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# THE MERGERS & ACQUISITIONS REVIEW

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SIXTH EDITION

EDITOR  
SIMON ROBINSON

LAW BUSINESS RESEARCH

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SIXTH EDITION

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[Adam.Sargent@lbresearch.com](mailto:Adam.Sargent@lbresearch.com)

# THE MERGERS & ACQUISITIONS REVIEW

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Sixth Edition

Editor  
SIMON ROBINSON

LAW BUSINESS RESEARCH LTD

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# EDITOR'S PREFACE

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Deal-making has remained on the agenda in the past year, although the first half of 2011 showed a stronger performance than the second half, which saw a significant fall in transactional activity. In the wake of continuing economic uncertainty, opportunities for acquisitions remain limited to companies and institutions on a stable financial footing. At the same time, corporates are beginning to focus on their core business and looking for ways to return value. Valuations remain favourably low for purchasers, and the prospect of striking a bargain makes cross-border M&A attractive for those who can afford it. While access to the loan market has remained difficult, cash-rich corporations have begun to swing the balance in their favour. Shareholder participation and a desire for control and accountability are on the rise, and an atmosphere of increased regulation, reform and austerity is building. We remain in a state of geopolitical flux, and these factors continue to complicate the global economic scenario. The period of widespread unrest in the Middle East and North Africa seems to be reaching a settled conclusion, although the situation in Syria (and possibly Mali and Sudan) is still volatile. A number of countries have seen fresh elections and a transition of leadership, including France and Russia, and a change of leadership in China is expected following the 18th National People's Congress this autumn, when the US presidential elections will also take place. The sovereign debt crisis and the ongoing uncertainty over the fate of the eurozone are further contributing to the lack of confidence in the markets.

All is not doom and gloom, however, and whereas the global picture remains difficult, there are signs of hope. The emerging markets have shown a persistent growth in outbound investment, spurred on by a desire to build a more prominent global presence and for the purpose of accessing new markets. European targets remain of interest to both US and Middle and Far-Eastern buyers. Inbound investment from the emerging markets into both Africa and Australia is on the rise, and this has strengthened activity in the energy, mining and utilities sector. The technology, media and telecoms sector has also shown signs of promise with some high-profile deals, and must be watched with interest in the coming year. There is hope that, as political and economic factors

stabilise, M&A activity will once more gather pace and momentum, and enter a new era of resurgence. We shall see.

Once again, I would like to thank the contributors for their continued support in producing this book. As you read the following chapters, one hopes the spectre of the years past will provide a basis for understanding, and the prospect of years to come will bring hope and optimism.

**Simon Robinson**

Slaughter and May

London

August 2012

## Chapter 10

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# BAHRAIN

*Haifa Khunji, Jessica Lang Roth and Sumana Abdulkarim<sup>1</sup>*

### I OVERVIEW OF M&A ACTIVITY<sup>2</sup>

Following a decade of strong economic performance, Bahrain's growth slowed from 2009 to 2011. The slowdown was in part caused by the global recession, but also by the political and social turmoil experienced by Bahrain in 2011. The slowdown has been most visible in two sectors affected by the global financial crisis, namely construction and finance.<sup>3</sup>

2012 has seen forecasters make positive projections for Bahrain's economy. According to a report by Standard and Poor's, Bahrain's economy is expected to grow by 3.5 per cent in 2012 and 4.1 per cent in 2013. This growth is slated to be backed by government spending and is expected to be matched by an increase in foreign direct investment ('FDI'), which has already reached \$300 million.

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 \$300 million for infrastructure projects and \$550 million for 50,000 housing units. The Economic Development Board's ('the EDB') *Bahrain Economic Quarterly* report also shows that Bahrain's annual real output grew at a rate of 2.2 per cent in 2011. 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 are transport and communications. Other sectors that influenced growth include manufacturing, financing services, mining and quarrying. The EDB anticipates that Bahrain will experience 4 to 5

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1 Haifa Khunji is a partner, Jessica Lang Roth is an associate and Sumana Abdulkarim is a legal assistant 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](http://www.deloitte.com/view/en_OM/om/press/press-releases/b47351b167276310VgnVCM2000001b56f00aRCRD.htm).

per cent growth by the end of 2012. This rate will fundamentally be driven by increase in manufacturing, crude oil production and government spending.

The health of the economy generally influences the pace and outcome of M&A, and so it will be helpful to have an overview of the rate of M&A in the wider Middle East, by way of comparison. Generally, this whole region has experienced a large decline in M&A and equity issuance in 2011, as unrest swept through it. This trend carried on throughout 2011 but was forecast to change in 2012. According to Deloitte, the gradual improvement in M&A deals in the Middle East throughout 2012 will be particularly visible among key players not affected by liquidity constraints, such as Saudi Arabia, Abu Dhabi and Qatar. Moreover, with a reported \$25 billion in corporate bonds and sukuk 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 in fact the only region in the world to enjoy a rise in value of M&A deals. According to Ernst & Young's M&A Tracker, the number of completed deals rose by 3 per cent in the region and the total value rose to 85 per cent compared with the fourth quarter of 2011. In the first quarter of 2012, 28 of the 126 deals made in the MENA region were reported in Egypt, more than any other country in the Middle East.

There are some notable M&A deals currently in the process of being completed in Bahrain, despite political factors and the adverse economic climate. One example is the merger between Bahraini Saudi Bank BSC and Al Salam Bank Bahrain BSC. The merger talks were initiated in May 2009 and were officially completed 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. Bahrain Saudi Bank will continue to operate its business as before and employees of former Bahrain Saudi Bank are now fully fledged employees of the newly converted Al Salam Bank.<sup>4</sup>

Some other recent notable acquisitions in Bahrain include:

- a* the acquisition by Bahrain's Arcapita Bank BSC(c) and its affiliates of a majority stake in J.Jill, a leading multi-channel speciality retailer of women's clothing based in the United States; Arcapita acquired its interest in J.Jill from Golden Gate Capital, which retains a minority stake in the business;<sup>5</sup>
- b* the acquisition by Bahrain's Investcorp of Coral Palm Plaza, a 135,672 square-foot shopping centre located in Coral Springs, Florida, as part of a joint venture with Lincoln Equities, for approximately \$120 million;<sup>6</sup>

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4 Al Salam Bank Bahrain, May 2012.

5 'Arcapita acquires leading US women's retail chain', [www.arcapita.com/media/press\\_releases/2011/05-16-2011.html](http://www.arcapita.com/media/press_releases/2011/05-16-2011.html).

6 *MENA PE Newsletter*, [http://ae.zawya.com/researchreports/p\\_2010\\_07\\_22\\_09\\_20\\_27/20110508\\_p\\_2010\\_07\\_22\\_09\\_20\\_27\\_075515.pdf](http://ae.zawya.com/researchreports/p_2010_07_22_09_20_27/20110508_p_2010_07_22_09_20_27_075515.pdf).

- c Investcorp's acquisition of the Residence Inn Manhattan Beach, a 176-room Marriott Hotel in Los Angeles, for approximately \$40 million;<sup>7</sup> 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.<sup>8</sup>

Unfortunately, Arcapita's acquisition did not prove to be a success for the company. In March 2011 the company filed for Chapter 11 bankruptcy proceedings under New York state law in Manhattan. The company's current asset value is \$3.06 billion and it is facing liabilities worth \$2.55 billion. According to the lawyers for Arcapita, the company's current status is a result of the global recession, which has resulted in Arcapita's inability to obtain liquidity from the capital markets. This major step taken by Arcapita is a logical one, and is the only way to have its many foreign investments protected from creditors seeking to obtain its assets; by filing for Chapter 11 bankruptcy, Arcapita will reach mutual agreements with creditors. Its largest creditor is currently the Central Bank of Bahrain, to whom it owes \$225.1 million; other major creditors include Commerzbank AG (\$164.7 million). The advantage of having a Chapter 11 bankruptcy application in place is that the board of Arcapita will be able to continue to manage and operate the business of the company.<sup>9</sup>

Looking forward, 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) (the 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.

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7 *Business Intelligence Middle East*, 'Investcorp makes US\$40 million acquisition of Residence Inn Manhattan Beach in Los Angeles', 19 June 2011, [www.bi-me.com/main.php?t=9&cg=3&id=53153](http://www.bi-me.com/main.php?t=9&cg=3&id=53153).

8 *Gulf Daily News*, 'Arcapita sells Europe portfolios for \$587m', 4 April 2011, [www.gulf-daily-news.com/source/XXXIV/015/pdf/page18-BUSI.pdf](http://www.gulf-daily-news.com/source/XXXIV/015/pdf/page18-BUSI.pdf).

9 Bloomberg, 'Arcapita Files For Bankruptcy Protection As Debt Talks Fail', 19 March 2012, [www.bloomberg.com/news/2012-03-19/arcapita-bank-files-for-chapter-11-bankruptcy-protection.html](http://www.bloomberg.com/news/2012-03-19/arcapita-bank-files-for-chapter-11-bankruptcy-protection.html).

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 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 ('the 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 ('the 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 GCC<sup>10</sup> with high value-added sectors such as financial services and manufacturing featuring heavily in the economic mix.<sup>11</sup> The government of Bahrain has sought to reduce dependence on declining oil reserves and encourage foreign investment by diversifying the economy.<sup>12</sup> Bahrain attracted around \$300 million FDI in 2011 despite political unrest. Nearly 20 companies from different countries around the world set up operations in Bahrain. According to the EDB, this helped Bahrain's economy grow by 2 per cent. Sheikh Mohammed bin Essa Al Khalifa, the EDB's CEO stated that the large number of international investments, from India to the United States, into Bahrain over the past year demonstrates that the kingdom's wide-ranging attractions to foreign investors remain as compelling as ever.<sup>13</sup>

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.<sup>14</sup> 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.<sup>15</sup>

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.<sup>16</sup>

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

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10 [www.bahrainedb.com/uploadedFiles/Bahraincom/BahrainForBusiness/Annual%20Economic%20Review.pdf](http://www.bahrainedb.com/uploadedFiles/Bahraincom/BahrainForBusiness/Annual%20Economic%20Review.pdf).

11 <http://twentyfoursevennews.com>, 18 June 2011.

12 [www.heritage.org/index/country/bahrain](http://www.heritage.org/index/country/bahrain).

13 *Gulf Daily News*, 'Bahrain attracting \$300m investment', 31 January 2012, [www.gulf-daily-news.com/NewsDetails.aspx?storyid=322725](http://www.gulf-daily-news.com/NewsDetails.aspx?storyid=322725).

14 [www.doingbusiness.org/data/exploreconomies/bahrain](http://www.doingbusiness.org/data/exploreconomies/bahrain).

15 'Bahrain the most economically free Arab nation', 2 November 2010, [www.bahrainedb.com/press-bahrain-ranked-the-most-economically-free.aspx](http://www.bahrainedb.com/press-bahrain-ranked-the-most-economically-free.aspx).

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

'future duty free zones in the world' from 700 free trade zones worldwide.<sup>17</sup> 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.<sup>18</sup>

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 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.<sup>19</sup> 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 \$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 \$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.<sup>20</sup>

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. According to Jarmo Kotilaine, chief economist at National Commercial Bank Capital: 'It will take at least until the second half of the year until investors reconsider [investments]. We're looking at a lost year.'<sup>21</sup>

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17 *Gulf Daily News*, 'Top global honour for Bahrain Logistics Zone', 25 June 2010, [www.gulf-daily-news.com/NewsDetails.aspx?storyid=280930](http://www.gulf-daily-news.com/NewsDetails.aspx?storyid=280930).

18 [www.biip.com.bh](http://www.biip.com.bh).

19 '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](http://www.gfh.com/en/default/gulf-finance-house-back-from-the-brink.html).

20 Bahrain News Agency, 20 May 2012.

21 [www.arynews.tv](http://www.arynews.tv), 1 March 2011.

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.<sup>22</sup>

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.<sup>23</sup>

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.<sup>24</sup>

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 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.<sup>25</sup>

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

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22 Ibid.

23 *Daily Tribune*, 'Increasing Coverage In A Growing Market', 26 February 2012, [www.dt.bh/searchdetails.php?key=301110213629&newsid=250212175658](http://www.dt.bh/searchdetails.php?key=301110213629&newsid=250212175658).

24 *Gulf Daily News*, 'Insurance sector posts solid growth in Bahrain', 28 May 2012, [www.gulf-daily-news.com/NewsDetails.aspx?storyid=331005](http://www.gulf-daily-news.com/NewsDetails.aspx?storyid=331005).

25 Central Bank of Bahrain, 22 June 2011.

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.<sup>26</sup> 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.<sup>27</sup> 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.<sup>28</sup>

One further development to watch is the recently announced a billion-dollar 'technology city', a park aimed at hosting small, medium and large technology companies to grow niche markets and attracting global science and technology companies to Bahrain.<sup>29</sup> This initiative should boost and encourage innovation in technology and scientific research, while providing a solid infrastructure for the technology sector in Bahrain.

Some acquisitions may be finalised later during the year. Batelco, which made a failed attempt to buy a stake in Zain Saudi in 2011, is keen to make an acquisition in 2012 to make up for lost profits. These lost profits are due mainly to competition originating from Zain, Viva and Mena Telecom,

Another merger possibly looming on the horizon involves Gulf Air and Bahrain Air. In an exclusive interview given to *Arabian Business*, the CEO of Bahrain Air Richard Nuttall emphasised the need to find a solution to the aviation crisis in Bahrain. The CEO made a strong case for a Gulf Air/Bahrain Air merger in the hope of enhancing the two airlines' network of flights, as well as enhancing the efficiency of airline operations.<sup>30</sup>

## 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.<sup>31</sup>

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

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26 'Bahrain TRA Plans for 2012', [www.itp.net/587795-bahrain-tra-plans-for-2012](http://www.itp.net/587795-bahrain-tra-plans-for-2012).

27 *Gulf Daily News*, 'Bahrain "best for telecom providers"' 21 June 2011, [www.gulf-daily-news.com/NewsDetails.aspx?storyid=308385](http://www.gulf-daily-news.com/NewsDetails.aspx?storyid=308385).

28 '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](http://www.bloomberg.com/news/2011-06-15/batelco-to-manage-zain-saudi-after-joint-purchase-of-stake-1-.html).

29 'Bahrain: 2011 report to explore key role earmarked for high tech industries', 17 May 2011, [www.zawya.com/story/ZAWYA20110517114239?q=Technology%20City%20bahrain%20daterange:2011-05-12..2011-05-17/](http://www.zawya.com/story/ZAWYA20110517114239?q=Technology%20City%20bahrain%20daterange:2011-05-12..2011-05-17/).

30 'Bahrain Air open to merger with state-backed Gulf Air', 20 March 2012, [www.arabianbusiness.com/bahrain-air-open-merger-with-state-backed-gulf-air-450616.html](http://www.arabianbusiness.com/bahrain-air-open-merger-with-state-backed-gulf-air-450616.html).

31 *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](http://www.emirates247.com/business/economy-finance/stanchart-sees-mideast-private-equity-deals-up-2011-01-09-1.339889).

2010 Middle East Investment Banking Analysis.<sup>32</sup> 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 \$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).<sup>33</sup>

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 \$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.<sup>34</sup> The rights offering, originally postponed in March due to market conditions,<sup>35</sup> closed on 22 June 2011.<sup>36</sup>

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 \$125 million in new equity and Tier 2 qualifying \$165 million in new sub-debt facilities.<sup>37</sup>

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

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32 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>.

33 'Mideast investment industry sees massive decline, says Thomson Reuters', 12 April 2011, [www.albawaba.com/mideast-investment-industry-sees-massive-decline-says-thomson-reuters](http://www.albawaba.com/mideast-investment-industry-sees-massive-decline-says-thomson-reuters).

34 'Zephyr Month in Review: Middle East, February 2011', [www.mandaportal.com/getattachment/57a84168-8fbc-4db7-8fe1-4c03f5bccee1/Middle-East,-February-2011](http://www.mandaportal.com/getattachment/57a84168-8fbc-4db7-8fe1-4c03f5bccee1/Middle-East,-February-2011).

35 'Bahrain Islamic Bank postpones capital hike', 7 March 2011, [www.reuters.com/article/2011/03/07/bahrainislamic-capital-idUSLDE7260NO20110307](http://www.reuters.com/article/2011/03/07/bahrainislamic-capital-idUSLDE7260NO20110307).

36 Tickerchart.com: 22 June 2011.

37 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](http://nasdaqdubai.blogspot.co.uk/2011_04_01_archive.html).

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.<sup>38</sup>

## **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 promulgated by Amiri Decree Law No. 23 of 1976, as amended, ('the 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.

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38 'Bahrain Stock Exchange officially launched', 2 February 2011, [www.bahrainedb.com/press-edb-welcoming-bfx.aspx](http://www.bahrainedb.com/press-edb-welcoming-bfx.aspx).

New legislation, which includes tougher punishments, will finally come into effect. The Shura Council has voted in favour of amendments by members of parliament relating to compensation for unfairly dismissed workers. Under the new law, any employee who has been unfairly dismissed will be entitled to a year's salary in compensation. Employers who violate the new labour law would be facing fines from 200 to 500 Bahraini dinars. The new law will be incorporated once it is referred to King Hamad Al Khalifa for ratification. It will come into effect the day it appears in the Official Gazette.<sup>39</sup>

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 do 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 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 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 have recently signed double-taxation treaties the following:

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39 Shura Council, 'New-look labour law is passed', 24 April 2012, [www.shura.bh/en/MediaCenter/News/CouncilNews/Pages/04-24-2012.aspx](http://www.shura.bh/en/MediaCenter/News/CouncilNews/Pages/04-24-2012.aspx).

- 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 already 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 merely provide for the mutual exchange of tax information.<sup>40</sup>

## **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**

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

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<sup>40</sup> *PWC Middle East Tax & Legal Update Report*, January 2012, [www.pwc.com/m1/en/assets/document/metlu-report-2012.pdf](http://www.pwc.com/m1/en/assets/document/metlu-report-2012.pdf).

expect private sector confidence and foreign investment to remain low, resulting in weak business growth among banks.<sup>41</sup>

Some relocations have also been witnessed as an inevitable by product of the 2011 crisis. 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.<sup>42</sup>

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.<sup>43</sup>

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.'<sup>44</sup>

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.<sup>45</sup>

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 April 2012, which proved to be a huge success with compelling economic benefits including airline tickets reservations on Bahrain's airlines, hotel reservations, taxi and car hire, shopping and restaurant reservations.<sup>46</sup>

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41 Moody's Investor Service, 'Moody's: Outlook remains negative for Bahrain's banking system', 17 April 2012, [www.moody.com/research/Moodys-Outlook-remains-negative-for-Bahrain's-banking-system--PR\\_243294](http://www.moody.com/research/Moodys-Outlook-remains-negative-for-Bahrain's-banking-system--PR_243294).

42 [www.ft.com](http://www.ft.com), 'Banks ponder Bahrain exodus', 8 June 2011.

43 '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](http://www.arabianbusiness.com/bahrain-credit-rating-lowered-at-moody-s-on-unrest-impact--402275.html).

44 '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](http://www.bloomberg.com/news/2011-04-06/safe-haven-dubai-gains-as-middle-east-turmoil-disrupts-lives.html).

45 Ibid.

46 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 in the kingdom.<sup>47</sup>

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.<sup>48</sup>

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.<sup>49</sup> 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.<sup>50</sup>

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.<sup>51</sup>

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.<sup>52</sup>

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.<sup>53</sup>

Bahrain's labour fund also recently announced a 10 million Bahraini dinars (\$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.<sup>54</sup>

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47 '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](http://www.arabianbusiness.com/aluminium-bahrain-says-on-course-beat-growth-targets-405933.html).

48 'Rebuilding Bahrain', 23 June 2011, [www.arabianbusiness.com/rebuilding-bahrain-406710.html](http://www.arabianbusiness.com/rebuilding-bahrain-406710.html).

49 '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](http://www.al-shorfa.com/cocoon/meii/xhtml/en_GB/features/meii/features/main/2011/03/14/feature-03).

50 Trade Arabia: Business News Information, 'Bahrain mulls plans for \$10bn GCC fund', 3 January 2012, [www.tradearabia.com/news/bank\\_210334.html](http://www.tradearabia.com/news/bank_210334.html).

51 See footnote 48, *supra*.

52 Ibid.

53 Ibid.

54 'Bahrain sets up \$26.5m SME rescue package', 25 May 2011, [www.arabianbusiness.com/bahrain-sets-up-26-5m-sme-rescue-package-402090.html](http://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.'<sup>55</sup>

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.<sup>56</sup>

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.<sup>57</sup>

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

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55 [www.islamicfinancenews.com](http://www.islamicfinancenews.com), February 2011.

56 Ibid.

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

## Appendix 1

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# ABOUT THE AUTHORS

### **HAIFA KHUNJI**

*KBH Kaanuun*

Haifa Khunji is a graduate of the University of Buckingham and a dual-qualified attorney in Bahrain and Kuwait with over 10 years' experience in corporate finance and banking. She trained and worked with three City firms in the region for seven years and prior to this worked for four years as in-house counsel for a multinational trading company in the UAE. She joined KBH Kaanuun as a partner at its inception and manages the Bahrain operation.

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.

### **JESSICA LANG ROTH**

*KBH Kaanuun*

Jessica Lang Roth is a UK graduate and associate at KBH Kaanuun. She has experience in corporate structuring and commercial law with a particular focus on Bahrain and other Gulf countries. She has been based in Bahrain since early 2008.

### **SUMANA ABDULKARIM**

*KBH Kaanuun*

Sumana Abdulkarim is a UK graduate and legal assistant with KBH Kaanuun. She has experience in company formations and commercial law as well as Bahrain litigation.

**KBH KAANUUN**

Al Zamil Tower  
Building 31, Road 383, Block 205  
PO Box 65005  
Manama Center  
Kingdom of Bahrain  
Tel: +973 172 12130  
Fax: +973 172 12132  
bahrain@kbh.bh

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