The Mergers & Acquisitions Review

Fifth Edition

Editor
Simon Robinson

Law Business Research

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PUBLISHER
Gideon Roberton

BUSINESS DEVELOPMENT MANAGER
Adam Sargent

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EDITOR'S PREFACE

After a prolonged period of uncertainty and decreased M&A activity, deal-making is undergoing something of a resurgence. Over the course of recent years, corporations across the world have been carefully navigating the economic downturn and attempting to consolidate their positions. In 2011 the market has proved more conducive to M&A and, at least in the first half year, confidence seems to be returning. Opportunities are seemingly limited to those companies and private equity houses that enjoy a stable financial basis. Governments have addressed the perceived failings of the regulatory framework and, for the most part, reforms have now been implemented. One of the underlying reasons for the drop in M&A was the drought of acquisition finance; without the necessary funding, few players were able to launch major takeover bids. However, the loan market appears to have gained a new lease of life and banks are adamant that they are willing and able to fuel well-conceived bids. The task that lies ahead of companies and funds is identifying truly value-generative targets and negotiating the new regulatory framework. There is increased emphasis on the views of shareholders following the financial crisis, and companies are best advised to gauge shareholder sentiment early. The provenance of M&A is undergoing a gradual shift, with deal-making in the Asia-Pacific region reaching its highest-ever level in 2010 and also representing its highest proportion of the total global value of M&A. In addition, the emerging markets are witnessing heightened deal activity, in particular the BRIC nations. These trends seem set to continue.

It would be premature, however, to suggest that M&A has completed a Lazarus-like revival. The recovery of deal-making is in its infancy and it is still highly susceptible to external forces. A number of major political and economic factors may impede sustained M&A activity, and could even force it to retreat. The sovereign debt tribulations in Europe, the weakening of the US economy, the 'Arab Spring' uprisings, the earthquake in Japan, rising commodity prices and global austerity measures all pose severe challenges. Given the fragile state of the global economy, such issues could well shackle the fledgling M&A revival. In short, economists remain uncertain about the health of M&A, and although many commentators hope that it will continue to gather pace, albeit slowly, there are a number of variables that may waylay deal-making. Economists have not ruled out short-term stagnation in deal value and volume, as a precursor to the dawning of an M&A renaissance further down the line.

I wish again to thank all the contributors for their continued support in producing this book – one would hope that in this uncertain time the following chapters should provide cause for cautious optimism, while also reiterating some of the lessons from the recent lean years.

Simon Robinson
Slaughter and May
London
August 2011

Chapter 10

BAHRAIN

*Haifa Khunji and Elise S Paul-Hus**

I OVERVIEW OF M&A ACTIVITY[1]

There has been much international focus on the Middle East and the Kingdom of Bahrain in recent months due to the political and security developments.

Following a decade of strong economic performance, Bahrain's growth slowed in 2009 and 2010. The slowdown was most visible in two sectors affected by the global financial crisis, namely construction and finance. As Bahrain's growth slowed, it avoided the recession experienced in Europe and North America and performed better than some of its neighbours in the Gulf Cooperation Council ('GCC') countries.[2] According to a UN report published recently, Bahrain's real GDP grew at 4.5 per cent in 2010 from 3.1 per cent in 2009.[3]

However, beginning in mid-February 2011, Bahrain has been rocked by the worst public unrest since the 1990s as protesters demanding sweeping political reform took to the streets.

Generally, the Middle East experienced a large decline in M&A and equity issuance in the first quarter of 2011, according to the Thomson Reuters Investment Banking League Table, as unrest swept through the region. Middle Eastern M&A based on target nation reached $4.9 billion in the first quarter, 42 per cent lower than the first

* Haifa Khunji is a partner and Elise S Paul-Hus is a senior associate at KBH Kaanuun.

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

2 Annual Economic Review 2010: Bahrain Economic Development Board.

3 The United Nations Economic and Social Council: 7 April 2011.

quarter of 2010. The most targeted industry in the region was the financial sector, which accounted for 34 per cent of the activity.[4]

According to recent market data, deal value in the Middle East weakened in the first quarter of 2011, falling to $3.594 billion from $4.627 billion in the fourth quarter of 2010 and was 60 per cent lower than the first quarter of 2010. Deal volume fell for the second successive quarter, all but erasing four consecutive periods of growth between the third quarter of 2009 and the third quarter of 2010.[5]

Despite political factors and the adverse economic climate, some mergers and acquisitions were completed in the last 12 months in Bahrain, including:

a the acquisition by Bahrain's Arcapita Bank BSC(c) and its affiliates of a majority stake in J. Jill, a leading multi-channel specialty retailer of women's apparel based in the US. Arcapita acquired its interest in J. Jill from Golden Gate Capital, which retains a minority stake in the business;[6]

b the acquisition by Bahrain's Investcorp of Coral Palm Plaza, a 135,672ft^2 shopping centre located in Coral Springs, Florida, as part of a joint venture with Lincoln Equities for approximately $120 million;[7]

c Investcorp's acquisition of the Residence Inn Manhattan Beach, a 176-room Marriott Hotel in Los Angeles, California, for approximately $40 million;[8] and

d Arcapita's sale of its 80 per cent stake in two Europe-wide portfolios of self-storage facilities to Shurgard Europe for $587 million.[9]

Looking forward, region-wide public sector support should translate into wealthier GCC states helping out Bahrain. This support, combined with higher oil output, should help maintain regional growth.[10] Bahrain is now expected to see its economy grow by 3.4 per cent this year, down from 4.2 per cent in a December survey.[11]

However, Bahrain's prospects remain unclear in light of the political uncertainty with lower investor confidence triggering capital outflows and a potential stalling of private sector activity and investment. To add to Bahrain's difficulties, its financial, telecommunications and transportation sectors face ever increasing competition from Dubai and elsewhere in the region.

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4 Albawaba.com: 12 April 2011.

5 Zephyr Quarterly M&A Report: Middle East Q1 2011.

6 Arcapita.com: 16 May 2011.

7 MENA PE Newsletter: April 2011.

8 Business Intelligence Middle East: 19 June 2011.

9 Gulf Daily News: 4 April 2011.

10 Andrew Gilmour, Senior Economist at Samba Financial Group as reported in the Khaleej Times Online: 17 March 2011.

11 Ibid.

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 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 a resolution 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 domicile 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 structures. 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 an issuer 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 elements. 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 GCC[12] with high value-added sectors such as financial services and manufacturing featuring heavily in the economic mix.[13] The Government of Bahrain has sought to reduce dependence on declining oil reserves and encourage foreign investment by diversifying the economy.[14]

The World Bank's 'Doing Business 2011' report ranked Bahrain at No. 28 out of 183 countries in the world for 'ease of doing business' for foreign investors.[15] 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.[16]

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.[17]

Also in 2010, the Bahrain Logistics Zone, Bahrain International Airport and the Bahrain International Investment Park ('BIIP') were ranked among the top 25 best

12 Annual Economic Review 2010: Bahrain Economic Development Board.

13 Twentyfoursevennews.com: 18 June 2011.

14 Heritage.org/Bahrain.

15 US Department of State: March 2011.

16 Bahrainedb.com: 2 November 2010.

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

'future duty free zones in the world' from 700 free trade zones worldwide.[18] 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.[19]

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

However, casualties of 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 over-reliance 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.[20]

The unrest in Bahrain has also impacted upon 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. 'It will take at least until the second half of the year until investors reconsider [investments]. We're looking at a lost year,' Jarmo Kotilaine, chief economist at National Commercial Bank Capital recently said.[21]

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.[22]

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.

The CBB recently 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

18 Gulf Daily News: 25 June 2010.

19 Biip.com.

20 Gulf Finance House: Issue 41 8-14 October 2010.

21 Arynews.tv: 1 March 2011.

22 Ibid.

premiums in the Kingdom, from 55.7 million Bahraini dinar to 56.7 million Bahraini dinar. 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 dinar in the first quarter of 2011, compared with 11.5 million Bahraini dinar in the first quarter of 2010.[23]

In terms of the telecommunications sector, Bahrain was seen as the Arab region's most vibrant country for the telecom industry to develop and flourish, according to an industry expert. 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 $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]

One further development to watch is the recently announced Technology City, a billion-dollar world-class park, aimed at hosting small, medium and large technology companies to grow niche markets and attracting global science and technology companies to Bahrain.[26] This initiative should boost and encourage innovation in technology and scientific research, while providing a solid infrastructure for the technology sector in Bahrain.

VI FINANCING OF M&A: MAIN SOURCES AND DEVELOPMENTS

Middle East private equity investment plunged by 80 per cent to $561 million in 2009, according to Gulf Venture Capital Association data.[27]

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.[28] 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.

23 Central Bank of Bahrain: 22 June 2011.

24 Gulf Daily News: 21 June 2011.

25 Bloomberg.com: 15 June 2011.

26 Zawya.com: 17 May 2011.

27 Emirates 24/7: 9 January 2011.

28 Gulfnews.com:12 January 2011.

However, syndicated loan activity declined by 78 per cent in the first quarter of 2011 (in comparison to the same period in 2010) to reach $2 billion, according to data from Thomson Reuters LPC. Fees generated in the Middle East reached $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 $16.7 million (a decline of 66 per cent over the same period last year).[29]

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 transactions below 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 $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.[30] The rights offering, originally postponed in March due to market conditions,[31] closed on 22 June 2011.[32]

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 I qualifying $125 million in new equity and Tier II qualifying $165 million in new sub-debt facilities.[33]

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 Middle East and North Africa (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.[34]

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,

29 Albawaba.com: 12 April 2011.

30 Zephyr: February 2011.

31 Reuters: 7 March 2011.

32 Tickerchart.com: 22 June 2011.

33 Nasdaq Dubai: 18 April 2011.

34 Bahrainedb.com: 2 February 2011.

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 promulgated by Amiri Decree Law No. 23 of 1976, as amended, ('Labour Law') regulates employment for both national and foreign employees. The Labour 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 Labour Law is applied as a matter of public policy regardless of the choice of law selected in the employment agreement.

One consideration following a successful merger or acquisition is often the termination of the employment relationship of certain employees.

In Bahrain, there are two types of employment contracts: those of a fixed duration and those of an indefinite duration. Fixed-term contracts will terminate automatically at the end of the period. If after the expiry of the term the employee continues to work and the employer continues to pay his wages, the contract is deemed to have been renewed for an indefinite duration on the same terms and conditions as the former agreement. For employees bound by fixed-term agreements longer than five years, they are able to terminate them at the expiry of the five year term without incurring any liability.

Contracts for an indefinite duration may be terminated by either party after giving a written 30-day notice or for the period stated in the agreement (which cannot be less than 30 days for employees paid monthly or less than 15 days for other employees). If a party fails to give the required notice, he will have to compensate the other party for the duration of the legal notice period.

If an employee is terminated without a valid reason, it is regarded as an abuse of right on the part of the employer and he has to indemnify the employee.

Unlike other jurisdictions, the amount of compensation payable is not fixed by law. The Bahraini courts have the right to determine the compensation based on the damages suffered in each case. However, consideration is given to customary practice, the nature of the work, the period of the contract and all the circumstances of the case including damages.

It is to be noted that the Bahraini courts have recognised the concept of 'reorganisation of the employer entity'. Employers may prove to the court that they have sustained losses and does not plan to replace the terminated employee and that the termination is part of a restructuring. If the court is satisfied, the employer is deemed to have justified the termination of employment.

The Labour Law also provides that if the number of employees exceeds the minimum requirements, the employer must first terminate non-Arab before Arab nationals and Bahraini citizens provided that the latter have the competence required for the type of employment.

Furthermore, under the Labour Law if an establishment is wholly or partially transferred, the person to whom it is so 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 dinar 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 introduction of such taxes by individual countries or the wider GCC for a defined period, speculation will continue.

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 rival's customers or to leave employment with a view to learning the secrets of their competitors. It prohibits any 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

Certainly, the first half of 2011 has proved to be a challenging time for Bahrain. The social unrest that began in February triggered by popular risings in Tunisia and Egypt was followed by the declaration of martial law in March and the lifting of the state of emergency in June.

However, some believe that even before the unrest erupted, Bahrain had been losing ground to its neighbours Dubai, Abu Dhabi and Doha.

Social unrest has had economic costs, with the tourism sector being particularly hard hit with the cancellation of the 2011 Formula One event, Bahrain's flagship international event, as a result of the political turmoil.[35] Business conferences have also been affected with several relocating to Dubai. The hotel occupancy rate in Manama, the capital, slumped to 33 per cent in the first quarter, the lowest in the MENA region, with occupancy estimated at only around 5-10 per cent at the peak of the crisis in March 2011.[36]

Corporate headquarters have also relocated either temporarily or permanently. Robecco, the asset management arm of Dutch lender Rabobank, which has $5 billion of regional assets under management, has decided to move its regional headquarters and staff from Bahrain to Dubai by the end of the year.[37]

Bahrain's credit rating was 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.[38]

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.'[39]

Deposits held by UAE banks increased 2.8 per cent in the first two months of this year after climbing by 6.8 per cent during all of last year, helped by the country's stable environment.[40]

In spite of the social unrest and the economic slowdown, there is hope.

Aluminium Bahrain, the world's fourth-largest aluminium smelter, recently said that it was on course to surpass growth targets this year despite the impact of the social unrest in the Kingdom.[41]

Higher oil prices, billions in Saudi investment and relative calm on the streets have also helped to restore some confidence in the regional trading and finance centre but no one is calling it an economic recovery just yet.[42]

35 Reuters: 21 February 2011.

36 Twentyfoursevennews.com: 29 May 2011.

37 FT.com: 8 June 2011.

38 Arabianbusiness.com: 26 May 2011.

39 Bloomberg.com: 7 April 2011.

40 Ibid.

41 Arabianbusiness.com: 19 June 2011.

42 Arabianbusiness.com: 23 June 2011.

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 $20 billion, with $10 billion going to each country.[43] It is anticipated that this support, which is spread out over 10 years, will assist in helping Bahrain to finance housing and infrastructure projects.

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 $100 per barrel to help balance the budget for its $22 billion economy, and may get help from robust oil prices currently above $108.[46]

Bahrain's labour fund also recently announced a 10 million Bahraini dinar ($26.5 million) fund to offer rescue packages to small and medium-sized businesses that have been worst hit by the recent political and social uprising.[47]

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.

43 Al-shorfa.com: 14 March 2011.

44 Arabianbusiness.com: 23 June 2011.

45 Ibid.

46 Ibid.

47 Arabianbusiness.com: 25 May 2011.

48 Islamicfinanceasia.com: February 2011.

49 Ibid.

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.

50 Gulf Daily News: 3 July 2011.

Appendix 1

ABOUT THE AUTHORS

HAIFA KHUNJI

KBH Kaanuun

Haifa Khunji is a graduate of the University of Buckingham in England. She is licensed to practise in Bahrain and Kuwait. She trained and worked with three London firms in Dubai, Doha and Kuwait for six years and prior to that spent four years working as in-house counsel for a multinational trading company based in Dubai. She joined KBH Kaanuun as a partner at its inception.

Haifa is particularly involved in corporate finance, banking and financial services as well as general corporate and commercial law. Haifa specialises in 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.

ELISE S PAUL-HUS

KBH Kaanuun

Elise S Paul-Hus is a dual Canadian and US-qualified lawyer with over 20 years' experience in international corporate and capital markets transactions.

She has acted for major listed and non-listed companies as well as institutional investors and investment banks in M&A transactions and corporate restructurings in the Gulf region. Elise has also represented issuers and banks in several public offerings and private placements in the Middle East, Russia, Japan and North America. Elise has worked in law firms in Montreal, Tokyo, Moscow and Dubai. She was also seconded to the Quebec Securities Commission.

She relocated to the Middle East in 2007.

KBH KAANUUN

City Tower
10th Floor
Sharq
Khalid Bin Al Waleed Street
PO Box 27353
Safat 13134
Kuwait City
Kuwait
Tel: +965 22412050/60
Fax: +965 22412040
kuwait@kbh.com.kw

Dubai International Financial Centre
Gate Village 7, Level 2
PO Box 506546
Dubai
United Arab Emirates
Tel: +971 4 709 6700
Fax: +971 4 709 6711
dubai@kbh.ae

www.kbh.ae