
THE MERGERS & ACQUISITIONS REVIEW

SEVENTH EDITION

EDITORS

SIMON ROBINSON AND MARK ZERDIN

LAW BUSINESS RESEARCH

THE MERGERS & ACQUISITIONS REVIEW

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SIMON ROBINSON AND MARK ZERDIN

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In presenting this seventh annual edition of *The Mergers & Acquisitions Review*, the publisher would like to extend warm and heartfelt thanks to editor Simon Robinson, who has recently retired from Slaughter and May. Simon has held the position of editor of *The Mergers & Acquisitions Review* since its inauguration seven years ago, and Simon and his partners at Slaughter and May have been instrumental in the success of The Law Reviews series. Thank you Simon.

The publisher would like to welcome Mark Zerdin, also a partner at Slaughter and May, as current and future editor of *The Mergers & Acquisitions Review*. We are delighted to have Mark on board, and we look forward to future editions in Mark's very capable editorial hands.

Gideon Robertson
Publisher, The Law Reviews
August 2013

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EDITOR'S PREFACE

This past year has seen some surprising twists and turns, not only in the mergers and acquisitions markets but also in the economic and political environments. November saw the re-election of Barack Obama, although this had less of an impact on the markets than an announcement by Ben Bernanke in May that the US Federal Reserve would consider a slowdown in its programme of quantitative easing. On the other side of the Pacific, Xi Jinping has outlined a new communist doctrine – the ‘Chinese dream’. The doctrine reflects the changing economic outlook in China where growth will be increasingly consumer rather than investment-led. A new political rhetoric has also emerged in Japan as Shinzo Abe, elected in a landslide December victory, seeks to reinvigorate the Japanese economy. Both rebrandings flirt with nationalist sentiment and the attitude of these two countries towards one another will continue to bear on the region’s business environment.

In Europe, despite an awkward Cypriot bailout, the sovereign debt crisis showed signs of stability and government bond yields are falling. Europe also improved its attractiveness in the eyes of investors and remains the largest destination for foreign direct investment. However, there has yet to be a return to growth. Investors seem split fairly evenly between those who believe Europe will emerge from the crisis in the next three years, and those who believe it will take five years or more. In any event, a return to the boom years is unlikely in the near future, particularly as the emerging markets see a relative slowdown. The IMF data for 2012 shows that the combined growth rate of India and China is at its lowest in over 20 years while global growth fell below 2.5 per cent in the second half of 2012. This global slowdown continues to pull M&A figures down making 2012 the fifth consecutive year in which deal values fell globally.

There are reasons for optimism though, particularly in the US market which has seen some substantial deals (the acquisitions of Heinz and Virgin Media being particular highlights). These deals have been made possible by the return of debt financing where the right deal can attract very favourable terms. Equities have also performed much more strongly over the past year. In May 2013 both the Dow Jones and the FTSE 100 hit record highs – validating to some extent the aggressive monetary policies pursued in

the US and the UK. Whether political will can start to lift the markets more broadly still remains to be seen.

I would like to thank the contributors for their support in producing the seventh edition of *The Mergers & Acquisitions Review*. I hope that the commentary in the following chapters will provide a richer understanding of the shape of the global markets, together with the challenges and opportunities facing market participants.

Mark Zerdin

Slaughter and May

London

August 2013

Chapter 10

BAHRAIN

Haifa Khunji and Maryia Abdul Rahman¹

I OVERVIEW OF M&A ACTIVITY²

Following a decade of strong economic performance, Bahrain's growth slowed from 2009 to 2011. This was partly due to the global recession, but was also a consequence of the political and social turmoil experienced by Bahrain in 2011. The decline has been most evident in two sectors affected by the global financial crisis, namely construction and finance.³

As forecasted Bahrain's economy grew in 2012, reaching 4.4 per cent in the first three-quarters of 2012 mainly driven by a strong recovery in the non-oil sector, and the full-year growth was 3.4 per cent. It is expected that the growth will continue throughout 2013 due to planned and implemented government spending in infrastructure and industrial investment. This is expected to be matched by an increase in foreign direct investment (FDI).

Another indicator that Bahrain is now on the mend is the number of financial services companies, which has risen from 401 to 404 in 2011. The government is also in the process of attracting more FDI and has introduced an economic stimulation programme in which it has allocated US\$300 million for infrastructure projects and US\$550 million for 50,000 housing units. The Economic Development Board (EDB) reported that Bahrain's annual real output grew at a rate of 2.8 per cent in 2012.

It has been said that Bahrain's economy has got back on its feet much faster than anticipated; the fastest-growing sectors that have aided in the growth of the economy

1 Haifa Khunji is a partner, and Maryia Abdul Rahman is an associate at KBH Kaanuun.

2 All statistics and references in this chapter are derived from publicly available sources but have not been independently verified.

3 www.deloitte.com/view/en_OM/om/press/press-releases/b47351b167276310VgnVCM2000001b56f00aRCRD.htm.

are transport and communications. Other sectors that influenced growth include manufacturing, financing services, mining and quarrying. The EDB further predicts that the gross domestic product could exceed 6 per cent in 2013.

The health of the economy generally influences the pace and outcome of M&A, so it is essential to have an overview of the rate of M&A in the wider Middle East, by way of comparison. Generally, this whole region experienced a large decline in M&A and equity issuance in 2011.

According to Deloitte, the gradual improvement in M&A deals in the Middle East throughout 2012 was deemed to be particularly visible among key players not affected by liquidity constraints, such as Saudi Arabia, Abu Dhabi and Qatar. Moreover, with a reported US\$25 billion in corporate bonds and *sukuks* maturing this year, Deloitte's M&A experts indicate that there are still opportunities in certain segments of the market, with a probable new round of asset sales as part of the additional refinancing plans. They further predict that the level of international interest in regional assets will likely remain passive, due to ongoing political instability across the MENA (Middle East–North Africa) region.

In the first quarter of 2012, the Middle East was the only region in the world to enjoy a rise in value of M&A deals. According to Ernst & Young's year-end MENA M&A update, the region's announced deal value grew from US\$31.6 billion in 2011 to US\$44.8 billion in 2013.

Despite political factors and the adverse economic climate, Bahrain Saudi Bank BSC and Al Salam Bank Bahrain BSC officially completed their merger in May 2012. Al Salam Bank took over all the assets and liabilities of Bahrain Saudi Bank with effect from 25 April 2012 and Bahrain Saudi Bank's operations have been incorporated into those of Al Salam Bank.⁴

By January 2013, it emerged that Al Salam Bank was in further discussion with BMI Bank. In May 2013, the boards of both BMI Bank and Al Salam Bank Bahrain reached an agreement to proceed with a merger deal by way of share swaps. If the merger of these banks goes ahead, it will create the third-largest bank in Bahrain with significantly higher underwriting capacity with total assets of approximately 1.7 billion dinar. This merger came about almost a year after Al Salam's merger talks with Bahrain Islamic Bank fell through.

i Some other recent notable acquisitions in Bahrain in 2013:

- a* National Bank of Bahrain and Social Insurance Organization Asset Management Company completed the purchase of the 51.6 per cent stake in Bahrain Islamic Bank, which was previously held by Investment Dar KSC. Each has now taken a 25.8 per cent stake in Bahrain Islamic Bank.⁵
- b* Ithmaar Bank has formally concluded a merger with one of its Bahrain-based associates First Leasing Bank;⁶ and

4 Al Salam Bank Bahrain, May 2012.

5 www.reuters.com/article/2013/03/10/bahrain-nbb-merger-idUSL6N0C209A20130310

6 www.gulf-daily-news.com/NewsDetails.aspx?storyid=348047

- c Capital Management House, Capinvest and Elaf Bank have successfully completed a three-way merger deal in January 2013, to create a financial institution with an estimated total equity of US\$340 million dollars and total assets in excess of US\$400 million.⁷

The future for Bahrain is uncertain as, despite political risk in Bahrain remaining high, economic activity will continue to be underpinned by growth in government spending, with a greater focus on infrastructure. The private sector will remain relatively sluggish and influenced by the global situation. Bahrain's economic prospects remain unclear in light of the lasting political uncertainty that has lowered investor confidence throughout 2011 and triggered substantial capital outflows and a slowing of private sector activity and investment.

II GENERAL INTRODUCTION TO THE LEGAL FRAMEWORK FOR M&A

The Bahrain Commercial Companies Law (Legislative Decree No. 21 of 2001) (BCCL) sets out the general rules and procedures that apply to the merger of domestic companies. The BCCL provides for two methods of merger: acquisition or consolidation. In all cases, a merger in Bahrain must not result in a monopoly of any economic activity, commodity or product.

Under the BCCL, a company can be wound up into another company by transferring its patrimony to an existing company or a merger can be effected by the winding up of two or more companies and incorporating a new one to which the patrimony of the merged companies is transferred.

In the case of a merger by way of acquisition, the merged company must pass a resolution approving its dissolution and proceed with an evaluation of 'in-kind' shares in accordance with the BCCL. The merging company then passes a resolution to amend its capital based on the result of the evaluation of the merged company. The capital increase is distributed among the partners in the merged company in proportion to their respective shares.

In the event of a merger by way of consolidation, each merged company must pass a resolution approving its dissolution. Then, a new company is incorporated in accordance with the BCCL. Subsequently, each merged company is allotted a number of shares equal to its shareholding in the new company's capital. These shares are distributed among the parties in each merged company in proportion to their respective shares therein.

Regardless of the method chosen, notice of the merger must be published in the Official Gazette and in one local daily newspaper. Any creditor may object to the merger within 60 days of the publication of the notice. In such case, the merger is not binding upon the creditor unless the creditor gives up his objection, a court rejects it or

⁷ www.bloomberg.com/news/2012-06-30/capinvest-elaf-and-capital-management-shareholders-accept-merger.html

the company pays or makes provision for the settlement of the debt of the creditor. If no objection is made within the 60-day period the merger is effective towards the creditors and the merging company is subrogated in all the rights and obligations of the merged companies.

As for newly created Bahraini companies, they can be constituted with 100 per cent foreign capital (except for the Simple Commandite, which requires a minimum of 51 per cent to be held by a Bahraini national). The only difference is that the contribution of foreign capital or foreign expertise to a Bahraini company is subject to approval of the Minister of Industry and Commerce.

However, certain business activities are reserved for Bahraini nationals and companies such as real estate services, rental, management of land and property (not including buying and selling, management of personal property or consultancy services), press, publication and distribution houses, film studios and management of cinemas and film distribution, land transportation of goods, persons and tourists as well as commercial agencies.

Other types of activities, which are reserved for Bahrainis and nationals of countries that are members of the GCC include accounting services (excluding auditing), cargo clearing and fishing.

Further restrictions are applicable in certain areas such as trade and retail where a minimum of 51 per cent Bahraini ownership is mandated. For companies constituted in one of the GCC countries, a Bahraini partner is required.

III DEVELOPMENTS IN CORPORATE AND TAKEOVER LAW AND THEIR IMPACT

The Central Bank of Bahrain (CBB) published the Takeovers, Mergers & Acquisitions Module to the CBB Casebook, which came into effect on 1 January 2009 and which includes general principles and rules applicable to takeovers and mergers of domiciled companies whose ordinary voting equity securities are listed on the Bahrain Stock Exchange (BSE) and overseas companies whose primary listing of ordinary voting equity securities is on the BSE.

The general principles and more detailed rules are similar to the principles and rules of the UK Takeover Code. In summary, the key principles are:

- a* all offeree shareholders must be treated fairly and equitably;
- b* minority shareholders must not be oppressed and rights of control should be exercised in good faith;
- c* information must not be made available to some offerees, which is not made to all shareholders;
- d* offers must be announced only after careful and responsible consideration and offerors and their financial advisers should be satisfied that the offeror can and will be able to implement the offer in full;
- e* offeree shareholders must be given sufficient time and information to reach an informed decision on an offer;
- f* disclosure must be full, prompt and not misleading;

- g* directors of the target must not take steps to frustrate a bona fide offer without prior shareholder approval; and
- h* directors of the target should appoint independent advisers in connection with an offer.

Furthermore, a number of countries in the MENA region have recently implemented effective risk management and corporate governance rules. Following this trend, Bahrain adopted a new Corporate Governance Code (the Code) initially for publicly listed companies, which became effective on 1 January 2011. The Code incorporates many international standards such as the independence of directors as well as training and constitution of audit, nomination and remuneration committees.

All joint stock companies, which are incorporated under the BCCL must abide by the Code by the end of 2011 or provide an explanation to their shareholders for not doing so.

The Code supplements the principles of corporate governance, which exist within the Bahrain legislative framework, such as rules regulating the convening and holding of shareholders and directors meetings, the dealing in company shares and the establishment of best practices through the adoption of a UK FSA-type principles-based approach to corporate governance. The Code requires all listed companies to explain non-compliance with a specific recommendation or rule in a comply-or-explain report to shareholders at annual meetings.

The Code includes interesting developments in the functioning of the board of a company. For example, no individual or group of directors should dominate the board's decision-making. As for companies who call themselves 'Islamic', they are subject to additional governance requirements and disclosures to ensure that they are in fact following shariah principles. The directive provides that each such company should establish a shariah supervisory board of at least three shariah scholars who will be responsible for ensuring compliance with shariah principles.

IV FOREIGN INVOLVEMENT IN M&A TRANSACTIONS

The government of Bahrain actively promotes foreign investments in Bahrain in line with the Kingdom's Economic Vision 2030, a comprehensive economic vision for the development of the economy.

Although Bahrain's economy is relatively overshadowed by the economy of its neighbours, Saudi Arabia and the United Arab Emirates, it has the most diverse economy in the GCC⁸ with high value-added sectors such as financial services and manufacturing featuring heavily in the economic mix.⁹ The government of Bahrain has sought to reduce dependence on declining oil reserves and encourage foreign investment by diversifying

8 www.bahrainedb.com/uploadedFiles/Bahraincom/BahrainForBusiness/Annual%20Economic%20Review.pdf.

9 www.twentysixsevennews.com, 18 June 2011.

the economy.¹⁰ Bahrain attracted around US\$780 million FDI in 2011 and similar figures in 2012. According to the EDB, this helped Bahrain's economy grow by 3.9 per cent in 2012, up from 2 per cent in 2011.

The World Bank's 'Doing Business 2012' report ranked Bahrain at No. 38 out of 183 countries in the world for 'ease of doing business' for foreign investors.¹¹ In 2010, Bahrain was also rated as the most economically free Arab nation in a report published by the leading international think tank, the Fraser Institute.¹²

Principal sectors open to foreign investment include technology, tourism, health care, education and training, manufacturing services, business services and industrial services. As mentioned above, companies can be constituted in Bahrain with 100 per cent foreign capital (subject to certain restrictions).

Opportunities for foreign investment also stem from Bahrain's programme of privatisation, which includes communications, transport, electricity and water, the ports and airport services.

In 2010, the Economist Intelligence Unit published a report highlighting information and communication technologies and knowledge-based industries as industries for further foreign investment in 2012 to 2014.¹³

Also in 2010, the Bahrain Logistics Zone, Bahrain International Airport and the Bahrain International Investment Park ('BIIP') were ranked among the top 25 best 'future duty free zones in the world' from 700 free trade zones worldwide.¹⁴ BIIP is an initiative developed by the Ministry of Industry and Commerce to attract export-oriented companies in manufacturing and internationally traded services by offering incentives such as 100 per cent foreign ownership, zero per cent corporate tax (with a 10-year hiatus) and duty-free access to the GCC markets.¹⁵

Further opportunities for investment in financial services may arise from Bahrain's recognition as a global centre for Islamic finance. However, following the recent political turmoil it remains to be seen whether Bahrain can regain its place or reputation as a vibrant regional financial centre.

V SIGNIFICANT TRANSACTIONS, KEY TRENDS AND HOT INDUSTRIES

Bahrain established itself as the Gulf's financial hub in the 1980s when banks handling the region's wealth left Beirut during the Lebanese civil war. Bahrain's financial sector accounts for about a quarter of its GDP and is a particularly important sector in the

10 www.heritage.org/index/country/bahrain.

11 www.doingbusiness.org/data/exploreeconomies/bahrain.

12 'Bahrain the most economically free Arab nation', 2 November 2010, www.bahrainedb.com/press-bahrain-ranked-the-most-economically-free.aspx.

13 Economist Intelligence Unit: Country Forecast May 2010: Bahrain.

14 Gulf Daily News, 'Top global honour for Bahrain Logistics Zone', 25 June 2010, www.gulf-daily-news.com/NewsDetails.aspx?storyid=280930.

15 www.biip.com.bh.

government's strategy of diversification from its oil industry. Bahrain's finance industry displayed considerable resilience in the face of the global financial crisis.

Casualties resulting from the financial crisis include Gulf Finance House (GFH), one of the region's best-known Islamic banks, which has been forced to undergo restructuring. GFH's overreliance on real estate projects, mismatched short-term funding and long-term assets as well as rising costs left the bank in a precarious position as asset prices dropped and credit markets seized up.¹⁶ However, almost two years later, after restructuring its debt, GFH has managed to make a new start by announcing in its financial results for the first quarter ending 31 March 2012 that it made a net profit of US\$1 million. This was achieved by using rigorous cost-cutting measures along with diligent debt restructuring. A major restructuring agreement was made recently with GFH's sukuk holders. The debt owed by GFH is US\$110 million and the new terms include that the repayment will be made over a course of six years. GFH will be able to manage its asset liabilities, as well as speed up its business growth.¹⁷

The unrest in Bahrain has had considerable impact on the financial industry and many believe it will undoubtedly take some time before Bahrain is able to restore its reputation as a business-friendly hub.

Jarmo Kotilaine, a chief economist at National Commercial Bank Capital, believes, 'It will take at least until the second half of the year until investors reconsider [investments]. We're looking at a lost year.'¹⁸

Mr Kotilaine also stated that the unrest would dampen Bahrain's real estate market to which many Bahraini banks and investment firms are exposed. 'We will have another wave of financial institutions running into financial difficulties,' he said.¹⁹

The insurance sector is one sector of the economy that does not appear to have suffered from the recent events. The development of the insurance industry was also considered an integral part of Bahrain's Economic Vision 2030 strategy. The insurance market in Bahrain consists of 27 domestic insurance companies and 11 branches of foreign insurance companies covering both direct insurance and reinsurance. According to the Bahrain Insurance Association, Bahrain's insurance penetration level is the highest in the GCC, with a rate of 3 per cent. The director of the Middle East Insurance Forum, David McClean, stated that Bahrain was still the powerhouse in the regional insurance industry. The CBB is the regulatory body for insurance in Bahrain, and is looking to maintain the sector's high reputation by issuing reform. Such reform measures include introducing laws on the use of client's money, solvency guidelines and the necessity that employees that work in the insurance industry are properly qualified.²⁰

16 'Gulf Finance House: Back from the brink', Issue 41, 8–14 October 2010, www.gfh.com/en/default/gulf-finance-house-back-from-the-brink.html.

17 Bahrain News Agency, 20 May 2012.

18 www.arynews.tv, 1 March 2011.

19 *Ibid.*

20 Daily Tribune, 'Increasing Coverage In A Growing Market', 26 February 2012, www.dt.bh/searchdetails.php?key=301110213629&newsid=250212175658.

According to the quarterly report of the EDB, the monetary contribution to the gross domestic product from the insurance sector has risen to 8 per cent in 2011, from 3 per cent in 2003. Much of the growth in the insurance sector stems from recent consumer awareness of the benefits of having insurance, as well as growth in real gross national income of 54 per cent from 2002 to the end of the decade. Other indicators of growth in the insurance industry include the number and types of businesses in Bahrain, as well as the persistent positive growth in net domestic credit. Conventional insurance, however, weakened in Bahrain between 2007 and 2010, most likely in reaction to the financial crisis.²¹

The CBB announced the results of insurance companies during the first quarter of 2011. The results showed a slight increase of 1.8 per cent in gross written premiums in the kingdom, from 55.7 million Bahraini dinars to 56.7 million Bahraini dinars. This growth was attributed to the increase in life insurance premiums and the growth of the Takaful industry (the Islamic alternative to insurance) in Bahrain. The Takaful industry in Bahrain has achieved significant growth, with total contributions (premiums) for Takaful companies growing by 16.5 per cent to reach 13.4 million Bahraini dinars in the first quarter of 2011, compared with 11.5 million Bahraini dinars in the first quarter of 2010.²²

In terms of the telecommunications sector, Bahrain was seen as the Arab region's most vibrant country for the telecoms industry to develop and flourish, according to industry experts. The Bahrain Telecommunications Regulatory Authority stated that it is planning to develop further competition in order to protect the interests of customers and take into account developing technological changes in 2012. The telecommunications sector at the moment contributes 4 per cent of the GDP of Bahrain and provides work for over 2,600 people.²³ Middle East business head of telecommunications consultancy Intercai, David Hughes, said the pace at which the industry had grown had taken the whole region by storm.²⁴ One transaction to note is the acquisition for US\$950 million by Batelco, Bahrain's largest phone company, along with Kingdom Holding (the conglomerate controlled by Saudi billionaire Prince Al Waleed Bin Talal) of a 25 per cent stake in Zain, Kuwait's biggest mobile phone operator. Following completion, the parties have agreed that Batelco will run Zain's Saudi unit.²⁵

21 Gulf Daily News, 'Insurance sector posts solid growth in Bahrain', 28 May 2012, www.gulf-daily-news.com/NewsDetails.aspx?storyid=331005.

22 Central Bank of Bahrain, 22 June 2011.

23 'Bahrain TRA Plans for 2012', www.itp.net/587795-bahrain-tra-plans-for-2012.

24 Gulf Daily News, 'Bahrain 'best for telecom providers'' 21 June 2011, www.gulf-daily-news.com/NewsDetails.aspx?storyid=308385.

25 'Batelco To Manage Zain Saudi After Joint Purchase Of Stake', 15 June 2011, www.bloomberg.com/news/2011-06-15/batelco-to-manage-zain-saudi-after-joint-purchase-of-stake-1-.html.

VI FINANCING OF M&A: MAIN SOURCES AND DEVELOPMENTS

Middle East private equity investment plunged by 80 per cent to US\$561 million in 2009, according to Gulf Venture Capital Association data.²⁶

By contrast, the Middle East saw renewed M&A activity in 2010 with more than 500 deals announced in the region, the most on record, according to Thomson Reuters 2010 Middle East Investment Banking Analysis.²⁷ Thomson Reuters' review of the Middle East investment banking industry for 2010 covers the region's M&A, debt and equity capital markets. The review includes rankings of banks and advisers operating in the Middle East based on deal activity and fees and provides an independent assessment of the market. In 2010, Middle-Eastern M&A, based on target nation, reached \$31 billion, more than double the activity seen during 2009.

However, syndicated loan activity declined by 78 per cent in the first quarter of 2011 (in comparison with the same period in 2010) to reach US\$2 billion, according to data from Thomson Reuters LPC. Fees generated in the Middle East reached US\$48.8 million during the first quarter of 2011 (58 per cent less than the same period in 2010). Of those fees, M&A generated US\$16.7 million (a decline of 66 per cent over the same period last year).²⁸

One of the key legacies of the financial crisis in the region has been the reduction in lending. Difficulties have arisen as a result of the retrenchment of the international banks with fewer banks competing to finance M&A transactions. In addition, financial institutions have adopted stricter lending principles to manage risks and local banks remain hesitant about financing leveraged acquisitions.

In the recent past, there have been very few deals publicly disclosed in Bahrain. However, the following transactions show that financial institutions are now at least generating a small deal flow.

In February 2011, Bahrain Islamic Bank BSC announced a rights offering of 546 million shares for a value of US\$145 million. The announcement of this deal accounted for the largest proportion of total capital raising deal value in the region – approximately 73 per cent.²⁹ The rights offering, originally postponed in March due to market conditions,³⁰ closed on 22 June 2011.³¹

26 Emirates 24/7, 'StanChart sees Mideast private equity deals up', 9 January 2011, www.emirates247.com/business/economy-finance/stanchart-sees-mideast-private-equity-deals-up-2011-01-09-1.339889.

27 Gulfnews.com, 'Middle East M&A activity hits a new high in 2010', 12 January 2011, <http://gulfnews.com/business/markets/middle-east-m-a-activity-hits-a-new-high-in-2010-1.745045>.

28 'Mideast investment industry sees massive decline, says Thomson Reuters', 12 April 2011, www.albawaba.com/mideast-investment-industry-sees-massive-decline-says-thomson-reuters.

29 'Zephyr Month in Review: Middle East, February 2011', www.mandaportal.com/getattachment/57a84168-8fbc-4db7-8fe1-4c03f5bccee1/Middle-East,-February-2011.

30 'Bahrain Islamic Bank postpones capital hike', 7 March 2011, www.reuters.com/article/2011/03/07/bahrainislamic-capital-idUSLDE7260NO20110307.

31 Tickerchart.com: 22 June 2011.

Bahrain's Ahli United Bank BSC (AUB) concluded on 31 March 2011 landmark capital raising agreements with the IFC Capitalisation (Equity) Fund LP and IFC Capitalisation (Subordinated Debt) Fund LP to provide AUB with Tier 1 qualifying US\$125 million in new equity and Tier 2 qualifying US\$165 million in new sub-debt facilities.³²

The proceeds of these capital issuances should lead to further funding being made available for M&A transactions. Now that the state of emergency has been lifted, Bahrain will start the process of rebuilding its reputation as a financial hub and an attractive place for foreign direct investments.

One additional positive note is the launch of the Bahrain Financial Exchange (BFX) in February 2011 as the MENA region's first-ever multi-asset exchange that is internationally accessible to trade securities, derivatives, structured products and shariah compliant financial products. It is anticipated that the BFX will promote ongoing growth of the financial markets in the region.³³

VII EMPLOYMENT LAW

As employers are obliged to cut costs following the global financial crisis a topic of interest has been the implication of redundancies and dismissals of personnel. Generally, the labour laws in Bahrain are very protective of employees and regularly employers are faced with having to justify their decisions of dismissing employees.

Bahrain Labour Law for the Private Sector, No. 23 of 1976, was repealed and replaced by the Bahrain Labour Law for the Private Sector, No. 36 of 2012 (the Labour Law), which was issued on 26 July 2012 and came into force on 2 September 2012. Implementing regulations to the new law are expected to be brought into force by the Minister of Labour.

The new Labour Law regulates employment for both national and foreign employees and extends its application to domestic workers. The new Labour Law, like the old law, sets up a highly regulated regime of employer-employee relationship and grants various rights and protections to employees, including provisions relating to health and safety, compensation for work injuries and occupational illnesses, conditions of employment of juveniles and women, annual and sick leave, limitations on working hours, payment of overtime and end-of-service gratuity. The new Labour Law builds on these rights and is arguably even more pro-employee with the intention to create a better investment environment in Bahrain by aligning the practices and benefits for private sector employment with Bahrain's public sector.

The new Labour Law grants an additional 15 days' paid maternity leave to female employees, and an additional 10 days' sick leave. Further, it grants 30 days' annual leave regardless of the duration of service, unlike the old law, which granted all employees 21

32 Nasdaq Dubai, 'AHLI United Bank Reports an 18% Rise in Q1/2011 Profit to US\$ 77.3 million' 18 April 2011, http://nasdaqdubai.blogspot.co.uk/2011_04_01_archive.html.

33 'Bahrain Stock Exchange officially launched', 2 February 2011, www.bahrainedb.com/press-edb-welcoming-bfx.aspx.

days' annual leave until the completion of five years' service with the same employer, following which it granted them 28 days.

The Labour Law applies as a matter of public policy regardless of the choice of law selected in the employment agreement.

The new Labour Law reinforces Bahrain's efforts to come in line with international standards, and it has aligned Bahrain's domestic law with several of the Arab and international labour treaties to which it is a signatory. The new Labour Law has removed the distinction between national and foreign employees in that it no longer requires employers to consider making non-Bahraini employees redundant before Bahrainis and then nationals of other gulf countries.

In addition to benefiting the working environment in the private sector, the new Labour Law has set the scene for much faster resolution of labour disputes. Under the new Law all labour-related claims must be filed with the Labour Office, all cases will be heard before a labour administration judge and the judge will propose a suitable amicable settlement, if no settlement is reached the case will be referred to the High Civil Court. The High Civil Court will hear disputes on an urgent basis and make a decision within 30 days of the date of the first hearing.

One consideration following a successful merger or acquisition is often the termination of the employment relationship of certain employees. The new Labour Law now requires the employer to notify the Ministry of Labour of potential redundancies at least 30 days before it informs the employee of his or her redundancy. Failure of the employer to notify the Ministry of the intended redundancies will make the dismissal unjustified, consequently doubling the employer's liability to pay compensation for such redundancy.

Under the Labour Law there are two types of employment contracts: those of a fixed duration and those of an indefinite duration. If the employee is made redundant, his or her entitlement to compensation will be determined by the form of contract of employment he or she has.

If an employee's employment is terminated without a valid reason, it is regarded as an abuse of right on the part of the employer and he or she has to indemnify the employee as per the provisions of the new Labour Law, which clearly set out the calculation for compensation available to employees in both unfair dismissal and redundancy situations.

The new Labour Law includes tougher punishments, non-compliance with the provisions of the Labour Law is a punishable offence with a term of imprisonment of up to three months, fines of 500 to 1000 Bahraini dinars, or both. In case of a repeat offence, the punishment will be doubled.

Furthermore, under the Labour Law if an establishment is wholly or partially transferred, the person to whom it is transferred is jointly responsible with the employer for discharging all the obligations imposed by this Law.

VIII TAX LAW

There is no concept of residency for tax purposes in Bahrain, as there are no taxes payable by employees in Bahrain. However, employers must pay social security contributions of a percentage of the first 4,000 Bahraini dinars of an employee's monthly salary.

There are no corporate, withholding, sales or value-added taxes imposed on business entities in Bahrain. There is no tax regime other than that on entities directly engaged in the exploration or production of crude oil or other natural hydrocarbons or on refining of crude oil. Income tax is levied at the rate of 46 per cent of the income derived by those entities.

There has been speculation as to whether corporate tax or VAT will be introduced in Bahrain or whether there will be some form of harmonisation of indirect tax across the GCC. Until further announcements are made that rule out the introduction of such taxes by individual countries or the wider GCC for a defined period, speculation will continue. In the context of double tax treaties, Bahrain continues to expand its network in this sector, and has recently signed double taxation treaties with the following countries:

- a* Bahrain–Czech Republic double taxation treaty, signed on 24 May 2011;
- b* Bahrain–Sri Lanka double taxation treaty, signed on 24 June 2011; and
- c* Bahrain–Georgia double taxation treaty, signed on 18 July 2011.

These treaties will only come into force once they have been ratified by the respective countries. The Bahrain–Uzbekistan double taxation treaty came into force on 12 January 2011.

Bahrain has also recently signed tax information exchange agreements with a number of countries including Denmark, the Faroe Islands, Finland, Greenland, Iceland, Norway and Sweden. These provide for the mutual exchange of tax information.³⁴

IX COMPETITION LAW

There is no generally applicable competition law in Bahrain.

Restrictive practices and agreements are not regulated in Bahrain. But an agreement is void when an obligation is undertaken for no consideration or for a consideration contrary to public policy pursuant to the Civil Law (Legislative Decree No.19 of 2001).

However, there are some provisions in the Constitution and the Law of Commerce (Legislative Decree No. 7 of 1987) that deals with this aspect. The Constitution stipulates that any monopoly shall only be awarded by law and for a limited time. The Law of Commerce, which is applicable to traders and to all commercial activities undertaken by any person giving protection to the owner of a trade name and trademark. It also prohibits traders from resorting to fraud and cheating when marketing their goods and further prohibits them from disseminating false or misleading information or using methods with regard to the origin or description of their goods or importance of their trade or their credentials that might have damaging effects on their competitors or might attract the customers of such competitors. It further prohibits a trader from inducing the employees of a competitor to assist them in attracting a rival's customers or to leave employment with a view to learning the secrets of their competitors. It prohibits any

³⁴ PWC Middle East Tax & Legal Update Report, January 2012, www.pwc.com/m1/en/assets/document/metlu-report-2012.pdf.

person engaged in the business of supplying information to commercial houses from supplying untrue statements about the behaviour or financial standing of a trader.

X OUTLOOK

Whereas 2011 proved to be challenging times for Bahrain, some sectors of the industry have stabilised and others have witnessed renewed growth in 2012. The banking sector has unfortunately not yet recovered, however, and a year on the outlook for the retail banking system in Bahrain remains negative. Credit rating agencies such as Moody's also expect private sector confidence and foreign investment to remain low, resulting in weak business growth among banks.³⁵

Some relocations have also been witnessed as an inevitable by-product of the 2011 crisis. Bahrain's credit rating was also lowered one level at Moody's Investors Service with a negative outlook, citing the impact of the recent political turmoil on economic growth and the weakening of the banking industry. Bahrain's government bond rating was reduced to Baa1, the third lowest investment grade, from A3. 'The main driver underlying Moody's decision to downgrade is the significant deterioration in Bahrain's political environment since February', Moody's said in a statement.³⁶

Dubai, on the brink of a debt default in 2009, has remained relatively stable and is emerging as a safe haven amid the turmoil in the Middle East. Although difficult to accurately quantify, businesses and capital inflows into Dubai have increased as a result of the political uncertainty in Bahrain. People from around the region 'are trying to bring money in as they consider this a safe haven,' said P Krishna Murthy, the head of the financial services division at the Al Rostamani Group. 'The UAE and Dubai happens to be at the forefront of this.'³⁷

Deposits held by UAE banks increased 10.6 per cent in 2012 after climbing by 6.8 per cent during all of 2011, helped by the country's stable environment.³⁸

Even though the social unrest has had economic costs – notably on the tourism sector, which suffered as a result of the cancellation of the 2011 Formula 1 event, Bahrain's flagship international event – Bahrain's economy benefited from the return of the Grand Prix in 2012 and 2013, which proved to be a huge success with compelling economic benefits including airline ticket reservations on Bahrain's airlines, hotel reservations, taxi and car hire, shopping and restaurant reservations.³⁹

35 Moody's Investor Service, 'Moody's: Outlook remains negative for Bahrain's banking system', 17 April 2012, www.moodys.com/research/Moodys-Outlook-remains-negative-for-Bahrains-banking-system--PR_243294.

36 'Bahrain credit rating lowered at Moody's on unrest impact', 30 May 2011, www.arabianbusiness.com/bahrain-credit-rating-lowered-at-moody-s-on-unrest-impact--402275.html.

37 'Safe Haven Dubai Gains As Middle East Turmoil Disrupts Lives', 7 April 2011, www.bloomberg.com/news/2011-04-06/safe-haven-dubai-gains-as-middle-east-turmoil-disrupts-lives.html.

38 Ibid.

39 Bahrain Economic Development Board.

Another positive prospect comes from Aluminium Bahrain, the world's fourth-largest aluminium smelter, whose spokesperson recently stated that it was on course to surpass growth targets this year despite the impact of the social unrest.⁴⁰

Other prospects for improvement come from higher oil prices, billions in Saudi investment and relative calm on the streets, which have also helped to restore some confidence in the regional trading and finance centre.⁴¹

In Bahrain, GCC support will help to ease the balance of payments pressures triggered by the recent political and security developments. The foreign ministers of the GCC announced in March 2011 the establishment of a development fund for Bahrain and Oman worth US\$20 billion, with US\$10 billion going to each country.⁴² It is anticipated that this support, spread out over 10 years, will assist in helping Bahrain to finance housing, infrastructure projects, roads and energy, while assisting key development projects. Bahrain needs to develop its investment infrastructure and at the same time as assisting in the promotion of its competitiveness; this is to ensure Bahrain's reputation as a key business hub.⁴³

After skyrocketing in March, the cost of insuring Bahraini sovereign debt has edged lower. Bahrain's five-year credit default swaps peaked at 350 basis points when the government cleared the streets of protesters, helped by security forces from Saudi Arabia. They are currently near 235 basis points but still higher than levels of below 200 before the unrest.⁴⁴

While local bankers cite a pick-up in retail bank assets in the past three months as a good sign, the prices of goods and services shrank in March, April and May, while the main stock index is down 7.4 per cent since February compared to a 2.7 per cent increase in Dubai.⁴⁵

Bahrain, a modest oil producer, requires oil prices of around US\$100 per barrel to help balance the budget for its US\$22 billion economy, and may get help from robust oil prices currently above US\$108.⁴⁶

Bahrain's labour fund also recently announced a 10 million Bahraini dinars fund to offer rescue packages to small and medium-sized businesses that have been worst hit by the recent political and social uprising.⁴⁷

40 'Aluminium Bahrain says on course to beat growth targets', 19 June 2011, www.arabianbusiness.com/aluminium-bahrain-says-on-course-beat-growth-targets-405933.html.

41 'Rebuilding Bahrain', 23 June 2011, www.arabianbusiness.com/rebuilding-bahrain-406710.html.

42 'GCC members to provide Oman and Bahrain with \$20 billion', 14 March 2011, www.al-shorfa.com/cocoon/meii/xhtml/en_GB/features/meii/features/main/2011/03/14/feature-03.

43 Trade Arabia: Business News Information, 'Bahrain mulls plans for \$10bn GCC fund', 3 January 2012, www.tradearabia.com/news/bank_210334.html.

44 See footnote 48, *supra*.

45 Ibid.

46 Ibid.

47 'Bahrain sets up \$26.5m SME rescue package', 25 May 2011, www.arabianbusiness.com/bahrain-sets-up-26-5m-sme-rescue-package-402090.html.

Deloitte believes that the ongoing economic distress will be one of the key drivers of M&A activity: 'Rather than there being factors driving people in an incentivised way, there are more push factors for people to think about M&A because of distress.'⁴⁸

The need to diversify sources of funding for banks that act more like private equity houses is likely to be another driver of M&A activity, Dawood Ahmedji, the European finance leader at Deloitte in Bahrain has said.⁴⁹

Other observers acknowledge that challenges exist. Ownership, pricing and cross-border issues, as well as regulatory frameworks that are not yet mature, are some of the factors that have kept M&A activity thin on the ground.

The recovery pace of M&A activity depends on how acutely sellers begin to feel the pinch and consequently lower their pricing expectations to meet those of buyers.

Recently, Bahrain has adopted a more conciliatory tone promising reforms. Bahrain's Crown Prince, who is widely seen as a moderate, said in a statement that he was committed to the reform path and confirmed that the Gulf state would listen to both domestic and international concerns.

Parliament and national dialogue chairman Khalifa Al Dhahrani pointed out that the landmark national dialogue, which began on 1 July, is a historic opportunity to overcome Bahrain's current critical stage without any preconditions.⁵⁰

It will remain a testing time for Bahrain over the coming months.

48 www.islamicfinancenews.com, February 2011.

49 Ibid.

50 Gulf Daily News, 'Nation hopes as talks begin', 3 July 2011, <http://gulf-daily-news.com/NewsDetails.aspx?storyid=309102>.

Appendix 1

ABOUT THE AUTHORS

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Ms Khunji also specialises in banking and financial transactions and her experience includes M&A and corporate restructuring, and banking and finance transactions in both the Kuwait and Bahrain markets. Her experience includes advising on secured and unsecured finance transactions, company acquisitions and banking and company law matters generally.

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Maryia Abdul Rahman is a graduate of the University of Southampton, a solicitor of England and Wales and an associate at KBH Kaanuun. She has experience in corporate and commercial law with a particular focus on labour law in Bahrain. She has been based in Bahrain since 2011 and has since developed her expertise in dealing with international clients, in particular advising them of their employment law obligations.

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