Association and DIFC FinTech Hive and our team members are active mentors with several global and regional accelerators.

Most importantly, we have established this practice within the largest law firm in the region with its multiple areas of deep specialization and expertise across all legislative and regulatory frameworks in the region. So in addition to the experts we have assembled in doing venture deals, we also have a whole range of lawyers to supplement our deal-making skills including specialists in intellectual property, technology, media, employment law, corporate structuring and setups, financial services regulation, etc.

I am very proud to be able to present to you this Venture Capital & Emerging Companies Law Review with content curated for anyone interested in the world of entrepreneurship, tech disruption and the financing of the coming generation of regional unicorns. Enjoy!

ABDULLAH MUTAWI

Partner, Head of Corporate Commercial, Al Tamimi & Company

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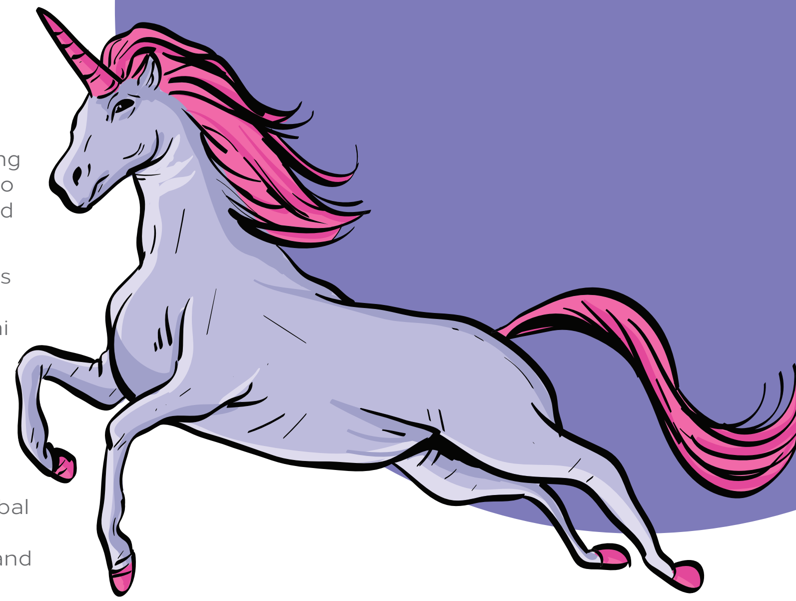

It has been a real pleasure to see the trail that Al Tamimi & Company has been blazing this last year in terms of a legal presence to be reckoned with in the venture capital and emerging companies ecosystem!

Law firms rarely invest in full-service teams outside of London and Silicon Valley to service the local VC industry but Al Tamimi has bucked the trend and built up a formidable capability in a relatively short period with several specialists joining the team from the region and internationally. The team is multi-national, multi-lingual and multi-jurisdictional and their ability to bring not only regional experience but global experience to bear means they really add value in our market where best practices and market norms are still in development.

Venture capital deals are highly specialized and require smart and experienced lawyers. The complexity of deals is disproportionately high relative to early stage ticket sizes so a firm has to know what it's doing to deliver successful deals at good value for money. As a VC, I have worked with the Al Tamimi team on multiple deals now and they have never failed to deliver.

The team's passion and energy for the industry is evident not only in the great content curated for this publication, but also in the significant pro bono work that they have undertaken assisting budding start-ups and their complete dedication to best practices in the industry.

I am particularly thrilled that Al Tamimi has recently partnered with MEVCA as the association's legal partner. Watching them in action putting together a structure and governance framework for MEVCA on a completely pro bono basis has been such a pleasure and the MEVCA team and I look forward to continuing this good work on behalf of the industry as a whole.

NOOR SWEID

Chairwoman, Middle East Venture Capital Association (MEVCA)

MEVCA
Middle East Venture Capital Association

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MEET THE TEAM

Over the past 18 months, Al Tamimi & Company has assembled a team of venture capital lawyers from some of the world's leading innovation and technology centres with mature and deep venture capital ecosystems. Our team is arguably the largest and most accomplished dedicated team of venture capital lawyers operating in the Middle East today and we are passionate about supporting the regional ecosystem, contributing to the development of regional market practices and standards and being involved in the region's biggest success stories. As our practice grows, we will build on our successes by continuing to invest in our team and producing substantive and value-added content for the benefit of the ecosystem as a whole including further editions of this publication.

Our dedicated venture capital team is supported by specialists across multiple domains including intellectual property, corporate structuring, financial services regulation, employment law, and many others. Please refer to the section at page 91.

ABDULLAH MUTAWI

Partner, Head of Corporate Commercial

Abdullah is one of the region's leading corporate lawyers specialising in high tech industries and has worked on some of the region's most high-profile technology related deals ranging from more than 100 private equity and venture capital deals and exits through to multi-billion dollar private and public company M&A transactions in the telecom, media, and technology industry. He has led deals all over the world involving companies and assets in more than 35 emerging and developed nations in North America, Europe, the Middle East, Africa and South and South East Asia. In his spare time, Abdullah is a musician, a photographer, an immodest-yet-mediocre chef and a loving husband and dad as well as being a prolific angel investor and co-founder and chairman of leading MENA seed and Series A micro-VC Dubai Angel Investors with a portfolio of 30 companies across the US, Europe and MENA region. He is passionate about the transformational power of technology, about supporting entrepreneurs and the investors who back them and about always paying it forward with mentorship and guidance for those just getting started or needing the transformational power of grey hair 😊

KAREEM ZUREIKAT

Senior Associate, Corporate Commercial

Kareem is a seasoned venture capital lawyer who has advised VC funds and entrepreneurs on numerous early and later-stage funding transactions across the Middle East, North Africa, Europe, North America and Southeast Asia. Kareem also regularly advises on buy-side and sell-side M&A transactions, including secondary sales linked to venture funding rounds. Kareem enjoys the fast-paced deal-flow generated by the VC ecosystem and is passionate about seeing investors and aspiring entrepreneurs work together to bring new technologies and opportunities to the world and the region and disrupt the way we do business and lead our day-to-day lives. Kareem believes that venture capital has been, and will continue to be, the key that unlocks the untapped talent in the region that the current and future generation of entrepreneurs hold.

RICHARD CATLING
Partner,
Corporate Commercial

Richard is an English qualified corporate finance lawyer and Partner in the corporate finance practice at Al Tamimi & Company and has practiced in Dubai since 2011 and prior to that in the City of London. Richard's varied practice includes advising on complex multi-jurisdictional mergers and acquisitions, family business restructurings, private equity and venture capital. In the VC space he has a strong track record advising investors, founders and management teams on a wide variety of issues affecting early stage companies, with a particular focus on early stage funding, employee incentives and shareholder disputes.

ANNA ROBINSON
Senior Associate,
Corporate Commercial

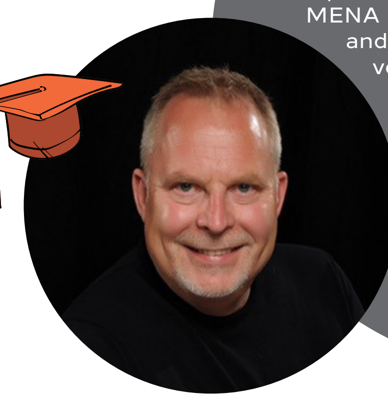
Anna is an English qualified M&A and venture capital lawyer. After studying, training and practising in England, Anna moved to Dubai at the beginning of 2018 to join the Corporate Commercial department of Al Tamimi & Company. Anna is experienced in advising both investors and companies on Series A and Series B investment rounds, including managing the legal due diligence and negotiating the financing documents. Anna is excited to be a part of the venture capital & emerging companies team and is very excited by the expanding range of companies and segments attracting venture investments.

INGY DARWISH
Senior Associate,
Corporate Commercial

Ingy is an Egyptian qualified M&A and venture capital lawyer. After obtaining her law degree from the University of Paris I Pantheon Sorbonne in partnership with Cairo University and her bachelor of arts in economics from the American University in Cairo, she started practising in Cairo where she worked at a leading law firm and then joined Al Tamimi in Cairo in 2016. Ingy has experience in early-stage technology funding deals including Series A and Series B investment rounds, early stage legal due diligence and negotiating the financing documents. She also has extensive M&A and capital markets expertise and deal experience. Ingy has recently joined the corporate finance team at Al Tamimi team in Dubai and is very excited to be at the centre of the venture capital ecosystem and the entrepreneurial revolution happening in the region.

DENNIS RYAN
Senior Associate,
Banking & Finance

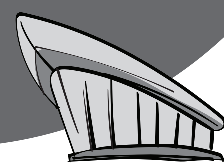
Dennis Ryan brings with him 29 years of experience as a banking and finance lawyer with a broad range of finance expertise in investment funds, including MENA private equity funds, real estate and infrastructure funds, REITs, venture capital funds and hedge funds. Dennis has been ranked as a Leading Practitioner in Chambers & Partners since 2010 and awarded 2014 IFLR Award for Restructuring Deal of the Year.



HUGO CUGNET

Associate,
Corporate Commercial

Hugo is a California qualified venture capital lawyer. After studying in France, Cambodia, and California, he practiced in the Paris office of one of Silicon Valley's top law firms. He has extensive experience representing both start-ups and companies in their venture financing rounds. Hugo has also had lots of experience advising digital native brands on a broad spectrum of legal matters and has mentored entrepreneurs every chance he gets. He is passionate about smart cities and believes that the 21st century will be defined by evolving forms of urbanization resulting from population growth. Convinced that the Middle East will be a driver of tomorrow's innovation, Hugo moved to Dubai last year to join Al Tamimi & Company and is thrilled to get the chance to advise bold entrepreneurs and visionary investors.



DANIEL STERLING

Associate,
Corporate Commercial

After studying in both Canada and the UK, Daniel trained and qualified in England working at the London office of one of the top American law firms specialising in venture capital, private equity and technology spheres. He has experience in corporate M&A, private equity and venture capital and has advised both founders and investors at all stages of the business life cycle. Looking to escape to warmer climates, Daniel has very recently moved to Dubai to join the Al Tamimi venture capital & emerging companies practice and to gain exposure to a broader range of corporate finance experience as well as broadening his cultural horizons.

HAYA AL-BARQAWI

Trainee Solicitor,
Corporate Commercial

Haya is a trainee lawyer currently undertaking her vocational training to qualify as a Solicitor of England & Wales. After completing her law degree at the University of Bristol, she joined Al Tamimi's corporate commercial department, assisting clients with an array of matters, and working mainly on venture capital investment and family business matters. She often engages multiple specialist teams within the firm, involving a number of jurisdictions, in delivering projects. Haya is passionate about working within a growing, talented, and focused team, and is excited by the opportunities that corporate law present.

POLLS: INSIGHTS FROM THE REGION'S LEADING VC FUNDS AND ANGEL INVESTORS

Abdullah Mutawi
Partner, Head of Corporate Commercial
a.mutawi@tamimi.com

Hugo Cugnet
Associate, Corporate Commercial
h.cugnet@tamimi.com

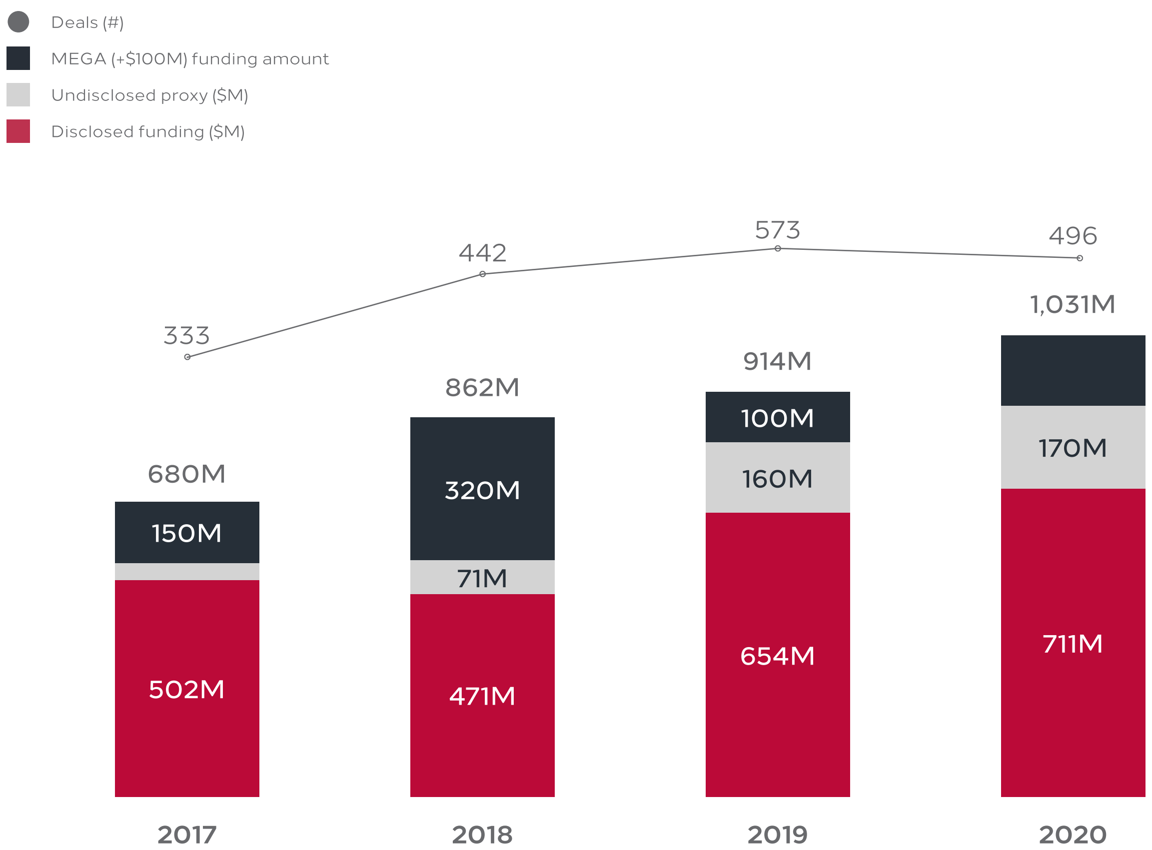
IN COLLABORATION WITH

MEVCA
Middle East Venture Capital Association

Polling angel investors and venture capitalists in the MENA region: testimonies of a growing ecosystem

In the wake of more and more regional success stories, the venture capital asset class has certainly taken on a life of its own over the past two years. The more traditional later stage private equity, once the regional go-to asset class of alternative investments, is losing ground for numerous reasons both obvious and not-so-obvious. Venture capital is attracting sovereign wealth funds, institutions, individuals, and family enterprises. In the family office category, there is a clear pattern of third-generation family members taking charge of diversifying into venture, and fund managers chasing big returns.

The growth of the MENA venture capital investments



Credit: MAGNiTT

Mid to late-stage private equity will typically see investors looking for controlling stakes, with cheques starting at the USD 10 to 50 million mark. In venture capital, cheques are much smaller, especially in the earlier stages of start-ups, and co-investments are the norm rather than the exception. Moreover, venture investors will avoid taking a controlling stake in a company, with contractual arrangements between shareholders dictating the governance obligations. Venture capital comes at a time when companies are at the early-stage of their development, and there needs to be room for future investors to participate in the upside.

Venture capital investors will write a much larger number of cheques with the same amount of capital as a PE investor, providing relatively stronger portfolio diversification. This is extremely important as the risk profile of companies is much higher, with both the potential rewards and probability of failure being very high. Contrarily to later stage private equity, venture investors cannot rely on financial fundamentals. Even with second and third-time founders, companies are often pre-revenue, and investors are looking at other factors to determine the strength of the opportunities.

Out of an abundance of curiosity and a desire to present some meaningful data, we have conducted two very similar surveys of both venture capital funds and active individual angel investors to find out their deciding factors when considering an opportunity. Angel investors are often successful entrepreneurs and professionals working in the entrepreneurial space, and are writing smaller cheques at an earlier stage than venture funds. They provide value through their investment and their advice, having been through the motions of growing a company, or having domain expertise and insight that can be applied by the start-up. Venture funds will typically come in after angel investors in companies looking to develop their vision or proof of concept and have a slightly different framework of analysis than angel investors.

Frameworks of analysis

Please rank each of the following in terms of importance in your investment decisions

ANGEL INVESTORS	VC FUNDS	
Quality of team	Quality of team	Most Important
Business model	Product Market Fit	
Product Market Fit	Moat / defensibility	
Go to market strategy	Traction	
Valuation	Go to market strategy	
Moat / defensibility	Business model	
Traction	Valuation	
More than one founder	More than one founder	
Vertical	Vertical	
Obvious route to exit	Obvious route to exit	
Projections	Projections	
Board seat	Board seat	Least Important

We can see from the results that angel investors and venture investors apply a similar framework of analysis. Quality of the team is the most important factor. As a matter of fact, not a single responder did not say that it was critical. At this stage, founders have the vision, plan, and drive to build the company. An early stage company is only as good as its founders.

For angel investors, the next most important things are the business model, go-to-market strategy, and product-market fit. This is a telltale sign that angels are investing early. They want to see that the founders have a path to product market fit and growth. The focus on business model and go-to-market strategy are a way to gauge the vision of the founder, which needs to be grounded in reality. Acquiring first customers is hard, and the necessary first step for product-market fit. Some start-ups will have product-market fit at this stage and be in hypergrowth, but most will only need to demonstrate a believable path to achieving product-market fit through customer acquisition strategies.

For venture investors, product-market fit is the clear second after the team, with less focus on go-to-market strategy and business model. In most cases, venture investors will help grow the company following initial demonstrable results. Product-market fit is proof that there is a strong addressable market, as well as the fact that the start-up found a way to address the issue being tackled. Venture investors will not look twice at a company that built a fantastic product if its potential customers are not interested in using it.

Another point of divergence in the groups is that moats and traction are keys for the venture investors, while comparatively less important for angel investors. This is a reflection of the different phases of an early-stage company. Angel investors will invest in the team and the vision, and it will be the founders' responsibility to build a unique product and add sufficient value to it in order stay a pioneer.

When venture investors come in, they will need to make sure that the start-up has defenses against the risk of being copied, and that they are making their name in their market. Traction will demonstrate growth potential and moats will demonstrate survival potential. Both of those are necessary.

Valuation is important for both groups, and so is the fact that the start-up has more than one founder. The fact that those factors are flipped for each group is a strong indicator of their differences. On the one hand, angels will be more willing to back a solo founder if they can identify with them and the valuation is right. They will have a stronger focus on price as the risk profile of the company is at the highest. On the other hand, venture investors will be more flexible on price if it means getting to back a promising company. However, they will want to see that there is a team than can keep up with the growth. It is very difficult for solo founders to stay on top of fast-growing companies and in most cases, solo founders will only be considered if they are repeat entrepreneurs with a proven track of success.

Being at the inception of the company's history, long-term considerations are less important. Exit opportunities are still far away and the company will go through drastic changes. It is important that the investors believe that there is a path to exit, but less so that this path is defined.

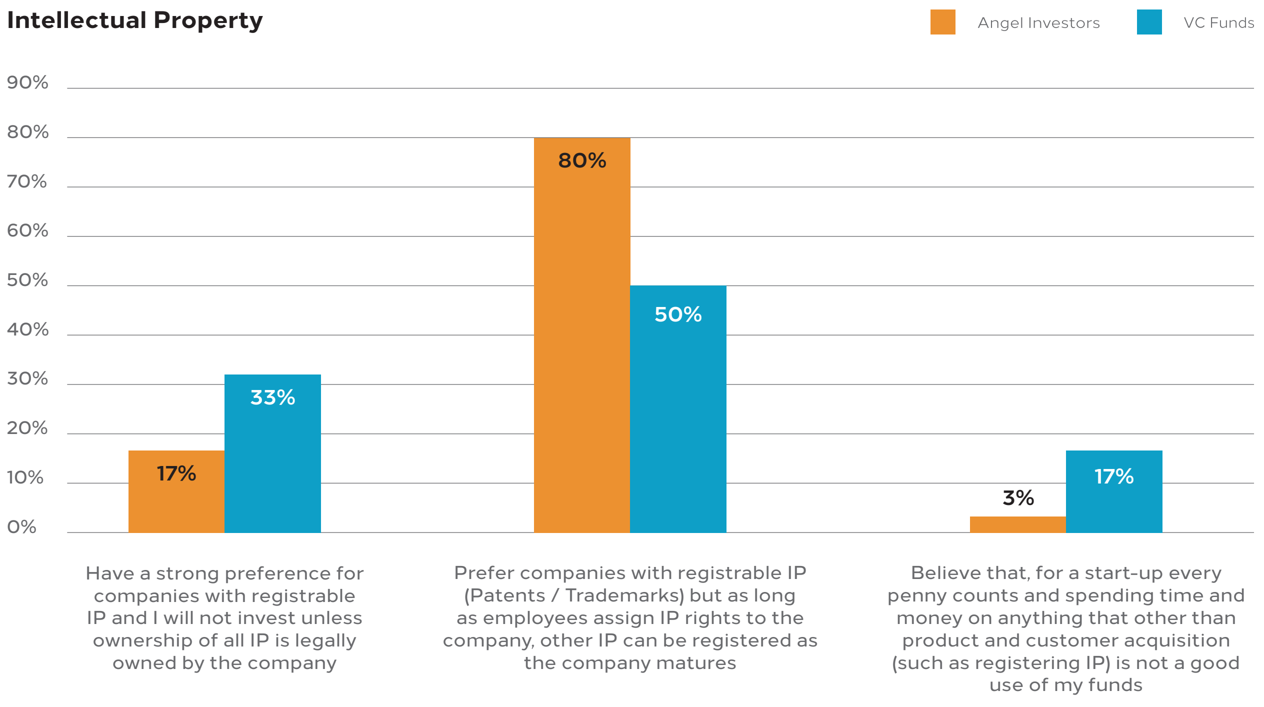
Finally, board seats and governance matters are at the bottom for both groups. This is because in the early stages, before Series A, governance will often be handled informally. Investors will provide advice to founders and the company is still small enough that there is no need for formal processes. However, we must note that even though it came last for both groups, it was still reported as far more important for venture investors than it was for angels. This reflects the fact that venture investors come in at a turning point for start-ups: their evolution from vision to adoption.

Considerations on company profile

There are two topics we wanted to analyze in further detail: intellectual property and employee incentive plans.

Start-ups are often built on their intellectual property. Deep tech start-ups will be highly valued thanks to their patents, digital native brands will hold value in their trademarks and logos, and companies built on operational excellence will need to protect their trade secrets. While trade secrets are not registerable, trademarks and logos are and can be expensive. Patents are a whole other level and can make start-ups fundraise for the sole purpose of being able to afford the registration. We asked investors their position on registerable IP:

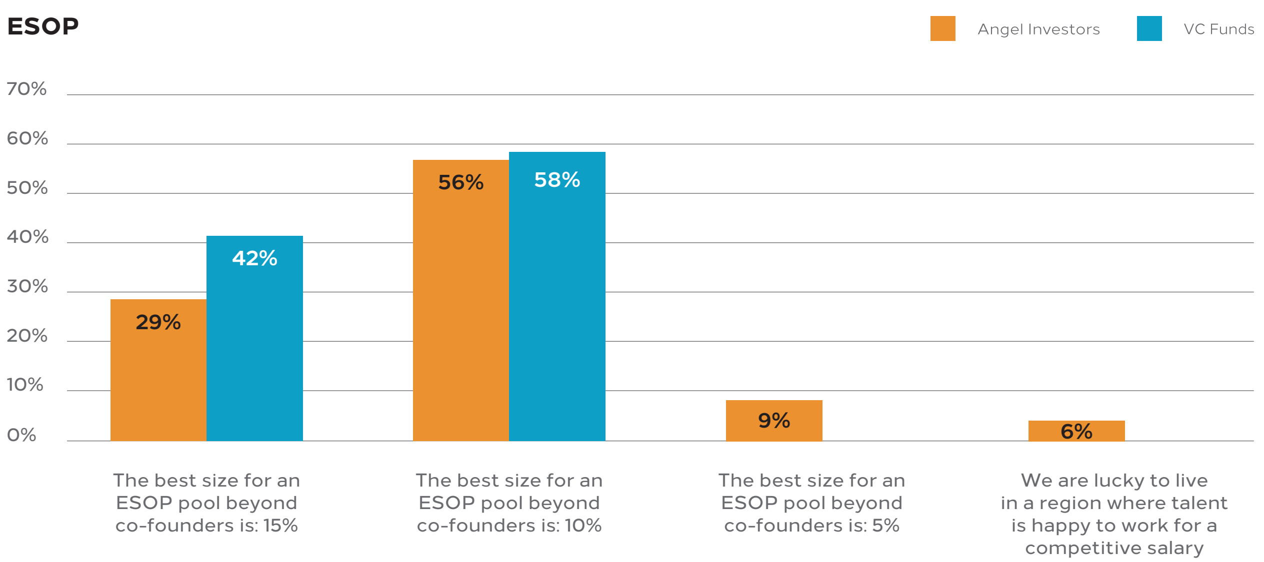
Intellectual Property



Both groups find it important, with angels allowing companies more leeway. Once again, this is because angels typically invest earlier, and will accept to fund less structured companies. Venture investors will typically make their funding conditional on the registration of the relevant intellectual property.

Another crucial consideration when developing a start-up is incentivizing employees. ESOPs are a strong, if not the best, tool to attract and retain top talent. We asked investor about their views:

ESOP

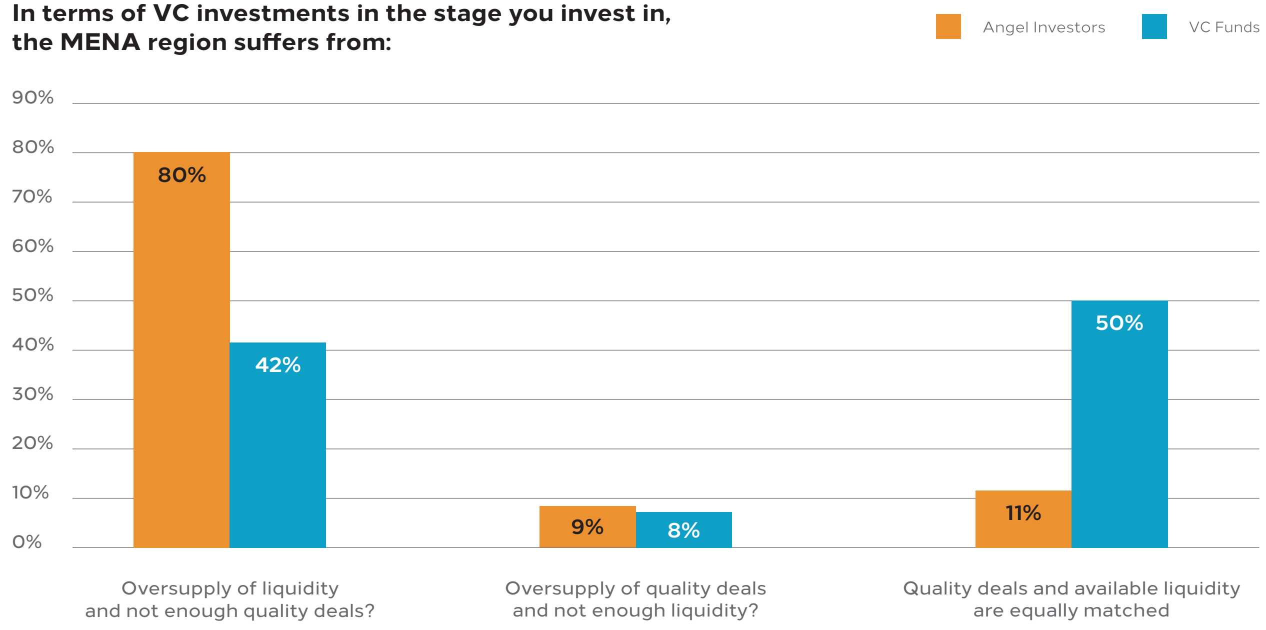


As expected, all investors find this crucial. There seems to be a market standard around 10% of fully-diluted equity reserved for incentivizing talent. A few years ago, the market standard was completely different and high salaries without equity were commonplace. With the growth of the ecosystem, founders came to realize that retaining top employees long-term was one of the most important thing and ESOPs were a way to make them a lasting part of the adventure. Market standard has shifted towards widespread adoption of ESOP. We can note that venture investors seem more inclined to allow for bigger ESOP pools, as they invest a stage where headcount growth is one of the key challenges, and many employees will need to be hired.

Market considerations

Another vertical we explored is the perception of the market by investors.

In terms of VC investments in the stage you invest in, the MENA region suffers from:

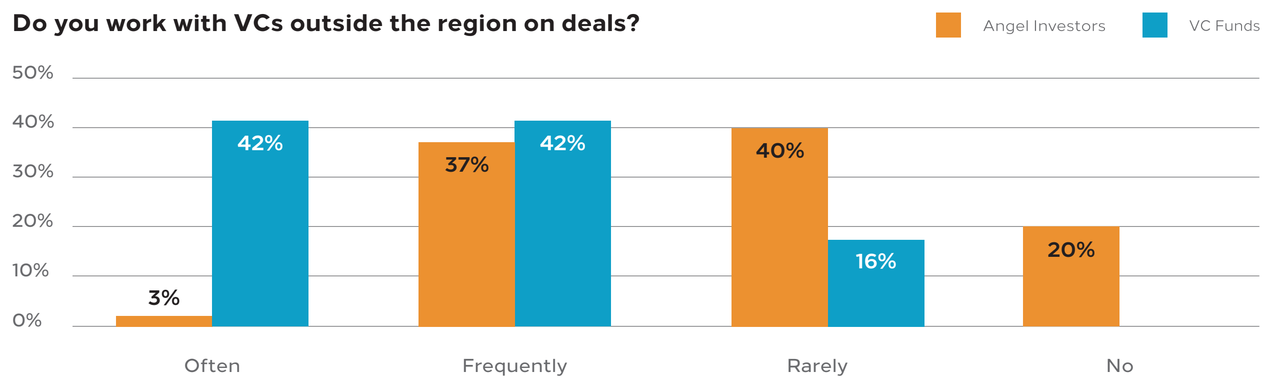


Angel investors overwhelmingly find that an oversupply of capital is present, while that sentiment is more tempered in venture investors. In our region, the ratio of angel investors to very early-stage companies is far greater than the ratio of venture capital funds to early-stage companies. This results in the fact that on average, angel investors see less deals, and less quality deals, than venture investors.

We must see this response as an opportunity to be seized. By continuing the efforts of growing the entrepreneurial ecosystem and creating support structures such as incubators, accelerators, and networks, we will allow more people to become founders. By lessening the risk of founding a company, potential founders that are on the hedge will accept the risk and launch their start-up. The capital available today will create the unicorns of tomorrow. Our region had a mismatch between capital and opportunities, and many governments and private entities are working at bridging that gap, and strengthening the region's ecosystem.

The improvements of the ecosystem are met with enthusiasm from beyond our region:

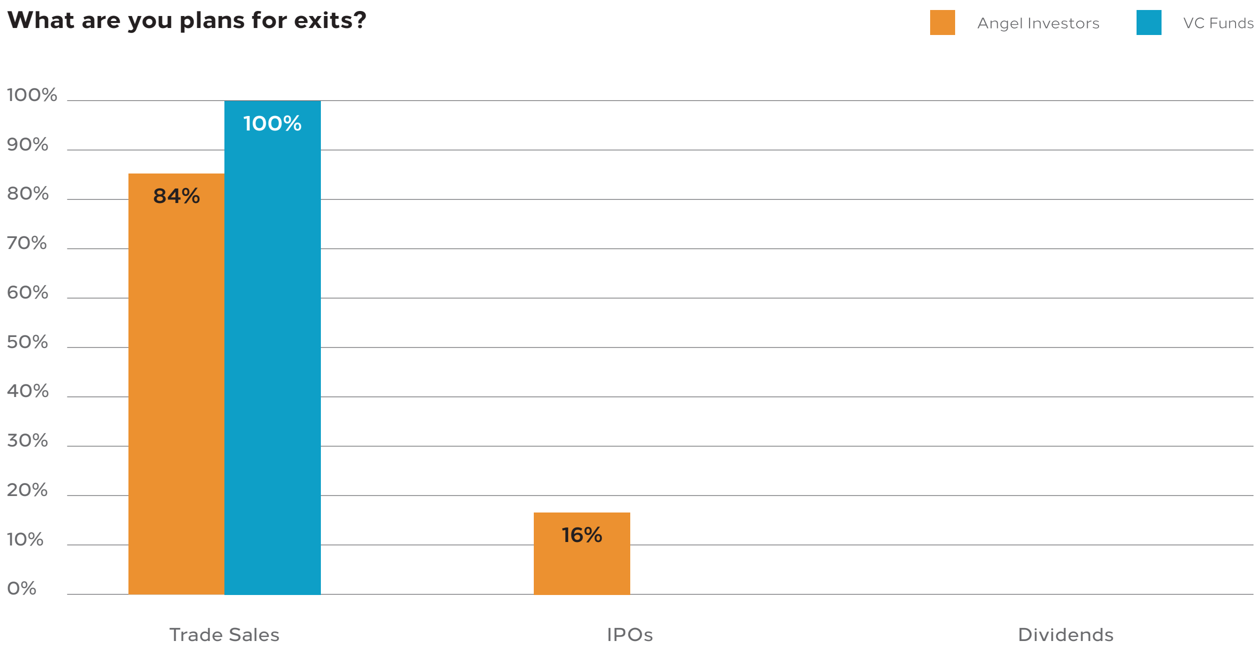
Do you work with VCs outside the region on deals?



This shows a strong interest and proves that the market believes in the MENA region. However, it is important to note that start-ups used to seek funding from international funds as there was no regional capital available for later stage start-ups. In the past couple years, this has drastically changed and the appetite for international investors is not driven by the lack of regional options anymore but rather by the heightened ambitions of MENA start-ups that want to penetrate markets beyond the region.

Those ambitions must be seen in light of the following finding:

What are you plans for exits?

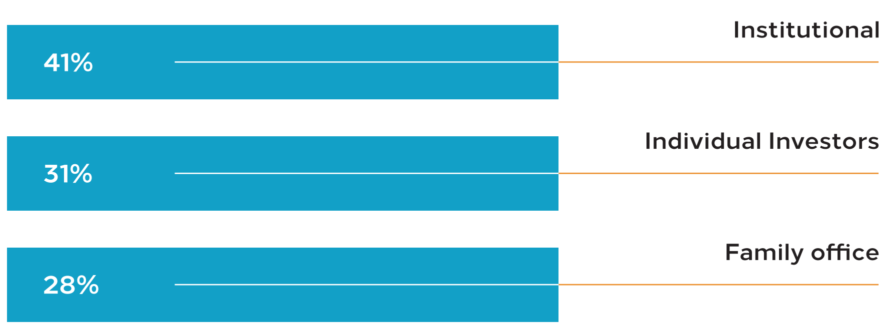


All investors believe that trade sales are the main, if not the only, exit option. This echoes what the ecosystem trend has been, with all major successful exits being acquisition by tech giants. Major international companies will acquire MENA start-ups and use their specific market knowledge and established dominance. Careem and Souq are the prime examples of this trend.

For now, there is little chance that a MENA start-up will establish itself as the major global player in its vertical. However, there is a good chance that a striving start-up will become the regional operator of a global player. Venture investors' and angels' enthusiasm shows that the market for major exits is there, the only caveat being that this market is thought to be limited to acquisitions.

Focus on venture funds

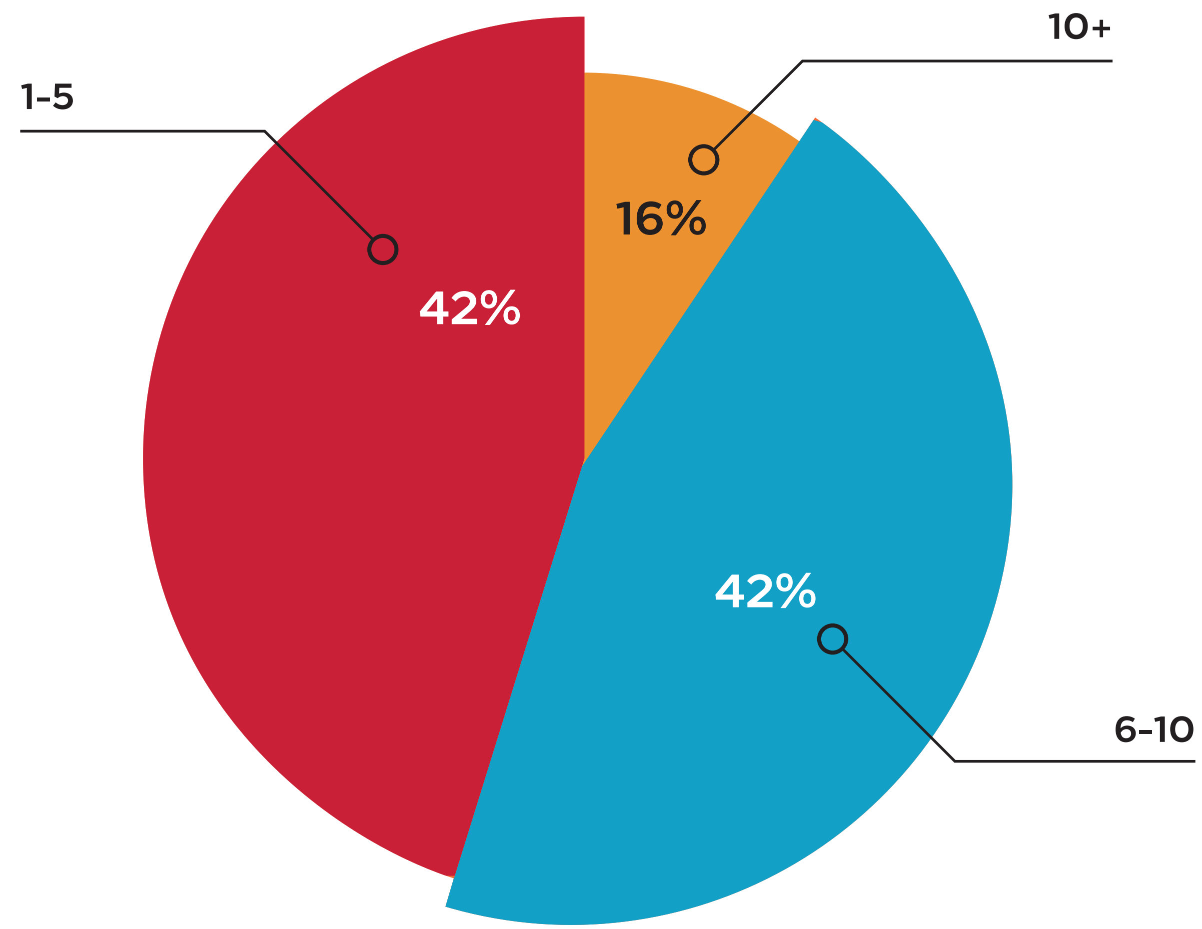
A final point of research was focused on venture funds and their composition:



This finding only reinforced our belief that the asset class is gaining traction across the region. The almost even mix of limited partners shows that venture is now seen as a diversification asset class rather than a gamble for daredevils.

This is further demonstrated by the growing number of funds and their varied approach to investing. Our last finding was that venture funds in the region had many different operational models, ranging from boutiques to more institutional entities, as shown by the varied headcount in different funds. This allows start-ups to find in a fund not only an investor, but also a partner that matches their expectations, no matter what they are:

How big is your team (excluding advisors, consultants)?



THE BUSINESS OF VENTURE CAPITAL

A great advantage of having a team that has worked on venture deals around the world is that we have been equipped with the experience to readily benchmark what we are seeing in the regional markets against market practices and norms elsewhere. While many of the principles of venture financing around the world are the same, there remains a stark contrast between the deal-making orthodoxies in Silicon Valley and the US market generally as compared, for example, to the British and European markets.

There is also a marked contrast between the orthodoxies of private equity and those of venture capital even though the latter can arguably be said to be a derivative of the former. The business of venture deals in our region remains relatively nascent as there is more familiarity perhaps with the PE way of doing things than the approaches taken by venture investors elsewhere. In this section, we focus on some key topics that are relevant to the principles of doing venture deals in general based on our aggregated experience and we take a deep dive into some of the more technical aspects of venture deals.

KNOW YOUR TERMS: **THE KEY TERMS OF A PRICED EQUITY VC TRANSACTION**

Abdullah Mutawi
Partner, Head of Corporate Commercial
a.mutawi@tamimi.com

Kareem Zureikat
Senior Associate
Corporate Commercial
k.zureikat@tamimi.com

The relationship between the founder and the investors is critical to the growth and success of a business and should always be approached with care. Founders will find themselves negotiating against their investors during each funding round, and it is useful for both the founders and the investors to be well versed in some of the basic venture capital funding market practices and terminology. This will help their mutual expectations, and hopefully minimise areas of disagreement. A lack of this market knowledge may lead to protracted negotiations which can kill a venture capital deal outright or impair the surviving founder-investor relationship.

The following is a summary of the main documents and key provisions of an equity funding round for a start-up.

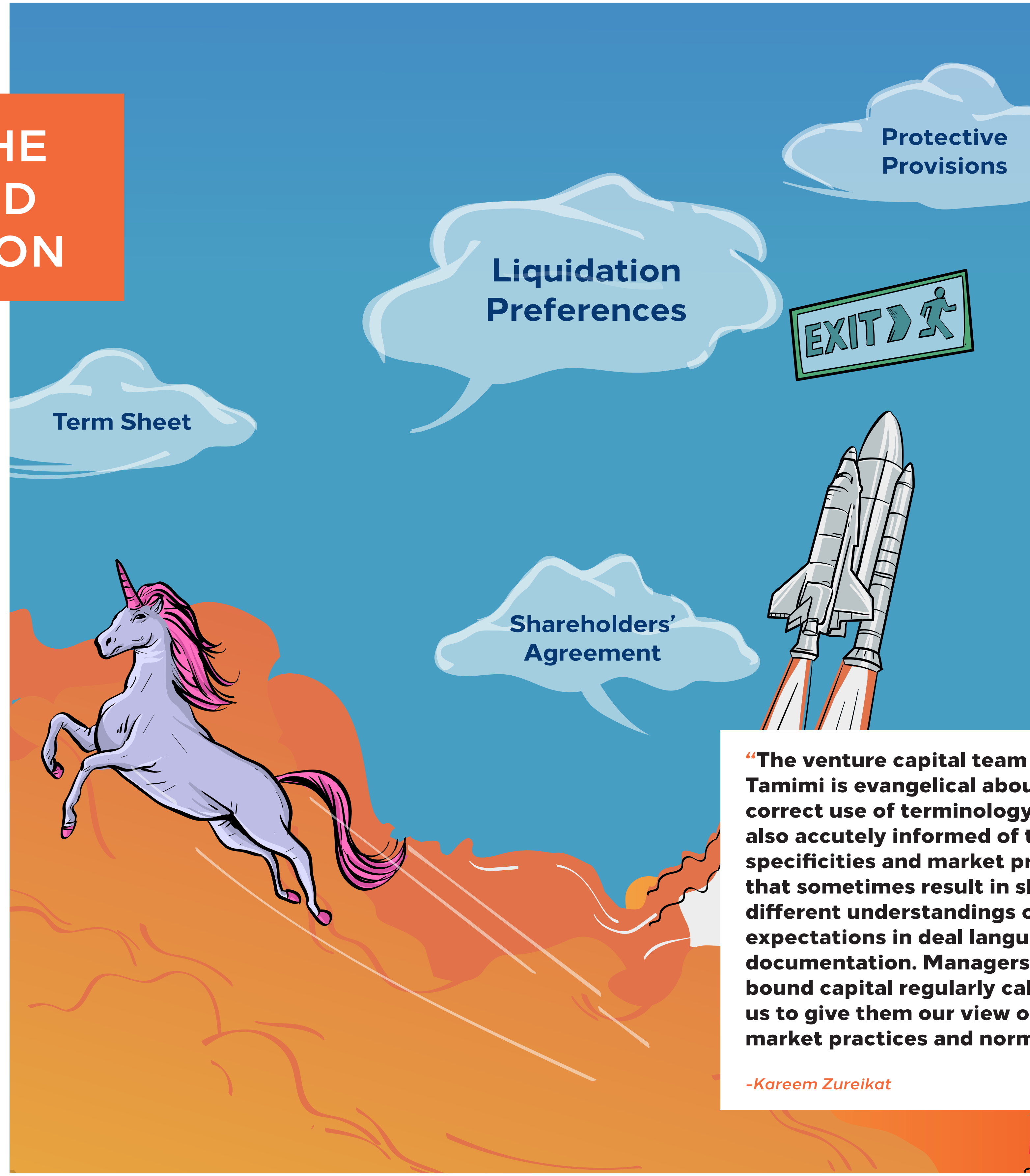
The transaction documents

Term sheet

Every venture capital transaction starts with the term sheet. Whilst a term sheet is typically expressed as a non-binding document, it is the foundation on which all other (binding) transaction documents are drafted. It is usual for investors and founders to outright reject any term in the (binding) transaction documents which does not reflect the provisions of the term sheet.

Subscription agreements

In order to "lock-in" the investment, binding subscription agreements are prepared setting out the key terms of the investment. A long form subscription agreement is commonly entered into between the company, the founders and the investors. To the extent the start-up has raised funds through a bridge round using convertible instruments such as a SAFE, KISS or convertible note, the bridge round investors will also sign up to the subscription agreement to document the conversion of their convertible instruments into shares.
The subscription agreement includes more comprehensive provisions normally geared towards protecting the investors' interest (such as warranties as to the condition, affairs and accounts of the business), and may also include requirements to restructure the company's management and operations either prior to or after the investment round.



> **"The venture capital team at Al Tamimi is evangelical about the correct use of terminology but also accutely informed of the local specificities and market practices that sometimes result in slightly different understandings or expectations in deal language and documentation. Managers of in-bound capital regularly call upon us to give them our view of local market practices and norms."**
>
> *-Kareem Zureikat*

Shareholders' agreement

The shareholders' agreement is the key binding agreement and will reflect, in binding form, the terms agreed in the term sheet. It will set out the rights of the investors and the founders, and will contain provisions that govern the management and operation of the start-up. Fundamentally, the shareholders' agreement is the document that reflects: (i) governance, and (ii) economics.

Key terms of the transaction documents

As the party taking the financial risk, each investor will seek preferential economic and voting rights over the rights of existing shareholders (including the start-up founders). A substantial portion of the provisions of each of the term sheet and the shareholder agreement will be geared towards protecting the investor's investment and ensuring that, at the appropriate time, the investor is able to liquidate its investment in priority (and on terms generally more favourable) to the previous round investors as well as the start-up founder.

The following are the key terms which investors will seek to include in a venture capital transaction.

Preferred shares and conversion

New round investors are typically offered preferred shares (or generally shares of a different class to the founders), which carry certain preferential economic and voting rights over the founders' ordinary shares ("Preferred Shares").

Preferred Shares are usually convertible into ordinary shares whenever this is beneficial to the investor(s). It is also common to detail circumstances or events which would lead to automatic conversion of the Preferred Shares, for example, in the event of an initial public offering of the company, where it is typically the case that only one class of shares (the ordinary shares) are listed on the exchange. The decision as to when the investor will convert its shares and the number of ordinary shares that it will receive in exchange is based on several factors, the most important being an assessment of whether or not the investor's liquidation preferences and participation rights (described below) would yield higher returns if the Preferred Shares were converted into ordinary shares at that time.

Liquidation preference and participation

A liquidation preference is a right of the investor to receive proceeds from a "liquidity event" as a priority to other classes of shareholders. What this means is that an investor will receive payment, as a result of such "liquidity event", before any of the founders or holders of ordinary shares. The definition of a "liquidity event" can vary, but typically includes the sale of a majority of the start-up's shares (or a sale of a controlling interest), a sale of a substantial portion of the start-up's assets or the winding up of the start-up.

> "A lack of market knowledge may lead to protracted negotiations which can kill a venture capital deal outright or impair the surviving founder-investor relationship."

A liquidation preference typically grants the preferred shareholder a minimum return equal to a multiple of the capital invested, in addition to any declared or unpaid dividends payable to the holder of the Preferred Shares. While investors may seek to negotiate higher return multiples, the standard market practice in the Middle East is to limit the liquidation preference payment to the capital invested by the investor, together with any declared or unpaid dividends locked into the entity.

Anti-Dilution

A key feature of these start-up funding transactions is the anti-dilution right. This should not be confused with a pre-emption right (see "Share transfer provisions – pre-emption rights" below for more details).

An anti-dilution right operates to protect an investor's economic interest if the value of the start-up diminishes after the date of the investment. Therefore, on a subsequent issue of new shares, if the shares are issued at a price-per-share that is lower than the price which the investor paid during its funding round (this is commonly termed a "down round"), the anti-dilution right would come into effect to minimise the economic downside of the down round on the investors holding preferred shares.

Protective provisions

Lead investors will always wish to ensure that their investment proceeds are being employed for the agreed purpose. They would also want to make sure that the start-up does not take certain critical decisions without the investor's approval.

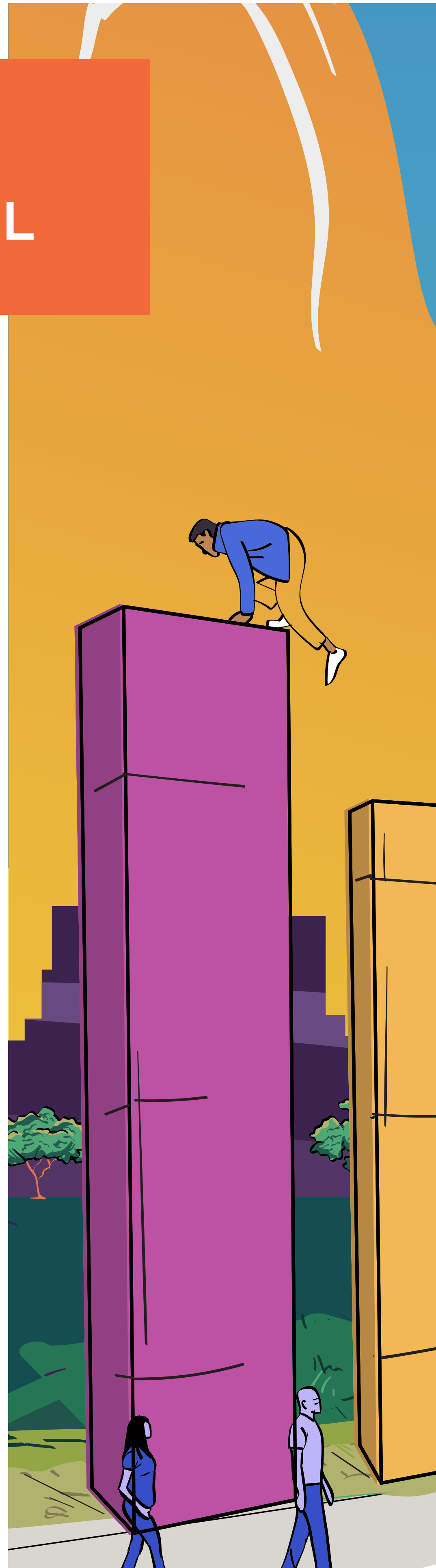
Share transfer provisions

There are several key clauses that grant the shareholders of a start-up (including its investors) certain protections in connection with the transfer of the start-up's shares or the issue of new shares by the start-up. These are found in the shareholders' agreement and are usually built into the articles of association of the start-up. These offer investors (and in certain instances only "major investors"), certain rights to purchase, sell or force the sale of the start-up's shares.

Final considerations

While once a simple transaction drawn up on a single page setting out indicative terms for the investment, funding round transaction documents have, over time, grown in length and complexity. A term sheet now can easily exceed 10 pages, with transaction documents being much longer.

Legal advice on any funding round is an absolute must: a bad call on a key funding provision could prove to be a costly and destructive mistake for a founder, an investor or even the business in the future. It is therefore essential that entrepreneurs and investors familiarise themselves with industry practices and expectations as to how these arrangements will work.



THE ECONOMICS OF A VENTURE CAPITAL DEAL

Abdullah Mutawi
Partner, Head of Corporate Commercial
a.mutawi@tamimi.com

Kareem Zureikat
Senior Associate
Corporate Commercial
k.zureikat@tamimi.com

Haya Al-Barqawi
Trainee Solicitor
Corporate Commercial
h.albarqawi@tamimi.com

Investors, whether in connection with a buyout, a late-stage investment, or an early-stage investment, are looking to capitalize on their investments. In a venture capital context, investments in early or growth stage start-ups are considered **"high-risk-high-reward"**, and investors look for more robust mechanisms to ensure that the value of their investment is protected. Liquidation preferences and anti-dilution protection are two of several venture-capital-specific provisions that provide a measure of comfort to investors.

Liquidation Preferences

As valuations balloon with each equity funding round, investors in each new round want some level of certainty that they will receive a return on their investment on a sale of their shares, and in a venture capital context, investors tend to take on larger risks when investing in start-ups that do not have either a strong track record or positive earnings. A liquidation preference therefore offers investors a tool to ensure they receive their investment back in preference and priority to other shareholders in certain specific cases.

Liquidation preferences are triggered on the occurrence of a **"liquidity event"**, which typically includes: (1) a sale of a majority of the voting rights of the start-up; (2) a sale of majority of the assets of the start-up; (3) a winding up; or (4) an IPO.

Three main limbs to understanding liquidation preferences are:

- Participation;
- Seniority; and
- Multiple.

Participation

Participating Liquidation Preference: In a participating liquidation preference, the investor gets a complete return of their capital investment first and in priority to all other shareholders, and then has the right to **"participate"** in the remaining proceeds distributed to all shareholders on a pro rata basis with the remaining shareholders.

By way of example, assume an investor made an investment of USD 1,000,000 in consideration for 100,000 Preferred Shares, for a resulting ownership of 50% of the start-up's share

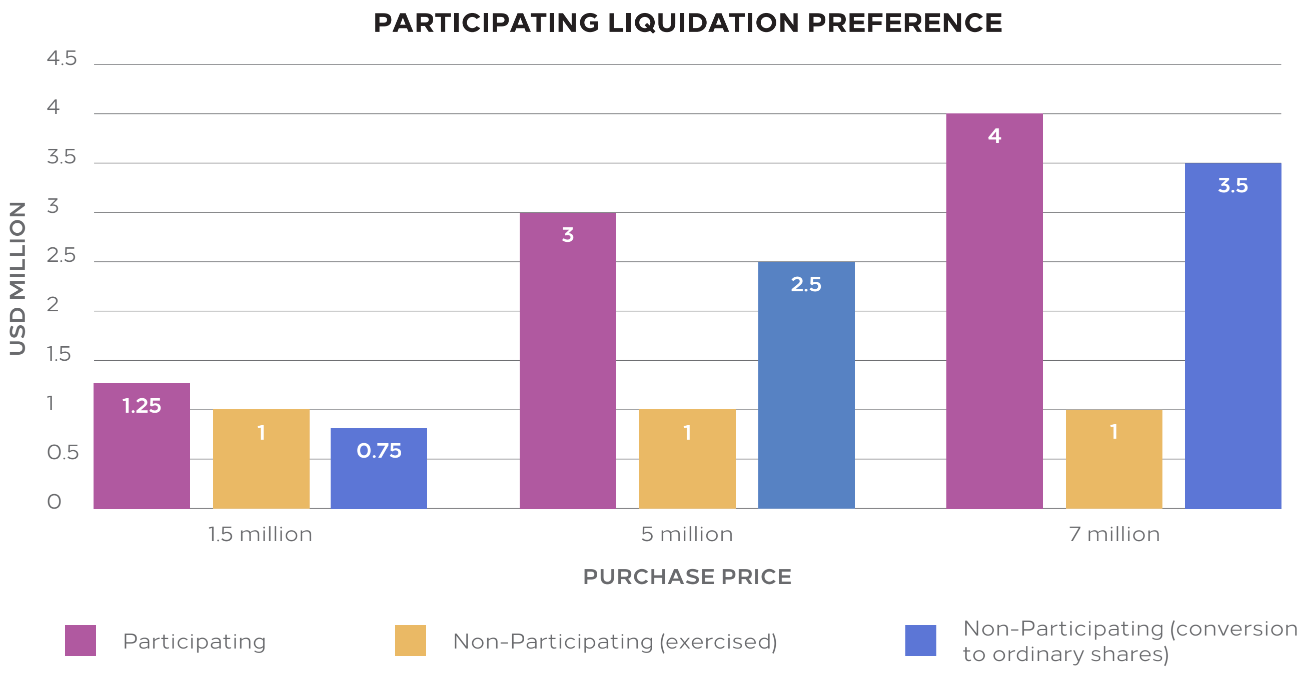
"**Our team has a deep understanding of the commercial dynamics of venture-backed businesses across multiple verticals and business models. The breadth and depth of our experience enables us frequently to suggest legal terms and solutions that are informed by that knowledge and the understanding that not all tech companies are equal when it comes to the commercial dynamics of the go-to-market and customer acquisition strategies, and the rate at which revenue generation can catch up with demands on capital and burn rates. On more than one occasion, we have advised a company to stress-test its financing strategy based on what we expect the company to need in further cash and, when such need is likely to occur.**"

-Abdullah Mutawi

capital. The terms of the investment include a liquidation preference equal to the full value of the USD 1,000,000 investment. The start-up does not perform as expected, and one year later, 100% of the start-up's shares are sold to a private equity investor at a total valuation of USD 1,500,000. Given that the investor has a liquidation preference in respect of the full value of its investment, the investor will receive USD 1,000,000 from the buyout, with the remaining USD 500,000 distributed to all shareholders pro rata. Had no such liquidation preference been included, the investor would have received USD 750,000, representing its 50% share of the total purchase price. But given that the investor has participation rights, the investor would first receive its USD 1,000,000, and would then be able to participate, on a pro rata basis, with the remaining shareholders in the remaining USD 500,000, and would therefore receive USD 1,250,000, which is its USD 1,000,000 investment, plus its pro rata share (namely 50%) of the remaining USD 500,000, which is an amount equal to USD 250,000.

Non-Participating Liquidation Preference: Unlike a participating liquidation preference, a non-participating liquidation preference gives the investor the choice of whether to be paid back its entire capital investment or alternatively share the proceeds of the liquidity event on a pro rata basis with all shareholders. The investor will choose the option which yields the largest returns. This is a more balanced liquidation preference as the investor does not receive two separate distributions as it would have had it held participation rights.

If we use the example above where an investor has made an investment of USD 1,000,000 for 50% of a start-up's share capital, and the start-up's shares are once again sold at a total valuation of USD 1,500,000, the investor would have to make a choice between two possible options; the investor could either exercise the liquidation preference and receive a guaranteed USD 1,000,000 back, or alternatively, can choose to convert its preferred shares to ordinary shares for USD 750,000 (i.e. 50% of 1.5 million). The choice here seems obvious, and the investor would most likely opt for the USD 1,000,000. However, should the company sell for a value higher than was anticipated, the investor will choose to receive its pro rata portion of the consideration.



Seniority

It is particularly important for entrepreneurs and venture capitalists to understand seniority structures when making an investment in order to determine where and when they will get their payout. While originally, pari passu structures were more common, standard seniority structures are gaining popularity for several years now.

Standard Seniority: As a general approach to venture capital funding rounds, new equity-round investors are offered preferred shares which carry preferential economic and voting rights. Therefore, liquidation preferences can be **"stacked"**, and payouts are in order form latest round to earliest round. This is the standard **"last in, first out"** approach, and each new funding round investor would receive its payout prior to the investors of the preceding funding round. The obvious risk for founders and early stage investors is that they could be left with little (to nothing at all) if the proceeds from the liquidity event are insufficient and the waterfall dries up due to payments of more senior liquidation preferences before more junior preference holders can realize a return.

Pari Passu Seniority: A pari passu liquidation preference gives all investors holding preferred shares equal seniority status. This means that all investors would share in at least some part of the proceeds and no one is left with nothing.

Tiered Seniority: This liquidation preference right is a hybrid of standard and pari passu seniority, where investors from different funding rounds are grouped into distinct seniority levels or **"tiers"**. Each tier of investors would then be treated as a separate class in terms of liquidation seniority, and the standard seniority approach would apply to each tier of investors. Then, within each tier, investors of that tier are paid in a pari passu format.

Return Multiples

A 1x multiple guarantees that the investor gets 100% of their money back. While the market standard approach to a liquidation preference is to grant the investor the right to receive all of its invested capital (which is venture capital lingo is a **"1x liquidation preference"**), investors may, in certain circumstances, request a multiple of their capital invested. Therefore, an investor may request 2x or 3x its invested capital to be paid on the occurrence of a liquidity event. While 2x or 3x multiples may be acceptable in certain rare scenarios, for example where a start-up may be willing to offer such return multiples in an insolvency rescue funding round, the market standard approach in the Middle East is a 1x liquidation preference.

Anti-Dilution Protection

Anti-dilution protection operates to preserve the economic value and not the ownership percentage of an investor's investment. It is therefore, in its simplest form, a mechanism that grants investors additional shares to compensate them for the diminution of the start-up's valuation in the future.

Anti-dilution provisions are typically included in a shareholders' agreement entered into between the shareholders and the start-up. Venture capital transactions in the United States do not typically use a shareholders' agreement, and the anti-dilution provisions are included in the amended and restated charter.

To illustrate potential investment risks that may arise, and how an anti-dilution right can protect the value of an investment, let's take the following example:

A company has a total of 1,000,000 shares in issue, all of which are issued to its founder prior to its Series A funding round. The start-up has found one investor for its Series A funding round, and the start-up and investor have agreed to an investment at a pre-money valuation of the start-up equal to USD 10,000,000. The investor agrees to invest USD 5,000,000 in the Series A funding round, at price per share equal to USD 10 (the 10,000,000 valuation divided by the 1,000,000 shares in issue). The company's issued share capital after the Series A round is 1,500,000, which is comprised of the founder's original 1,000,000 shares plus the new 500,000 Series A shares issued to the investor (calculated by dividing the investment amount (USD 5,000,000) by the price per share USD 10), and therefore the founder owns 66.67% of the company and the Series A investor owns 33.3%.

Assume, that the Series B funding round valuation was less than the Series A valuation (i.e. the value of the start-up after the closing of the Series A funding round diminished). This is what is called a **'Down Round'** in a venture capital context. What would happen then? For illustrative purposes, assume (in a rather extreme case) that the start-up has not done well and the Series B funding round occurs at a pre-money valuation of USD 2,000,000, which means the price per share for the Series B investor is USD 1.33. Assume also that the Series B investor invests USD 10,000,000 as part of the Series B funding round, the Series B investor would receive almost 7,518,796 new Series B preferred shares.

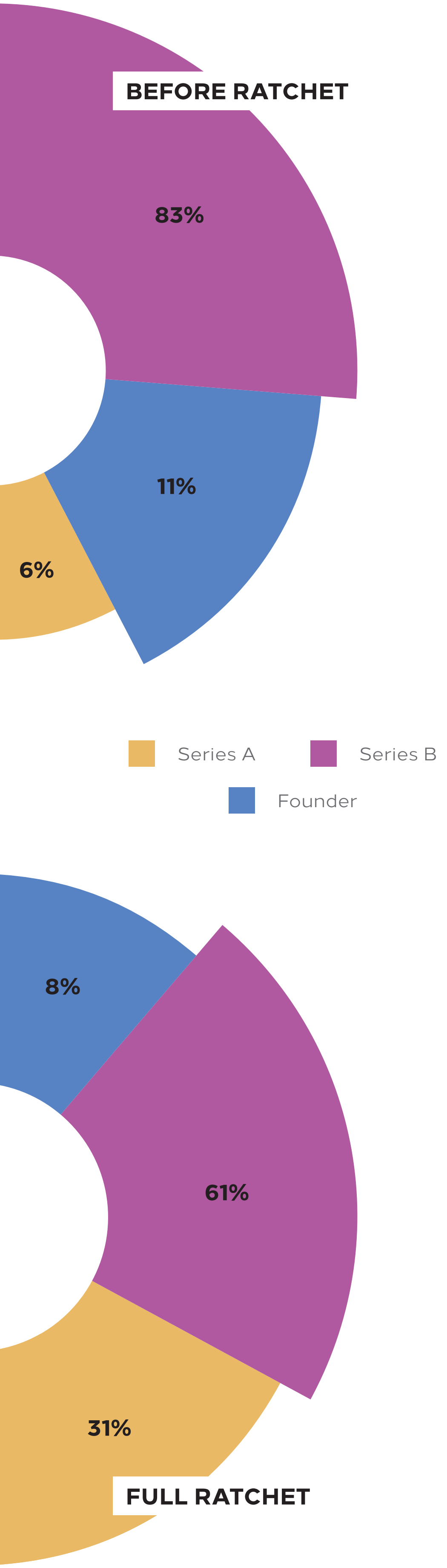
In this case, the Series A investor's overall ownership and value position has deteriorated significantly; its ownership has been diluted to 5.5%, and its 500,000 shares that were once worth USD 10 per share are now worth USD 1.33 per share!

"While commonly misinterpreted as a right of first refusal on capital raises (i.e. the right to maintain the same ownership percentage in a company on new dilutive issues of shares) anti-dilution protection operates to preserve the economic value and not the ownership percentage of an investor's investment. It is therefore, in its simplest form, a mechanism that grants investors additional shares to compensate them for the diminution of the start-up's valuation in the future."

Given the loss of return due to the devaluation of the start-up, anti-dilution protections kick-in during a Down Round to adjust the overall value of the Series A investor's position by allocating more shares to the Series A investor. So how does this happen?

If a Down Round closes, the anti-dilution provisions under the relevant documents may provide that the start-up would issue to the Series A investor **'bonus shares'** to compensate for the diminution in the Series A investor's investment. These shares would be issued for no consideration, or, if that is not permissible under applicable laws, at par value.

An alternative and more common mechanism is to adjust the **"Conversion Price"** for the Series A investor. Given that investors typically receive preferred shares when investing in a start-up, the funding round documents provide for a mechanism for conversion of the preferred shares into common shares, for example, on an initial public offering. The Conversion Price usually starts as the price per share at which an investor has subscribed for its shares and this would then be adjusted in the event of a Down Round. Therefore, using our example above, the initial conversion price for the Series A investor is USD 10. If, however, the start-up closes a Down Round, the Conversion Price will be adjusted downwards



such that, upon conversion of preferred shares into common shares, the holder of preferred shares would receive more ordinary shares for its preferred shares (i.e. the conversion is no longer a 1:1 for the conversion of a preferred share to an ordinary share). This is because an investment of USD 5,000,000 at a price per share lower than USD 10 results in more shares being issued to the investor.

Whether the agreements provide for the issue of bonus shares or an adjustment to the Conversion Price, anti-dilution provisions are inherently tied to the value of the shares.

So how do we calculate the number of **'bonus shares'** or the adjusted Conversion Price based on the price per share paid by the investor?

There are two formulas; a weighted average formula and a full ratchet formula. The full ratchet formula is a rather draconian approach to anti-dilution, and the venture capital ecosystem has moved further away from full ratchet anti-dilution protection, although it may still appear or otherwise be justified in certain specific instances, for example, when an investor is investing in a distressed start-up and seeks additional protections.

The full ratchet formula is straight forward; it replaces the price per share at which an investor has invested (using our example, a price per share of USD 10 for the Series A investor) with the price per share paid by investors in the next funding Down Round (using our example, a price per share of USD 1.33 paid by the Series B investor). Therefore, the Series A investor would receive such number of shares had the Series A investor subscribed for shares at a price of USD 1.33 (i.e. its original investment of USD 5,000,000 divided by USD 1.33, which gives the Series A investor a total of 3,759,398 shares). That's more than 3,200,000 **"bonus shares"** issued to the Series A investor.

The weighted average formula is slightly more complicated, as the formula does not simply substitute the original price per share (i.e. USD 10 for our Series A investor) with the new price per share (i.e. USD 1.33), but rather assesses the weighted average effect of the amount of money raised during, and the share price for, the Series A funding round, together with the amount of money raised under, and the share price for, the Series B Down Round, on the overall value and capitalisation of the start-up.

There are two weighted average formulas; a broad-based formula, and a narrow based formula. A narrow-based formula only takes into account the issued preferred shares of the start-up, whereas the broad-based formula takes into account the fully diluted capitalisation of the start-up (i.e. all issued shares, including common and preferred shares). Narrow-based formulas are investor-friendly, as they result in a more significant reduction in the Conversion Price on a Down Round when compared to the broad-based formula.

The issue of shares pursuant to anti-dilution clauses comes at the expense of someone else: the founder or other holders of other shares that do not carry anti-dilution rights or who's anti-dilution rights are not triggered by the Down Round. Therefore, one perspective is that anti-dilution penalises the founder for the start-up's lack of success, although investors would argue that this is fair and reasonable given that it is the founder(s) that drive the day-to-day business.

"In a venture capital context, investments in early or growth stage start-ups are considered "high-risk-high-reward", and investors look for more robust mechanisms to ensure that the value of their investment is protected."

Liquidation rights and anti-dilution rights can carry significant implications on the investor and the founders, so it is vital that legal and financial advice is sought prior to agreeing to confer any such rights under the terms of each equity funding transaction.

SHARE TRANSFER RIGHTS AND CONTROL PROVISIONS IN A VENTURE CAPITAL DEAL

Abdullah Mutawi
Partner, Head of Corporate Commercial
a.mutawi@tamimi.com

Kareem Zureikat
Senior Associate
Corporate Commercial
k.zureikat@tamimi.com

In addition to the economics of a venture capital deal, venture capital investors will want to ensure that they receive sufficient rights to exercise a degree of control over the decision-making process of the start-up, as well as a degree of control over the issue and transfer of shares in the start-up. These provisions are included in the shareholders' agreement for the funding round.

Protective Provisions and Voting Control

Investors will always wish to ensure that their investment proceeds are being employed for the agreed purpose. They would also want to make sure that the start-up does not take certain critical decisions without the investor's approval. These critical decisions are commonly referred to as "reserved matters", and include any decision to: (i) reduce or otherwise alter the rights attached to the investor's shares; (ii) involve material capital or operational expenditure; or (iii) change the nature of the business. These are three examples of what is usually a two-page list of "reserved matters" in respect of which the investor would reserve a veto right.

Reserved matters typically operate at the board level, where the lead investor in a funding round would be given a board seat. It is a standard approach to have board meetings only deemed to be quorate with the presence of the investor-nominated director, and the "reserved matter" decision would only pass provided the investor-nominated director votes affirmatively on that decision. Reserved matters also operate on the shareholder level in respect of certain key decisions, including those which, as a requirement of applicable law, require the affirmative vote of the shareholders. In this instance, it is common for the "reserved matter" shareholder resolution to require the affirmative vote of a certain percentage of the holders of preferred shares.

Share Transfer Rights

The mechanics governing transfers of shares of a start-up are of vital importance to investors and founders' alike. These provisions can give shareholders the right to participate in future funding rounds, the right to acquire shares before they are transferred to third parties, or even force the sale of the shares of the minority shareholders in the event of a buyout. They can have a significant impact on the process for selling shares in the start-up, and if drafted incorrectly, can potentially frustrate buyout transactions or at least cause sufficient issues and complications with the sale process.

We have summarised some of the most common share transfer rights below.

Pre-emption rights

A pre-emption right is offered to existing shareholders in respect of any future issues of shares (or other convertible securities) by the start-up, giving the existing shareholders the first option to purchase the newly issued shares. A pre-emption right typically offers the shareholders a right to maintain (or increase) their ownership percentage by subscribing for new shares on a pro rata basis. A failure by the existing shareholders to subscribe for the shares typically allows the start-up to offer these shares (or any remaining portion that remains unsubscribed by the existing shareholders) to third parties. In certain instances, the pre-emption rights are offered to only a certain class of shareholders, or certain 'major investors' that hold a significant portion of the outstanding preferred shares.

> **"It is standard for a lead investor to want a seat on the board of directors, to have timely access to relevant information, and to actively participate in the strategic decisions of the company. A seat on the board will be of limited use however without having given due considerations to matters of board composition, voting thresholds and both the substance and administrative framework for board reserved matters. At the same time, start-up founders need to have the space to run their company while delivering on the expectations of their investors. Negotiated well, board rights will be a powerful tool in delivering on the priorities of the investor while allowing the company to be managed by the team the investor believed in."**
>
> *-Anna Robinson*

A standard approach to every new funding round is to either obtain waivers from all non-participating shareholders in respect of their pre-emption rights, or otherwise offer the new shares to the existing shareholders first, and then (after the expiry of the period during which existing shareholders may exercise their pre-emption rights) offer the new shares to the new investors.

Rights of first refusal

A right of first refusal is offered to existing shareholders in respect of any transfer of shares by a shareholder in the start-up to a third party. The right gives the existing shareholders of the start-up a right to purchase the shares being sold before a third party can acquire the shares. In a venture capital transaction, a right of first refusal may also be granted to the start-up in priority to the existing shareholders.

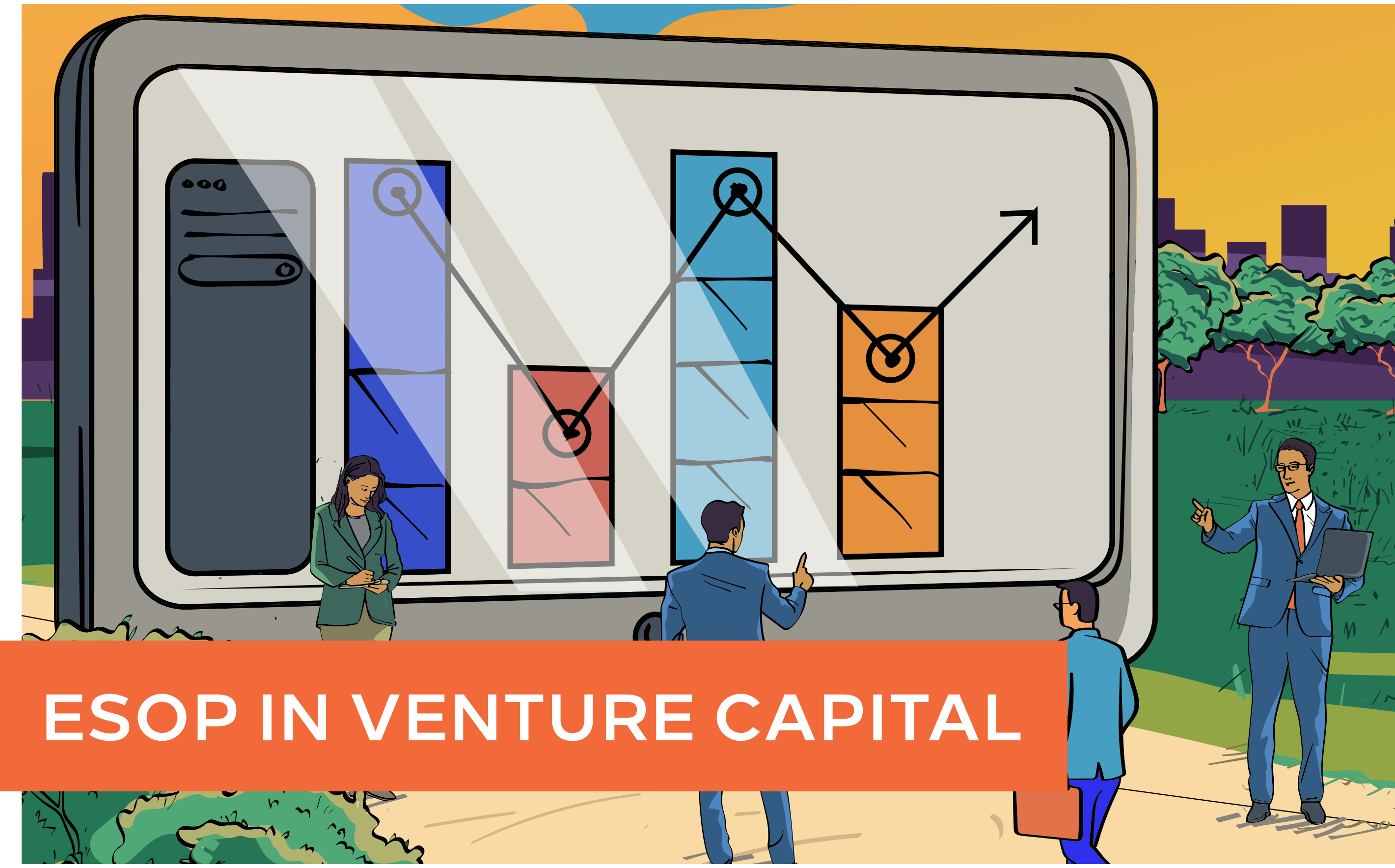
In certain instances, the rights of first refusal are offered to only a certain class of shareholders, or certain "major shareholders" that hold a significant portion of the outstanding preferred shares.

Tag along (co-sale) rights

A tag along (or co-sale) right is typically offered to the holders of preferred shares upon the transfer of shares in the start-up to a third party, particularly transfers by the founder or co-founders. The right gives the investor (as minority shareholder and holder of preferred shares) the right to join the sale of shares to a third party. Investors and founders should be very careful when drafting the tag along right, as the key players should seek to limit the tag along right to circumstances where a majority of the start-up's shares are being sold, or otherwise in circumstances when the founders seek to dispose of a significant percentage of their shares. Otherwise, any transfer of shares by a minority shareholder could trigger a flood of accepting (also known as "tagging") shareholders.

Drag along rights

A drag along right is usually offered to a majority of the shareholders (or such number of shareholders that can exercise control over the start-up's management and affairs). It is usually triggered upon the sale of the company, which is typically described as a sale of 50% or more of the company's assets or shares. The drag along right gives the controlling shareholders the power to force the sale of the minority shareholders' shares alongside their own. Investors and founders should discuss the appropriate triggers for a drag along right and should ensure that only significant transfers trigger a drag along right.



ESOP IN VENTURE CAPITAL

Abdullah Mutawi
Partner, Head of Corporate Commercial
a.mutawi@tamimi.com

Kareem Zureikat
Senior Associate
Corporate Commercial
k.zureikat@tamimi.com

Haya Al-Barqawi
Trainee Solicitor
Corporate Commercial
h.albarqawi@tamimi.com

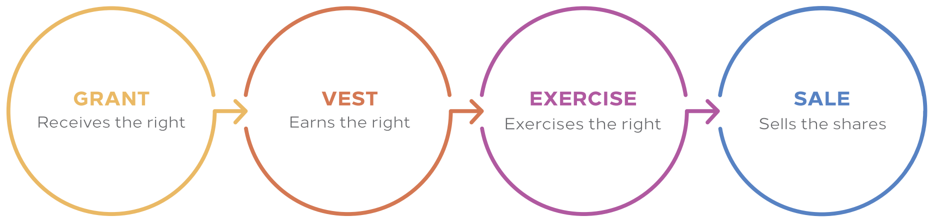
The key to any great start-up are its employees; those that have been there with the founders from the start and those that join later on and help grow the business. With limited cash at the start, and with long working hours and the uncertain future of the business, it isn't always easy for a budding start-up to lure the best talent in the market. This is why start-ups offer employees a share in the ownership of the company. This idea of ownership is one of the key incentives that will attract top talent to the company, and comes in the form of a share incentive scheme, also known as an employee share option plan ("ESOP"). ESOPs align the employee's goals with that of the company's, as the employee benefits from the company's growth.

ESOPs come in a variety of shapes and sizes, the most common are:

- Standard share option schemes;
- Stock purchase plans;
- Restricted stock unit plans; and
- Phantom share plans.

Standard share option schemes work exactly as described in figure 1 below; the grant, vesting, and exercise of options. While the share option scheme grants the employee the right to options, stock purchase plans grant the employee the right the purchase shares usually at a discount from fair market value. Restricted stock unit plans work quite differently, as under this plan an employee is awarded the right to receive shares, without having to purchase them, on a pre-determined date subject to fulfilment of specified conditions or the achievement of certain targets. Different still are phantom share plans, which are a form of long-term deferred compensation using the start-ups shares as the measuring device for calculating the value of the deferred compensation; the company simply credits these phantom shares on its books and as the value of the company's shares rises or falls, so does the value of the phantom stock.

While ESOP schemes may differ, they all share the same essential purpose of retaining, rewarding and incentivising employees. ESOPs are options given to an employee and may be exercised for shares or cash in lieu at some point. They involve 4 main stages: the grant of the options, the vesting of the options, the exercise of the options, and the sale of the exercised options. ESOPs are normally offered to employees at a pre-determined price. The vesting schedule is typically a period of three to four years, during which shares vest in milestone-linked or periodic (e.g. quarterly or monthly) tranches. Typically, there will be a 'cliff' which is a specific date within the vesting timetable which crystallises the first vesting (even if multiple vesting milestones have been passed. For example, if there is a cliff at the one-year mark (which is typical), an employee leaving within the first year would not be entitled to any shares, and all the shares that should have vested within the first year vest at the same time at the one-year mark. Afterwards, the determined schedule applies normally. This allows companies to retain their top talent, and to motivate them due to the personal stake they hold in the success of the company.



Standard share option scheme

Should an employee leave the business before the end of the three-year or four-year mark, they only have rights to the option shares that have already vested at the time, and the employee's ability to keep those options will likely depend on whether their departure from the start-up was due to mutual agreement and/or resignation (good leaver) or due to a dismissal for cause (bad leaver). The inclusion of these good-leaver and bad-leaver provisions is important, as the founders will not want former employees retaining ownership in the start-up once they have left, particularly if the employee was a bad leaver.

A point that founders would need to keep in mind is that it is important to look at ESOP plans in the long-term. As mentioned above, an ESOP is one incentive the company can use to lure talent its way. As start-ups grow, this will undoubtedly require the hiring of further employees and it is essential that the start-up has the hiring capacity to keep up with such changes.

It is important to note that the creation of ESOP equity pools has the effect of diluting the ownership of existing shareholders in the start-up. Therefore, investors and founders should be alive to the fact that the size of the ESOP pool, and the dilutive effect the pool will have on each of them, is discussed and agreed during negotiations. It is also important for the founder and investors to agree to the valuation bearing in mind the current ESOP pool, and whether any increases to the ESOP pool will be required in connection with the new funding round. Here, it is important to ensure that the uses of the terms 'pre-money valuation' and 'post-money valuation' specify whether they include or exclude the ESOP pool or any increases to the ESOP pool. Otherwise, disagreements may arise when share prices and share allocations are made in a funding round.

When planning on setting up an ESOP, there are many factors that a company should take into account, such as the value of the shares to be granted, the terms of the share option agreement, and the number of shares the company is willing to offer, to name a few. One important element that often arises with founders is how the ESOP will be implemented given the terms of the company's constitutional documents and the classes of shares available. Therefore, due consideration should be given to the jurisdiction of incorporation, as the laws of the jurisdiction can determine the degree of flexibility the start-up has in terms of what it can include in its constitutional documents with respect to the ESOP, including its ability to issue different classes of shares and specify the rights that attach to them.

Whether you are the founder or an investor, legal advice with respect to employee share option plans is an absolute must, as it may have significant repercussions on the economics of the start-up and its ability to attract the required talent for the business.

"Investors and founders underestimate the importance of an adequately sized and well-structured ESOP as part of their capital structure. As the talent pool in the region grows and as the number of second-time entrepreneurs bring their ideas to market, meaningful stock options are going to be an essential part of the compensation toolkit for founders who want to attract the best people while maintaining capital efficiency. We have been preparing best-in-class ESOP plans for several years which are adapted to local market norms and local laws as required."

-Abdullah Mutawi

PRE-MONEY VS POST-MONEY SAFES, THE KEY DIFFERENCES YOU NEED TO KNOW

Abdullah Mutawi
Partner, Head of Corporate Commercial
a.mutawi@tamimi.com

Kareem Zureikat
Senior Associate
Corporate Commercial
k.zureikat@tamimi.com

While a handful of start-ups are lucky enough to find themselves generating significant revenue at an early stage, the vast majority will be burning capital to scale-up and generate traction in the market faster than their revenues can keep up. With banks unwilling to extend conventional debt financing to start-ups, founders typically have two options: when raising funds; undertaking a priced equity round; or obtaining financing through convertible notes.

Securing funding from a priced equity round is a time-consuming, expensive and difficult process, with a significant amount of time and cost being allocated to investor due diligence, legal fees and transaction negotiation. There is also the somewhat daunting task of agreeing to a valuation for an early stage company, which can be a more speculative process when compared to a standard discounted cash flow or multiples approach used for mature companies. The process can therefore be cumbersome to the investor and the founder alike, and should not be treated as the only available option for financing.

Venture capitalists and founders have demanded a simpler and faster way of deploying capital to early-stage start-ups, which resulted in the creation of the convertible note. With time, however, the convertible note grew in complexity, and without a standard form adopted in the market, several variations of the convertible promissory note were in circulation, which led to longer negotiations and caused ambiguities as to how the convertible note operates and what each investor would actually receive upon conversion of the convertible note into shares.

Y Combinator's pre-money SAFE (Simple Agreement for Future Equity) was born in 2013, offering an even simpler and cheaper alternative to funding other than by way of a priced equity round, and in 2018, Y Combinator released its post-money SAFE.

The SAFE is not a debt instrument – it has no repayment date – and is not strictly an equity instrument. It is, in its simplest form, an agreement that the funds extended by the investor to the start-up will be either repaid or converted into shares based on certain defined conditions set out in the SAFE. The main trigger for conversion of the SAFE into equity is the successful closing by the start-up of a priced equity financing round.

One of the most important problems the SAFE has solved is the need to agree to a valuation prior to the investment, and instead the investors and the start-up would typically agree to a "valuation cap", ignoring for the purposes of this article the ability to agree to a discount, a valuation cap and a discount, or an MFN (Most Favoured Nations) clause.

A valuation cap represents the maximum valuation at which the investment will convert into shares. Therefore, if the valuation of the start-up on the upcoming priced equity round is less than the valuation cap, the investment will convert at that lower valuation, whereas if the valuation of start-up on the upcoming priced equity round is more than the valuation cap, the investment will convert at the valuation cap.

The pre-money SAFE assumes that the valuation cap is the value of the business prior to the investment made by all SAFE holders. The issue with this is that the start-up could continue to raise funds through pre-money SAFEs, including through high resolution fundraising (i.e. issuing SAFEs at different terms and valuations for different investors). This creates uncertainty for

"When it comes to convertible instruments, there is no doubt that regional investors have a high degree of faith in the SAFE instrument. This is more so since the post-money SAFE was introduced and adopted as the standard form in the US."

-Hugo Cugnet

the investor and the start-up the investor's ownership percentage and the dilutive effect subsequent pre-money SAFEs will have on an investor's ownership. By way of example, assume a start-up enters into a pre-money SAFE with an investor for a total investment of USD 100,000 at a valuation cap of USD 900,000.

Subsequently, and given that a SAFE does not limit a start-up's ability to raise additional funds through other SAFEs, the start-up continues to raise funds for a period of 6 months raising a total amount of USD 200,000 from a number of other investors at a pre-money valuation of USD 900,000. These subsequent investments will dilute the ownership of our USD 100,000 investor. This situation gets even more uncertain for both the founder and the investor if the start-up raises additional funds at different valuations.

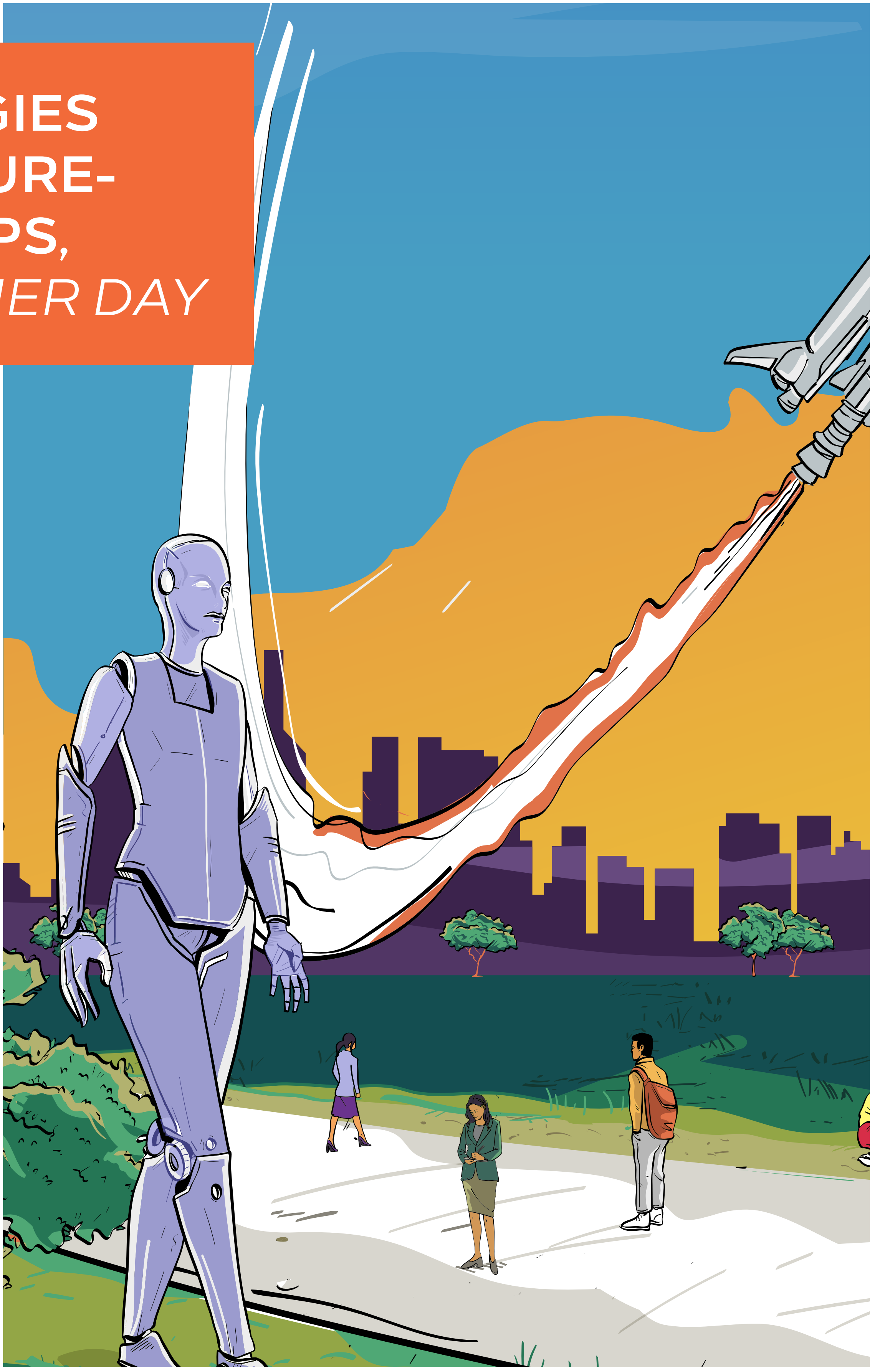
Now, compare this approach with the post-money SAFE, which describes the valuation cap as post-money value not only for our investor's USD 100,000, but for the total amount of money the start-up anticipates it will need to raise in the next 6 months using SAFEs. In this case, the investor and the start-up would agree that the business will likely need an additional USD 300,000 in the future, and can agree to a valuation cap of USD 1,200,000, which is the pre-money value of USD 900,000 plus the anticipated total investment of USD 300,000 over 6 months. This way, it will be much simpler for our investor and the founder to calculate the investor's ownership interest.

Therefore, the post-money SAFE treats investments using the post-money SAFE as its own "funding round", and each investor in this funding round will know its ownership percentages with certainty.

Pre-money SAFE notes can still be used for small investment tickets and where neither the founder nor the investor are certain that the business will be able to raise funds through a priced-equity round in the future, and therefore the pre-money SAFE gives the business the flexibility of not committing to a post-money value. Alternatively, if the investment ticket is larger or if the founder and investor are confident that the business will pursue a priced equity round next, the post-money SAFE may be the more suitable alternative offering certainty for the business, the founder and all SAFE investors.

While the SAFE note is a standard form document that helps founders and investors close investments quickly with minimal negotiations, it is important that neither founders nor investors take this for granted and that both parties seek legal advice to understand the legal and economic effects of the SAFE, including in the more somewhat complex scenarios where different SAFEs and different valuations are issued and what this means in the future when the SAFE is converted into equity or repaid.

TURNAROUND STRATEGIES FOR DISTRESSED VENTURE-BACKED TECH START-UPS, *LIVING TO FIGHT ANOTHER DAY*



Abdullah Mutawi
Partner, Head of Corporate Commercial
a.mutawi@tamimi.com

MENA tech start-ups and the Covid Cash Crunch

While there is no doubt that the Covid-19 pandemic had a very negative impact on the global economy in 2020, a cursory review of global stock markets will show 2020 as a vintage year for the technology sector with a wall street bull-run that added billions of dollars of 'value' to the FAANG and 'tier 2' tech companies and saw the word's first trillion-dollar valuations, also in tech.

For the vast majority of tech companies however, 2020 created enormous uncertainty and a fair amount of distress. This was particularly the case in Q1 and Q2 when lock-downs and hyper-cautious cash preservation strategies meant that companies in all sectors were slashing costs to keep their heads above water and venture finance was in meagre supply. No more was this visible than in the early-stage tech company sector.

A fundamental principle of running a tech start-up is that entrepreneurs are expected to utilise as much of their seed or Series A cash as possible on the pursuit of building, testing, iterating, launching the tech/product and on driving customer acquisition, engagement and stickiness post-launch. They are not expected to draw higher than subsistence salaries or indeed to pay their employees generous salaries either. The founder's equity and ESOP pools are meant to take care of that. In most tech verticals, start-ups are also not expected to make a profit for many years while they throw everything at growth and, in some cases, growth is driven in the early years by spending money to acquire customers that don't even generate revenue. So, while bricks and mortar SMEs were able respond to Covid-19 by cutting costs, this was not a straightforward exercise for tech start-ups.

Another key factor when looking at tech start-ups is to understand the dynamics of funding and running an early-stage company. Delicate navigation is required to balance the objectives of spending to grow and not spending so much that you run out of money before your next fund raise. This is the foundation upon which venture capital is built. Founders wanting to protect their equity against over-dilution in the early stages of the company's life frequently limit the size of their fund raises to only the cash they think is necessary to hit the KPIs enabling them to achieve their targeted next valuation. This means precious little spare cash for contingencies.

When an unforeseen event like Covid-19 hits them, most tech start-ups have nowhere obvious to turn beyond cancelling salaries altogether and cutting back or further bootstrapping on the tech and product. And those strategies can only be sustained for a very short period of time which means that many companies face the prospect of running out of cash and having to fold. When this scenario arose with Covid-19, the path to survival for many companies meant looking to raise funds at short notice in an environment where funds themselves were uncertain about what was going to happen next and were not readily reaching for their cheque books.

Is death inevitable?

In the MENA region there were many examples of companies hitting a wall and having to fold. One example of a successful turnaround, which actually took place just before Covid-19, was that of logistics start-up Fetchr which was saved from bankruptcy at the 11th hour by an emergency injection of cash enabling it to restructure and turnaround the business.

In its early days, Fetchr was one of the darlings of the regional tech start-up scene, having raised over USD 50 million in venture funding including a USD 41 million Series B equity financing which was one of the largest rounds for a Middle Eastern start-up at the time. Unfortunately, various factors led to a catastrophic cash crisis at the company and its management ended up being days away from placing the company into a formal insolvency process when the rescue package was concluded.

However, turning around a company in that situation required enormous focus by the turnaround team and management. The mechanism by which the liquidity was raised was an equity down-round with a 'pay-to-play' mechanism that resulted in any existing shareholder declining to participate in the financing being diluted to almost zero.

Down round equity financing

Venture capital financings typically follow a common pattern of equity funding rather than debt financing as tech start-ups do not have the commercial dynamics that would enable them to raise debt (with the exception of venture debt which is beyond the scope of this article). An initial 'seed' round (more often than not raised on convertible instruments rather than share issuances) will be followed by Series A, Series B, Series C rounds and sometimes beyond. Each such round will confer preferences with the shares issued including anti-dilution rights and liquidation preferences in increasing order of seniority. The expectation of founders and investors alike is that in each subsequent round, the price per share will increase (an 'up round') consequently reducing the dilutive impact of that subsequent financing on the shareholdings of those who have invested earlier and, crucially, the management and employees with stock options.

A down round financing is a priced-equity financing round where the price per share is lower than the price per share paid by investors in a previous financing round. Due to the equity-dilutive and negative psychological impact a down-round can have on investors and employees of the company itself, a down-round will generally be the last resort after alternative strategies such as cutting expenses or divesting non-critical assets (if there are any) have been considered and eliminated.

'Pay-to-Play'

When a down round is being led by existing investors in the company, the existing investors may insist that other existing investors participate in the financing. The rationale being that if they are prepared to write a further cheque when the company is at the point of failure, they want other investors to either stump up the cash or accept some negative consequences which can range from punitive (e.g. a mandatory conversion to ordinary shares thereby stripping those shares of any preferences) to existential (e.g. wiping those shareholders out through the participating investors being able to invest their funds at a nominal pre-money valuation).

Navigating the down round

If the investors agree that a down round is the only viable option, there will typically be a race against time to get a deal done and funded before the company hits the wall. In scenarios such as this, there are a number of important considerations and issues the deal sponsors will have to keep in mind.

> "In most tech verticals, start-ups are also not expected to make a profit for many years while they throw everything at growth and, in some cases, growth is driven in the early years by spending money to acquire customers that don't even generate revenue. So, while bricks and mortar SMEs were able respond to COVID-19 by cutting costs, this was not a straightforward exercise for tech start-ups."

Rights Under Shareholder Agreements

Sponsors and their counsel should review the applicable governing documents of the company to assess all the applicable rights accruing to shareholders, sometimes multiple layers of rights depending on how many share classes are involved. They will also need to establish what consents are required to effectuate a new equity financing; again, this can be complex and layered as an insolvent tech start-up that has raised multiple equity rounds in the past will have multiple sets of consent from each share class. Counsel should also advise on whether other restrictions may exist that could block a new equity financing.

In addition to the governance dimensions of shareholder agreements, there are also likely to be significant issues around the economics of a down round and the triggering of anti-dilution mechanisms. Anti-dilution mechanisms are very common in venture backed SHAs and they have the ability to complicate things pretty quickly in a down round due to the effect of an anti-dilution clause being triggered on the conversion ratio of preferred shares to common shares. While a deep analysis of how anti-dilution mechanisms is beyond the scope of this article, the key point for the sponsors of a down round to consider is how anti-dilution is dealt with in their overall restructuring/turnaround strategy.

Typically, investors in a down round will be existing investors. But it is almost certain that any new investor(s) participating in the financing will insist on the waiver by the existing preferred shareholders of their anti-dilution rights. Moreover, the new investors will most likely insist on a preferential anti-dilution formula such as a full-ratchet formula rather than the more common broad-based weighted average formula to apply to the new round. These issues are not insurmountable but sponsors and their counsel should be aware that emotions and tensions will always run very high in a down round scenario and they should have a robust and watertight negotiation strategy so as not to waste precious time in negotiations in the limited time available before the money runs out.

If the team is good, take care of the team

In cases like Fetchr, where an aggressive root and branch restructure of the business is the only hope of reversing the death spiral, it is inevitable that the senior management will be an immediate casualty needing to make way for an external team with the experience and expertise to execute the turnaround plan. Turnaround teams and down-round investors need to be decisive and swift in executing the plan.

But there are plenty of scenarios where the investors might still believe in the management team despite the company running out of cash or may feel, for whatever reason, that retaining the team is their only chance of seeing a return on their investment. In such situations the sponsors of a down round have to be conscious of the impact the round will have on the team and, in particular, understand the way in which any anti-dilution rights (see above) in the shareholders' agreement will impact the value of the management team and employees' shares. If the operation of the anti-dilution right has the effect of materially reducing (or wiping out) the upside for the team, this is going to kill the team's motivation to stay on.

Retaining the team in such situations might involve cash payments or equity incentives or a combination of those. In many down round situations, the sponsors and investors of the round will agree to an adjustment of the founder/employee stock options by creating a fresh ESOP pool that will be allocated after the round is closed and the effects of dilution have taken place. In situations where short term emergency cash is required to stave off insolvency proceedings, the sponsors of the round may agree to significant equity incentives that would vest upon the completion of certain turnaround milestones such as closing an initial 'breathing room' tranche to keep the company afloat while restructuring takes place followed by a further significant equity allocation upon closing a second investment tranche once the restructuring is completed within a specified timeframe. This type of arrangement certainly aligns incentives and provides the investors with some protection in the event that the turnaround team is not able to execute on its immediate mission.

No matter what structure is used to adjust employee incentives, the employees themselves have to believe in the turnaround plan and that the company has a viable and realistic strategy to save the company from the death spiral, re-establish value-creation and ultimately to achieve an exit. If the sponsors of the round have a strong belief that a strong exit is viable in the short to medium term, they might also consider a management carve out plan that carves out a small portion of the exit deal proceeds and allocates those contractually to the management team. The reason for doing this is to circumvent the liquidation preferences in the SHA so that management get incentivised with a 'top slice' of deal proceeds. If the management team believe in the possibility of the exit in the short to medium term, this is a highly motivating tool but requires expert knowledge to structure and negotiate. And it will be another element of the restructuring that will almost certainly require shareholder approval along with all the other approvals such as waiving pre-emptions, anti-dilution rights and so forth.

Fiduciary duties

Generally speaking, in all its major decisions, a board is required to exercise fiduciary duties to act in the best interests of the company. It might be easy to assume that a decision that will save the company from bankruptcy is preferable to allowing the company to collapse with the presumption that such a decision is consistent with fiduciary duties.

MENA tech start-ups are usually structured with a 'holdco' domiciled in a common law jurisdiction such as Delaware, Cayman, BVI, ADGM or DIFC. There are almost always one or more wholly-owned 'opcos' sitting in each of the countries where the company is operational. In MENA, we often observe that the same board members may sit on a holdco board at say Cayman or Delaware level in addition to sitting on an opco board in the UAE, KSA or Egypt. When considering a down-round, sponsors and their counsel will need to consider not only the law at the holdco level applicable to the proposed down round but also to the relevant laws where the directors reside and work.

For example, under Article 68 of the UAE Bankruptcy law, a Company must petition the court to commence bankruptcy proceedings after 30 consecutive business days from it either being unable to pay its debts when they fall due or being balance sheet insolvent. If the directors or senior management team fail to initiate the prescribed procedures under Article 68 of the Bankruptcy Law, this could be regarded by the UAE court as "mismanagement" of the company within the meaning of Article 162(1) of the Commercial Companies Law ('CCL') as recently amended wherein directors and executive management are potentially liable towards the company, shareholders and third parties for all acts of fraud, abuse of authority, breach of the provisions of the CCL or the company's articles of association, and mismanagement.

At the Cayman and Delaware level (the level at which equity financings are raised) lawyers advising companies on down rounds have to consider the rise in equity holder litigation associated with down rounds and the decision-making that led to such financings taking place. Such cases have focused on the duty of care imposed on a board to follow a process of due consideration such as whether the board considered all reasonably available information, was appropriately engaged, and evaluated available alternatives. Litigation in those jurisdictions has also focused on conflicts of interest and challenging whether members of a board acted for the purpose of advancing the interests of the company and its shareholders or whether they have been motivated by a conflicting interest.

> "Sponsors and their counsel should be aware that emotions and tensions will always run very high in a down round scenario and they should have a robust and watertight negotiation strategy so as not to waste precious time in negotiations in the limited time available before the money runs out."

Legal frameworks will be very different across these legal systems but the sponsors of a down round and their counsel will need to be very clear on what duties are owed by the directors (and in some cases shareholders with management control) of a company and to whom those duties are owed. The applicability and meaning of applicable national law will also need to be tested and provided for.

Conclusion

The above considerations are headline items and barely scratch the surface of the myriad issues and challenges that the sponsor of a turnaround strategy and possibly a down round will need to navigate.

The most important thing to remember is that when cash is running out fast, the clock is ticking and the deal needs to be structured, papered and closed very rapidly indeed. Sometimes in a manner of days. There is no time to waste and the sponsors of the down round and their counsel are going to have to be prepared for multiple simultaneous discussions with relevant stakeholders and, more often than not, their legal counsel. It is not just a race for structuring, papering and procuring the relevant consents. The 'buy-in' is equally important and sponsors could do worse than having someone in charge of the comms strategy who is incentivised to do all the relevant communications to ensure that they get the deal done.

Finally, appointing the right legal counsel is also critical to the success of a turnaround because the strategy has failed the moment a technical insolvency comes into existence. Knowledge and assuredness at the holdco level is not sufficient. Local laws need to be heeded and boards need to ensure that there is no insolvent trading at the opco level or failure to adhere to local laws even where the financings and the down round itself is taking place in a different holdco jurisdiction.

THE GROWING POPULARITY OF THE **DIFC** AND THE **ADGM** OVER THE CAYMAN ISLANDS AS A JURISDICTION OF CHOICE FOR MENA-BASED PRIVATE EQUITY AND **VENTURE CAPITAL FUNDS**

Dennis Ryan
Senior Associate
Banking & Finance
d.ryan@tamimi.com

Jody Waugh
Deputy Managing Partner
Banking & Finance
j.waugh@tamimi.com

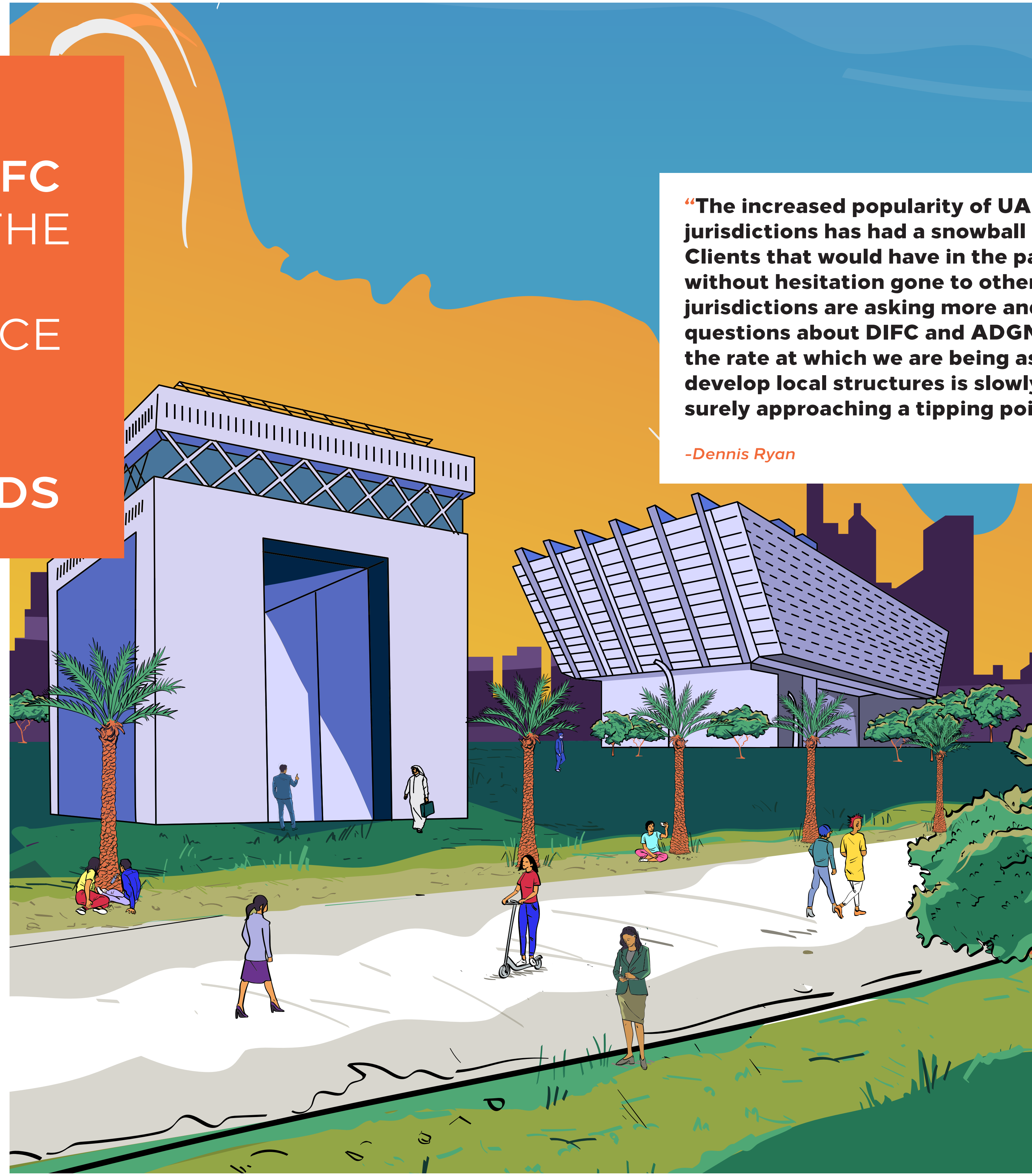
Abdullah Mutawi
Partner, Head of Corporate Commercial
a.mutawi@tamimi.com

For any potential manager looking to establish a VC and raise and manage funds in the region, one of the key considerations will be the jurisdiction in which the fund will be set up.

Until recently, the Cayman Islands have been the popular choice for private equity and Venture Capital ("VC") funds in the MENA region. However, we have been witnessing a growing trend for domiciling these types of funds in the Dubai International Financial Centre ("DIFC") and the Abu Dhabi Global Market ("ADGM").

This article looks to provide some key insights into the growing popularity of UAE-based offshore fund domiciling.

One question we are frequently asked, is why not follow the legal fund structures used by the established Silicon Valley VC funds? The first thing to remember is that in the US private equity and venture capital funds are typically established using a Delaware platform or a Cayman Islands platform for reasons, such as tax efficiency in a highly taxed environment, which are specific to the needs of investors in that specific place. This is the primary reason that this remains the dominant structure used by Silicon Valley and New York funds to this day.



"The increased popularity of UAE jurisdictions has had a snowball effect. Clients that would have in the past without hesitation gone to other jurisdictions are asking more and more questions about DIFC and ADGM and the rate at which we are being asked to develop local structures is slowly but surely approaching a tipping point."

-Dennis Ryan

Those tax drivers, however, are of minimal relevance to potential fund managers and investors from the MENA region looking to deploy in regionally based portfolio companies. This is one of the key reasons why we are seeing a growing trend away from domiciling private equity and VC funds in the Cayman Islands to domiciling them in the DIFC and the ADGM.

What are the other reasons for the trend?

The DIFC and the ADGM offer very similar platforms to the Cayman platform in that they apply common law and have very proactive and responsive regulators; the key differentiator being that DIFC and ADGM are regionally based.

Dubai is consistently highly ranked in the Global Financial Centres Index which has been in existence for 14 years now. Many international and regional banks, asset managers and investment advisors are established in the DIFC making it an attractive jurisdiction for financial firms seeking to establish themselves in the region.

The ADGM is the newest regional financial centre. It is an attractive jurisdiction for financial start-ups because its regulator is proactive and seeking to position itself as a dynamic and pro-business financial free zone.

Both the DIFC and the ADGM have been creative in enhancing their private equity platforms. They offer a diverse choice of fund structures and licensing options, creating a unique regional platform to launch, distribute, manage, domicile and promote all types of private equity (including VC) funds. Another interesting and unique feature is their ability to support a domestic private equity structure as required by public-private partnerships; very much a growing trend encouraged by governments in the region. Finally, they also understand and have instituted a regulatory framework for Sharia compliance and Islamic finance generally which addresses a need that the traditional 'offshore' jurisdictions do not have.

In spite of the region's mixed financial fortunes in recent years, headline-grabbing tech exits such as the acquisitions of Souq.com by Amazon and Careem by Uber are driving extraordinary momentum in the VC space. Tantalised by the rich exits achieved by the early stage investors in these deals, institutions, high-net-worth individuals and family offices from this region have started to diversify their portfolios in new ways.

Undoubtedly, private equity was the predominant 'alternative' asset class in the late 90's and early 'noughties'. However, inherent in the PE model was the requirement that LPs would deploy between USD 10m and USD 100m with fund managers whose strategy was to deploy their committed capital into 10 or 12 portfolio companies with a fairly rigid 'hold period' of around five years. But with high-profile PE failures and a fatigue with the 'two and twenty' compensation model, we have seen a real move by regional investors to reassess the PE model and towards taking similar positions in funds where the GP will look at a much higher volume of earlier-stage deals. VC is, of course, a subset of PE and certainly the pre-cursor to growth stage PE so the investors are not changing focus entirely. Most VC GPs still opt for a 'two and twenty' model but, for the investors, the strategy is now more nuanced with the following being the typical thesis:

- much higher deal volume;
- much smaller ticket sizes;
- co-investment with other funds being the norm and not the exception;
- seeking out earlier stage valuations; and
- accepting that the failure rate can be high but where the smaller proportion of winners will deliver more lucrative exits.

"The DIFC and the ADGM have gained international recognition as world-class regulators offering private equity platforms that are competing, in a very meaningful way, with the traditional Cayman Islands funds regime. They are doing so by being proactive, cost-effective and extremely creative at meeting and increasingly exceeding the demands of sponsors and private equity and VC fund managers."

VC funds do, of course, come with substantially diverse investment theses where the strategy can favour specific verticals, business models, geographies and funding round stages. The number of seed funds that are popping up is impressive but, typically, VCs establishing themselves in the region are looking at either the Seed to Series A categories or the Series B to C categories with a few of the bigger funds keeping dry powder, as an integral part of their investment thesis, to double-down in follow-on rounds on their star performing portfolio companies. All of this means that the number of funds and GPs appearing in the VC space is already much higher than the PE firms of yesteryear.

Further, due to a key VC differentiator being the much smaller ticket sizes, there are multiple options for a much larger body of investors who want to get into the space. This is significantly deepening the pool of available investors in the region and another reason why the DIFC and the ADGM have an incentive to establish long-term solutions of their constituents' needs and, increase the offers and services addressing their issues.

Finally, we have also observed a growing trend of international fund managers seeking liquidity in the region. As a regionally based specialist legal counsel, and with our unrivalled understanding of the local market and regulatory environment, we have found ourselves as the first port of call for many such fund managers with their unique fundraising objectives leading them to set up in the DIFC and the ADGM.

Do you see any particular developments on the horizon for either the DIFC or the ADGM?

The DIFC and the ADGM have made significant strides in the VC arena. The ADGM recently introduced a calibrated VC fund manager framework streamlining the applicable regulatory requirements for certain types of VC firm to be established with greater ease and speed. The subscription for such firms is limited to USD 100 million unless otherwise agreed with the regulator. The waiver of most of the prudential regulatory requirements and the absence of minimum regulatory capital requirements are key features of such licenses. To assist a VC fund in the ADGM to save costs, the regulator does not require the GP to appoint an internal auditor, independent custodian, independent valuer or independent fund administrator. These are very attractive features for start-up funds. This new framework is bespoke to the ADGM and has many features aimed at attracting VC managers and GPs to set up in this jurisdiction.

The DIFC has also recognised and responded positively to the growing regional appetite for VC as an asset class, establishing the DIFC's USD 100 million FinTech Fund in 2017 which is aimed at investing in start-ups from incubation through to the growth stage in order to help FinTech firms looking to access the MEASA markets.

The FinTech Fund objective is to leverage the DIFC's FinTech platform consisting of attractive experimental licenses, market leading pricing and collaborative spaces.

What about fund managers who are marketing or promoting a foreign fund in the region. Do they benefit by establishing their investment vehicles on those two platforms?

Marketing and promotion of foreign funds in the United Arab Emirates imposes additional requirements that domestic funds established in the DIFC or the ADGM do not face. A fund manager who wishes to promote a foreign fund in the UAE has a duty to register the fund with the Securities and Commodities Authorities ("SCA"), to annually renew its registration and subject itself to certain prescribed exceptions.

"Each regulator has created flexible fund platforms that are enhanced by the ease of marketing and promotion throughout the UAE through a passporting regime that is resulting in fund managers embracing the DIFC and the ADGM as jurisdictions of choice over the Cayman Islands for MEASA-based investors and investments."

Registration of a foreign fund requires the funds to be registered or regulated within foreign jurisdictions or otherwise be able to demonstrate that the fund is not exempted from any regulation or supervision rules or the regulations for preparing and issuing periodic reports at its domicile of incorporation. The SCA will look at each application on a case-by-case basis to determine if the particular applicant meets this standard.

The attraction in establishing a VC fund in the DIFC or the ADGM is the ability to promote such funds throughout the UAE following the recently signed Passporting Agreement by the SCA, the DIFC and the ADGM. The Passporting Agreement facilitates the mutual promotion and oversight of investment funds established in the different jurisdictions within the UAE. It will enable local fund managers authorised by the DIFC, the ADGM or the SCA to market their funds throughout the UAE without the need for further authorisation or approval, provided they meet the relevant requirements and notify the respective regulators.

What effect will that have on the region?

The DIFC and the ADGM have gained international recognition as world-class regulators offering private equity platforms that are competing, in a very meaningful way, with the traditional Cayman Islands funds regime. They are doing so by being proactive, cost-effective and extremely creative at meeting and increasingly exceeding the demands of sponsors and private equity and VC fund managers.

Each regulator has created flexible fund platforms that are enhanced by the ease of marketing and promotion throughout the UAE through a passporting regime that has resulted in fund managers embracing the DIFC and the ADGM as jurisdictions of choice over the Cayman Islands for MEASA-based investors and investments. This enables investors to access growth opportunities with greater ease and efficiency. It will invariably bolster the UAE's economic diversification strategy and attract more foreign direct investment and new investors and institutions to participate and support the growth of the local economy and the development of the region.

REGULATORY FOCUS

For foreign venture investors and regional investors alike, the regulatory frameworks impacting the operations of an investee or prospective investee company in our region can be complex waters to navigate. Early-stage investments in tech are already a highly risky asset class, and getting comfortable with regulatory risk is usually a pre-requisite to reaching for the cheque book.

Early-stage financing in any market is unlikely to be a space where warranties or even indemnities are going to provide any comfort to an investor. As with all emerging market opportunities, due diligence around regulatory compliance and ensuring that gaps are filled and problems are fixed prior to capital being deployed is a critical tool in minimising and mitigating risk. Simply put, if it can't be fixed before you invest, walking away is likely to be the better strategy.

In this section, we examine a small selection of regulatory topics that we have had to consider over the years for clients and investors alike operating in the disruptive technology-driven environment.

I AM JUST A START-UP, DO I NEED TO WORRY ABOUT TAX?

Janet Gooi
Senior Associate
Tax
j.gooi@tamimi.com

Introduction

You have secured funding for your start-up. Your minimum viable product and marketing strategy is in place. Your newly hired team looks promising. With so many aspects of establishing a start-up to consider, do you really need to worry about taxes for your start-up? In short, the answer is 'yes'.

The Gulf Co-operation Council ("GCC") region remains an attractive region for starting a business due to the favourable tax regimes in most GCC countries. However, there is a general misconception that there are few or no issues with taxes in the GCC. In line with the GCC's diversification strategy and its attempt to reduce its dependence on revenue from hydrocarbons, individual countries have committed to introducing new indirect taxes and other tax reforms. The evolving tax regimes of the region pose a challenge to entrepreneurs who are seeking to establish a presence in the GCC, or investors looking to sell, divest or acquire a business in the GCC.

In this article, we will provide an overview of some of the key taxes in the GCC that start-ups should consider as part of their business planning.

Overview of the taxes in the GCC region

1. Corporate tax

Generally, corporate tax is a form of direct tax levied on the taxable profits of entities. Non-residents of a GCC country may be subject to corporate income tax or withholding tax depending on the domestic rules in the specific GCC country in question. Non-residents who conduct business in a GCC country (through a permanent establishment) are subject to corporate income tax whereas non-residents who generate taxable income from sources in that GCC country may be subject to withholding tax.

In practice, certain GCC countries such as the UAE and Bahrain only enforce corporate tax in specific sectors such as the oil and gas production sector. In Kuwait, the KSA and Qatar, corporate tax is imposed in respect of the non-GCC shareholding.

2. Withholding tax

Withholding tax is a tax that is deducted at the source on payments made by a resident in a GCC country to non-residents. Different withholding tax rates apply depending on the nature of the payments made by the resident to the non-resident. The UAE, Kuwait and Bahrain do not impose withholding taxes whilst the other GCC countries generally impose withholding tax on payments of interest, dividends and royalties from its residents to a non-resident or retention taxes.

The domestic withholding tax rates of a jurisdiction may be reduced under a double tax treaty that is in force between the countries of the payor company and the recipient of the income, provided certain conditions are met.

Prior to entering into any cross-border transactions, start-ups should carefully assess the withholding tax implications and obligations in making any payments to non-residents.

3. Zakat

Zakat is a form of Islamic tax that is currently only enforced in certain GCC countries such as the KSA and Kuwait. For instance, in the KSA, Zakat is imposed in respect of the shareholding in resident companies attributable to Saudi or GCC nationals. Zakat is paid by the resident company at the rate of two and a half per cent based on the higher of adjusted net profits or the Zakat base.

4. Value added tax ("VAT")

VAT is a form of consumption tax imposed on the supply of goods and services and is charged on the value added at each stage of the supply chain. The unified GCC VAT Agreement sets out broad principles that should be followed by all the GCC countries in their VAT laws whilst also providing flexibility in certain matters. Each GCC country will enact its own VAT legislation based on these common principles.

To date, only the UAE, KSA and Bahrain have implemented VAT. Oman and Qatar are expected to introduce VAT in 2021 and Kuwait is likely to implement VAT at some point in the future.

Under the GCC VAT Agreement, all GCC countries have agreed to implement VAT at the standard rate of five per cent. However, the KSA recently announced that it will increase the standard rate of VAT to fifteen per cent effective from 1 July 2020, as part of the KSA's measures to mitigate the economic impact of the COVID-19 pandemic. To date, the UAE has ruled out any immediate plans to increase VAT in the UAE beyond its current standard rate of five per cent.

5. Excise tax

Dubbed the 'sin tax', excise tax is a form of indirect tax levied on specific goods which are typically harmful to human health or the environment. In a joint effort to reduce the consumption of unhealthy and harmful commodities, the GCC countries agreed to implement excise tax by way of the Common GCC Excise Tax Agreement.

To date, the UAE, KSA, Bahrain, Oman, and Qatar have implemented excise tax for certain tobacco products at 100 per cent, energy drinks at 100 per cent, and carbonated drinks at 50 per cent. In Oman and Qatar, excise tax is also imposed on 'special purpose goods' (such as alcohol or pork products) at 100 per cent. The UAE and the KSA also recently extended the scope of excise tax to include sweetened drinks and other tobacco products.

6. Customs duty

The GCC has a unified customs duty regime. Customs duty is imposed at the first point of entry of goods into the GCC. Imported goods are generally subject to customs duty at the rate of five per cent of the cost, insurance, and freight invoice value. However, certain goods may be subject to customs duty at a higher rate whereas other goods may be exempt.

> "There is a general misconception that there are few or no issues with taxes in the GCC. In line with the GCC's diversification strategy and its attempt to reduce its dependence on revenue from hydrocarbons, individual GCC countries have committed to introduce new indirect taxes and other tax reforms"

7. Real estate transfer taxes/ stamp duty

In Oman and Bahrain, stamp duty is imposed on the transfer or registration of real estate. In the UAE, a registration fee is levied on the transfer of ownership of land and the transfer of shares in companies holding real estate.

8. Payroll taxes

Generally, the GCC countries do not impose payroll taxes. However, it is important to note that employers are subject to social contribution obligations in all GCC countries.

Final remarks

Given the limited taxation in the GCC, establishing a start-up in the region is an attractive option compared to other more established economies which often have convoluted tax webs. However, investor awareness needs to be heightened – an additional layer of complexity for start-ups in the region may materialise due to: (i) the introduction (and proposed introduction) of new taxes such as VAT; and (ii) discrepancies between domestic tax legislation, double tax treaties and the approach of the tax authorities. In view of the international pressure on tax transparency and the GCC's diversification strategy, it is anticipated that the tax regimes in the GCC will continue to evolve. Entrepreneurs with current or potential business interests in the GCC should continuously monitor GCC tax developments and regularly assess their tax risk management strategies.

E-COMMERCE: A PRIMER ON RELEVANT UAE LAWS AND REGULATIONS IMPACTING THE E-COMMERCE INDUSTRY

Martin Hayward
Head of Digital & Data
m.hayward@tamimi.com

Willem Steenkamp
Partner
Corporate Commercial
w.steenkamp@tamimi.com

Based on the success of Amazon.ae, Noon.com, and other platforms in the UAE online marketplace, traditional bricks and mortar retail business are increasingly seeking to establish their own e-commerce portals as an add-on to their existing business models. However, a successful e-commerce platform involves more than just acquiring a domain name and adding a payment process gateway. Retailers need to make sure that they comply with the legal and regulatory framework surrounding online sales to customers in the UAE.

We take a look below at the key considerations in the context of applicable UAE laws and regulations as they relate to the e-commerce ecosystem.

Licencing Requirements

Retailers that operate e-commerce platforms need to make sure that they are, in fact, licensed to undertake e-commerce activities as part of their current trade licence. If not, those retailers need to make sure that their licensed business activities are expanded to cover e-commerce. The addition of an e-commerce activity to the license is subject to the discretion of the relevant authorities and often the decision of whether to permit the addition of such activities is based on whether the e-commerce activity is compatible with the retailer's existing licensed activities. In the event that the authorities determine that e-commerce cannot be added to a retailers existing licensed activities, a new license would be required.

Although retailers have the option to simply add e-commerce to their licensed activities, quite often they opt instead for setting up separate entities to own and operate their e-commerce platform. Structuring their online business in this manner allows retailers to ring fence risk under the operating entity and also to centralise their e-commerce business.

Terms and conditions of sale

It is common practice, both locally and internationally, to attach terms and conditions of sale to the use of a website or e-commerce portal. These terms and conditions of sale will then govern the way in which the retailer and its online customers will interact with each other in respect of the sale of the retailer's products online.

The terms and conditions of sale might include details relating to delivery, refund policies, termination of accounts, and interactions between the users. But more importantly the terms and conditions of sale must contain any terms that are required by the operators of the payment gateway. Over time, we have seen an increase in the number and scope of these requirements but it is important to note that the payment gateway operator will not allow the e-commerce portal to commence operations until it has seen the final version of the applicable terms and conditions of sale of the retailer.

"a successful e-commerce platform involves more than just acquiring a domain name and adding a payment process gateway."

In operating an e-commerce platform, it is very important to have clear terms and conditions of sale to reduce any ambiguity and increase customer trust, and to highlight any key transactional terms to the consumer, maybe as a pop-up window at one point during the sale.

Privacy Policy

In addition, an e-commerce site must have a privacy policy that is appropriate for the countries in which it operates. The most important role for the privacy policy is to provide customers with the confidence that their data will be properly stored, used, protected and done in accordance with the applicable law. This law analysis needs to be done carefully – the operator of the website may inadvertently mean that the operator must consider more than one country's laws.

It is important to note that the payment gateway operator will also expect that certain provisions are included within that policy. One provision commonly required is the provision that data (such as credit card details) will in fact be used by third parties that are assisting with the provision of certain services.

Although there is no specific data protection legislation in the UAE (with the exception of some of the UAE's free zones) data protection is governed and regulated by a combination of legislative and practical measures, including the UAE Penal Code. Specifically, Article 379 of the UAE Penal Code prohibits the use or disclosure of 'secret' information without the consent of the person to whom the secret relates. Breach of this Article incurs potential penal liability in the form of a fine and/or incarceration for the individual that is responsible for the use and/or disclosure of such information. The cybercrimes law may also be applicable in certain circumstances and contains severe penalties.

Electronic Contracting

The emergence of an online marketplace in the UAE resulted in commercial transactions and contracts of sale being concluded electronically. The most common methods of contracting with a customer online are by way of 'click-to-accept' (i.e. a physical act by the customer to indicate their consent to the contract) and deemed consent by way of a customer's general use of a website.

In the UAE, the Electronic Transactions and E-Commerce Law (Federal Law No 1 of 2006) generally permits the execution of contracts between two parties via electronic means, and expressly states that the consent and acceptance of contracts may be expressed via electronic communications.

The risk of contracting in this manner is that the way in which the terms and conditions of sale are delivered to the customer (e.g. electronically) creates the opportunity for customers to argue that no contract of sale was concluded in respect of an online sale of products since they never read or agreed to the terms and conditions of sale. As such, retailers are advised to take steps to ensure that such arguments are limited to the extent possible. For example, retailer should ensure that each customer 'click-to-accept' the terms and conditions of sale which relate to his/her purchase of goods before a transaction can be concluded as opposed to just having the terms placed in the 'legal' section on the website where the customer may or may not see them.

Copyright

A person (or company) that creates content usually has the legal right to determine whether or not a third party can use that content. This position is generally the case across the world and certainly applies in the UAE. This means that, if the retailer that operates an e-commerce site is commissioning a freelancer to produce content for the site, then it needs to enter into an agreement with that freelancer to confirm the ownership of the material created as well as the use that can be made of the material by both parties.

For ad hoc content, the relevant retailer should obtain a written licence from the owner of the content before using it. The only time that content could legitimately be used without a written licence would be for material that is clearly a press release or some other form of publicity – these are specifically provided in order to be used by third parties and therefore judicious use of that content (that is, within the expected usage and within a reasonable time from the date of the press release) will be unlikely to raise claims of copyright infringement.

Retailers should also be careful with the use of stock image libraries and music libraries. These libraries do have some limits on the use that can be made of their materials and it is wise to check the fine print in all cases. There have also been numerous cases of 'bait and switch' tactics with music libraries, where "unlimited use of music" was advertised but was not reflected within the standard terms that are sent to, and signed by, the user. There is an entire industry devoted to chasing entities that use music in excess of the licensed terms.

Content

Content on e-commerce sites, can fall broadly into three categories:

- content created by the operators of the e-commerce site – this will include the description of goods but might also include editorial content;
- content that is provided by third parties for use on the e-commerce site, such as press releases or articles about the products sold on the site; and
- content that is created by the customers, commonly known as user-generated content, which could include reviews or comments in forums.

It is important to recognise that, with all of these three types of content, the retailer that operates the e-commerce site is considered to be the publisher of the material, and so may be found liable for that content if it is found to breach the rights of another party, or breaks any laws or regulations. Whilst content regulation is quite a complex area of law that requires separate attention, note that Federal Law No 15 of 1980 (concerning Publications and Publishing) ("P&P Law") contains a list of material that is unacceptable for publication within Chapter 7. In addition, Federal Law No 5 of 2012 (on Combating Cybercrimes) ("Cybercrimes Law") contains other matters that are not permitted in relation to activities on the internet. The National Media Council ("NMC") has further regulations that will apply ("NMC Regulations").

Not only does the retailer that operates the e-commerce site have to consider these laws in the creation of its own content but also when using the content of others. More particularly, this becomes problematic when the site allows user generated content to be created and shared. Customer reviews and contributions to forums can become confrontational and may inadvertently constitute a breach of the P&P Law or the Cybercrimes Law. For this reason, many a retailer that operates the e-commerce site actively monitor user-generated content before they permit it to be published.

"e-commerce means extending usual business operations beyond the retail sector and into the publishing sector."

Marketing

As an e-commerce site will fundamentally contain marketing for goods or services, it will be considered to be advertising and as such will be subject to the regulations that apply to such content. Advertising content is regulated by the NMC, as part of the NMC Regulations, as well as particular issues that have been included in guidelines issued at the end of 2018 ("Guidelines").

These standards cover false and misleading claims, and the need for advertising to be clear and unambiguous. They also include provisions about clearly determining the identity of the advertiser in each case. The Guidelines, in particular, are helpful for ensuring compliance across the board as they are a helpful summary of the various law and regulations.

Social Media

Many entities, whether online or otherwise, are more and more frequently using social media to reach a wider audience and promote their business. The same content laws apply to any such activity, and we regularly advise our clients to ensure that they have effective social media policies in place to regulate their employees' use of social media and to ensure that there is a consistent approach with how the business is promoted. More importantly, the social media policy will (hopefully) raise awareness to the individual employees that the regulatory regime governing content also applies to content displayed on social media platforms. Simply posting comments on behalf of an employer does not exonerate an employee of any liability under this regulatory regime.

In conclusion, the establishment of e-commerce sites can be considered to be a logical extension of a retail brand or a simple way for a company to create and maintain a direct relationship with their customer base. However, e-commerce means extending usual business operations beyond the retail sector and into the publishing sector. As many retail operators are generally unaccustomed to considering matters such as liability for the publishing of content, or the management of data in accordance with a privacy policy, it is important that they not only set up appropriate documentation in each case but also establish protocols to ensure internal compliance with the various laws that will apply to their new business operations.

THE GROWTH OF THE GIG ECONOMY

Samir Kantaria
Partner, Head of Employment & Incentives
s.kantaria@tamimi.com

Companies such as Uber, Airbnb and Deliveroo, have become international household names over the past few years. These technology companies are rapidly taking over the markets in which they operate and are pushing the gig economy into new sectors.

The gig economy has led to an increased trend in flexi-working models, with control over working schedules and activities. Uber, for instance, created a model that operates on a technology platform thereby allowing its contracted drivers, who are predominately self-employed, to work at their convenience by accessing the platform through the Uber app when they wish to work.

Conversely, self-employed individuals do not have the same benefits, rights and protections as employees and this has created an ongoing dispute in many jurisdictions. For Uber, the exclusion of rights and protection is hugely beneficial, and means that it is does not have to provide the same benefits as it would for its employees. For the individuals themselves, this position is, of course, disadvantageous.

The UK, as an example, has been engaged in a legal battle over the last three years in which Uber drivers claim that they are entitled to the same benefits generally provided to employees, such as protection of wages, and an entitlement to the national minimum salary. In 2016, an employment tribunal determined that Uber drivers were employees and were entitled to the same benefits as a full time worker. Uber appealed the decision and argued that Uber was an agent for its drivers, as reinforced by the fact that the two parties had not signed an employment contract. Unfortunately, for Uber, both the appellate court and the UK Supreme Court upheld the tribunal's decision. In the court's view, any driver who:

- had the app switched on;
- was operating within the territory in which he or she is authorised to work; and
- was both able and willing to accept assignments;

was deemed to be working for Uber under a contract of employment.

The judgment is an important one as it sets the tone for other tech-companies operating under similar models and concepts.

There is an increasing number of people willing to work part-time or in temporary positions within the remit of the gig economy culminating in cheaper, more efficient services. In the modern digital world, it is becoming increasingly common for people to work remotely or from home, ultimately facilitating independent contracting work. Despite this, a number of jurisdictions, including the UK, have attempted to re-characterise the independent contractor/self-employed status of individuals to permanent employees. Many believe that this re-characterisation is contrary to the model that gig economy companies are attempting to develop.

How does the gig economy work in the UAE?

The UAE is not as flexible as other jurisdictions and does not accommodate many types of business models. Before an expatriate is eligible to work in the UAE, they must receive approval from the UAE immigration and labour authorities and are required to obtain a residence visa and work permit. As part of this process, individuals are required to enter into a standard short form employment contract prescribed by the UAE authorities.

Because of this requirement, the set-up of on-demand companies such as Uber and Careem is significantly different to the model in other jurisdictions, and follows the classic employer-employee relationship. As such, the individuals (such as the drivers of the Uber cars) are entitled to the same statutory protections as all other employees in the UAE, including overtime, sick leave and pay, annual leave, the right not to be unfairly dismissed and end-of-service gratuity. This model is also encapsulated throughout the GCC region and works in the following way:

1. The booking platform operator (for example Deliveroo) enters into a commercial services agreement with a locally licensed and registered transportation services company; and

2. Deliveroo effectively agrees the outsourcing of its deliveries to the transportation services so that, Deliveroo does not engage the riders directly. This means that the riders remain employees of the transportation services company throughout – not Deliveroo. The fact that the UAE does not permit a rider to be engaged directly by Deliveroo (as there are licensing constraints) is not generally a matter of consideration in other countries in which these type of models operate, making the operation of the gig economy in the UAE unique.

The future of the gig economy in the UAE

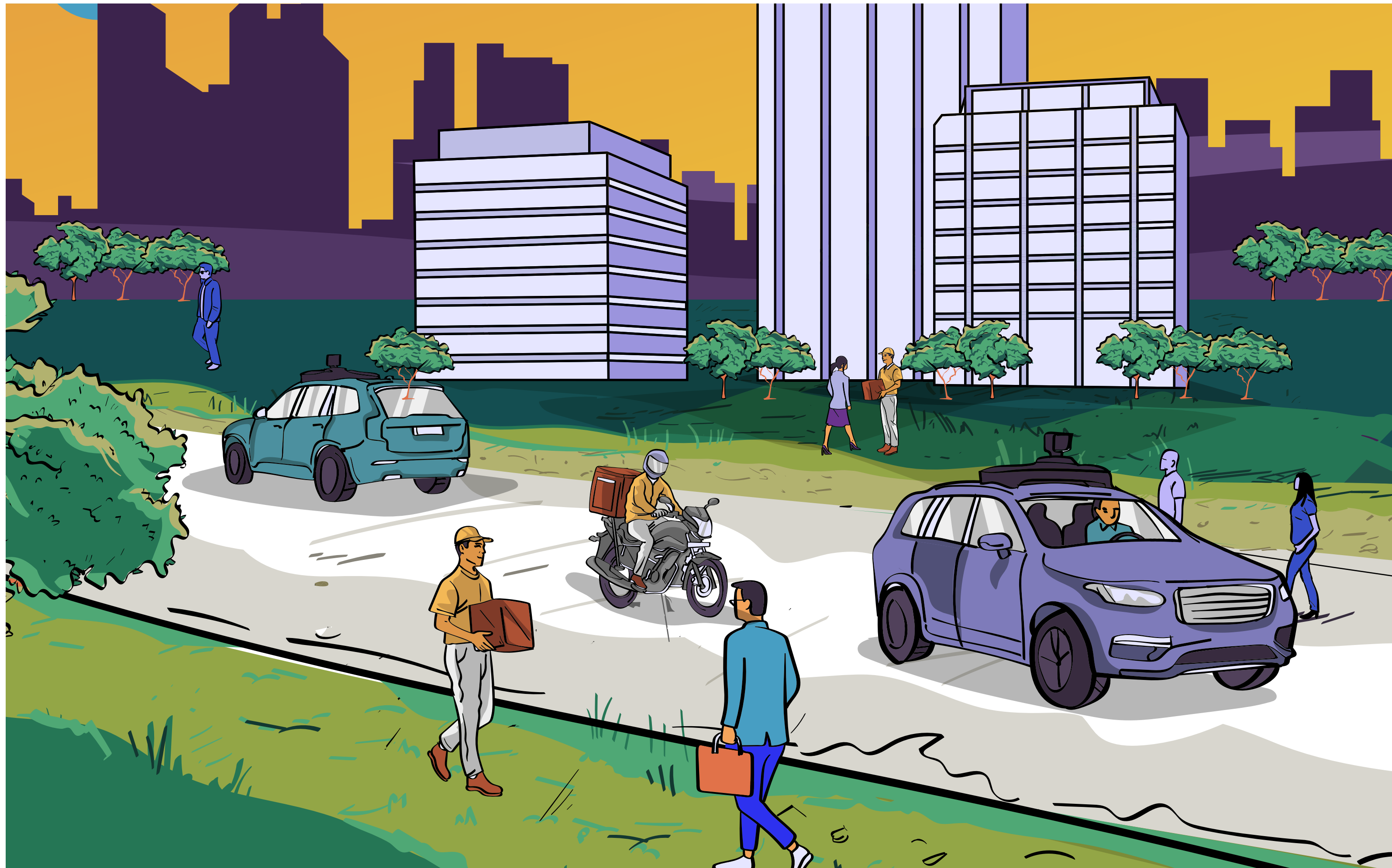
In recent times, the number of consultancy-type arrangements within the UAE has significantly increased for the reasons mentioned below. Over the past couple of years, an excess of USD 3 billion has been raised on the back of technology investments in the region with Careem becoming the UAE's first tech start-up with a valuation of over USD 1 billion at exit.

With the increased focus on investment in the gig economy, more and more individuals are looking to provide their services as freelancers, with the flexibility that this offers to them. The UAE has also recently simplified the process to set up SMEs, which will help entrepreneurs to be their own sponsor for immigration purposes. Free zones have become much more accommodating to the concept of freelancers and contractors can set up their own businesses to render services to other companies. For example, both Twofour54, a media and entertainment free zone in Abu Dhabi, as well as the Dubai Creative Clusters (formally known as TECOM) free zone in Dubai, accommodate freelancer arrangements and have numerous freelancers available for hire who are registered through their databases. Work outside of the free zone is not permitted and as such, there is a limit as to how far this approach can be adopted within other free zones or onshore.

Currently, given the above restrictions, the ability of residents to work flexibly in the UAE remains challenging.

However, it is clear that the UAE is accommodating greater flexibility and the trend of flexible working is increasing. As a further example, the Ministry of Human Resources and Emiratisation has now established a part-time working regime whereby certain skilled employees are able to work part time for up to two employers. The individual would require a temporary work permit specifically for part-time jobs, and consent of both companies in order to do so.

With employers looking to cut down on permanent employees but retain the flexibility to access certain services when required, flexible working would open up the employer's ability to access a more substantial pool of labour without incurring the same risk and financial exposure associated with hiring full-time employees. Such trends are going to inevitably increase and we are likely to see a parallel development of the gig economy in the UAE as legislative concessions continue in the years ahead.



SOCIAL MEDIA CAMPAIGNS AND INFLUENCERS: KNOW THE LAW

Martin Hayward
Head of Digital & Data
m.hayward@tamimi.com

Charlotte Sutcliffe
Associate
Digital & Data
c.sutcliffe@tamimi.com

The rise of social media across the past decade has had a significant effect on the way that brands interact with consumers. Not only is social media now taking a large percentage of global advertising budgets, it is providing an effective way for brands to communicate directly on a B2C level. With this rise of social media, we saw the introduction of a new type of brand ambassador – the social media influencer.

All of this occurred under the umbrella of media and advertising laws that were not always designed to deal with the way that the new media operated. Governments globally are reacting accordingly, and brands need to stay agile and keep up to date with new rules and regulations on a regular basis.

So what are the rules covering social media advertising and the use of influencers in the United Arab Emirates?

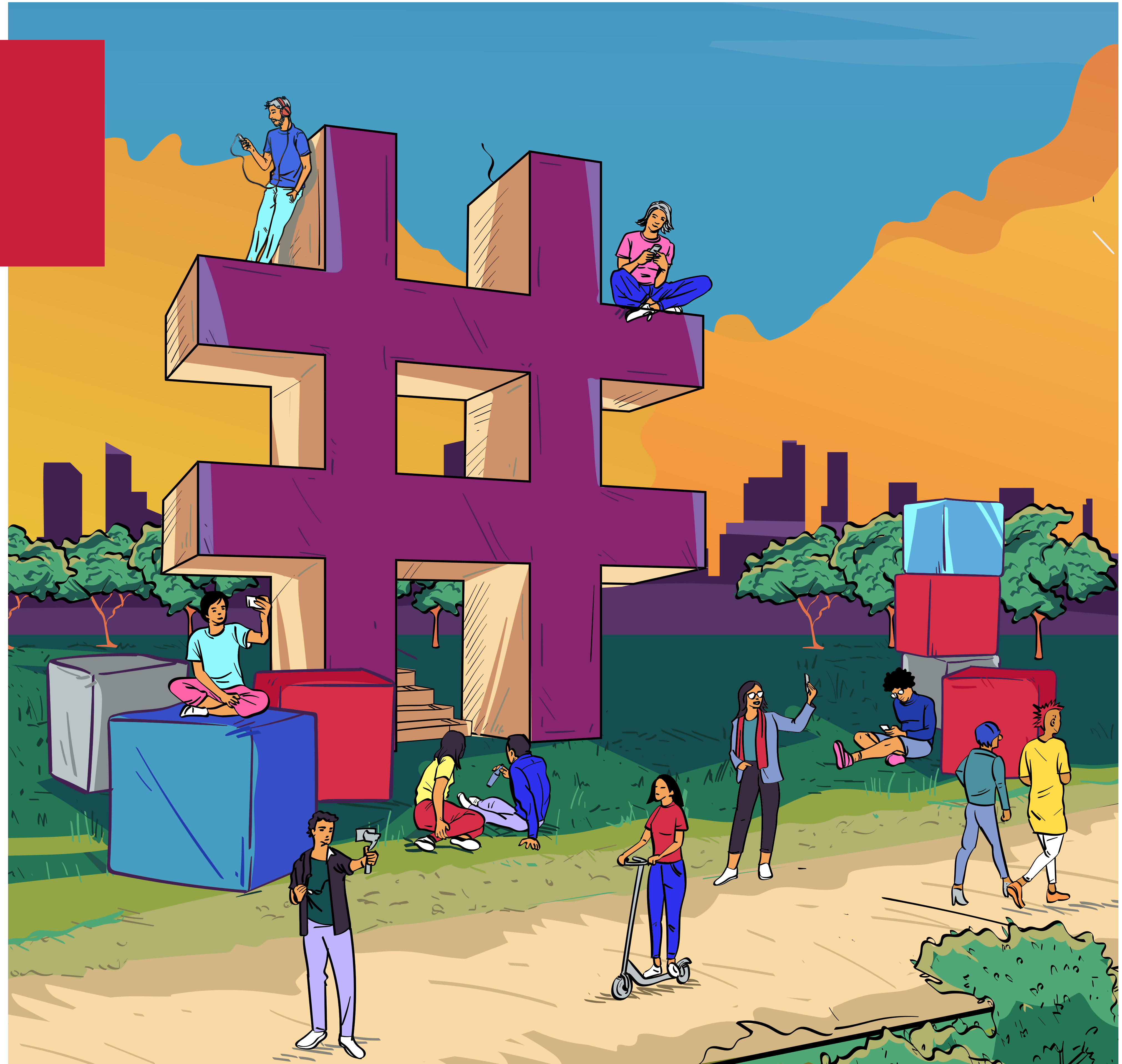
Content rules generally

These rules are found across a few sources, most of which are directed towards media and advertising generally. The source of the law is a 1980 law - Federal Law No. 15 Of 1980 Governing Publications and Publishing ("PPL"). The PPL contains the basics of content regulation despite it being passed about 15 years before the internet became commonly used.

To address the issues, and to confirm the position in relation to content guidelines in particular, the UAE passed Cabinet Resolution No. (23) of 2017 Concerning Media Content ("2017 Cab Res"). That Cabinet Resolution gave the National Media Council the right to pass further regulation in the area, and they then passed the Chairman of the Board's Resolution No. (26) of 2017 on Media Content ("2017 NMC Res"). This added much more detail to the 2017 Cab Res. Pertinently, it includes a lengthy description of the sort of content that is prohibited in the UAE (Article 5) and these restrictions applies to both content and advertising. It is important to note that these two Resolutions are media agnostic – they apply equally to all media.

Influencers in Social Media

2018's Electronic Media Activity Regulation Resolution was passed to address the issue of media



outlets bypassing the 1980 PPL and distributing media content online without a licence form the National Media Council ("NMC"). However, as part of the 2018 E-Media Res, the NMC included a licensing regime which would apply to influencers. Specially, and very clearly, it states "Social Media accounts' owners who offer paid advertising services shall obtain a license from the National Media Council."

This 2018 Res notes specifically that the owner of such sites are subject to compliance with all media and advertising standards – a position that is not surprising given the broad application of the 2017 Cab Res and the 2017 NMC Res.

An initial flurry of press about this issue has calmed down with agencies being permitted to arrange licences for multiple influencer clients. This created a new industry in town – specialised influencer agencies.

How Do Consumers Know It's an Ad?

Globally there is a strong move towards including clear declarations that advertising is in fact advertising, in an effort to ensure there is no consumer confusion. This government concern pre-dates the rise of social media – magazines, radio and television have all been subject to similar requirements over the years.

In the UAE, Article 19 of the 2017 Cab Res states: "All paid advertising material must be explicitly and clearly stated as paid advertising material." The 2017 NMC Res adds a little more to this in Article (43): "All paid advertising materials or items shall include a clear and candid indication that they are paid advertising materials or items." This applies to all advertising in all media, including social media. On a strict interpretation of the law, a Facebook page for a brand should clearly state that it is advertising. In practice this is not always occurring, with brand utilising alibi pages, for example, or otherwise assuming consumers will understand the advertorial style of the pages.

Article (45) (7) does add further complication for such practices. It states that "the identity of the advertisement must be made clear and be presented as they are special and independent from the other advertising and editing materials or items, and borders must be placed to be separate such advertisement from any other material or item as well as intervals or time breaks in case of TV and radio broadcasting." Again, it is not a simple matter to properly analyse social media pages for compliance with this requirement.

To try and clear up this ambiguity, particularly in relation to influencers, the government issued a Guideline for Advertising late in 2018. The Guidelines, aside from providing a neat summary of laws applicable to advertising, do also contain the following list of special conditions for social media. Key points include the use of the hashtag "#ad" or "#paid_ad" for disclosure – "thank you to …" or "in cooperation with…" are not sufficient. These hashtags must be legible and easy to find – readers should not have to scroll down to find them. Video content must include a verbal reference to the disclosure within the video.

> "With the rise of social media, we saw the introduction of a new type of brand ambassador – the social media influencer."

When Does an Influencer Have to Disclose?

Any licensed influencer who presents advertising must comply with the advertising standards, which would of course include the above disclosure regime. Interestingly though, the definition of "Electronic Advertising" does actually include unpaid presentations though: "Any paid or unpaid form of presentation or promotion of ideas, goods or services by electronic means or network applications."

Our view is therefore that, on strict interpretation, all advertising whether paid or unpaid should include a disclosure.

From a brand perspective, it is interesting to note that the 2018 E-Media Res does state that the account owner is responsible for the content. We have not yet seen brands being sent notices about influencer content, but we are still in the early stages of the implementation of this resolution.

Other Common Issues

We regularly see brands making an assessment of the content standards and general sensibilities of the UAE from their home countries. This often results in content that either insults the market or overly conservative content. Similarly, influencers themselves cannot be depended on to provide a compliant assessment of the market or to know the governments 'hot button' issues.

It is also interesting to note that influencers are still steadfastly ignoring the guidelines, and omitting "#ad" or "#paid_ad" from social media posts that are clearly paid advertising. However, many brands are allowing this to continue, seeking high interaction numbers from these campaigns. Ultimately, the NMC will choose to take action which will inevitably result in a significant amount of PR for the matter. Compliance with the laws, with contracts with influencers clearly requiring that compliance, will become an essential part of doing business in this sector of the marketing industry.

IMPACT OF GDPR AND MENA DATA PROTECTION LAWS ON COMPANY VALUATIONS

Haroun Khwaja
Senior Counsel
Digital & Data

Value of data v. Risk of breach

Data is fast becoming one of the most important assets for most businesses and nations. More and more companies are increasingly reliant on data in pursuing business objectives ranging from driving internal automation and digital transformation to improving algorithms used in customer facing applications. Data is frequently hailed as the new oil, with companies and even some governments seeking to claim ownership to it (despite it arguably being a personal asset which belongs to the individual to whom the data relates). However, what sometimes seems to be missed is that data, much like oil (to take the analogy of oil spills), is a double edged sword; whilst it promises to be a key driver of innovation and new source of wealth, if handled without care, it can also turn out to be the cause of significant financial and reputational damage to the guardians and beneficiaries of such data (particularly in the case of personal data). Take for example, the data scandal that engulfed Facebook and Cambridge Analytica (a British political consulting firm). Facebook's market capital valuation dropped by USD 35 billion and customer mistrust took hold, shortly after news of the data breach broke out. Cambridge Analytica had, without consent, harvested and used the personal data of approximately 50 million Facebook profiles for political advertising purposes. Only a few months later, CNBC reported that Facebook posted another USD 120 billion drop in its market valuation after missing analysts' projections on key valuation metrics such as revenue and advertising figures (which one may reasonably speculate to have been attributable to the Cambridge Analytica incident), and shortly thereafter Facebook lost roughly 3 million daily users in the EU following the introduction of the General Data Protection Regulation ('GDPR').

GDPR's limited impact on MENA entities

In the last year or so, more and more companies in the MENA region began to take notice of data protection compliance largely due to the extraterritorial application of the GDPR and the associated hefty penalties it imposes for non-compliance. The penalties under the GDPR range up to EUR 20 million or four per cent (whichever is higher) of an entity's total worldwide annual turnover in respect of the previous financial year. Up until more recently, data protection compliance was largely a concern for MENA based companies that offered goods or services to, or monitored the behaviour of, persons in the EU (particularly start-ups, e-commerce platforms and other tech enabled companies that handle large volumes of personal data in the course of their business).

Proliferation of regional data protection laws – a complex compliance challenge for all

With the surge in local data protection laws in the region, with some already in place and others revised to align more closely with the GDPR (for example the UAE's Dubai International Financial Centre (DIFC), Lebanon, Morocco, Qatar and Tunisia), newly enacted ones (for example Bahrain and Egypt) and others expected to be introduced in the near future (for example the UAE (onshore) and KSA), data protection compliance has become crucial for all entities processing personal data in the region (and no longer only those providing goods or services to, or monitoring the behaviour of, individuals in the EU).

As such, there is an increasingly complex data protection landscape, both across and within jurisdictions in the region, that entities will need to navigate. For instance, although the UAE does not currently have a comprehensive modern data protection law, it does have provisions relating to privacy in a number of federal laws. Examples include the Penal Code, the Telecommunications Law and the Anti-Cyber Crime Law (which all carry criminal penalties), sector specific data protection provisions (such as the Dubai HealthCare City Authority's regulations on the retention, use, disclosure and transfer of patient health data) as well as data protection laws that are specific to the financial free zones (namely, the Dubai International Financial Centre and the Abu Dhabi Global Market). It remains to be seen if the anticipated UAE federal data protection law (if and when enacted) will override the existing privacy related laws, and if not, how it will interact with them. In particular, it will be interesting to see whether personal data can be transferred between the mainland and the various free zones.

Obligation to comply with multiple federal laws

Although most of the national data protection regimes share, to some degree, similar concepts and principles (such as the lawful bases available for the processing of personal data, restrictions on transfer of personal data abroad, breach notification requirements etc.), significant differences exist. An example would be the differing timeframes under the various national laws within which individuals and the relevant regulator are to be notified in the event of a personal data breach. If a company or organisation with operations in multiple countries were to suffer a personal data breach, it would have to notify the regulator and the affected data subjects in the relevant jurisdictions in accordance with the breach notification requirements (if any) in each of those jurisdictions. To illustrate this further, an Egyptian company with operations in both Egypt and Qatar, would have to comply with both the Egyptian Data Protection Law and the Qatari Data Protection Law (in respect of personal data of individuals in Qatar). So, if a data breach were to occur affecting individuals in both countries, the company would need to notify the Egyptian Personal Data Protection Centre within 72 hours from the time of the breach, and data subjects to be notified within 3 days (from the time the Personal Data Protection Centre is notified). Additionally, the company would need to notify the Qatar data protection authority, however given no such timeframe is specified, it would be reasonable to expect that such notification should be made without undue delay.

> "It is important to note that an entity's compliance with its obligations under the laws of one jurisdiction, will not excuse it from having to comply with the laws of another jurisdiction that also applies to it (for example by virtue of the company's processing of personal data relating to that country as well)."

It is important to note that an entity's compliance with its obligations under the laws of one jurisdiction, will not excuse it from having to comply with the laws of another jurisdiction that also applies to it (for example by virtue of the company's processing of personal data relating to that country as well). That is, an entity's obligations to comply with more than one federal law in such a scenario, exists in parallel, and is not mutually exclusive.

Consequently, companies with international operations, will need to ensure their regional or global compliance programme is tailored to manage their compliance obligations with each of the national laws having regard to the legislative disparities and local nuances. Having said that, the majority of these regional laws have been drafted with the GDPR (or its predecessor EU Directive in mind). As such, entities that are already GDPR compliant have a solid foundation, and need only adjust their compliance activities in each jurisdiction to account for the obligations that are different to, or more onerous than the GDPR.

Increasing focus at board level

For the reasons noted above, there has been increasing focus at a board level in the EU, Australia, Brazil, Canada, Japan and certain States in the US (most notably California) on both internal compliance and the compliance status of potential target companies in a corporate transaction context. Consequently, some deals have been failing to close around the globe because of concerns in relation to the target's data protection compliance. This trend is likely to be more pronounced in the MENA region in this new era of proliferating modern data protection regimes.

It is also likely that data protection compliance will begin to receive heightened attention by the boards and management of entities throughout the region due to the fact that some of the regional data protection laws, for example the Bahrain Personal Data Protection Law and the Egyptian Data Protection Law, impose criminal penalties (in the form of imprisonment and/or fines) for breaches of various provisions that would typically be the subject of civil penalties under other modern data protection regimes. This raises the stakes for board members and management of entities in the MENA region.

Impact of compliance on profits and valuations

As is the case under the GDPR, regional data protection laws impose penalties (in some cases of a criminal nature as noted above) for non-compliance, and both listed and privately held companies face the possibility of reduced valuations (if potential acquirers were to determine, during the course of their due diligence activities, that the relevant target is not compliant with the data protection laws of one or more jurisdictions in which it operates, but the acquirer nevertheless elects to proceed with the deal).

If in such a case, the target cannot demonstrate (by way of its documentation, policies and technical and organisational measures) that it has been, is,

> **"Previously seen as a secondary concern in our region, there is a new emphasis placed on privacy compliance. Companies are exposed to both legal and severe reputational risks if they do not meet their obligations."**
>
> *-Haya Al-Barqawi*

and will be compliant going forward with its data protection obligations, the acquirer should seek a reduction in the purchase price and/or seek revisions to the share purchase agreement (for example by including appropriate indemnities to protect it against any potential financial penalties that may be imposed by regulator(s) and compensation claims that may be brought by individuals affected by a previous breach). Further, it is recommended that an additional 'buffer' be embedded into any price reduction so as to offset any costs that may also be incurred (separate to regulatory fines) post acquisition in remediating the operations of the target (for example the need to undertake more detailed assessments, implement appropriate technical and organisational measures, hire new resources such as a Data Protection Officer, and roll-out training across the organisation etc).

As noted above, given that some jurisdictions in the region impose criminal penalties for certain breaches, price reductions and indemnities will not provide adequate protection, which ultimately may result in deals that are not closed for fear that management and officers of the acquiring company may be held to account, although one would expect that authorities would be unlikely to sanction the new management for the violations of the previous administration.

DIGITAL SIGNATURES, THE LAW IN THE UAE

Andrew Fawcett
Senior Counsel
Digital & Data
a.fawcett@tamimi.com

What is a digital signature? How is it different from an electronic one? In a world where new technological solutions materialize on daily basis, users often find themselves confused by the number of options at their disposal, also confused if those solutions are regulated by domestic laws or not.

Understanding the difference between digital signature and electronic signature is important to know how far they are regulated.

History of Signatures

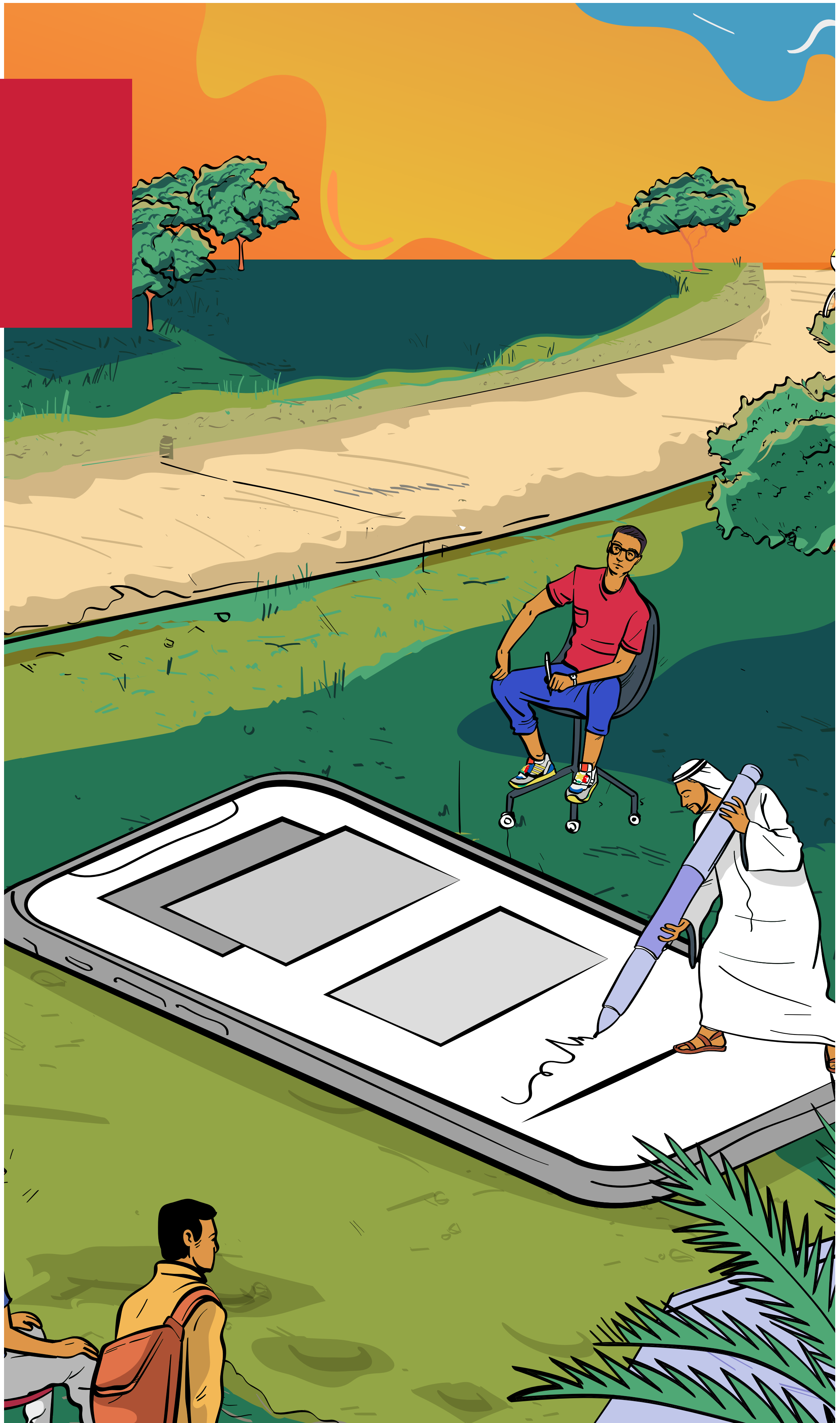
A look back at the changing face of the signature from the distant past right through to present-day, how have signatures evolved throughout history?

1. Ancient Signature

- Romans were known to use signatures during the reign of Valentinian III around 439 AD, but it wasn't until 1069 that a signature from a well-known figure appears in the history books, that of nobleman and military leader "El Cid" from Medieval Spain.
- In 1677, the English Parliament passed the State of Frauds act that made the signature the everyday marker it is today. The new law stated contracts must be signed, a measure that during its time was an effective guarantee against fraud. By the time John Hancock signed America's Declaration of Independence in 1776 the signature was a binding contract and used widely around the world.

2. Modern Signature

- Fast forward to the 1980s and technology was already rapidly changing the role of the signature. The rise of the fax machine meant more contracts were being scanned and sent electronically, and legislation in both the United States and United Kingdom changed to adopt this shift.
- In 1996 the United Nations Commission on International Trade Law (UNCITRAL) adopted the Model Law on Electronic Commerce, which was the first legislative text to adopt the fundamental principles of non-discrimination, technical neutrality and functional equivalence which are considered to be founding elements of modern electronic law. This was followed in 2001 by the UNCITRAL Model Law on Electronic Signatures which sought to enable and facilitate the use of electronic signatures by establishing criteria of technical reliability for the equivalence between electronic and hand -written signatures. These UNICTRAL Model law have been the basis for enactments of electronic signatures laws of many states.
- The EU regulation on Electronic Identification, Authentication and Trust Services (eIDAS) which oversees electronic identification and trust services for electronic transactions in the EU's internal market entered into force in 2014 (and applied from 1 July 2016). EIDAS has created standards for which electronic signatures, qualified digital certificates and other proof for authentication mechanisms enable electronic with the same legal standing as transaction that are performed in hard copy.
- In 2002, Emirate of Dubai issued the Electronic Transactions and Commerce Dubai Law No. (2) of 2002.
- In 2006, The United Arab Emirates issued the Federal Law No. (1) of 2006 Concerning E-transactions and e-commerce.
- Besides, The Federal Law No. (36) of 2006 has been issued to amend Federal Law No. (10) of 1992 The Law of Evidence in Civil and Commercial Transactions by adding Article (17-bis), which give the electronic signature the same probative force given to the signature.



Is there a difference between electronic signature and digital signature?

Very generally, 'electronic signature' is a broad term referring to any electronic process that indicates acceptance or approval of an agreement or a record. An electronic signature would encompass a simple digital scan of a 'wet signature' through to a much more sophisticated authentication mechanism. A 'digital signature' is one specific type electronic signature.

Typical electronic signature solutions use common electronic authentication methods to verify signer identity (e.g. as an email address, a corporate ID, or a phone PIN). If increased security is needed, multifactor authentication may be used.

Digital signatures use certificate-based digital identifiers (generated and authenticated by public key encryption) to authenticate signer identity and demonstrate proof of signing by binding each signature to the document with encryption. Validation occurs through trusted certificate authorities or trust service providers.

Digital signatures, like handwritten signatures, are unique to each signer. Digital signature solution providers currently follow a specific protocol, called PKI (Public Key Infrastructure). PKI requires the provider to use a mathematical algorithm to generate two long numbers, called keys. One key is public, and one key is private.

When a signer electronically signs a document, the signature is created using the signer's private key, which is always securely kept by the signer. The mathematical algorithm acts like a cipher, creating data matching the signed document, called a hash, and encrypting that data. The resulting encrypted data is the digital signature. The signature is also marked with the time that the document was signed. If the document changes after signing, the digital signature is invalidated.

Digital signatures has sophisticated and complex encryptions which does not allow for any kind of manipulating with the signed documents.

In brief, all digital signatures are electronic, but not all electronic signature are digital.

The UAE Regulations:

Back to regulation developments in UAE concerning electronic signatures:

Federal Law No. (1) of 2006 Concerning E-transactions and E-commerce ("ETL"), defines Electronic Signature as:

Any letters, numbers, symbols, voice or processing system in Electronic form applied to, incorporated in, or logically associated with an electronic message with the intention of authenticating or approving the same.

Under the ETL a person may rely on an Electronic Signature to the extent that such reliance is reasonable. In determining whether it is reasonable for a person to have relied on an Electronic Signature regard must be given, if appropriate, to the following (see Article 18 of ETL):

- The nature of the underlying transaction which was intended to be supported by the Electronic Signature;
- The value or importance of the underlying transaction, if this is known;
- Whether the relying party in respect of the Electronic Signature has taken appropriate steps to determine the reliability of the Electronic Signature;
- Whether the relying party in respect of the Electronic Signature took reasonable steps to verify if the Electronic Signature was supported by an Electronic Attestation Certificate, or if it should be expected to be so supported;
- Whether the relying party in respect of the Electronic Signature knew or ought to have known that the Electronic Signature had been compromised or Any agreement or course of dealing between the originator (i.e. the person by whom, or on whose behalf, the data message containing the Electronic Signature is sent) and the relying party, or any trade usage which may be applicable; and
- Any other relevant factors.

In practical terms, when considering how best to implement electronic signatures it is recommended to use a solution that is likely to meet as many of these Article 18 criteria as possible.

The ETL expressly contemplates the use of digital signatures.

An Electronic Attestation Certificate is defined under the ETL as a certificate issued by a Certification Services Provider confirming the identity of the person or entity holding an Electronic Signature creation tool.

A "Certification Service Provider ("CSP") is defined as an accredited or authorized person or organization that issues Electronic Attestation Certificates, or provides other services in this regard. A Certification Service Provider is required to be licensed by / registered with the Telecom Regulatory Authority ("TRA"), and the current process contemplates a licensing system for local entities wishing to be recognized as CSPs under the Electronic Transactions Law, and a registration system for foreign entities wishing to be recognized under the law.

Presently, CSPs registered with the TRA include: Adobe, Lleida, Palaxo, Ascertia, First Abu Dhabi Bank, Digital Trust and Docusign.

> **"We are seeing a real uptick in demand for digital signatures and are thrilled to see rapid adoption in the legal industry where physical closings were a staple. Led by the impact of COVID-19, mentalities are changing."**
>
> *-Daniel Sterling*

Accordingly, using a CSP's electronic signature and digital certification solution will enhance the reliability of an electronic signature under the ETL.

The ETL also provides for a "Secure Electronic Signature" An Electronic Signature will be treated as a Secure Electronic Signature, if, through the application of a prescribed or commercially reasonable Secure Authentication Procedures agreed to by the parties, it can be verified that an Electronic Signature was, at the time it was made:

- Limited to the person using it;
- Capable of verifying the identity of that person;
- Under that person's full control, whether in relation to its creation or the means of using it at the time of signing; and
- Linked to the electronic message to which it relates, in a manner which provides reliable provides reliable assurance as to the integrity of the Electronic Signature.

In the absence of proof to the contrary, reliance on a Secure Electronic Signature Electronic Signature is presumed to be reasonable under the Electronic Transaction Law (and that the Secure Electronic Signature is the signature of the person to whom it relates).

"Secure Authentication Procedures" are procedures aimed at verifying that an electronic message is that of a specific person and detecting error or alteration in the message, content or storage of an electronic message or Electronic Record since a specific point in time, which may require the use of algorithms or codes, identifying words or numbers, encryption, answerback or acknowledgement procedures, or similar information security devices.

In order to determine whether a Secure Authentication Procedures are commercially reasonable, such procedures shall be considered in the commercial circumstances at the time of use thereof, including:

- The nature of the transaction;
- The experience and skill of the parties;
- The scope of similar transactions conducted by either or both parties;
- The presence and cost of alternative procedures;
- Generally used procedures in similar types of transactions.

It is important to understand that the ETL does not expressly deem that having an Electronic Signature supported by an Electronic Attestation Certificate issued by CSP to be a Secure Electronic Signature.

While it may well be that having an Electronic Attestation Certificate issued by CSP will be a Secure Authentication Procedure, it remains open under the ETL for it to be determined in a particular case if it is a commercially reasonable Secure Authentication Procedure.

It is also important to understand that not all the electronic signature solutions offered by licensed CSPs in the UAE are supported by qualified digital certificates that would mean that they would be considered equivalent to handwritten signatures under the EU eIDAS regulation. Accordingly, due diligence on what CSP, and more particularly, what solution is to be used, is recommended to get the maximum benefit of the UAE law.

Enhancing the reliability of the electronic signature solution is critical, as in assessing the evidential weight of electronic information, due regard will be paid by the Court (under Article 10 of the ETL) to the following:

- The extent of the reliability of the manner in which one or more of the operations of executing, entering, generating, processing, storing, presenting or communicating was carried out;
- The reliability of the manner in which the integrity of the information was maintained;
- The extent of reliability of the source of information, if identifiable;
- The extent of reliability of the manner in which the identity of the originator, if relevant, was ascertained; and
- Any other relevant factor.

Finally, it is important to recognise that Article 6 of the Electronic Transactions Law provides that nothing in the ETL requires a person to use or accept information in Electronic form, but a person's agreement to do so may be inferred from the person's affirmative conduct.

Consequently, it is recommended that a contracting party wishing to rely on an electronic signature, incorporates specific reference to the use of a particular electronic signature solution in the contract documentation, so that there will be less likelihood that another party can challenge the use and reliability of the electronic signature. A Court should also recognise that the parties had agreed that the use of electronic signatures, and that a particular electronic signature solution provider is reliable.

> "In the absence of proof to the contrary, reliance on a Secure Electronic Signature is presumed to be reasonable under the Electronic Transaction Law."

Conclusion

While the ETL refers to "electronic signatures" only, the provisions in the law for electronic signatures to be supported by electronic attestation certificates issued by CSPs and secure electronic signatures that use secure authentication procedures actually contemplates what have become more colloquially known as "digital signatures". Further the ETL indicates that digital signatures are the most reliable electronic signatures under that law.

That does not mean that use of digital signatures is necessary in every case. As discussed above, under the ETL reliability (and presumptions of reliability) is determined through a number of factors including the nature and value of the underlying transaction and commercial reasonableness. So for a low risk and low value transaction a simple electronic signature can be viable.

The enhanced reliability afforded to digital signatures under the ETL does not mean that simple electronic signatures are not reliable. It simply means that if reliability of an Electronic Signature were challenged in Court, the party relying on that signature will need to establish it is reasonable for them to have done so in the particular case.

While the ETL has been in force since 2006, the uptake of electronic signature solutions (particularly CSP solutions or digital signatures) had not been widespread in the UAE. However, the current COVID-19 circumstances, and the need to undertake transactions remotely, has significantly increased the usage of electronic signatures, and the Courts will be required to have a greater understanding of electronic signatures and digital signatures and their reliability. In addition, we understand that there are likely to be changes to the laws to further support the use of electronic signatures and digital signatures.

FINTECH FOCUS

As one of the most experienced law firms dealing with financial services regulation and transactions in the region, we have played a significant role in advising multiple international and regional players on their plans to launch fintech businesses and solutions throughout the Middle East.

The vast array of technologies, solutions and business models comprising this rapidly emerging sector extend across all mechanisms by which individuals and institutions access financial services, whether as investors, lenders or consumers. The greatest challenge facing the fintech ecosystem globally has been that regulation across the globe has been unable to keep pace with the speed at which technology solutions are disrupting the traditional financial services ecosystem.

Throughout the evolution of the fintech ecosystem, we have been advising clients on the regulatory challenges that face them as they disrupt or enable financial businesses to launch, operate and commercialise financial technology solutions. These have included financial institutions or global fintech operators with operations across multiple jurisdictions to emerging companies launching businesses in a single jurisdiction to venture capital or private equity funds looking to deploy capital into the fintech category and also to issuers and advisers working on the emerging asset classes within the crypto and blockchain domains.

In this Fintech Focus section of this publication, we take a quick look at some of the trends and developments in three of our key jurisdictions.

FINTECH IN THE UNITED ARAB EMIRATES

Divya Abrol
Partner
Banking & Finance
d.abrol@tamimi.com

Ashish Banga
Senior Associate
Banking & Finance
a.banga@tamimi.com

The UAE, including the Abu Dhabi Global Market ("ADGM") and the Dubai International Financial Centre ("DIFC"), continues to be actively involved in the development of the financial technology ecosystem within the MENA region particularly in respect of cryptoassets (otherwise described as 'virtual assets'), the regulatory laboratories and testing licenses, financial technology licensing, digital banking and crowdfunding.

Given the broad scope of the subject, this article focuses on areas of cryptoassets, the associated regulatory 'laboratories' and the testing licenses.

Cryptoassets, Virtual Assets and Initial Coin Offerings ("ICOs") and the Central Bank and Securities and Commodities Authority ("SCA")

There are currently no formal regulations on cryptoassets or ICOs onshore in the UAE. There have been several press releases and statements issued by the UAE Central Bank confirming that it does not approve any private cryptocurrencies or schemes and has not issued any licenses in the UAE. However, no formal notification or guidelines have been issued by the Central Bank in this regard.

Initially the UAE SCA issued a public warning statement, in February 2018, on ICOs reiterating that the SCA does not regulate, mandate, or recognise any ICOs. The statement also highlighted the risks associated with investments in ICOs. This was followed by an announcement, later that year, indicating the SCA's intention to regulate ICOs and recognise digital tokens as securities.

Taking a step further, the SCA, in October 2019, issued draft regulations relating to cryptoassets. The SCA invited feedback from various market players regarding these regulations. The draft regulations primarily dealt with token issuance requirements, trading and safekeeping practices with an emphasis on protecting investor interests, financial crime prevention measures, cryptoasset safekeeping standards, information security controls, technology governance norms and conduct of business requirements for all market intermediaries.

In the midst of these developments, the Dubai Multi Commodities Centre ("DMCC"), one of the free zones in the UAE, issued licenses for conducting 'proprietary trading in cryptocommodities'. Activities of the entities holding such licenses are limited to trading in cryptoassets for and on their own behalf.

Dubai Financial Services Authority ("DFSA")

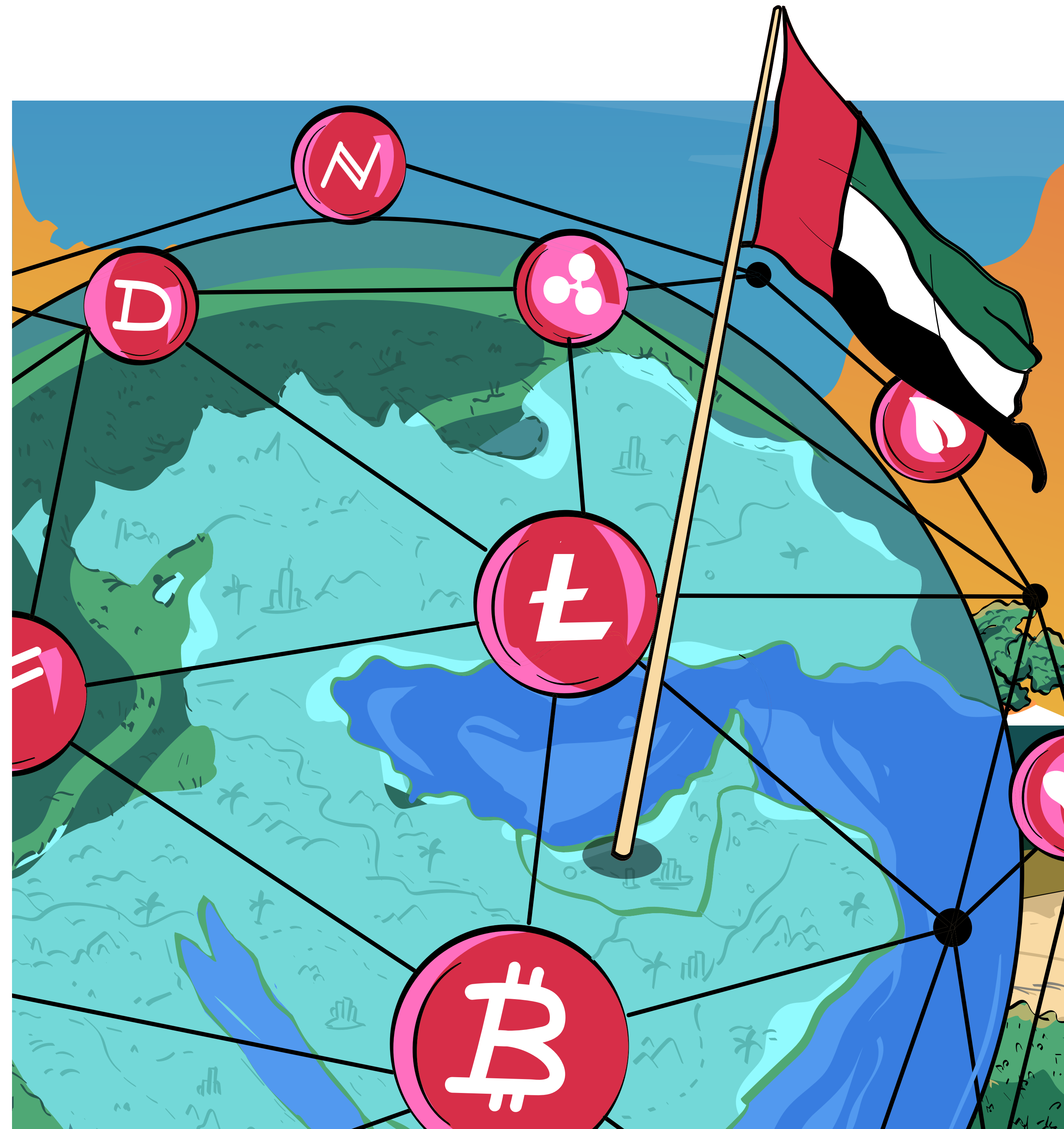
Similar to the onshore position, there are no laws or regulations around cryptoassets in the DIFC. In 2017, DFSA issued a statement highlighting that the issuance and offering of cryptoassets and the systems and technology that support them are complex and therefore have a high risk associated with them. In said statement, it was confirmed that it does not regulate product offerings in connection with cryptoassets and also that it would not license firms undertaking such activities. There has been no change in this position since then.

Financial Services Regulatory Authority ("FSRA")

Taking a lead on the regulation of cryptoassets in the ADGM, in June 2018 the FSRA issued guidance on conducting cryptoasset activities and accordingly amended the relevant financial regulations applicable to ADGM. This guidance was supplementary to, and is to be read in conjunction with, the FSRA's earlier guidance on the regulation of ICOs, token offerings and virtual currencies issued in October 2017.

These guidelines were supported by an additional guidance 'Regulation of Digital Security Offerings and Cryptoassets under the Financial Services and Markets Regulations' and 'Cryptoasset Activities' both of which were issued by the FSRA earlier in 2019.

In February 2020, FSRA issued further guidelines amending the existing guidelines around crypto assets, ICOs and digital securities introducing the following changes: (a) replacing the term



'Crypto Asset' with 'Virtual Asset', in order to align the terminology with that of the Financial Action Task Force,the inter-governmental body established to set standards and promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and related threats to the integrity of the international financial system; (b) amending the existing regulations and guidelines to move from a bespoke regulated activity of 'Operating Crypto Asset Business' to dealing in virtual assets within the scope of the underlying regulated activity (e.g. providing custody, operating a multilateral trading facility, dealing in investments, etc.) ("Virtual Asset Guidance"); (c) updating regulation of digital security offerings and virtual assets under the Financial Services and Market Regulations 2015 ("ICO Guidance"); and (d) regulating digital securities activity in ADGM ("Digital Securities Guidance").

Similar to the previously issued cryptoasset guidance, the Virtual Asset Guidance applies to: (a) applicants intending to carry on a regulated activity in relation to virtual assets in or from the ADGM; (b) licensed entities conducting a regulated activity in relation to virtual assets in or from the ADGM; (c) recognised investment exchanges with a stipulation on its recognition order permitting it to carry on the regulated activity of operating a multilateral trading facility (in relation to Virtual Assets) within ADGM; and (d) applicants and licensed entities in respect of the use of stablecoins in or from the ADGM.

The ICO Guidance is applicable to those considering the use of ICOs to raise funds including those considering transacting in, and the general use of, virtual tokens and virtual assets. Whereas, the Digital Securities Guidance sets out the FSRA's approach to the regulation of use of or using, digital securities within ADGM including activities undertaken by recognised investment exchanges, multilateral trading facilities, issuers, reporting entities, licensed entities conducting a regulated activity in relation to virtual assets and licensed entities providing custody or operating a private financing platform, amongst others.

Stablecoins are blockchain based tokens that are valued by reference to an underlying fiat currency or basket of assets. Typically, these are less volatile than typical virtual assets, which makes them a more lucrative option as a medium of transfer of value within the virtual asset domain. In addition to being a 'safe' store of value, the ability to liquidate a stablecoin to fiat currencies seems to be higher than virtual assets, therefore leading to a growing demand for such digital tokens.

"Whilst the Central Bank, the SCA, FSRA and DFSA have their own sets of laws, rules, regulations as well as guidelines for regulating fintech activities within their respective jurisdictions, efforts are being made to align the regulatory landscape and boost the overall development of the fintech ecosystem."

Testing Laboratories

Sandbox

Following the SCA's announcement in September 2018, indicating its intention to regulate ICOs and recognise digital tokens as securities, it also approved draft regulations setting the regulatory controls for the fintech sector in the form of a pilot regulatory environment (i.e. the sandbox) in order to enhance and support the financial integrity of financial technology companies.

The draft regulations explained Sandbox as a process-based framework that shall allow entities to test innovative products, services, solutions and business models in a relaxed regulatory environment, but within a defined space and duration. Under this framework, the SCA intends to work together with the participants to evaluate the innovative products, services, solutions or business models with a view to identifying legal and regulatory requirements which can potentially be relaxed or waived throughout the duration when the participants are within the Sandbox regulatory regime.

The SCA continues to discuss the said framework as well as the draft regulations with the relevant market players and is currently inviting comments on Sandbox controls from these players.

Fintech Hive accelerator

Similar to the SCA's proposed Sandbox regime, Fintech Hive is an accelerator programme of the DIFC aimed at encouraging technology entities that have a product or service offering that benefits the financial services sector or the digital space. The programme allows fintechs, insurtechs, regtechs and Islamic fintechs, an opportunity to develop, test and adapt their technologies in the DIFC, in collaboration with top executives from the DIFC and regional established financial institutions.

To the extent applicants intend to provide innovative solutions in the financial services sector, the DFSA offers an innovation testing licence to such applicants. This restricted financial services licence allows qualifying applicants (i.e. participants) to develop and test innovative concepts from within the DIFC, without being subjected to all the regulatory requirements that normally apply to regulated firms. In order to determine the level of restriction and support the DFSA works with the participants to understand the business proposal and establish the appropriate controls for the safety of clients (if any) involved, on a case-by-case basis.

The validity of such a licence typically ranges from a period of six to twelve months, during which the participants are expected to complete the testing and development of the solution. At the end of the prescribed period, if the participant meets

the outcomes detailed in the regulatory test plan, it can opt for migration to full authorisation. If it does not meet the outcomes, the participant will be required to cease activities within the accelerator programme.

RegLab

The ADGM RegLab is a regulatory framework introduced by the FSRA to provide a controlled environment to fintech participants to develop and test innovative solutions.

The FSRA offers licenses for developing financial technology services within the RegLab. Such a licence permits the participants to develop and test innovative fintech services, business models and delivery mechanisms. Similar to the DFSA model, in order to facilitate such development and testing, FSRA assesses the risks posed in each fintech participant's business model and accordingly tailors a set of appropriate regulatory controls on a specific, case-by-case basis. These regulatory controls are less onerous than those applicable to regulated entities in general in the ADGM. The tailoring of regulatory controls is usually subject to restrictions regarding the scope and scale of the test activities in order to mitigate the associated risks and impact.

The licence is typically valid for a period of two years, during which the participants are expected to successfully develop and test their fintech solution, to a point it can be commercially launched. Similar to the DFSA approach, at the end of the testing period, the participant is provided an option to migrate to a full licence, if the trial is successfully completed and the innovation is ready to be commercially launched. However, if this is not the case, the participant is required to cease its activities in the ADGM and exit the RegLab.

"The UAE, including the Abu Dhabi Global Market ("ADGM") and the Dubai International Financial Centre ("DIFC"), continues to be actively involved in the development of the financial technology ecosystem within the MENA region."

Conclusion

Whilst the Central Bank, the SCA, FSRA and DFSA have their own sets of laws, rules, regulations as well as guidelines for regulating fintech activities within their respective jurisdictions, efforts are being made to align the regulatory landscape and boost the overall development of the fintech ecosystem.

These jurisdictions do not provide for any passporting arrangements. Accordingly, the fintech participants will have to limit their activities within the jurisdiction in which they are incorporated and would therefore require additional licensing for conducting activities in other jurisdictions.

FINTECH IN THE KINGDOM OF BAHRAIN

Natalia Kumar
Senior Associate
Banking & Finance
n.kumar@tamimi.com

Gargi Agarwal
Trainee Lawyer
Banking & Finance
g.agarwal@tamimi.com

Introduction

The legal and regulatory landscape in the financial sector in Bahrain and the wider Middle East has continued to see a period of change and reform over the past year. In line with international best practice, regulators have continued their pursuit towards liberalisation and modernisation of laws to enhance business opportunities for investors.

This articles looks back on some of the key financial services' legal and regulatory developments in the fintech sector of Bahrain.

Central Bank of Bahrain ("CBB") issues new regulations

In November 2018 the CBB issued regulations on open banking that apply to 'account information service providers' and 'payment initiation service providers' in Bahrain, thereby taking the lead in introducing open banking regulations in the MENA region. Open banking enables consumers' personal information to be shared between organisations in a standardised and secured manner as it obtains the explicit consent of consumers. Through the use of application programming interfaces, third party financial service providers can access the information efficiently and cost effectively thus enabling the development of innovative fintech solutions. The Open Banking Module is included in Volume 5 of the CBB Rulebook that governs ancillary service providers.

In January 2019, Bahrain become the first nation to enact the Model Law on Electronic Transferable Records globally, as developed by the United Nations Commission on International Trade Law. The Electronic Transferable Records Law which "introduces electronic transferable records that are functionally equivalent to commercial documents and instruments issued on paper, such as bills of lading, bills of exchange, cheques, promissory notes and warehouse receipts. These electronic documents allow the person who holds them to claim payment of a sum of money or delivery of certain goods, enabling the merger of the finance and logistics supply chains in a single data workflow." Additionally, Bahrain also updated its Electronic Communications and Transactions Law, which, among other things, provides for wider use of electronic communications in business.

In February 2019, the CBB issued regulations to govern and license 'regulated crypto-asset services' that include trading, dealing, advisory and portfolio management services in 'accepted crypto-assets' either as a principal, agent, custodian or as a crypto-asset exchange within or from Bahrain. Overseas domiciled/incorporated persons/ entities dealing in crypto-assets can obtain a licence and operate within Bahrain as an 'overseas crypto-asset service licence'. The Crypto Asset Module is included in Volume 6 of the CBB Rulebook that governs Capital Markets.

Additionally, in March 2019, the CBB issued directives on 'Digital Financial Advice', which is the provision of financial advice using technology (also commonly known as robo-advice or automated advice). Digital financial advice is subjected to a comprehensive governance and controls framework as the technology is based on algorithms and assumptions that translate consumer inputs into financial advice.

In March 2019, the CBB, in collaboration with the Information & eGovernment Authority and BENEFIT, also launched the first Electronic Know Your Customer ("eKYC") project in the Arab region. "The project is intended to provide an advanced state-of- the-art online platform and a database for financial institutions to authenticate the identities of their clients as well as validate their information before granting financial services. The project also aspires to help fintech companies that offer financial and banking products using online applications as well as facilitate the launch of their products and services.

"The PDPL, amongst other things, provides individuals with rights in relation to how their personal data is collected, processed and stored."

In August 2019, the CBB issued regulations on insurance aggregators (i.e. intermediaries with an insurance broker's licence who operate an online platform, whether hosted on an internet website or available as a smart device application which provides price comparisons and facilitates the purchase of insurance policies from several insurance licensees) enabling customers to find and choose insurance quotes from several insurance companies under a single electronic platform or mobile device application.

On 18 January 2019 and 1 August 2019, the Competition Law (Law No. 31 of 2018) and the Personal Data Protection Law (Law No. 30 of 2018) ("PDPL") respectively came into force. The PDPL, amongst other things, provides individuals with rights in relation to how their personal data is collected, processed and stored. It imposes new obligations on how businesses manage this, including but not limited to, ensuring that personal data is processed fairly, that data owners are notified of when their personal data is collected and processed and that data owners can exercise their rights directly with the businesses.

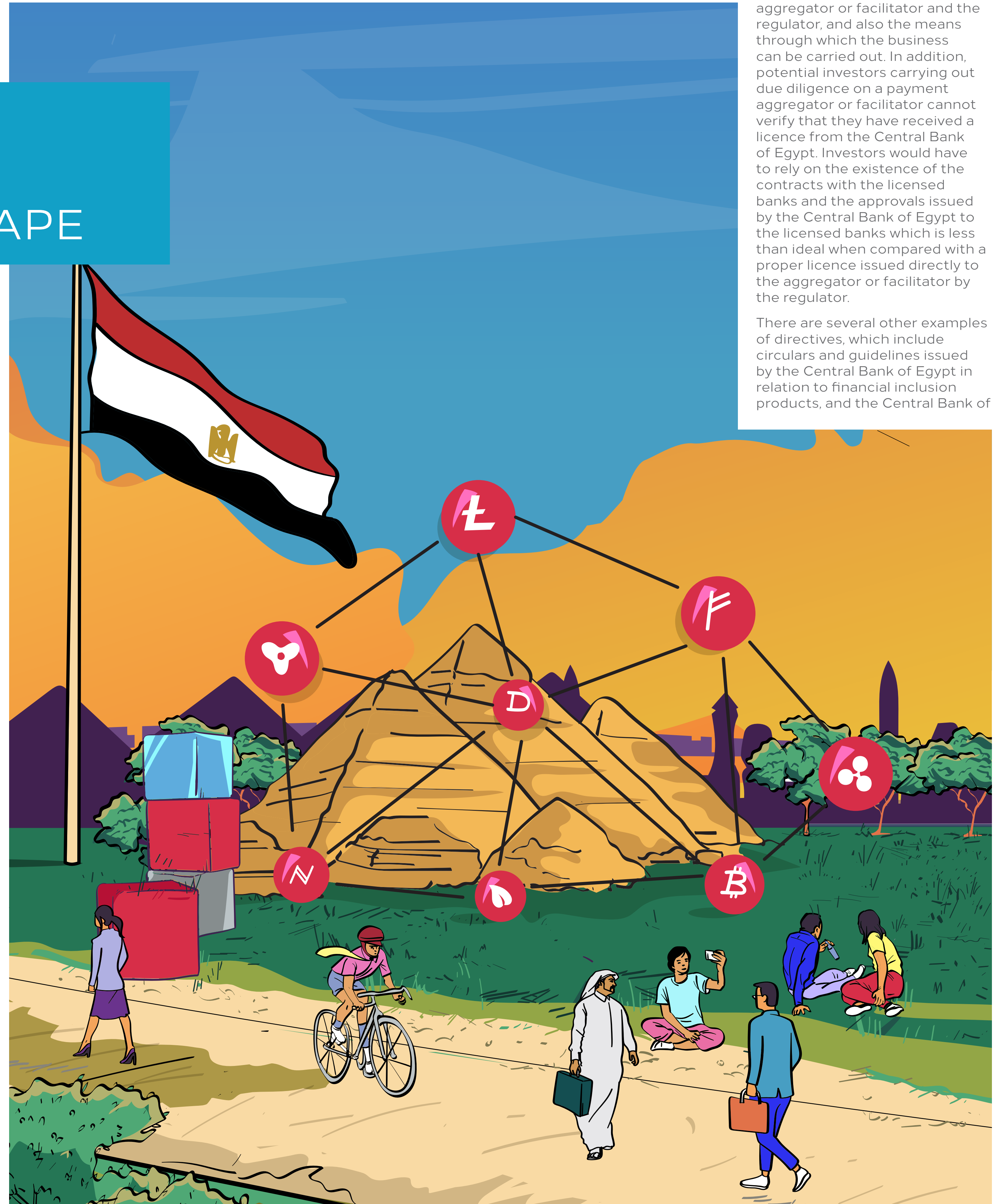
In October 2020, CBB in collaboration with Bahrain Economic Development Board, Bank ABC, ila Bank, BENEFIT, National Bank of Bahrain ("NBB") and Bahrain Islamic Bank ("BisB") has launched FinHub 973, a digital fintech lab with the aim of creating a collaborative ecosystem in the fintech sector by establishing a gateway for investment opportunities in the region, while fostering innovation and supporting integration between financial institutions and fintech start-ups. FinHub 973 will be powered by Fintech Galaxy's FinX22 platform, which is a cloud-based open innovation platform. The FinX22 platform will offer an open banking API sandbox that enables fintech start-ups to develop, test and deploy fintech solutions.

In conclusion, Bahrain's fintech success is a result of collective efforts to build a comprehensive ecosystem with new regulations and information. We anticipate that the fintech sector will continue to develop apace into the future.

FINTECH IN EGYPT: BE AWARE OF THE REGULATORY LANDSCAPE

Abdullah Mutawi
Partner, Head of Corporate Commercial
a.mutawi@tamimi.com

Ingy Darwish
Senior Associate
Corporate Commercial
i.darwish@tamimi.com



Investing in fintech in Egypt is very attractive because there is huge demand for disruptive payment and financial solutions. On the one hand, a very large segment of the population does not use traditional banking methods or is unbankable due to existing laws, regulations and rules. The result is a growing need for financial inclusion, something which is recognised by the Egyptian government and the Central Bank of Egypt. On the other hand, one of the outcomes of the recent macroeconomic reforms is that the lower income, reduced savings and purchasing power of a significant portion of Egyptian consumers, has created the need for different and more robust forms of financing.

However, there are several obstacles facing start-ups focusing on providing fintech solutions. The first key obstacle is cultural, as many Egyptians are reluctant to embrace non-traditional financial solutions and prefer transacting in cash and holding their savings in cash or in tangible assets. The other key obstacle is legal. On the legal and regulatory side, despite the growing interest from the Government of Egypt and the Central Bank of Egypt in launching initiatives to support and promote financial inclusion, there is still no clear legal or regulatory framework for entities operating in the fields of payment solutions or systems, payment services or financial technology.

To date, these entities are regulated by various directives issued by the Central Bank of Egypt which are addressed to licensed banks and contain instructions for these licensed banks (regulated by the Central Bank of Egypt) when dealing with such entities. For example, the Central Bank of Egypt issued guidelines to banks regulating their dealings with payment aggregators and payment facilitators. These guidelines include details outlining different procedures and requirements that must be complied with by banks when contracting with payment aggregators and facilitators. Subject to compliance with such procedures and requirements, the Central Bank of Egypt then permits the relevant bank to contract with the payment aggregator or facilitator. It should be noted that the required licence is issued to the relevant bank and not to the payment aggregator or facilitator. This creates a dependency on the banks, who necessarily operate as the interface between the aggregator or facilitator and the regulator, and also the means through which the business can be carried out. In addition, potential investors carrying out due diligence on a payment aggregator or facilitator cannot verify that they have received a licence from the Central Bank of Egypt. Investors would have to rely on the existence of the contracts with the licensed banks and the approvals issued by the Central Bank of Egypt to the licensed banks which is less than ideal when compared with a proper licence issued directly to the aggregator or facilitator by the regulator.

There are several other examples of directives, which include circulars and guidelines issued by the Central Bank of Egypt in relation to financial inclusion products, and the Central Bank of Egypt's directives regarding bank client rights. The latter includes elements regulating different aspects of electronic payment service providers and other financial technology service providers. The common aspect of these directives is that they are aimed at the banks licensed by the Central Bank of Egypt, being the channel through which the Central Bank of Egypt monitors and regulates payment solutions, systems and services, as well as financial technology.

Finally, the Government of Egypt recently approved the draft of a new banking law, which was submitted to the Egyptian House of Representatives but is yet to be passed. The draft includes a chapter addressing payment systems and services, and financial technology. It provides for the Central Bank of Egypt to directly license and regulate payment systems and payment service providers, as well as regulate different aspects of financial technology. The relevant chapter of the draft refers to detailed criteria and regulations being issued subject to decisions of the board of the Central Bank of Egypt. As this law has yet to be passed by the House of Representatives the detailed criteria and regulations will be issued in due course once the new law has been approved. Therefore, potential investors in start-ups or established businesses in the fintech sector are currently not able to assess whether those start-ups or businesses would be compliant with those criteria and/or whether they would be able to obtain the required licenses. Similarly, potential investors are currently not in a position to determine what the impact of complying with the new regulations would have on the business model of investee companies. This results in uncertainties around the stability and sustainability of a business, its growth potential and ultimately, its valuation.

THE CAIRO START-UP SCENE

Ingy Darwish
Senior Associate
Corporate Commercial
i.darwish@tamimi.com

According to start up platform Magnitt's 2019 MENA Venture Investment Report Egypt is the most active venture capital market in the MENA region in 2019 with 25 per cent of all transactions in the region, which also makes it one of the fastest growing start-up ecosystems in the world.

Many factors contribute to the continuous growth of the start-up sector in Egypt making it the hub for start-ups in the region.

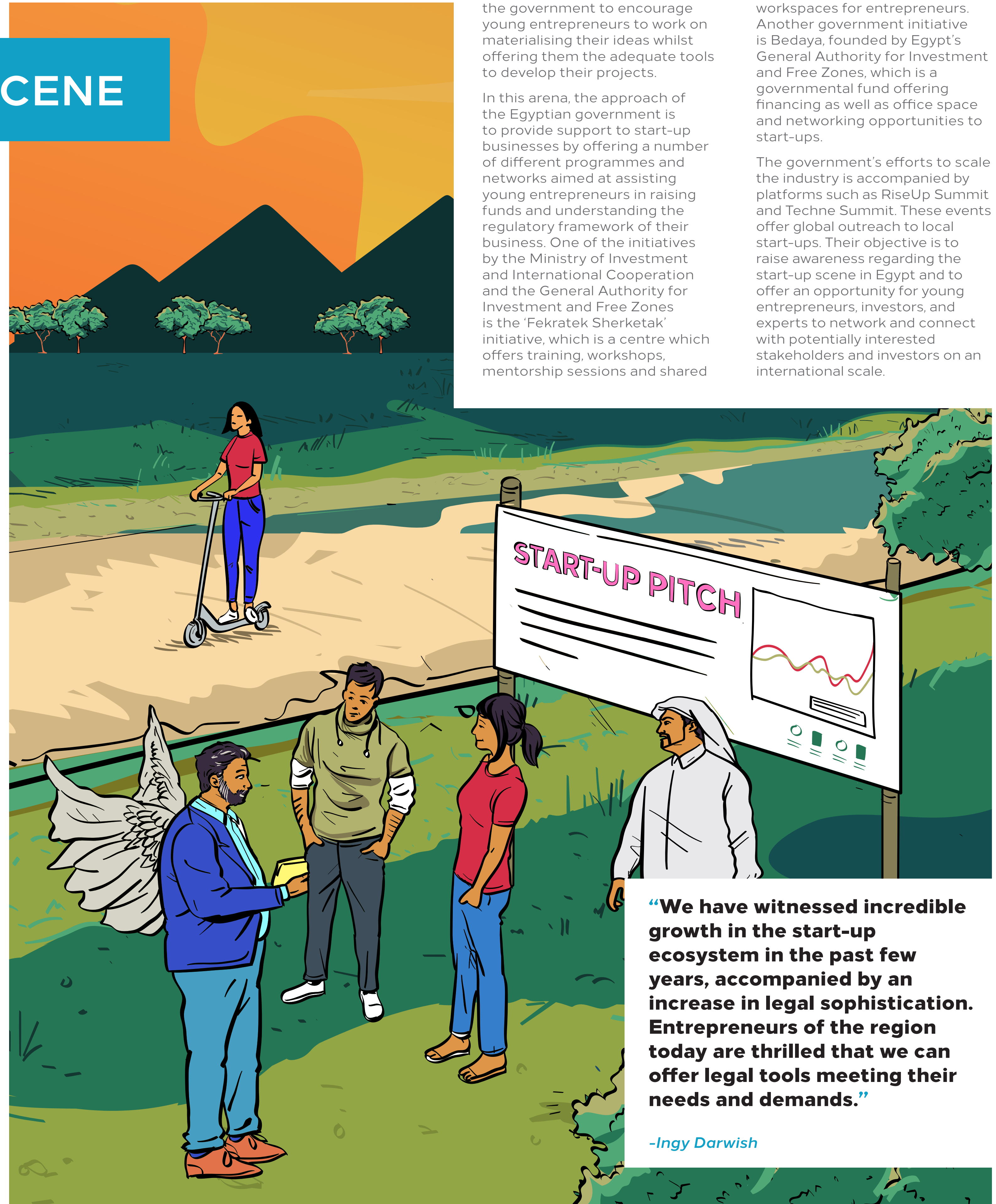
What makes Cairo a vibrant start-up scene?

Egyptians, face various challenges in their everyday activities such as dependence on cash, traffic congestion, poor quality of public transportation, and longer commutes due to limited job offers. Consequently, Egyptians have increasingly been turning towards technological and innovative solutions to overcome these challenges. With a population of over 100 million, Egypt is the largest consumer market in the MENA region making it a lucrative platform for investors.

The Egyptian government has successfully introduced various economic and structural reforms to tackle a number of embedded issues in the economy to create a more attractive and dynamic investment climate and sustain growth. Additionally, as part of its ongoing efforts to make Egypt the most attractive investment destination in the MENA region, the Egyptian legislator is seeking to expand the implementation of various legal, economic and institutional reforms to improve the business climate and promote local, regional and international investment.

Young entrepreneurs have sensed the domestic appetite for technological advancement triggered by both the difficulties facing Egyptians in their daily routines and growing internet penetration. They have begun offering innovative technological solutions for major issues, giving rise to a strong wave of entrepreneurship enhanced by the government approach to support start-ups in Egypt. Furthermore, this growing access to and availability of the internet combined with the high unemployment rate has exposed young Egyptians to alternative ways of doing business and therefore encouraged them to start developing their own projects. This change in mindset has been strongly encouraged by the Egyptian government through its continuous efforts to scale the industry by launching several initiatives to support the start-up sector.

Correspondingly, there has been a remarkable shift in the mindset and attitude of Egyptians towards doing business with many founders of start-ups, manifesting in a greater willingness to take risks. This change comes as a result of the awareness-raising measures adopted by the business community and the government to encourage young entrepreneurs to work on materialising their ideas whilst offering them the adequate tools to develop their projects.



In this arena, the approach of the Egyptian government is to provide support to start-up businesses by offering a number of different programmes and networks aimed at assisting young entrepreneurs in raising funds and understanding the regulatory framework of their business. One of the initiatives by the Ministry of Investment and International Cooperation and the General Authority for Investment and Free Zones is the 'Fekratek Sherketak' initiative, which is a centre which offers training, workshops, mentorship sessions and shared workspaces for entrepreneurs. Another government initiative is Bedaya, founded by Egypt's General Authority for Investment and Free Zones, which is a governmental fund offering financing as well as office space and networking opportunities to start-ups.

The government's efforts to scale the industry is accompanied by platforms such as RiseUp Summit and Techne Summit. These events offer global outreach to local start-ups. Their objective is to raise awareness regarding the start-up scene in Egypt and to offer an opportunity for young entrepreneurs, investors, and experts to network and connect with potentially interested stakeholders and investors on an international scale.

"We have witnessed incredible growth in the start-up ecosystem in the past few years, accompanied by an increase in legal sophistication. Entrepreneurs of the region today are thrilled that we can offer legal tools meeting their needs and demands."

-Ingy Darwish

In addition, the fact that a large percentage of the population is unbanked creates the need for new financial technology solutions to enable financing for the unbanked, for the purpose of increasing financial inclusion. With the increasing need for innovation and the shift towards digitalisation, many Fintech start-ups have emerged in the country to promote financial inclusion by offering more affordable financial solutions and extending credit facilities to the unbanked population.

Many Fintech solutions focus on developing platforms for cashless and remote transactions in order to facilitate the transfer of remittances, payment of utilities and bills, and even money saving schemes. These solutions increase the accessibility to credit for lower income individuals and the unbanked population. More importantly, these solutions have helped ease the rigid bureaucratic procedures associated with the banking sector, and thereby contributing to greater financial inclusion.

What are the obstacles?

Nevertheless, there are a number of factors that still hinder the attractiveness of Egypt as a hub for venture capitalism. First, political turmoil and, as a result, security concerns in Egypt and throughout the Middle East and North Africa may reduce investor appetite.

Second, despite the serious efforts to improve the legal framework for investments in Egypt and the attempts to regulate certain sectors, low level, bureaucratic bottlenecks as well as the existence of loopholes in the overall legal framework are still stifling real progress on the ground. Only time will tell whether true and meaningful change will occur from the bottom up.

Third, a culture of mistrust in the banking system makes cash the primary payment method in Egypt. This is an obstacle that the private sector and the government must address with the aim of establishing trust in the financial systems in order to persuade them of the full potential of Fintech solutions.

INTELLECTUAL PROPERTY FOCUS

While due diligence in an M&A transaction can be an all-encompassing exercise, the primary areas of focus in a venture deal are going to be limited to the critical assets of a start-up and its 'corporate health' and compliance. When we talk about 'critical assets', we are referring primarily to the intellectual property ("IP") of the company along with its key team members (see article on ESOPs in section 1 for a discussion on taking care of the latter category).

The IP assets of a company can be looked at as both legal and non-legal categories of IP. Registrable and enforceable IP rights such as patents and trademarks are what many investors generally regard as the primary IP rights from a legal standpoint. There are of course also non-registrable but enforceable legal IP rights such as copyrights. The final category, however, is frequently overlooked by investors and founders and this is the non-registrable intellectual property that falls into the category of business secrets and which are frequently critical to a company maintaining a 'moat' or advantage against a competitor racing to acquire your customers faster than you can.

In this section, we will take a brief look into the key IP rights that start-ups and their investors should primarily be interested in including patents, trademarks and the broader question of IP rights in general and how to ensure that, as an investor, you are not putting your money into a company that doesn't end up owning or controlling its IP.

TRADEMARK PROTECTION FOR START-UPS

Omar Obeidat
Partner, Head of Intellectual Property & Competition
o.obeidat@tamimi.com

Trademark protection for any business would seem to naturally fall as a priority in the outset of any venture. This is realised by large corporations that would seek protection of their trademarks well in advance of launching products or services. The same could not always be said of start-ups although it may be argued that start-ups, particularly in the B2C segment, have more reason to seek protection of their trademarks early on. As opposed to B2B, start-ups with B2C that target end users will need to build a brand that can contribute to strong market recognition of that brand. On the other hand, B2B start-ups may require less scope of protection, particularly geographically, depending on their targeted customers. It is fair to say that tight budgets in start-ups leave them with less leverage in fighting trademark disputes should their adopted trademark be the subject of a dispute. If anything, early protection of trademarks is a cost saver considering the high costs of trademark disputes when compared to trademark clearance and registration. The initial costs of setting up a business, development, employee salaries, vendors fees and marketing are usually expenses with which start-ups become consumed and consequently they do not wish to burden their business with extra costs. However, trademark protection is not an extra cost. In fact, it is a necessary expenditure and more importantly an acquired asset adding value to the business.

Choosing the right trademark is key for a sustainable adoption and growth of a brand. A trademark that is fanciful and creative can help the business grow far away from the crowded noise in the space of descriptive names. Trademarks as opposed to any other intellectual property right can live forever and do not expire if maintained correctly. As such, it is necessary to choose a trademark that can live indefinitely and, accordingly begin the process of ascertaining whether this trademark is capable of registration and protection.

Clearing a trademark is an exercise that, when carefully done, aims at adopting a trademark that is immune to challenge. A trademark clearance is the first most important step to complete in the process of trademark protection. Clearance would be conducted against all categories of relevant services and goods and in all relevant territories. The clearance of

a trademark not only occurs in trademark registers but also covers domains, social media account names, trade names and online searches. Most jurisdictions require a government fee in order to conduct official trademark search applications. Once a trademark is cleared, it would be, on the face of it, available for trademark registration. Furthermore, it is necessary that trademark clearance takes into account various meanings in languages where the trademark is intended to be used and also ensure the chosen trademark is in line with public order and morals.

The registration process should sensibly determine the scope and geographic reach desired by the entrepreneur or business. Determining the scope of goods and services will depend on how many usages are intended by the relevant trademark. It is also necessary that a trademark covers, not only the core class of goods and services but also, relevant goods and services in classes other than the core class. For example, an e-commerce app would logically cover: classes related to software; trading, and computer services. There are also instances where a preventive class is necessary in order to deter a competitor from riding on the goodwill of a trademark. Once registered, the trademark will grant the owner exclusive rights to use, and powers to prevent third parties from associating with or infringing the mark.

A registered trademark is an asset of the proprietor and adds value to its business. This value is a key factor to be identified and considered in any due diligence aimed at valuing a business. Moreover, interested investors can take interest in a business with healthy assets such as registered trademark rights. Investors realise and appreciate the value of intellectual property assets and would want such assets to be the collateral that protects their investments enabling them to grow and increase in value.

WHO OWNS THE IP RIGHTS? ARE YOU FULLY PROTECTED?

Rasha Al Ardah
Partner
Intellectual Property
r.alardah@tamimi.com

One of the most crucial issues for investors when evaluating a new investment opportunity is the company's intellectual property ownership and security over it, which determine the strength of the intellectual property right. Without strong intellectual property and established protection over the associated rights, few investments would be made into new or growing enterprises.

Who owns the intellectual property is a crucial issue to be considered. From an investor's perspective, an ideal scenario would entail a company's intellectual property having already been vested and registered (where possible) with the appropriate body. Hence, a company that is looking to attract investors must ensure that all intellectual property rights are vested in it. While it may seem easy to achieve there are many issues to be taken into consideration.

There are two types of intellectual property rights; registered and unregistered rights. Registered rights are those rights that must be applied for. The created work should fulfil specific criteria in order to be approved and subsequently benefit from the protection of such rights given to it post-approval (for example, the right to license the work). Examples include patents, designs and trademarks. Unregistered rights, on the other hand, are rights that arise automatically on the creation of the work, without the need for any specific formalities or registration, the most common such right being copyright. Both rights are equally important to any business however, as there is no inherent record of the work, special care should be taken when dealing with unregistered rights (especially when it comes to ownership).

The ownership of intellectual property can be a complex issue, especially when it is created by an employee or by a third party who is not an official employee (for example, if the work is created prior to establishing or when commissioning a third party to create). There is a common misconception that whatever is done during employment is automatically owned by the company however, in reality, this is not always the case. It is not a given that the company owns the intellectual property rights relating to such work, unless there is a clear agreement regarding the transfer of ownership of the IP to the company.

Another issue that adds to the complexity of ownership, is when several people work on one project, some may change roles, change projects or even leave the company altogether. This may create an issue regarding who owns the intellectual property and the level of contribution of each party to the overall work. In such circumstances, again the company will not necessarily have automatic ownership of the right. Proper agreements should be put in place at the earliest stage of the project in order to ensure ownership rests with the company.

The agreements sought are typically known as assignment agreements, and can be entered into between the company and the relevant employees, agents, and/or consultants etc., irrespective of whether the creator is employed by the company or not. The assignment will be in writing and clearly define and describe the exact work and rights being transferred, only then may a company claim it maintains ownership of the intellectual property. In many instances, obtaining an assignment can be challenging, especially if it is required at a later stage (for example, after the product proved successful). When asked to sign an assignment agreement at the request of a company, many employees, former employees or third parties decline to do so. In such cases, negotiations should be entered into and carefully managed in order to secure the assignment of the relevant intellectual property right. In some cases, a company may consider obtaining a licence instead of an assignment. In other instances, negotiations may fail, and a company may need to reconsider its product, the relevant IP and perhaps seek an alternative solution.

> "There is a common misconception that whatever is done during employment is automatically owned by the company.
>
> However, in reality this is not always the case."

It is worth mentioning that, whilst copyright is not required to be registered, it can be recorded with the UAE Copyright Offices to create evidence of ownership. To record the copyright at a UAE Copyright Office, an assignment is usually requested from the authors, especially if the applicant is a company. This only supplements the importance of obtaining an assignment as an important requirement to facilitate the recording copyright but accordingly ensure smoother enforcement of your rights.

Regardless of the situation, it is in the interests of a company (and advisable) to take the question of ownership seriously, actively take steps to ensure that it either owns the IP or obtains a licence for use, and not let anything remain unresolved. The cost of infringing IP rights could be huge if the matter is not resolved during the early stages.

Accordingly, companies should ensure that all employees working on major products for the company have executed clear assignment agreements that have the effect of transferring the IP rights related to such products to the company, and for any agreement established with a third party, to also ensure that the IP right is transferred or licensed. In addition, it is imperative that a company registers all of its registrable intellectual property rights as soon as possible, and selects the correct IP form of protection and registration for the respective works, as registered IP rights attract more robust legal protection than unregistered ones.

WEAPONISING IP

Ahmad Saleh
Partner, Head of Patents & Designs (R&D and Innovations)
ah.saleh@tamimi.com

The COVID-19 global pandemic has not only affected the safety and security of people around the globe, but has undoubtedly made a substantial economic impact worldwide. The characteristics of the virus and the measures taken to limit its transmission led to a slow-down in general economic activity across a number of industries including hospitality, leisure and airlines. However, for some sectors the slow-down has offered an unexpected opportunity to develop, grow and expand fledgling businesses that, on any other given day, might struggle to compete with the established, successful giants in their respective fields.

COVID-19: Digital change and disruption

Indeed, COVID-19 has provoked, and is likely to continue to provoke, a very strong wave of change and disruption. Among the companies likely to benefit from this wave are digital innovation-driven enterprises. Such companies are already actively pivoting at the core of the 4th industrial revolution, and are optimally positioned to take advantage of the potential opportunities presented by COVID-19 which is effectively acting as a catalyst for their business operations. Against this background, we anticipate the emergence of two types of companies: Type A; and Type B. Where a large proportion of Type A companies will be market established companies profiting from the new digital market needs to expand their operations, many Type B companies will be outsiders and entrepreneurs and start-ups coming with disruptive innovations leading to business disruption in various industries. Disruption is a business concept and occurs when a "disruptive innovation" once introduced leads to the creation of a new market by overtaking an existing one displacing related established market leading businesses, services and products.

Type A Companies

This type of company generally provides a service or product that complements established companies. We note that they generally focus on the provision of required ICT support to established businesses across various industries. They form part of the supply chain and will support those businesses in overcoming existing challenges by means of digitalisation and virtualisation. This may include

developing online platforms, remote access systems, mobile applications, cybersecurity systems, business and supply chain management systems, and so on. At the core of Type A companies are software developers and other ICT related businesses. Type A companies are likely to see unprecedented growth in their operations because businesses have and will increasingly turn towards digitalisation and the integration of new, innovative digital technologies into their operations and supply chains in order to avoid continue their business operations during this type of crisis.

Innovative technology consistently creates value from a business perspective, from a legal perspective however, ensuring the underlying IP is appropriately protected is imperative and should, be sought where possible. The appropriate IP protection not only further secures investments made in the technology but also restricts others from exploiting it without official authorisation. Failure to do so can lead to disastrous business and financial consequences including bankruptcy. It is important to understand which form of IP protection is the most effective and appropriate in any one case.

Copyright or Patent?

Whilst software is protectable under 'copyright', it is recommended that this type of protection be supported by other types of legal protection. Copyright protection will protect a computer code in itself however, it falls short of protecting the technical concept or process underlying the software code. This is important where the value of software revolves around a new innovative 'technical solution' to a 'technical problem' (a new 'technical concept' or 'technical process'). In order to protect a new technical concept, one must look to patent protection. It is worth bearing in mind that patent protection may prove to be more difficult to obtain as patent laws normally require the application of a high threshold of novelty, inventiveness and practical application for the innovation to be eligible.

The 'work around'

Fortunately, some countries have developed a more simplified type of patent sometimes referred to as a 'utility model' or 'petty patent'. This type of patent sets a lower threshold in order to guarantee protection and has the added bonus of being comparatively simple, cheap and more efficient to obtain. China is at the forefront of adopting less stringent standards when it comes to applying for patent protection. The Chinese experience has resulted in the grant of millions of dollars' worth of utility models every year. This type of protection is also available in the UAE and some other countries in the MENA region. Consideration of protection under a patent or utility model would require a thorough consideration by a patent attorney from both a technical and legal perspective. When applying for patents for innovations, it is advisable to avoid descriptions relating to 'software' or 'business related method' as the patent laws of most countries prohibit protection in such instances.

Type B Companies

This type of enterprise could be considered a 'threat' to established companies as they focus on finding ways of developing new technologies that completely disrupt the 'traditional' way of doing business. These innovation-driven companies can either be completely new start-ups or existing companies currently serving secondary markets which may benefit from the current health crisis.

At the time of writing, we are currently in a very fertile period for 'potential disrupters' to take on these large established companies (which lack the necessary business agility required to survive) by surprise, leaving them incapable of reacting quickly enough to disruptive attacks. In order to gain a foothold in their preferred market(s), disruptors will continue to push and challenge the status quo until they impose new markets service them, and eventually displace existing market-leading companies and their related business operations.

In fact, due to the COVID-19 outbreak, the vulnerable financial and competitive positions of a large number of established companies and the increasing market need for new innovative substitutes to respond to the changing consumers' needs and behaviour makes the current time ideal for innovation-driven companies to launch their disruption attacks. There is no doubt that the technological advancements in the digital arena, from computing power to Big Data and 5G connectivity will be important enabling factors. This will likely lead to business disruption in a number of industries.

> "We are currently in a very fertile period for 'potential disrupters' to take on these large established companies (which lack the necessary business agility required to survive) by surprise, leaving them incapable of reacting quickly enough to disruptive attacks."

Netflix, Amazon and Uber are very good examples of companies which started small, targeted secondary markets and moved upstream to take over the main markets and disrupt the then established companies. Disruption in these cases was without doubt enabled partially by the underlying innovative platforms developed by these companies. However, this, in and of itself, was not enough to disrupt established markets. Additional favourable external factors existed at that time including: (a) technological advancements in the digital space (i.e. the proliferation of smart phones, higher connectivity, computing and video streaming capabilities at lower costs); and (b) the users' appetite for a change of behaviour and readiness to adopt new ways of doing things, both of which proved decisive in the support, deployment and use of these platforms by global users on a wide scale.

Without any doubt, disruption is highly demanding, difficult to achieve, and requires tremendous internal preparation and business skills including a formalised vision and market assessment, innovative technology supporting the vision, and targeted disruption strategy. While some companies will make it through, many others will try and fail. Patents can be used as an important weapon to enhance the odds.

Importance of Patents

This type of "disruptive innovation" generally leads to the development of new, innovative and revolutionary technologies, products, business processes and services. IP protection, mainly patents, should be sought by these emerging companies whenever possible. Subject to their approval, a patent can be employed in a variety of ways to help both secure ownership, expand or maintain market share and prevent external exploitation.

A patent can offer secure a business' market share and act as a barrier against competition seeking to enter the market. Patent protection is one of the most powerful weapons (and in most cases the only weapon) that innovation-driven emerging companies can use to fight large, established companies which have the money, influence and resources, all of which emerging companies are generally deprived. Patents can also be used to leverage the position of an emerging company during business negotiations for a potential joint venture with an emerging company or a cross-licence agreement. It can be used as a tool to sue a competitor for infringement in case of a breach on the one hand, and on the other profit from a potential settlement or court award. Equally, it can also be used to protect against a potential attack.

Patents in practice

Smartflash vs Apple (2015) is a good example in which a small US company (Smartflash) won an award exceeding USD 500 million in damages against Apple for the infringement of its patents related to iTunes. Apple's business suppliers also offer a good example on how patents can be monetised and used as complementary products to an existing company. In fact, Apple's suppliers, including Qualcomm, Texas Instruments and many other smaller companies, have thousands of patent licenses as part of their products supplied to Apple which is considered to have one of the most sophisticated and efficient supply chain management systems in the world involving thousands of underlying patent licenses.

Patents and Market Leaders

Of course, just as patents are available to emerging companies, they are also available to established companies that are generally active in the arena of patent protection. Established companies also use these tools to expand their global footprint and put their competition under pressure within the confines of the laws in question. Patents provide a very powerful tool to established companies as they can act as a barrier preventing new entrants into (established) markets as well as defend against disruption by restricting, or slowing down, any potential attempted disruptive attack from taking over their main business stream.

Consider Huawei, this Chinese giant will have the chance to grow and spread at an unprecedented pace against the backdrop of the COVID-19 pandemic. It would not be surprising if Huawei achieves the pinnacles of the world's corporate superpowers because it has the capacity to use the IP rights' weapon as both as a tool to exert influence and protect its IP (it already has over fifty thousand patents in the field of 5G and IoT). From another perspective, experienced American companies such as Qualcomm and, are also prepared with tens of thousands of patents in readiness for any future patent competition.

> "Patent protection is one of the most powerful weapons (and in most cases the only weapon) that innovation-driven emerging companies can use to fight large, established companies which have the money, influence and resources, all of which emerging companies are generally deprived."

With all the power conveyed through patents and the high business stakes they involve, it is crucial that private business interests acknowledge and comply with national security and public health interests particularly in the current climate where human lives are at stake. A recent example involved the US patent troll Labrador Diagnostics LLC which used a portfolio of old patents to sue BioFire, a US company that makes and distributes COVID-19 tests. Fortunately, Labrador Diagnostics later agreed to provide royalty free licenses for COVID-19 testing. The law also provides legal mechanisms for such situations.

Conclusion - a powerful tool for emerging and established companies

The wave of digital change and disruption provoked by the COVID-19 outbreak will certainly lead to an increasingly competitive market which may, in turn, lead to a complete change of business dynamics and demographics. Patent war strategies are among the most frequent and crucial important business wars, all of which start the moment patent protection of important business assets (in particular innovation) is sought. The magic of patents is that they can provide a very powerful weapon for emerging companies and established giant companies alike. They offer emerging companies the ability to leverage their positions against the business interests of larger companies that may have a more established and dominant business presence than them. On the other hand, they provide existing companies with the means to act as market barriers and defend against market penetration by future competition, as well as slowing down possible disruption attacks. Patent protection should be considered very early on in the process and treated as a priority by businesses that rely on a business strategy based on technological innovation or distinctiveness with a view to achieving success. Securing patents as part of a company's portfolio is in the interest of both business owners and investors alike.

EXPERTS ACROSS ALL RELEVANT SKILL SETS

CORPORATE

Abdullah Mutawi
a.mutawi@tamimi.com

Kareem Zureikat
k.zureikat@tamimi.com

Richard Catling
r.catling@tamimi.com

Anna Robinson
a.robinson@tamimi.com

Ingy Darwish
i.darwish@tamimi.com

Hugo Cugnet
h.cugnet@tamimi.com

Daniel Sterling
d.sterling@tamimi.com

Haya Al-Barqawi
h.albarqawi@tamimi.com

Andrew Tarbuck
a.tarbuck@tamimi.com

CORPORATE STRUCTURING

Nasouh Raslan
n.raslan@tamimi.com

Rad El Treki
r.eltreki@tamimi.com

Sultan Akbar
s.akbar@tamimi.com

DIGITAL & DATA

Martin Hayward
m.hayward@tamimi.com

Andrew Fawcett
a.fawcett@tamimi.com

Nick O'Connell
n.oconnell@tamimi.com

Charlotte Sutcliffe
c.sutcliffe@tamimi.com

BANKING & FINANCE

Dennis Ryan
d.ryan@tamimi.com

Divya Abrol
d.abrol@tamimi.com

Ashish Banga
a.banga@tamimi.com

EMPLOYMENT & INCENTIVES

Samir Kantaria
s.kantaria@tamimi.com

Gordon Barr
g.barr@tamimi.com

INTELLECTUAL PROPERTY

Omar Obeidat
o.obeidat@tamimi.com

Ahmad Saleh
ah.saleh@tamimi.com

Rasha Al Ardah
r.alardah@tamimi.com

Mariam Sabet
m.sabet@tamimi.com

TAX

Shiraz Khan
s.khan@tamimi.com

Janet Gooi
j.gooi@tamimi.com

Michael Citrome
m.citrome@tamimi.com

BUSINESS DEVELOPMENT & MARKETING DIRECTOR
Barbara Koenen-Geerdink
b.koenen@tamimi.com

HEAD OF MARKETING
Sharon Danso-Missah
s.missah@tamimi.com

CONTENT LEAD
Hugo Cugnet
h.cugnet@tamimi.com

CREATIVE LEAD
Shriya Sanjeev
s.sanjeev@tamimi.com

ARTWORK
Alston Rodrigues
alston.rodrigues@hotmail.com

For more information
info@tamimi.com

www.tamimi.com

@AlTamimiCompany

Al Tamimi & Company

التميمي و مشاركوه
AL TAMIMI & CO.