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, Fawer, 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 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. We 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, 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

NOOR SWEID
Chairwoman, Middle East Venture Capital Association (MEVCA)
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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.
ANNA ROBINSON
Senior Associate,
Corporate Commercial

Anna is an English qualified M&A and venture capital 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. 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.

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.

INGY DARWISH
Senior Associate,
Corporate Commercial

Ing 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. Ing 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. Ing 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.

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 employees, incentives and shareholder disputes.

Meet the Team
Meet the Team
**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.
Polling angel investors and venture capitalists in the MENA region: testimonials 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.
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 revenue-per-share, 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.

For angel investors, the next most important things are the business model, go-to-market strategy, and product-market fit. This is a tell-tale 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 is 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.

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.

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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:

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:

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 realized 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:

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 realized 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.
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:

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:

- 41% Institutional
- 31% Individual Investors
- 28% Family office

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.
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.
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.

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 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.

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

1. 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 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.

Shareholders’ agreement

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.

To the extent that only one class of shares (the ordinary shares) would lead to a condition, affair or event which investors will seek to include in a venture capital transaction.

The venture capital team at Al Tamimi is evangelical about the correct use of terminology but also acutely 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

Know your terms: The key terms of a priced equity VC transaction

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The Business of Venture Capital

The Business of Venture Capital
The Business of Venture Capital

THE ECONOMICS OF A VENTURE CAPITAL DEAL

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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 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) an IPO; (4) an an IPO.

Three main limbs to understanding liquidation preferences are:
- Participation
- Seniority
- Multiplicity

Participation
Participating Liquidation Preferences. 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 shares.

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 protect the shareholders of a start-up (including its investors) 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 best industry practices and expectations as to how these arrangements will work.

“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.”

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 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.

THE BUSINESS OF VENTURE CAPITAL

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

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. When 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 waterfalls drain 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 economic value.

Given the loss of return due to the deviation 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 bonus shares would be issued for no consideration, or, if that is not permitted 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 prefer to receive 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, via a 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. However, if a start-up closes a Down Round, the Conversion Price will be adjusted downwards.

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 issued shares capital after the Series A round is 15,000,000, which is comprised of the founder’s original 10,000,000 shares plus the new 5,000,000 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’s ownership percentage 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 133. 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 75,178,796 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.

PARTICIPATING LIQUIDATION PREFERENCE

<table>
<thead>
<tr>
<th>Participating</th>
<th>Non-Participating (exercised)</th>
<th>Non-Participating (conversion to ordinary shares)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.25</td>
<td>1</td>
<td>0.75</td>
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<tr>
<td>1.5 million</td>
<td>7 million</td>
<td>5 million</td>
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PURCHASE PRICE

- Participating
- Non-Participating (conversion to ordinary shares)

Conversion of the preferred shares into common shares, for example, via a 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. However, if a 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 1.35 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 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 equity shares that do not carry anti-dilution rights or who’s anti-dilution rights are not triggered (using our example, a price per share lower than USD 12.50). Therefore, one perspective is that anti-dilution penalises the founder for the start-up’s lack of success.

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.

Although investors would argue that this is fair and reasonable given that it is the founder(s) that drive the day-to-day business.

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

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SHARE TRANSFER RIGHTS

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 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. 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 consideration 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*

### 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.

### 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) as 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

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

- **Standard share option schemes**
- **Stock purchase plans**
- **Restricted stock unit plans**
- **Phantom share plans**

Standard share option schemes work exactly as described in figure 1 below: the granting, 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 to 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 by an employer to purchase the employer’s company stock at below-market price.
employee and may be exercised for shares or cash in lieu at some point. They involve 4 main stages: the grant, the exercise of the options, the vesting of the options, the exercise of the options, the sale of the exercised options. 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, vesting is a specific date within the vesting timetable which marks the end of the vesting even if multiple vesting milestones have been passed. For example, if there is a cliff at the one-year mark, it is typically an employee leaving within the first year would not be entitled to any shares, and all the shares that would have vested within the first year vest at the same time as 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.

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 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 served as a bad leaver.

A point that founders would need to keep in mind is that it is important to look at ESOP provisions 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, it is unavoidable that the hiring of further employees and it iis essential that the start-up has the hiring capacity to keep up with such hires.

It is important to note that the creation of ESOP equity pools has the effect of diluting the current shareholders of the company. As start-ups grow, 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 the long-term. As mentioned above, an ESOP is one-incentive the company can use to lure talent its way. As start-ups grow, it is unavoidable that the hiring of further employees and it is essential that the start-up has the hiring capacity to keep up with such hires.

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the investor and the start-up’s ownership percentage and the dilutive effect subsequent pre-money SAFEs will have on the 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.

“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
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 shareholder’s 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

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 world’s first trillion-dollar valuations, also in tech.

For the vast majority of tech companies however, 2020 created enormous uncertainty and a far 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, profit for many years while they 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, profit for many years while they 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, profit for many years while they 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, profit for many years while they 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, profit for many years while they 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, profit for many years while they are meant to take care of that.

Another key factor when looking at tech start-ups is to understand the dynamics with trading 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

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TURNAROUND STRATEGIES FOR DISTRESSED VENTURE-BACKED TECH START-UPS, LIVING TO FIGHT ANOTHER DAY
cash or accept some negative consequences, such as punitive (e.g. a mandatory conversion to ordinary shares) and other forms of dilution as a result of taking on additional financing (or adding dilution in the form of an anti-dilution mechanism). This is because the shareholders are often willing to accept these terms.

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 deals the shareholders will have to think about.

**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 the management team and employees’ shares. If the ability to operate the anti-dilution rights has the effect of materially reducing (or wiping out) the investment, or any other action going to kill the team’s motivation to stay.

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

In a down round due to the effect of a concentration of preferred shares on the value of the management team so that the company running out of cash may feel shares that carve out a small portion of the exit deal proceeds that are to contractually be paid to the management team. The reason for a down round may have to do with the liquidation preferences in the governing documents. If the management team believe in the possibility of the exit in the short to medium term, this is indeed a highly motivating tool but requires expert knowledge to structure and negotiate. And it will be another element of the restructuring that will depend on the structure and shareholding approval along with any other provisions 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 act in the best interests of the company. It is possible to locate a assumption that a decision that will save the company from bankruptcy is preferable even if it allows the company to collapse with some upside for the management team. The reason is running out fast, the clock is ticking and the deal needs to be closed and closed very rapidly indeed. Sometimes in a matter of days.

There is no time to waste and the sponsors of the down round and the management team need to have to prepare for multiple simultaneous discussions with relevant stakeholders and, more often than not, their legal counsel as well as their immediate and near-term rent of equity financing. The buy-in is equally important and sponsors could do well to make it clear that having someone on the board who is incentivised to do all the relevant communications to ensure that the deal gets the job done.

Finally, appointing the right legal counsel is also critical to the success of a turnaround because the strategy has failed the moment the cosy legal advice comes into existence. Knowledge and assuredness at the holding company level is critical to advancing the interests of the company, its management team or whether they have been motivated by a conflicting interest.

Legal frameworks will be very different across these legal systems but the key takeaway is that the sponsors and their counsel will need to consider not only the law at the holding level applicable to the proposed down round but also the relevant law where the directors reside and work. For example, under Article 68 of the Bankruptcy Law, the company must petition the court to commence bankruptcy proceedings after 30 consecutive business days if the company has been unable to pay its debts when they fall due or be balancing shares of their senior management team falls within the provisions of the UK’s Insolvency Act 1986. This is because, under the provisions of Article 12 of the Commercial Companies Law (CCL), any recent amendment 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 management.

At the Cayman and Delaware level (at 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 taken 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 alternative scenarios. Litigation in those jurisdictions has also focused on conflicts of interest and challenging whether members of a board acted in the best interests of the company, advancing the interests of the company, or whether they have been motivated by a conflicting interest.

**Sponsors and their counsel should be aware that emotions and tensions will always run high in any 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.**
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’’).


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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.

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 Islands 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 of 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

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A growing trend encouraged by governments in the region resulted in the proliferation of venture capital (VC) funds. They are doing so by being proactive, cost-effective and extremely creative at meeting and increasingly exceeding the demands of sponsors and private equity (PE) fund managers.

The DIFC and the ADGM have gained international recognition as world-class regulators offering private equity 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.

Each regulator has created flexible fund platforms that are enhanced by the ease of marketing and promotion 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 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.

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.

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 firms 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 licences. 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 framework is bespoke to the ADGM and has many features aimed at attracting VC managers and GPs to set up in their 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, 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 Authority (‘SCA’), to annually renew its registration and subject itself to certain prescribed exemptions.

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 by any of 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 relevant requirements and notify the respective regulators.

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 licences. 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 framework is bespoke to the ADGM and has many features aimed at attracting VC managers and GPs to set up in their jurisdiction.

Further due to 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 to increase the offer 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 and financial advisory firm, we have understood 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.
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.
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. Non-residents who generate taxable income from sources in that GCC country may be subject to withholding tax.

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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 percent 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 the 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. Import duties 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.

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.

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, licenced 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 retailer’s existing licensed activities; a new license would be required.

Although retailers have the option to simply add e-commerce as a new licensed activity, 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 platform. These terms and conditions of sale will then govern in which country the retailer and its online customers will conduct their transactions in respect of the sale of the retailer’s products online.

The terms and conditions of sale must include details relating to delivery, refund policies, termination of accounts, and interactions between the retailer and its customers. 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 regulatory requirements. It is important to note that the payment gateway operator will not allow the e-commerce portal to commence operations until it delivers the final version of the applicable terms and conditions of sale to the retailer.

In the 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 contractual provisions 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 aspect of this privacy policy is to provide customers with the confidence that their data will be properly stored, used, protected, and destroyed in accordance with the applicable law. This law analysis needs to be done carefully. The operator of the website may inadvertently mean that they have not accommodated more than one country’s laws.

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

The risk of contracting in this way is that the terms and conditions of sale are delivered to the customer [i.e. on the e-commerce site] and the opportunity for customers to argue that no contract of sale was concluded in respect of an online sale of products that are governed and regulated by a combination of legislative and practical measures, including the UAE Penalty 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 who 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 [or not 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 electronic manner is that the terms and conditions of sale are delivered to the customer [i.e. on the e-commerce site] and the opportunity for customers to argue that no contract of sale was concluded in respect of an online sale of products that are governed and regulated by a combination of legislative and practical measures, including the UAE Penal Code.

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Copyright

A person or company that creates content usually has the legal right to determine whether or not that content should be provided and certainly applies in the UAE. This means that, if the retailer that operates an e-commerce site is commissioning a freelancer to create content for the site, then it needs to enter into an agreement with that freelancer to determine if, and in what manner, the material created as well as the use of the material and any revenue that is created 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 way that content could legitimately be used without a written licence would be if the material is clearly a press release or if the content is under copyright protection - these are clearly stipulated in the UAE Penal Code. In the event of any infringement, the retailer should obtain a written licence from the owner of the content before it is used.

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 the content if it is found to breach any terms or to be otherwise in breach of the law. Furthermore, the regulation is quite a complex area of law that requires separate attention, note that Federal Law No 15 of 1980 [concerning Publications and the Press (‘P&P Law’)] contains a large number of regulations to apply. These standards cover false advertisements and the need for advertising to be clear, fair, and not misleading.

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’s regulatory remit. Further, whilst the NMC has included in guidelines issued at the end of 2018 [Guidelines for E-Commerce Sector], these standards cover false advertisements and misleading claims and require that the need for advertising to be clear and fair. These guidelines also include provisions about the need for advertising to be clear and fair. These guidelines also include provisions about the need for advertising to be clear and fair. These guidelines also include provisions about the need for advertising to be clear and fair. These guidelines also include provisions about the need for advertising to be clear and fair. These guidelines also include provisions about the need for advertising to be clear and fair. These guidelines also include provisions about the need for advertising to be clear and fair.

Social Media

Many entities, whether online or otherwise, are more and more frequently using social media to reach a wider audience and
Companies such as Uber, Airbnb and Deliveroo have become increasingly associated with the ‘gig economy’ 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 ‘flex-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 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 and rights of protection as employees, such as protection of wages, and an entitlement to the national minimum salary. In 2018, 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 was 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. The gig economy 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, it 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 transportation services company; and
2. Deliveroo effectively agrees the outsourcing of its delivery to the transportation services company, 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 freelance 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.

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.

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 granting 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.
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...
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 Cabinet Resolution 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 material 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.

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.

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

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 topics or 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 has the power 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 their compliance, will become an essential part of doing business in this sector of the marketing industry.

The value of data cannot be underestimated. It 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). 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).

Valuable data is 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 (similarly to oil, 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).
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 reducing revenues. Regional data protection authorities 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.

In such a case, the target cannot demonstrate (by way of its documentation, policies and technical and organisational measures) that it has been, is 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/or fines for breaches of various provisions that would typically be triggered by the acquirer’s management and management of entities in the MENA region.

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DIGITAL SIGNATURES, THE LAW IN THE UAE

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What is a digital signature? How is it different from an electronic one? In a world where new technological solutions make it easy for users to sign documents, 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 UNCITRAL 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 (5) of 2006 Concerning E-transactions and e-commerce
- Besides, The Federal Law No. (56) 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) which 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 have sophisticated and complex encryption which does not allow for any kind of manipulating with the signed documents. In brief, all digital signatures are electronic, but not all electronic signatures are digital.
The UAE Regulations:
Back to regulation developments in UAE concerning electronic signatures
Federal Law No. (3) of 2006 Concerning Electronic Transactions and E-commerce (‘ETL’) defines Electronic Signature as:
Any letters, numbers, symbol, voice, sound, or any other form in Electronic form applied to or associated in any manner 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 considering 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 ensure that the identity of the person to whom it relates;
• Whether the relying party in respect of the Electronic Signature was supported by an at test Certificate, or (if the Electronic Signature was not ascertained); and
• 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 signatory (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, Palaces, Ascerta, 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 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 reliable provided in a manner which provides assurance as to the integrity of the Electronic Signature.
The ETL also requires a person to use a Secure Attestation Certificate issued by a CSP to be a Secure Electronic Signature. While it may well be that having an Electronic Attestation Certificate issued by CSP to be a Secure Electronic Signature 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 the nature of the underlying transaction and commercial context. The reliability of an electronic signature solution 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 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 of the information, 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 it’s reliability or 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.

Conclusion
While the ETL refers to ‘electronic signatures’ only, the provisions in the law for electronic signatures are the most reliable electronic signature solutions supported by electronic attestations certificates issued by CSPs and secure electronic signatures that use secure authentication procedures. The ETL 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 would 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 digital signatures. 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.
In the absence of proof to the contrary, reliance on a Secure Electronic Signature is presumed to be reasonable under the Electronic Transaction Law.
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In the absence of proof to the contrary, reliance on a Secure Electronic Signature is presumed to be reasonable under the Electronic Transaction Law.
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.
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.

Cryptos, 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 cryptoassets, ICOs and digital securities introducing the following changes: (a) replacing the term...
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.

Testing Laboratories

Sandbox

Following the SCA’s announcement in September 2018, indicating its intention to regulate ICOs and recognize 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). The sandbox is designed to provide support and 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 waivered throughout the duration when the participants are within the Sandbox regulatory regime.

The SCA continues to discuss the rules and regulations with the relevant market players and is currently involved in discussions 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 DFSC 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 DFSC 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 DFSC 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 DFSC offers with the proposed innovations, 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, the participant meets the outcomes detailed in the sandbox framework in order to be granted full authorisation. If it does not meet the outcomes, the participant can opt for cease activities within the accelerator programme.

RegLab

The ADGM RegLab is a regulatory framework introduced by the FSCA 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 DFSC 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 DFSC 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.

Conclusion

Whilst the Central Bank, the SCA, FSRA and DFSC have their own sets of rules, laws, 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 passing 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.

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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 article 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 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 became 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 amongst other things, provides for wider use of electronic communications in business.

In February 2019, the CBB issued regulations on account 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 & E-Government 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 to facilitate financial and banking products using online applications as well as facilitate the launch of their products and services.

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 based 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 consumers 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) 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 and evolve into the future.
FinTech Focus

FINTECH IN EGYPT: BE AWARE OF THE REGULATORY LANDSCAPE

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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 processes 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.

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 services, 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.
According to start up platform Magrabi’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 government has encouraged young entrepreneurs to work on materialising their ideas whilst offering them the adequate tools to develop their projects.

In this era, 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 both domestically and internationally.

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 procedures as well as the existence of loopholes in the overall legal framework are still stifling progress on the ground. Only time will tell whether the current 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.

“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

The Cairo Start-up Scene

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The Cairo start-up scene is thriving in recent years, with many Egyptian young entrepreneurs delivering successful solutions for major issues, offering innovative technological solutions that have begun shaping the world.

Many factors contribute to the continuous growth of the start-up scene in Egypt, making it the hub for start-ups in the region. What makes Cairo a vibrant start-up scene?

In recent years, Egyptians have been turning towards technological and innovative solutions to overcome challenges such as dependence on cash, traffic congestion, poor quality of public transportation, and longer commutes due to limited job offers. Consequently, the Egyptian government has been encouraging young entrepreneurs to work on materialising their ideas whilst offering them the adequate tools to develop their projects.

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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 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 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.

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 securing 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 geographical 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 delay 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?

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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 fulfill 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 licence 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. This is not an automatic ownership (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 project has been sold or successfully). 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.

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 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.

“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.”
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 continue their business operations during this type of crisis.

Innovative technology consistently creates value from a business 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’, which sets a lower threshold in order to get protection. This has the added bonus of being lower cost and more efficient to obtain. China is at the forefront of adopting this approach, but more and more countries are moving in the same direction. For example, the United Arab Emirates (UAE) has introduced such a system.

‘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.’

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 and maintain market share and prevent external exploitation.

A patent can offer secure a business’ market share and act as a barrier to companies 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 as a barrier to the position of an emerging company during business negotiations to help potential joint ventures with an emerging company or a cross-licence agreement. It can be used as a tool to sue a competitor for infringement and put pressure on them through the courts. 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 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’s standard products, including Qualcomm, Texas Instruments and many other smaller companies. Having 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 chains in the world, ensures that they are capable of defending themselves against potential patent infringement.

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 to their (established) markets as well as defend against disruption by restricting or slowing down any potential attempted disruptive attack from taking hold over their main business stream.

Consider Huawei: this Chinese giant will have the chance to grow and succeed at an unprecedented pace against the backdrop of the COVID-19 pandemic. It would not be surprising if Huawei achieves the pinnacle of the world’s corporate superpowers because it has the capacity to use the IP rights’ weapon as both 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 technology companies such as Qualcomm and, are also prepared with tans of those who have been in readiness for any future patent competition.

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. The current climate in which private business interests and public health interests are at stake is an example of 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 induced by the COVID-19 outbreak will certainly accelerate the highly competitive market which may, in turn, lead to a complete change in market compositions and demographics. Patent war strategies are among the most powerful and crucial important business weapons, all of which can be leveraged to protect 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.

According to the World Intellectual Property Organization (WIPO), the world’s corporate superpowers (of the world’s corporate superpowers (i.e., the top 50 companies) own tens of thousands of patents in their respective fields. From another perspective, the US company Apple which is considered to have one of the most sophisticated and efficient supply chains in the world, already has over fifty thousand patents in the field of 5G and IoT. From another perspective, experienced American technology companies such as Qualcomm and, are also prepared with those who have been in readiness for any future patent competition.

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.

For emerging companies and established 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.

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