Defense Contracting in the Middle East

Regulatory controls, commercial practices, engaging agents, combating bribery, taxation, human rights and international humanitarian law

Saudi Arabia • UAE • Qatar • Kuwait • Iraq
Oman • Jordan • Lebanon • Egypt

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Overview

Your connection to defense in the Middle East

The defense industry deals in sensitive, complex and high-value products that are vital to national security across global markets. The industry sits at the interface of business and government. Much of what defense contractors do, including research and development, is often publicly funded and subject to rigorous regulatory controls. Many governments require defense contractor personnel to undergo security clearances at the secret or top-secret level before being cleared to staff particular projects. In many cases, export controls restrict the types of military technology that may be sold to third parties or intellectual property that may be transferred to foreign governments. Many companies choose Dentons to guide them through the web of legal complexities that they must navigate when defense contracting in the Middle East.

Nick Simpson
Managing Partner
Riyadh, Saudi Arabia
D +966 11 200 8678 x. 202
nick.simpson@dentons.com

John Balouziyeh
Senior Legal Consultant
Riyadh, Saudi Arabia
D +966 (0) 11 200 8678
john.balouziyeh@dentons.com

In-depth defense industry knowledge and cross-practice expertise

Succeeding in this environment requires a legal partner with a proven track record. We have advised on a wide variety of defense matters across the Middle East, ranging from advising on business establishment, procurement and operations, commercial contracts, employment, offset and other regulatory matters. Sector clients we have worked with include BAE Systems, Boeing, Cassidian, EADS, Honeywell, L3Harris, Northrup Grumman, Oshkosh Defense, Saab AB, Science Applications International Corporation (SAIC) and the UK Ministry of Defence, among others.

Dentons has extensive experience advising on **international humanitarian law (the law of armed conflict), anti-bribery and corruption, export controls, sanctions, business and human rights, government contracting, public procurement, public-private partnerships**, **international criminal law and military justice**, all areas of importance to the defense sector. Dentons has advised multinational companies, NGOs, governments and international organizations on international human rights law and transitional justice in conflict and post-conflict countries. We have prepared compilations of international humanitarian law cases from international criminal tribunals, an award-winning UN Volunteers-sponsored database of international law and have advised multiple UN agencies on international law, including the law of armed conflict.

The defense industry calls for lawyers who can handle the most valuable and complex competitive processes, contracts and disputes; who understand how governments and local business environments operate; who can apply their skills and experience in exacting circumstances and whose discretion is assured. Dentons can call on staff members that hold the highest government security clearances, including at the TS/SCI (Top Secret/Sensitive Compartmented Information) level and can draw upon the expertise of **Dentons Global Advisors** in offering our defense clients services in **business and geopolitical risk advisory**; crisis, dispute and issue management; addressing government challenges; and risk assessment and mitigation. Our team can help you effectively, drawing on years of experience with local administrative processes and officials. Our contacts, particularly in government and municipal departments, allow us to appreciate the importance not only of what the law says, but also of how it is applied.

An unrivalled regional and global network

Our offices in the Middle East provide **advice on international, regional and local law** through a seamless network of offices with unrivalled geographical reach. With a team of experienced lawyers fluent in Arabic, English, French, Spanish and other languages, our practice is well positioned to advise our clients on all aspects of the countries in the region in which they do business.

Dentons is the world's largest law firm, serving clients in more than **200 locations** in over **80 countries**. We are one of the oldest international law firms in the Middle East region and have the broadest network of any international firm, with offices in Abu Dhabi, Amman, Beirut, Cairo, Doha, Dubai, Istanbul, Jeddah, Muscat and Riyadh. When necessary, we also use our Nextlaw Referral Network which includes **750+ law firms** and **36,000+ qualified lawyers**. Our footprint means that we have the ability to quickly and easily draw in any expertise needed to help you navigate the pathway to success.

Contributors

Muhammad Abdelnasser is a member of Dentons' Corporate and Commercial practice in Riyadh and focuses on mergers and acquisitions. He has practiced in the region, including in Egypt and Saudi Arabia, for 14 years. Muhammad has advised on company sales and acquisitions of private and public companies, on the corporate aspects of restructuring of distressed companies and on real estate transactions undertaken in Saudi Arabia, Egypt and other Middle East countries. Muhammad is fluent in English and Arabic.

Saif Al Saryreh is an associate attorney at Dentons' Amman office. He is a member of the Corporate, Commercial, Banking and Project Finance practice groups. He has advised national and international clients and financiers on energy and renewables matters as well as general commercial matters. Saif also has experience in negotiating contracts with governmental officials and prominent energy clients in Jordan. His experience also extends into mergers and acquisitions, and capital markets. Before joining Dentons, Saif worked in the Projects department of a top tier Jordanian Law firm. He holds an LL.M. from the University of Kent and is fluent in English and Arabic.

John Balouziyeh advises companies, NGOs, contractors, and individuals on international law, rule of law and foreign investment matters. He has advised clients on investing in the Middle East, public-private partnerships, joint ventures, legal and legislative reform, and government contracts and procurement. In the defense sector, he has advised on government procurement contracts with various Middle Eastern governments and has advised on local, regional and international laws that impact investment in the Middle East. An active member of the Middle East CSR Committee, John leads Dentons' award-winning pro bono partnership with the Norwegian Refugee Council (NRC), which advises Syrian refugees on the laws of Lebanon, Jordan, Turkey and Iraq.

John serves as an officer in the Judge Advocate General's Corps of the US Army Reserve (JAG). He has served at the Guantánamo Bay war crimes tribunals, the Pentagon and the US Military Academy at West Point, holding a number of billets, including defense counsel, prosecutor and legal advisor in the areas of international human rights law, criminal law and international humanitarian law. He currently holds TS/SCI (Top Secret/Sensitive Compartmented Information) security clearances.

Michael Camburn – Tax Executive Senior Director, is the Deloitte KSA and Bahrain Indirect Tax leader. Michael has specialized in indirect tax for more than 28 years. He has a wide advisory portfolio and has worked with many large, global organizations to help them implement VAT, supporting processes, controls and compliance functions. He has also worked extensively in the field of customs and global trade assignments, assisting clients with complex supply chain and other transactional issues. Michael has worked across several different sectors and has helped them with respect to several supply chain and VAT optimization projects. He leads the defense sector for Deloitte Indirect Tax in KSA and Bahrain, primarily focusing on tax structuring and helping clients to ensure supply chain optimization. Michael holds BA (Hons) in Spanish and Economic History and a Master's in Business Administration. He is also a Chartered Tax Advisor.

Elias Chedid is the managing partner of Chedid Law Offices in association with Dentons in Beirut. He has a diverse practice, which draws on a strong experience gained abroad. He has spent 10 years working in New York, Paris, and Dubai with international law firms, before returning to the 60-year old family practice.

Elias focuses on sales and purchases of strategic assets, joint ventures and strategic alliances, investment structuring in an international context, technology, telecom, energy, regulatory work, project finance, construction and infrastructure.

Elias is a dual Lebanese and French citizen and has been a member of the Beirut Bar since 1998, the New York State Bar since 2001, and the Paris Bar since 2002. He received an LL.B. degree in French law and Lebanese law from the Saint-Joseph University Law School of Lebanon in 1997, where he ranked first throughout his four years of study. He received a Master's degree (D.E.A) in Private Law from the University of Paris 1 – Sorbonne, with honors, in 1998. He also received his LL.M. (Master of Laws) degree from Harvard University Law School in 2000, where he was a staff member of the Harvard Negotiation Law Review. Elias is a native Arabic speaker and also speaks French and English fluently.

Dorina Drowniak is a paralegal in Dentons' Doha office. She is a member of the Corporate and Commercial team. Being fluent in five languages, Dorina provides valuable support to the Corporate and Commercial team which is specialized in both inbound and outbound transactional work. Dorina has built extensive knowledge on business set-up, restructuring and winding-up procedures in addition to support in commercial disputes.

In relation to the defense sector, with her substantial knowledge of the Tenders Law with regards to the procurement of contracts, she has assisted in advising on government procurement contracts with various governmental bodies and has advised on local, regional laws that impact investment in Qatar.

Farhan Farouk – Tax Executive Senior Director, is the Deloitte KSA Business Tax leader. Farhan joined Deloitte KSA in 1989 and has more than 31 years of experience. From a tax perspective, he currently deals with international tax and compliance matters. He specializes in tax matters relating to contract structuring, transfer pricing, and withholding taxes. His clients include a large number of subsidiaries of multinational companies operating in the defense, petrochemical, manufacturing, e-commerce, contracting, and service industries. Farhan serves/served six of the top 10 global defense and aerospace companies, and is well experienced with the KSA direct tax issues faced by such companies. He is a regular speaker on Saudi Arabian taxation at Deloitte conferences. Farhan is a Chartered Accountant and a fellow member of the Institute of Chartered Accountants in England and Wales.

Jamie Gibson has been practicing law in the Middle East since 2008. Jamie has very broad international corporate and commercial experience, with a focus on mergers and acquisitions, joint ventures, corporate restructurings and regulatory advice. He is an expert on foreign direct investment in Oman and has advised clients in a wide range of sectors, including defense, construction, FMCG, oil and gas, financial institutions, manufacturing and infrastructure.

Catherine Gilfedder is a senior associate and solicitor-advocate specializing in international arbitration. She has experience of acting for corporate and state clients in commercial and investment treaty disputes under the ICSID, ICC, LCIA and UNCITRAL rules. She also regularly advises on public international law and business and human rights issues. Catherine acts for a range of NGOs on issues of international human rights and humanitarian laws, and previously worked as a business and human rights advocate for the international legal action charity Reprieve. She also serves as a duty advocate at the Asylum Support Appeals Tribunal in London.

Catherine holds a double first-class honors degree in Law from Cambridge University and an LL.M. in International Law from University College London, obtaining a distinction and the Cheng Cheng-Nan prize for the top graduate Public International Law student. She obtained her Higher Rights of Audience before the English Courts in 2012.

Sara Holzschuh is a member of Dentons' White Collar and Government Investigations practice, advising and representing entities and individuals that are targets or subjects of government investigations or enforcement actions, and leading or conducting internal investigations into potential or alleged violations of cross-border, anti-bribery and anti-money laundering laws, trade sanctions and export controls. Where a government investigation has resulted in initiation of a formal enforcement action, Sara has vigorously defended clients against actions brought under the anti-bribery provisions of the Foreign Corrupt Practices Act, federal anti-money laws and regulations, as well as cases alleging mail, wire or tax fraud or violations of the federal False Claims Act. This includes representation of defense contractors and their senior executives in cross-border, anti-corruption investigations, federal fraud investigations, export control investigations, and federal procurement violations.

A former prosecutor herself, Sara understands the full spectrum of compliance risks companies face in the current enforcement environment, and her practice includes counseling clients on risk avoidance and mitigation wherever they do business. In coordination with her colleagues around the world, Sara conducts global risk assessments and compliance program benchmarking reviews, recommending enhancements as needed; assists with the development and implementation of US national and global compliance programs; creates compliance training programs for employees and compliance officers; conducts investigations into suspected violations of compliance policies and standards; and defends clients in enforcement actions that stem from compliance failures. Sara has helped global companies that operate in the defense space understand the risks of entering new markets, pursuing new growth strategies, mitigating and investigating third party business partner risks, and developing/enhancing/testing their compliance programs. Prior to entering private practice, Sara was a special assistant US attorney (SAUSA) on the Organized Crime Strike Force/Violent Crimes Unit of the US Attorney's Office for the Western District of Missouri.

Craig Hughson is a senior associate in the UAE Corporate and Commercial team at Dentons and has been based in our Abu Dhabi office since 2012. Craig has more than 12 years of international and Middle East experience working with companies on strategic M&A and joint venture transactions. He also helps numerous clients from across the globe set up their business operations in the UAE, both onshore and in many of the UAE's free zones. Craig's commercial experience includes advising clients on UAE Labor Law issues and UAE registered commercial agencies.

Jorge Restrepo is an American practicing attorney and former US Army Judge Advocate officer with international leadership experience gained through managing programs in high-pressure, austere environments, across national, cultural, and organizational boundaries in Iraq, Egypt, the Balkans, Kuwait, Pakistan, Colombia, the UAE and Japan. He established New Frontiers International FZ LLE Legal and Business Consulting (NFI) and Frontera International Corporate Services Provider, LLC (FICS) in the UAE and New Frontiers Business Consulting, LLC (ASTEKI NWE, LLC) in Iraq. He has practiced in Iraq since 2005 and has an unrivaled network of professional contacts in Iraq for the benefit of his clients. Jorge currently advises several USG contractors and other high-profile clients on successfully managing and navigating legal, contractual, and other business matters throughout Iraq. He can be reached at jrestrepo@nfilaw.com.

Zaher Nammour has practiced law in the Middle East for more than 17 years, including 15 years in Qatar. He was a member of the team that established Dentons' Doha office in 2007. Zaher has extensive experience in corporate joint ventures, mergers and acquisitions, restructuring, corporate governance, public offerings, private placements and the related regulatory framework. Zaher has advised on restructuring and acquisition of multi-million dollar companies in Qatar and abroad.

In addition to his corporate expertise, Zaher is also recognized for his real estate and dispute resolution experience and in-depth knowledge of Qatar law in this area. Over the years, he has counseled both foreign investors as well as local entities (private and governmental) on a number of large-scale infrastructure projects, including The Pearl, Lusail and the Qatar Integrated Railways Project.

Darshi Sanganee is an Indian lawyer and a qualified Company Secretary and is presently based in Dentons' Muscat office. She has been practicing Oman law for more than seven years and has an in-depth knowledge of the legal framework – both the black letter of the law and its application. She specializes in corporate law and advises public and private companies on corporate restructuring, mergers and acquisitions, corporate governance and compliance matters. Before joining Dentons, Darshi worked in a leading Indian law firm where she advised on capital markets transactions, mergers and acquisitions, and corporate governance issues.

Mary Ann Sharp served as General Counsel for a US defense contractor with various FMS contracts and offset obligations in the Middle East before she moved to Kuwait in 1996. Her experience with US government contracting and local Kuwait administration and operation of FMS and direct commercial contracts has given her a unique perspective in advising both US and non-US defense contractor clients in Kuwait and the region, in addition to advising those clients seeking direct commercial contracts with the KMOD, the National Guard or Ministry of Interior. The first successful offset joint venture in Kuwait was achieved under her guidance and advice, including the establishment of a local joint venture company that has held FMS and direct Kuwait Ministry of Defense contracts continuously since 1995 in Kuwait. She routinely provides advice to defense contractors doing business in Kuwait, including on labor laws, income taxes, agents and distributors, office leasing, foreign direct investment, disputes with customers, and the establishment and operation of branches and subsidiaries. She is a regular contributor to the main global legal publications on Kuwait agency and distribution laws, as well as employment laws.

Nick Simpson is the Head of Dentons' Saudi Arabia practice and is based in Riyadh. Formerly the Managing Partner of the firm's Muscat, Oman office, he has over 20 years of experience advising clients across a variety of sectors on the full range of their corporate and commercial requirements. This includes company establishment, mergers and acquisitions, joint ventures, company flotations and offerings (equity and debt). As a trusted adviser to local companies, funds, conglomerates and major international corporates, Nick was recognized in the market as a 'Leading Individual' in the Legal 500 2018 guide. He also received accolades in the Chambers Global 2019 guide, which noted that clients are impressed by his "excellent knowledge, patience and communication skills." Under his leadership, the Tier 1 ranked Corporate team was regarded as "highly sought after for its multi-jurisdictional capabilities" and described as a "leader in Oman" and as being, "well equipped to advise both domestic and international clients, with a deep bench of Arabic and English-speaking practitioners."

Nick was admitted to practice in England and Wales in 1999 and New South Wales, Australia in 2004. Prior to joining the Dentons Muscat office, Nick worked for Dentons in London and then a leading international firm in Australia. Thereafter he successfully grew his own practice in Sydney focusing on corporate, commercial and property matters, before merging with Kemp Strang, an Australian firm, in 2012.

Kuwait

Mary Ann Sharp
Senior Legal Consultant
Doha, Qatar
D +974 4459 8960
maryann.sharp@dentons.com

Kuwait defense sales

Direct commercial sales to the Kuwait Ministry of Defense (KMOD) and the security forces (which includes the Kuwait National Guard, the Ministry of Interior police, and the Amiri Guard) have slowed down significantly in Kuwait over the past several years, while foreign military sales (FMS) activity through letters of offer and acceptance (LOAs) with the US government has increased. The US currently has US$19.3 billion in active government-to-government FMS cases with Kuwait. Approval for an FMS sale of Apache helicopters to the Kuwait Air Force has recently been announced. The top categories of direct commercial sales to Kuwait include military electronics, fire control/night vision, and aircraft.

Kuwait and the US have had a formal defense cooperation agreement (DCA) in place since 1991. Approximately 13,500 US forces are currently based in Kuwait, primarily at the US Army Base, Camp Arifjan, and the Kuwaiti Air Force's Ali Al Salem Air Base. Only three countries host more US forces than Kuwait.

FMS and direct commercial sales are subject to the relevant Kuwait laws regarding commercial agents. Most FMS contracts include compliance with local laws provisions but, even if not specified, there is no exemption from compliance with local Kuwait laws by US contractors or US sellers that has been agreed between Kuwait and the US, except for the Kuwait corporate income tax exemption under the DCA. In particular, the labor and immigration requirements of Kuwait law are cost-drivers that should be accounted for when pricing bids and complied with when performing in Kuwait.

For US FMS, pursuant to DFARs 225.7303-4, Contingent fees, subsection (b)(1), "Under DoD 5105.38-M, LOAs for requirements for the governments of Australia, Taiwan, Egypt, Greece, Israel, Japan, Jordan, Republic of Korea, Kuwait, Pakistan, Philippines, Saudi Arabia, Turkey, Thailand, or Venezuela (Air Force) shall provide that all US government contracts resulting from the LOAs prohibit the reimbursement of contingent fees as an allowable cost under the contract, unless the contractor identifies the payments and the foreign customer approves the payments in writing before contract award (see 225.7307(a))."

Accordingly, the Kuwait government customer must approve the compensation for the local commercial agent as an allowable cost under the FMS contract, before contract award. Other or additional compensation for the commercial agent, which is not claimed as an allowable cost under the FMS contract, is not regulated by the US or Kuwait governments.

For direct commercial sales with values equal to or greater than KWD100,000 (approximately US$330,000), the obligations of the Disclosure of Commissions Law, No. 25 of 1996, will be highlighted in the sales contract and require official disclosure of the commission to the public sector customer and the Public Audit Bureau. Non-disclosure is a crime punishable by imprisonment and fines, and cancellation of the public sector contract.

Doing business in Kuwait

Kuwait's Decree Law No. 68 of 1980 Concerning the Promulgation of the Commercial Law (the Commercial Law) provides that a non-Kuwaiti national or entity may engage in commercial business in Kuwait only through a Kuwaiti agent or through a local company with Kuwaiti majority ownership.

The Commercial Agencies Law, No. 13 of 2016 (the Commercial Agencies Law) provides that only a Kuwaiti-registered corporate entity with no less than 51% Kuwaiti ownership, a Kuwaiti individual, or a group of Kuwaiti individuals, who is registered in the Commercial Register and is licensed to practice the business activity of the commercial agency (which term includes agent, distributor, franchisee and licensee) may act as, and register in, the Commercial Agencies Register as, a commercial agent in Kuwait.

The Commercial Agencies Law requires commercial agents for foreign companies doing business in Kuwait and makes no exceptions for direct commercial sales or FMS. It provides that the intermediary must be bound directly to the principal, or its legal representative, by an agency agreement. The Commercial Agencies Law obligates every commercial agent to register the agency agreement with the Commercial Agencies Register at the Ministry of Commerce and Industry, failing which the agency agreement will not be enforceable in Kuwait.

The Public Tenders Law, No. 49 of 2016 provides for direct purchasing by the KMOD, the Amiri Guard, the National Guard and the Ministry of Interior (collectively, the security forces) under statutory guidelines. Further, it exempts foreign bidders from the requirement to have a local agent or partner to do business in Kuwait prior to the award of the public sector contract. Amiri Decree No. 95 of 2017 defines military materials and construction, establishes specialized military purchases committees for the KMOD and the security forces, and sets out procedures for procurements, including procurements via the FMS systems. Each specialized military purchases committee sets out its own rules for applications, registrations and pre-qualifications for each tender. Each committee maintains registers of approved suppliers, contractors, consultants and service providers.

Standardized contracts have been adopted by these committees that include advance payment bank guarantees, performance guarantees, liquidated damages for delay, required Kuwaitization percentages, required national content for supplies and national contractors for local services, and long-term warranties with commitments on supply of spare parts.

Joint ventures are not typically used in military contracting in Kuwait, although they can be more efficient when civil works are required and they can replace the need for an agent. Joint ventures are considered to be unregistered companies under Kuwait Companies Law, No. 1 of 2016. Particular care must be given to terminate via proper liquidation, failing which the local party's right to continue to share profits may not terminate.

Commissions

The typical range of commissions or other remuneration for commercial agents depends on the value of the sales contract, with lower commission rates applying to higher valued contracts, and higher rates applying to lower valued contracts. Generally speaking, commissions may range from 1% to 20% of the contract value less pass-through costs. There are no Kuwait laws that provide for restrictions on the place, manner or currency of the payments to local agents. According to the agreement of the parties, the agent may be paid in or outside Kuwait, in kind or in any currency.

However, official disclosure of commissions is required by law. The Disclosure of Commissions Law provides at Article 2: "Where such payment has been made, the party named must have an accredited agent, having an actual or selected domicile in Kuwait; and the name of the intermediary must be stated in the disclosure, his capacity, profession, or function, and his domicile and place of his or his representative's business; in particular mention shall be made of the amount, percentage and kind of the commission, as well as the person to whom it has been or will be paid and the place of payment."

Gifts, hospitality and other benefits given to public officials must be officially disclosed by the public official unless they are worth less than KWD3,000 (approximately US$9,900) when received. There are no legal restrictions on the kind of benefits, but alcohol and immoral entertainment are prohibited because they are illegal in Kuwait. For public officials who are acting as commercial agents, the Conflict of Interests Law, No. 13 of 2018 requires they not act as agents in regard to transactions with their government employer. In addition, the Anti-Corruption Authority and Financial Disclosures Law, No. 2 of 2016 requires that they officially disclose all agency payments or other benefits in values greater than KWD3,000 received by them or their extended families.

Labor and tax aspects

Legal employment issues concerning employees brought into Kuwait to perform defense contracts include, without limitation:

- compliance with Kuwait Labor Law, including 30 days' annual paid leave (vacation), restricted overtime, overtime premium pay and compensatory days, paid sick leave and 90-day notice period;
- the requirement for direct deposit of employee salaries and cash benefits in Kuwaiti Dinars into local bank accounts;
- statutory conditions for visa transfers of incumbent personnel;
- driver's licenses restrictions for employees newly entering Kuwait;
- base access rules for employees and required documentation; and
- a sponsor requirement to provide statutory medical insurance for employees.

Kuwaiti national employees are provided with social insurance, unemployment payments, and other benefits from the Kuwait government with certain contributions from their employers. It is critical to determine the Kuwaitization percentage applicable to the underlying public sector contract, and whether or not this obligation is shared with the local sponsor/agent, because these aspects drive up costs.

Tax issues can become critical if not properly addressed. Annual net profits from direct commercial contracts are subject to the Kuwait Corporate Income Tax Law, No. 3 of 1955, amended by Law No. 2 of 2008. The tax rate is a flat 15% on income sourced

from Kuwait operations and deductions are limited, especially when there is no tax treaty in place, as is the case between the US and Kuwait. Tax declarations are filed annually and must be supported by locally-audited financials, books and records. All local parties are required to retain 5% of every payment to foreign parties, including payments from the public sector customers under direct commercial contracts, until annual tax clearances are obtained from the tax authority. Releases of retentions typically lag by one or two years.

Customs duties (5% CIF) are typically covered by the public sector customer. There is currently no Value Added Tax, nor any income tax on individuals.

Saudi Arabia

John Balouziyeh
Senior Legal Consultant
Riyadh, Saudi Arabia
D +966 (0) 11 200 8678
john.balouziyeh@dentons.com

Introduction

In 2016, Saudi Arabia announced the launch of Vision 2030, a national plan designed to diversify the Saudi economy, reduce the nation's dependence on oil and develop the health, education, infrastructure and military sectors. One of the key goals of the plan involved localizing manufacturing and increasing government military spending. The National Transformation Program 2020 (NTP) was subsequently put into place by the Saudi Arabian government to help achieve the ambitions of Vision 2030.

A key component of Vision 2030 has been building up the region's most advanced military. This build-up aims not only to create new jobs and diversify the national economy, but also to secure Saudi Arabia from growing threats across the region. With the proliferation of conflict all around Saudi Arabia—including civil war and internal disturbances in Yemen to the south, armed conflict in Iraq and Syria to the north, incursions by ISIS along Saudi Arabia's border to the northeast, growing tensions with Iran to the east and piracy threatening Red Sea trade routes to the west—Saudi Arabia has committed to defense spending as a national security priority.

With approximately US$50 billion in defense spending allocated in 2021, Saudi Arabia, the world's second largest importer of military supplies, ranks number one in the Middle East region in military spending and among the top four globally. Under Vision 2030 and the NTP, Saudi Arabia aims to become a global leader in the defense industry by localizing more than 50% of military equipment spending by 2030 and exporting military equipment across the region by 2040 and globally by 2050. This commitment to become a regional powerhouse for military manufacturing gives rise to widespread opportunities for defense contractors investing in the Arabian Gulf.

Opening investment to foreign firms in the military manufacturing sector

Traditionally, opportunities for defense contractors in Saudi Arabia have been limited to the sale of armaments and other military equipment to the government of Saudi Arabia and ancillary services, such as maintenance, repair and overhaul (MRO). The sphere for defense contractors has been further restricted by regulations banning foreign investment in the manufacture of military equipment, devices and uniforms. Vision 2030 modifies these restrictions under its stated goal of developing manufacturing to meet the Kingdom's military needs, create job opportunities and retain resources within the country.

Military manufacturing is a sector that has historically been placed on the so-called "negative list," a catalog of sectors maintained by the Supreme Economic Council in which foreign investors may not carry out investment. Recent years have witnessed a shift in Saudi policy, with investment licenses issued to foreign companies in military manufacturing for the first time following the announcement of Vision 2030. Today, the Ministry of Foreign Investment (formerly, the Saudi Arabian General Investment Authority, or SAGIA) permits foreign firms to invest in the military manufacturing sector in partnership with private Saudi companies and government-owned corporations, provided such partnerships are endorsed by the Saudi government. In response to relaxations in foreign investment, many defense companies have sought out local Saudi partners at trade shows hosted in Saudi Arabia, including the World Defense Show, scheduled to take place in Riyadh in 2022, and at military exhibitions hosted in neighboring countries, such as the International Defense Exhibition & Conference (IDEX), scheduled to take place in Abu Dhabi in 2023.

Payments of commissions to local agents

One of the challenges that foreign defense firms face when doing business in Saudi Arabia is the legal prohibition on paying commissions to agents for the sale of military equipment to Saudi government agencies. Council of Ministers Resolution no. 1275, dated September 18, 1975 (Resolution no. 1275) prohibits any company that has concluded a contract with the Saudi Arabian government for the supply of armaments or military equipment to pay any sum as commission to any intermediary, sales agent, representative or broker, regardless of whether the contract has been concluded between the foreign entity and the Saudi Arabian government directly or via a third-party state. Resolution no. 1275 is thus an exception to the general permissibility of the use of agents hired under a commission basis in Saudi Arabia. Whereas foreign companies may generally pay local agents a commission for procuring contracts with the Saudi government, such commissions are prohibited for contracts for the sale of military equipment.

Resolution no. 1275 poses a significant challenge to foreign manufacturers aiming to procure contracts with the Saudi Arabian military. If they engage a local Saudi Arabian agent, they cannot offer an incentive for the successful procurement of military contracts through the payment of a commission. Foreign manufacturers may offer such agents a fixed salary, yet agents are more likely to produce better results if they are rewarded for their successful efforts on a commission basis. As discussed below, defense contractors have implemented a variety of measures to address this dilemma.

Success fees

One way to provide payment to agents while complying with Resolution no. 1275 is through the payment of success fees, comprised of fixed one-time payments each time a contract is awarded. Although a success fee is a way of remunerating agents without paying commissions, some may view it as contravening Resolution no. 1275 by couching hidden commissions as other forms of payment. This argument may, however, be challenged. A success fee is not technically a commission under Saudi law and policy, provided it is paid on a fixed fee rather than on a percentage basis.

Adjusted salary scales and annual bonuses for employees

Another strategy is to hire the agent as an employee and remunerate the agent through an adjusted salary scale. Alternatively, a defense firm may implement an annual bonus scheme that looks to a consultant's or an employee's success in procuring contracts in the previous year as one of several performance-based factors subject to an annual review. To avoid being deemed to be a hidden form of paying commissions, the salary scheme and annual bonus scheme would need to be based on a variety of factors rather than being tied solely to the volume of annual sales generated.

Subcontracting and teaming arrangements

Some defense contractors may not wish to engage agents on an employment basis, given the attendant duties and responsibilities imposed on employers in Saudi Arabia, as well as the difficulty involved in terminating employment contracts in Saudi Arabia. Rather, the foreign company may prefer the flexibility of engaging an agent as a contractor without the duties and potential liabilities that arise when hiring employees. In such a case, subcontracting and teaming arrangements are likely the most appropriate form of offering consideration for the successful procurement of military contracts.

An example of a subcontracting arrangement that can be used by a foreign company without contravening Resolution no. 1275 is one in which a foreign manufacturer agrees that if a local representative successfully procures a government defense contract, the foreign manufacturer will in turn award contracts to the representative equaling a certain percentage of the value of the contracts won. While these arrangements do not contravene Saudi law, they may be abused by companies that use them to circumvent Resolution no. 1275 by never actually awarding any subcontracts (i.e. they pay the 5% of the value of the main contract without ever actually subcontracting work to the agents). In the event of an investigation, such a practice likely would be deemed prohibited by Resolution no. 1275 as a hidden commission couched as a subcontract.

A second form of offering consideration to an agent for successfully procuring contracts is through teaming arrangements, where a foreign manufacturer and a local agent agree to bid on contracts together and to share profits. The foreign company can take the lead in designing and manufacturing products of the bid specifications, with the local agent taking the lead in participating in bids and government relations. The arrangement can be anything from an agreement to share work and split profits to an unincorporated joint venture where the two companies bid as partners. As discussed further below, the parties may wish to formally incorporate a joint venture as a limited liability company (LLC) or joint stock company, with the Saudi agent holding an ownership interest in the entity that bids for and executes government defense contracts.

Joint venture with a Saudi partner

As mentioned above, foreign defense contractors may also consider forming a local joint venture company with a Saudi partner to either sell armaments or other military equipment to the Saudi government or manufacture such equipment in-Kingdom. A joint venture agreement can be negotiated where the local partner focuses on business development and winning government contracts, whereas the foreign partner manufactures and fulfills sales to the Saudi government through the joint venture.

Joint ventures may be governed by an agreement without ever formally incorporating a legal entity. However, the Saudi government is increasingly pushing foreign investors towards forming a local LLC or another business organization in Saudi Arabia with a Saudi partner as a condition to winning government contracts. In many cases, the General Authority for Military Industries (GAMI) and Saudi Arabian Military Industries (SAMI) provide a list of terms that they wish to see incorporated in the articles of association of locally formed entities. In many cases, the terms require a minimal ownership of 51% by a local Saudi party, though many of the terms are ultimately negotiable.

A joint venture arrangement ensures that the local partner is incentivized for its efforts in winning government contracts and that the incentive is structured in a way that complies with Resolution no. 1275. Rather than paying the local partner a commission, the local partner holds shares in an LLC. The market value of those shares, and of any dividends that might be distributed, is directly related to the local partner's success in winning government contracts. This leads to a win-win situation that is compliant with Saudi law and aligns with the Saudi government's vision of job creation and knowledge transfer.

Conclusion

Vision 2030 and the NTP present unprecedented opportunities for defense contractors to invest in Saudi Arabia. The Saudi government has partnered with the world's leading defense contractors, aiming to incubate an indigenous defense manufacturing sector. Many of Saudi Arabia's historic restrictions in foreign investment, including blacklisting of foreign investment in military manufacturing, have been lifted. Other restrictions, including prohibitions on payments of commission to agents for sales of military equipment, remain on the books. With the proper legal representation in place, foreign defense contractors can implement strategies to win major government contracts, while remaining compliant with Saudi Arabia's foreign investment and commercial agency regulations.

Vision 2030 grants foreign defense firms opportunities to procure contracts not only with the Ministry of Defense and its branches (the Royal Saudi Arabian Land Forces, the Royal Saudi Navy, the Royal Saudi Air Force), but also with the Ministry of the National Guard, the Ministry of Interior and state-owned enterprises, such as the Military Industries Corporation (MIC) and SAMI. Moreover, state-owned corporations such as TAQNIA (Saudi Technology Development and Investment Company) and Advanced Electronics Company Ltd. (AEC) are eagerly seeking the right partners for local defense manufacturing. Opportunities abound for foreign defense companies committed to forming joint ventures aimed at job creation, training opportunities and the transfer of knowledge and technology.

Iraq

Jorge E. Restrepo
Managing Director, Attorney
New Frontiers Business Consulting LLC
D +964 750 736 6443
jrestrepo@newfrontiersbc.com

Introduction

The corporate, tax, and other legal compliance landscape for US government (USG) contractors and foreign firms doing business in Iraq has significantly changed since 2009. Iraq's Coalition Provisional Authority (CPA) Order 17 expired on December 31, 2008, thus stripping most of the exemptions and waivers USG contractors enjoyed from having to comply with Iraqi corporate, tax, and most other laws.

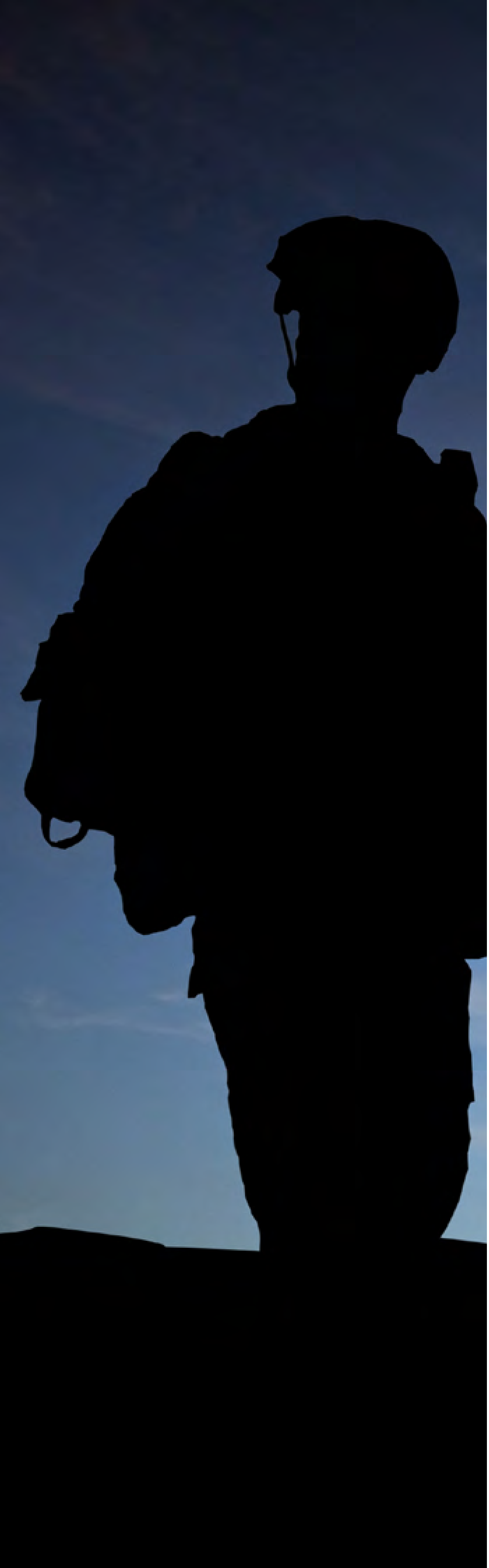
Contrary to popular belief, as of today Iraq and the US still have not signed any official new status of forces agreement (SOFA) or security agreement which grants any waivers and exemptions to USG contractors from complying with Iraq's corporate, tax, labor, immigration or any other legal requirements. The US Embassy in Baghdad has encouraged and directed US companies working in Iraq to comply with Iraqi laws since the expiration of CPA Order 17 (revised) because the current US/Iraq MOUs do not exempt USG contractors from any Iraqi law.

This hard reality has left many USG contractors in de facto non-compliance with Iraqi legal requirements, thus exposing them to significant legal risks which could seriously hamper their ability to continue performing their USG contracts in Iraq and prove to be disastrous to both the USG contractors and their clients. The bottom line is that USG contractors are subject to all Iraqi laws and regulations, with very few minor exceptions.

The main sectors that all USG and foreign companies should immediately address and comply with are corporate registration, Iraqi corporate and employee tax, Iraqi labor law and immigration to avoid headaches in the future or until the US and Iraq officially publish a new agreement to provide USG contractors relief from some Iraqi laws.

This chapter provides a general guide for USG contractors in Iraq, focusing on key legislative and institutional matters, including:

- the legal frameworks of the central government of Iraq (GOI) and the Kurdistan regional government (KRG) jurisdictions;
- the applicable laws in the key areas of interest for USG contractors doing business in Iraq (particularly, corporate law, tax law, labor law, and immigration law); and
- business opportunities for USG contractors in Iraq.



Observing Iraq's two main jurisdictions: the central GOI and the KRG

Companies should be aware that if they plan to conduct business throughout all of Iraq, then they must observe and comply with both the central GOI and KRG legal requirements. This can prove to be particularly tricky with immigration, taxes and social security regulations; therefore, they should take the time to plan thoroughly their entry and operational requirements before conducting business in Iraq.

The Kurdistan region has enjoyed de facto autonomy since 1991 after the International Coalition imposed a no-fly zone on Saddam Hussein's government. Iraq's 2005 Constitution introduced federalism, where in principle it codified the devolution of powers to the Kurdistan region of Iraq (KRI) and the provinces. However, most of the implementing laws that are required to make this a clear process have not been passed by Parliament due to political deadlock, mainly between the KRG and the GOI; this has resulted in an erratic implementation of federal laws by the KRG and, to a lesser extent, Iraq's provinces, which complicates doing business in Iraq.

Article 115 of the Iraqi Constitution grants the KRG the powers to legislate on all areas that are not reserved or exclusive to the GOI, which are quite extensive considering that Article 110 only grants nine exclusive federal GOI powers. However, in practice, the GOI retains influence and control over the KRG, mainly through the allocation and disbursement of the annual federal budget for the KRG and the control over Iraqi airspace.

The KRG tends to use federal laws as the primary law, but at times issues implementing regulations with significant differences from those of the GOI law. Such differences exist in the corporate registration, immigration, labor, tax and other laws.

General corporate registration requirements

Under Iraqi Company Law No. 21 of 1997 and Regulation No. 2 of Foreign Companies Representation in Iraq of 2017, foreign companies must register either a local subsidiary company (such as an LLC) or a branch in order to legally carry out the obligations under a contract and do business in Iraq. Recent amendments of Company Law No. 21 added the requirement of having a local shareholder to hold at least 51% of a new local company to be established; this requirement does not apply to the registration of branches of foreign companies. Although generally the KRG implements company and formation regulations similarly to the GOI, it has not implemented the recent amendments mentioned above and still allows 100% foreign shareholder ownership of local companies.

Generally, USG contractors planning to conduct business in both central Iraq and its Kurdistan region should register two separate branches or entities respectively to facilitate compliance with both jurisdictions, mitigate political risk, avoid areas with conflicting implementing regulations and minimize double taxation risks.

The following table lays out the most important distinctions between the registration of branches and subsidiaries in Iraq that USG contractors should consider:

Basis for comparison	Branch	Subsidiary
Meaning	Branch implies an establishment set up by parent company, to perform the same business operations, at different location.	Subsidiary company is understood as the company whose full or partial controlling interest is held by another company.
Reports to	Head office.	Holding company.
Business	Branch conducts same business as parent organization.	Subsidiary may or may not conduct same business as parent organization.
Separate legal standing	No.	Yes.
Account maintenance	Either separately or jointly.	Separately.
Ownership interest	The parent organization has 100% ownership interest in the branch.	The parent organization has >50-100% ownership interest in the subsidiary.
Liabilities	Extends to the parent company.	Limited to the subsidiary.

Iraqi labor law and social security compliance requirements

Regardless of what the "governing law" clause states in the employment agreements between USG contractors and their expat employees working in Iraq (inclusive of the Kurdistan region), all employer/employee relationships are governed by Iraqi law by operation of law. This means that USG contractors must be knowledgeable of Iraqi labor laws and regulations, including Iraq Labor Law No. 37 of 2015 and former Labor Law No. 71 of 1987 applicable to the KRG; the Retirement and Social Security for Workers Law No. 39 of 1971; and Labor and Social Affairs Law No. 12 of the Kurdistan Region of Iraq of 2007 for the KRG. Such familiarity will help minimize liability against labor-related lawsuits and violations.

Moreover, all USG contractor expat and local employees must be registered with the Iraqi and KRG Ministry of Labor's Social Security Offices (SSO) respectively and must make monthly payments along with their employer, unless the USG contractor has obtained an exemption from the SSO. If the USG contractor expat already registered in their country of origin, they have to provide this documentation to the Ministry of Labor in order to have an exemption, and the company is not required to pay their monthly contributions, after having registered.

Monthly social security contributions are calculated at 17% of the employee's base salary, whereby the employee is responsible for 5% and his/her employer for 12%. As for KRG, exemptions are possible but difficult to obtain. There are no big differences between the two laws; the labor law in GOI has included the private and public sectors to be covered by the social security.

Iraqi labor law also requires the employers to request and obtain work permits for all their foreign employees working in Central Iraq. This is an additional and separate requirement from the visa process. Although this legal requirement has not been widely enforced by the GOI in the past, as of late 2020, the GOI's Ministry of Labor started actively seeking companies which are not compliant with the work permits and has started enforcing the requirement through the Ministry of Interior and Ministry of Finance. In practice, most USG contractors are not compliant with this requirement, but should reconsider to avoid potential future issues with the GOI.

The KRG does not require work permits for foreign personnel working in the Kurdistan region.

Iraq tax registration, reporting, and filing requirements

To date, there is no exemption available from taxation requirements for USG contractors from the GOI or the KRG.

Generally, standard DOD/DOS contracts and FMS contracts do not exempt companies from Iraqi tax compliance requirements unless they fit into one of the below categories:

- Exemptions by special law or international agreement.
- First class hotels.
- Commissions of money transfers through Iraqi banks.
- Aviation entities.
- Commercial business income.
- Industrial projects and contracts.
- Other exemptions approved by the Iraqi Parliament.

Once USG contractors register their branch or local LLC, they must then register with Iraq's General Commission on Taxation (GCT) and/or the KRG GCT and file their financial statements for their business activities in Iraq and/or the KRI on an annual basis in a similar manner to the US. This includes both corporate and employee income generated while in Iraq. Generally, the corporate tax rate is 15% of net taxable income in both central Iraq and the Kurdistan region; however, the GCT retains the right to increase the tax rate based on the company's registered business activity in central Iraq.

Central Iraq's Employment Income Tax (EIT) is incremental from 5% to 15% based on the employee's base taxable monthly salary. However, the KRG imposes a flat 5% EIT on the employee's base taxable monthly salary.

Iraq immigration law compliance requirements

All USG contractor expat personnel must apply for and obtain Iraqi visas prior to traveling to Central Iraq, even if they possess CAC cards. Fortunately, the US has been able to negotiate a relatively streamlined process for accepting and processing visas for USG contractors and their subcontractors' expat personnel. Currently, the GOI issues single 30-day single entry visas (SEVs) and normal 6 to 12-month multi-entry visas (MEVs), which must be renewed on an annual basis. Average processing time for a 30-day SEV is one to two weeks, while it takes anywhere from one to three months to obtain an MEV for USG contractor personnel depending on backlogs and government staff restrictions during the COVID-19 pandemic.

Therefore, it is critical that USG contractors take these processing times into consideration before agreeing to a mobilization timetable because this could prove to be disastrous for their contractual obligation requirements if they are unable to mobilize the required personnel in time.

USG contractors arriving in and operating in the Kurdistan region must observe completely different KRG immigration regulations as laid out below.

KRI immigration v. federal government of Iraq legal compliance requirements

Just when USG contractors thought it could not get more complicated, the KRI has its own set of laws which impose on USG contractor personnel who enter and work in their region. USG contractors who operate in both the KRI and federal Iraq must then comply with both legal regimes, including immigration. Although the KRG currently allows DOD CAC holders entry and exit, technically, the KRG requires that all foreigners apply for and obtain an "Ikama" or residency card every year if they plan to work mainly within the KRI.

Opportunities for USG contractors in Iraq

Despite the many challenges of doing business in Iraq, there are still lucrative opportunities with defense contracts and other investment projects as listed below:

- The DOD LOGCAP V Program, USACE programs and FMS contracts continue after the drawback of US military forces in Iraq.
- Interested parties can conclude direct sales agreements with the Iraqi government, especially through the Iraqi Ministry of Defense and the Ministry of Foreign Affairs.
- Requests for projects and services (such as logistic equipment) are periodically published on the websites of the relevant ministries or through their contract department.
- The competent ministries are exempt from the application of the Government Contract Execution Law and follow special regulations which are more efficient and flexible for foreign companies to execute their projects.

- Companies may register their qualified projects in Central Iraq or the Kurdistan region as an investment and thus obtain an investment license, which provides the below benefits under the National Investment Law No. 13 of 2006 (and amendments) or the Kurdistan Investment Law of 2006.
- The GOI investment provides the following incentives:
    - Ten-year corporate tax exemption from the date of commencement of commercial operations (15 years if Iraqi participation is more than 50%).
    - Full repatriation of investment and revenues.
    - Right to employ required foreign labor.
    - Exemption from import duties for necessary equipment and materials throughout the period of the project implementation.
    - Exemption from taxes and fees for primary materials imported for commercial operations.
    - Protection from nationalization or expropriation.
    - One-stop shop for entity registration, tax, labor and immigration requirements.
- The KRG investment provides the following incentives:
    - Fee simple provision of land plots for nominal charges in specified areas.
    - Exemption from taxes and custom duties as well as provision of public infrastructure to the project metes and bounds.
    - Exemptions from corporate taxes and customs duties are granted for 10 and five years respectively, starting from the beginning of operations.
    - Other similar benefits as the GOI.

Disclaimer

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United Arab Emirates

Craig Hughson
Senior Associate
Abu Dhabi, United Arab Emirates
D +971 2 613 1513
craig.hughson@dentons.com

Background

The UAE's annual defense expenditure averaged US$26.6 billion across 2016 and 2020 and this is expected to increase to an annual average of US$37.8 billion. Initiatives that are expected to drive the country's future defense spending include focus on:

- the protection of vital infrastructure;
- the ongoing territorial disputes with Iran; and
- ongoing domestic defense industry building.

Defense-related procurement operations are excluded from the UAE's general procurement laws (Art. 2(b) of Resolution No. (4) of 2019 Concerning the Procurement and Warehouse Management Regulations in the Federal Government).

Role of Tawazun Economic Council (Tawazun) and the UAE offset program

Offsets

Tawazun oversees the defense and security industry in the UAE. In 2019, Tawazun introduced new policy guidelines for the Tawazun Economic Program (TEP). The TEP is a so-called offset program through which foreign defense contractors are obligated to contribute to economic development in the UAE to offset against purchases of their products and services. According to Tawazun, the goal of the TEP is to ensure that defense-related procurement in the UAE results in industrial participation by defense contractors in the UAE in order to generate high-value economic, social and strategic benefits to the UAE.

In summary, Tawazun requires a defense contractor to enter into a TEP agreement with Tawazun containing offset obligations equal to 60% of the supply contract value, this being a condition to entering into a supply contract with the government of the UAE (directly or indirectly) exceeding a certain threshold value. Defense contractors must fulfill these offset obligations by generating offset credits through Tawazun-approved projects.

Accordingly, defense contractors are advised to understand Tawazun's role when considering their supply line and to factor this into any UAE business model.

The threshold value at which the TEP applies is AED36,730,000 (approximately US$10 million). If the value of the supply contract is less, then no obligations are incurred (unless the defense contractor or its parent company are already subject to offset obligations pursuant to one or more supply contracts entered into by that defense contractor).

Project categories and priority sectors

Defense contractors can generate offset credits by creating a project in one of the following three categories:

- **Investment**: Traditional equity joint ventures with local partners, or partnerships without equity, such as co-production or technology co-development;
- **Contractual engagement**: Sign a work package contract with a local UAE supplier or manufacturer to export products, provide services to foreign buyers, or create supply opportunities for local industry. The main types of projects considered in this category include export work packages (focused on enabling local suppliers with export opportunities), and local content – import substitution (focused on awarding work packages directly to UAE suppliers to localize the supply chain); and

- **Capability development**: Providing knowledge, technology and/or capabilities to UAE nationals or local entities. Types of projects in this category include: (i) technology transfer (process know-how, intellectual property or training and development programs); or (ii) internships and job placements for UAE national graduates to work with defense contractors in international locations.

We understand that Tawazun will consider projects that meet the UAE's strategic needs, including the following priority sectors:

- Aerospace
- Infrastructure and transportation
- Communication technology
- Education technology
- Sustainability, environment and climate change
- Food and water security

Credit multipliers

There are nine different ways in which credits can be generated by defense contractors which are subject to different multipliers that have multiplier values ranging from 0.5 to 2.0. Tawazun may also award bonus multipliers based on items such as manufactured products certified as "made in the UAE" or involving employing UAE nationals in engineering, management or leadership roles.

Other key Tawazun matters

- **Bank guarantees**: These will be required for an amount of 8.5% of the value of the obligation and remain in place for the duration of the project.
- **No penalties for performing companies**: If a defense contractor complies with its obligations at the end of the relevant period of performance but there is an offset credit shortfall, the defense contractors can choose either to pay the shortfall value (from the bank guarantee) or, alternatively, roll the entire shortfall value forward into another project.
- **Banking and trading of credits is allowed**: If a defense contractor generates more credits than required to fulfill its offset obligations, the surplus can be "banked" for up to five years following completion of the relevant project and deducted from future offset obligations, or can be "traded" to another defense contractor.

Doing business and coming to market in the UAE

Summary

The UAE is a federation of seven Emirates comprising the Emirates of Dubai, Abu Dhabi, Sharjah, Umm al-Quwain, Ras Al Khaimah, Fujairah and Ajman. Generally speaking, there are three main options for doing business. These are:

- establishing an entity "onshore" in the relevant Emirate;
- establishing an entity in one of the free zones in the relevant Emirate; and/or
- appointing a validly licensed UAE agent or distributor, which means a non-UAE party does not need to set up its own UAE entity.

For business establishment and carrying out business purposes, parties need to treat each Emirate and each free zone within a relevant Emirate as a separate jurisdiction. For example, if a party wishes to carry on business in more than one Emirate then, strictly speaking and subject to certain tolerated practices, that party would need to establish a presence in each Emirate where it intends to carry on business.

Onshore entities: limited liability companies (LLCs) and branches

"Onshore" means any area outside the free zones in the relevant Emirate. Entities established onshore will be subject to the Federal Commercial Companies Law No. 2 of 2015 (the Onshore Companies Law), which has historically provided that:

- onshore LLCs must have a UAE shareholder (either a UAE national or company wholly owned by UAE nationals) who holds 51% of the shares; and
- onshore branches must appoint a UAE national (or company wholly owned by UAE nationals) as a national service agent whose role is to provide administrative support to the branch.

With regard to onshore branches, the UAE national will not have any management or economic control over the branch and instead will usually be remunerated by way of an annual fee. A branch office is generally limited to conducting business related to services. If a party wishes to import and trade (i.e. buy/sell/rent)

products or equipment, then a branch office is not permitted to carry out this type of business and an onshore LLC would need to be established instead.

With regard to onshore LLCs, where the commercial intent is for the foreign shareholder to have 100% of the economic, voting and management rights in the LLC, it is common practice for the foreign shareholder and the UAE shareholder to enter into nominee or "side" agreements which seek to recognize and reflect the intended 100% beneficial ownership and control over all shares by the foreign shareholder. Please note that the legal enforceability of nominee side agreements is a legal grey area but entirely standard for foreign parties setting up onshore LLCs with a nominee structure.

Recent amendments to the Onshore Companies Law

The Onshore Companies Law was recently amended to potentially allow non-UAE entities to own up to 100% of a UAE onshore LLC. However, as things currently stand, no formal announcements have yet been made to clarify in what circumstances a non-UAE party could hold more than 49% of the shares in an LLC (or indeed if this will be possible in respect of the defense industry sector).

The previous requirement in the Onshore Companies Law for branches to have service agents has also been repealed. However, the practical effect of this has not yet been implemented and so, for now, branches still need to appoint a UAE national as service agent. Although the term "agent" is used, the service agent is not in fact an agent of the branch in the normal sense as the service agent does not act on its behalf. Given the nature of a branch office (i.e. it is not a separate legal entity from the parent company), the service agent is not a shareholder in the branch office.

Free zone entities

Free zones are defined geographical areas which were established to encourage foreign investment into the UAE. Each free zone has its own company rules and regulations regarding the types of legal entity available, their establishment and ongoing governance. Many of these free zones are focused on particular sectors or industries. The main appeal of the free zones to foreign investors is that they permit 100% foreign ownership (with no local UAE national involvement) and, to the extent that taxes are introduced, there are tax holiday periods (which are generally 15-50 years from the date the company is set up) – however, please note that VAT (which was introduced in the UAE in 2018) applies, generally speaking, to free zone companies. Please also note that, as there are five free zones in Abu Dhabi and more than 30 in Dubai, a comparative review of each free zone is beyond the scope of this brochure.

For entities established in a free zone, the main restriction is that the business of the free zone entity must be carried on from within that free zone and should not strictly speaking be carried on onshore or in another free zone. However, in the last few years Abu Dhabi has operated a "dual license" system which allows an Abu Dhabi free zone entity to operate in "onshore" Abu Dhabi by obtaining "sponsorship" from the relevant Abu Dhabi free zone authority. Similar dual licenses are available from certain Dubai free zones to do business in onshore Dubai.

Timeframes and other relevant matters for entity set-ups

The overall timeframe for a set-up (either onshore or in a free zone) is likely to take around six to 12 weeks, starting from the time at which the necessary corporate authorities are first executed and subsequently notarized, legalized and attested for use in the UAE, along with the relevant shareholder's corporate documents. Free zone companies can generally have a single corporate shareholder. The liability of UAE companies and the liability of any shareholder is limited to the shareholding in the capital of the company.

It is generally a mandatory requirement in all free zones and for onshore entities to lease office or warehouse premises.

Appointing a validly licensed UAE agent/distributor

As an alternative to setting up a licensed entity in the UAE, it is possible to appoint a sales agent or distributor. Such appointments are made on a registered or unregistered basis. The principal difference between a registered and unregistered agreement is that registered agreements provide enhanced protective rights for the UAE commercial agent under the UAE Commercial Agencies Law, including, in particular, in relation to exclusivity and enhanced rights agents on termination.

Unregistered agreements are, generally speaking, regulated like most other commercial contracts in the UAE by the UAE Civil Code and UAE Commercial Transactions Law, albeit their legal status is not guaranteed. Nevertheless, to avoid a commercial agent benefiting from the protections granted by registration, many principals prefer to be party to an

unregistered agreement. Unlike registered agencies, unregistered agencies can be terminated at the end of a fixed term or during the term pursuant to the terms of the relevant agreement. In contrast to registered agency agreements, damages awarded to an unregistered commercial agent due to early termination by the principal will be based on general principles of contractual damages.

As a result of these key differences and, in particular, the protective rights afforded to the agent, it is necessary to establish whether an agreement is (or is capable of being) a registered or unregistered agreement. Additionally, it will be necessary to assess if a defense contractor can do business with Tawazun through the use of an agent and assess the extent to which such a structure impacts offset assessments.

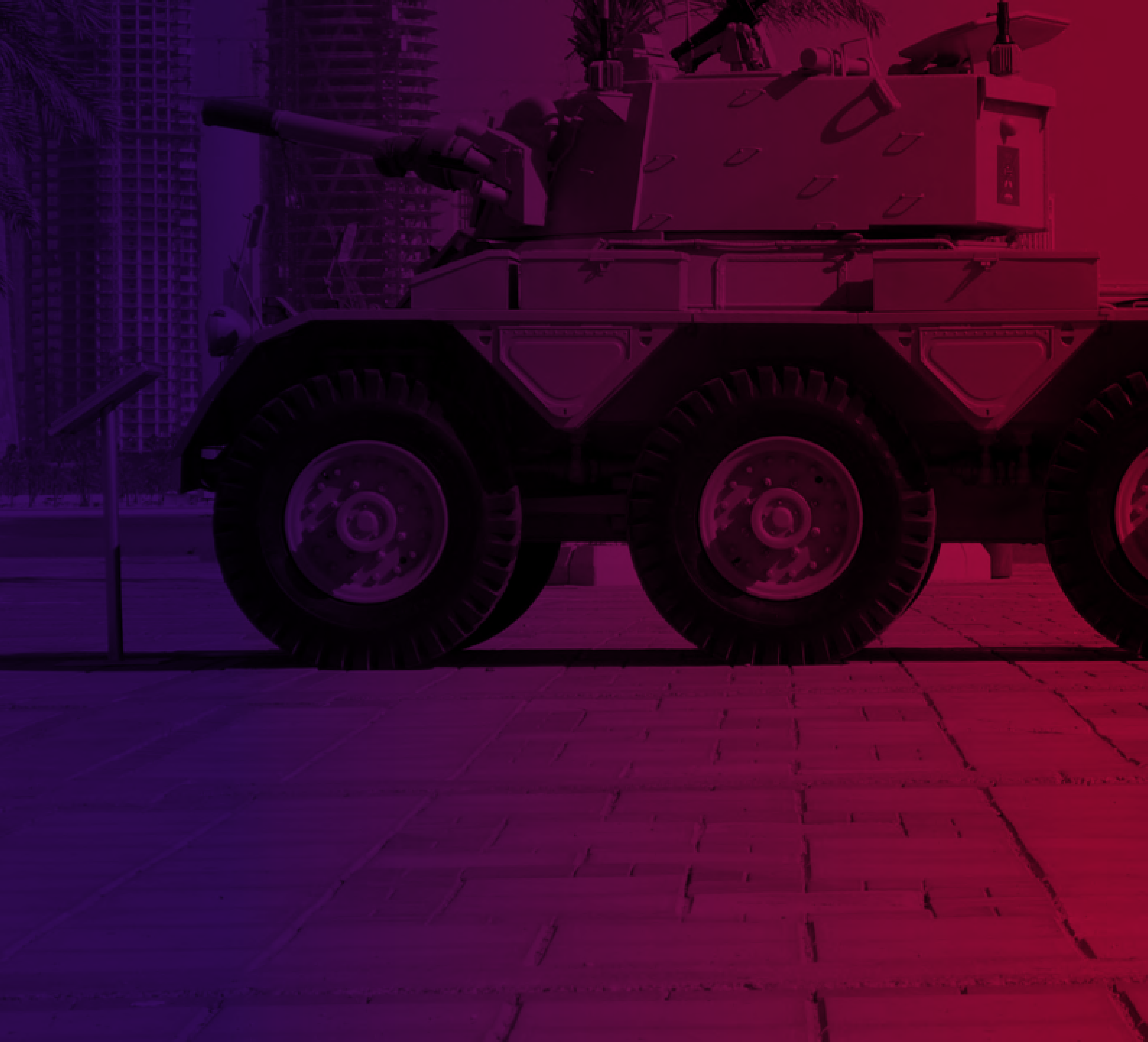
Conclusion

The role of Tawazun and engagement with the TEP is crucial for all defense contractors wishing to do business in the UAE. Accordingly, it is recommended that defense contractors engage with Tawazun at an early stage in any planned project to discuss project parameters and interpretation of the TEP.

Qatar

Zaher Nammour
Partner
Doha, Qatar
D +974 4459 8973
zaher.nammour@dentons.com

Dorina Drowniak
Paralegal
Doha, Qatar
D +974 4459 8972
dorina.drowniak@dentons.com



Defense contracting in Qatar

The procurement of contracts by government ministries and other public bodies in Qatar is governed by Law No. 24 of 2015, promulgating the Law Governing Tenders and Auctions (the Tenders Law) and its amendments. Under Article 2 of the Tenders Law, armed forces, police and other military entities are not required to comply with the Tenders Law when the tender relates to a matter that is considered confidential in nature.

The Tenders Law, which came into effect on June 13, 2016, applies to ministries, public corporations, committees and other government agencies, but continues to exclude Qatar Petroleum, Qatar Investment Authority and police forces, armed forces and other military bodies in relation to certain tenders of secret nature. It may be applied to other entities that are financed fully or partially by the state.

The Tenders Law and its Executive Regulations provide government entities with more flexibility in government procurement and contractual conditions, as compared to the old Tenders Law, issued by Law No. 26 of 2005. It offers service providers and, in particular, small and medium enterprises more opportunities to compete in the procurement process.

Defense procurement is usually conducted directly by the relevant government entity. When a matter is considered confidential, the procurement process may be restricted to certain preferred bidders or procurement may be handled directly through a single supplier.

Barzan Holdings is a commercial company established in the Qatar Science Technology Park (QSTP) and is owned by the Ministry of Defense of Qatar. Barzan Holdings has become the joint venture partner of a number of defense projects to promote the defense industry and to support research and development of defense activities in Qatar.

Market entry – foreign investment in Qatar

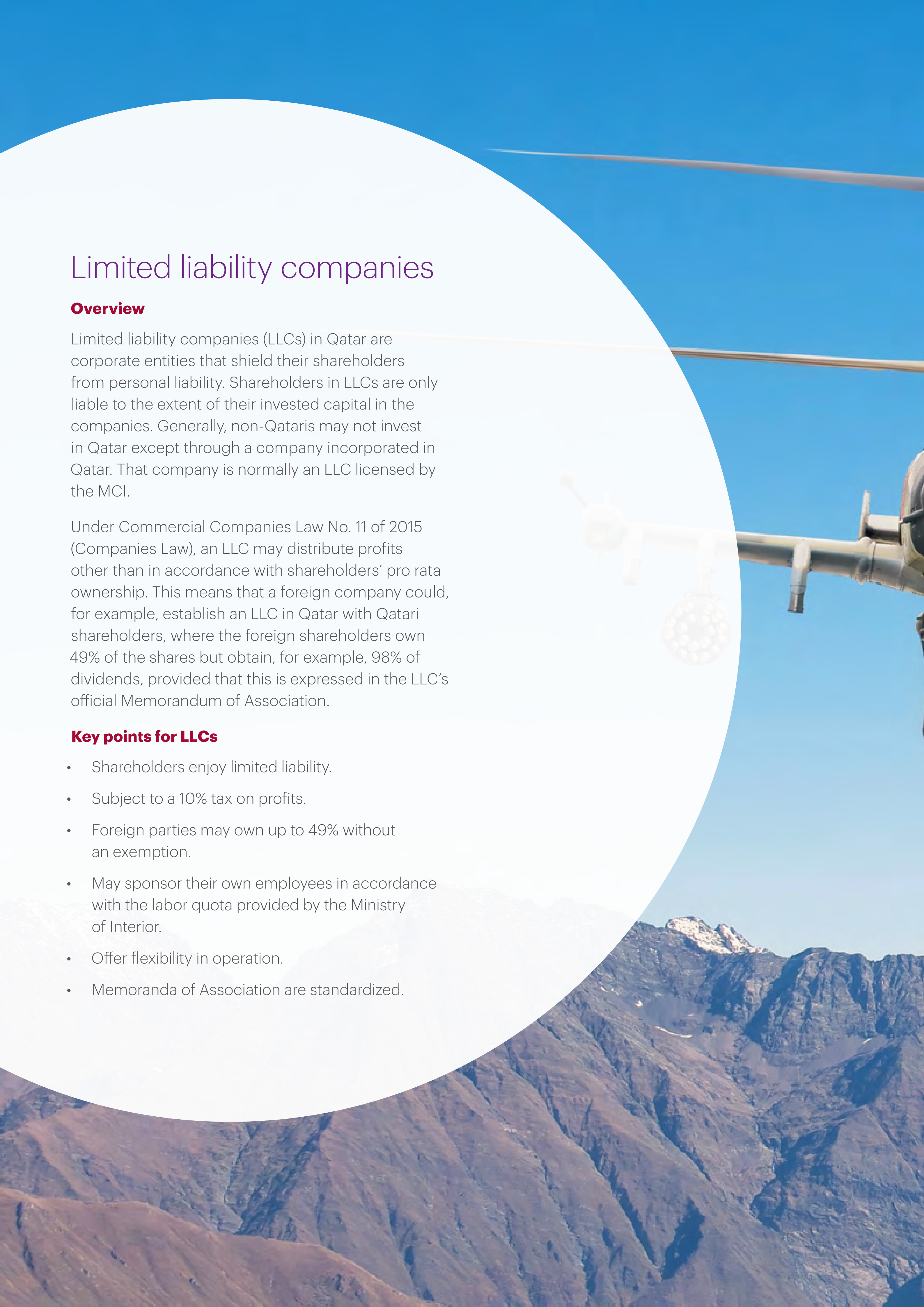
Former rule: 49% maximum ownership for permanent entities

Under Foreign Investment Law No. 13 of 2000, the general principle in Qatar was that investors cannot own more than 49% of a company. This meant that, to establish a company in Qatar, a foreign company needed a local partner to own 51% of the share capital of the new company.

However, it was possible under Foreign Investment Law No. 13 of 2000 for a foreign investor to own up to 100% of an investment in Qatar if the activities fell within the sectors of agriculture, industry, health, education, tourism, developing natural resources, energy, mining, consulting, technical, information technology, cultural, sports, entertainment and distribution services. Such ownership exceeding the 49% threshold required an exemption from the Ministry of Commerce and Industry (MCI) to that effect. If the company demonstrated that it would provide cutting-edge technology and training of local expertise within the approved sector, the exemption was likely to be issued.

Current rule: 100% ownership for permanent entities

Qatar has enacted Foreign Investment Law No. 1 of 2019, which now enables foreign persons to own up to 100% of any investment in any sector. The Executive Regulations for the new Foreign Investment Law were issued in June 2020. They state that foreign investment is open up to 100% in areas that are determined as eligible by the MCI. The process for approval requires the investor to provide a business case for its project and a feasibility study. The same will go through a determination process by the MCI and approval will be determined on the merits of the submission.



Limited liability companies

Overview

Limited liability companies (LLCs) in Qatar are corporate entities that shield their shareholders from personal liability. Shareholders in LLCs are only liable to the extent of their invested capital in the companies. Generally, non-Qataris may not invest in Qatar except through a company incorporated in Qatar. That company is normally an LLC licensed by the MCI.

Under Commercial Companies Law No. 11 of 2015 (Companies Law), an LLC may distribute profits other than in accordance with shareholders' pro rata ownership. This means that a foreign company could, for example, establish an LLC in Qatar with Qatari shareholders, where the foreign shareholders own 49% of the shares but obtain, for example, 98% of dividends, provided that this is expressed in the LLC's official Memorandum of Association.

Key points for LLCs

- Shareholders enjoy limited liability.
- Subject to a 10% tax on profits.
- Foreign parties may own up to 49% without an exemption.
- May sponsor their own employees in accordance with the labor quota provided by the Ministry of Interior.
- Offer flexibility in operation.
- Memoranda of Association are standardized.

Foreign branches

Overview

Article 3 of new Foreign Investment Law No. 1 of 2019 allows foreign companies to be licensed in Qatar for the purpose of carrying out a contract of public benefit in Qatar. The license is in the form of a ministerial decision from the MCI, followed by issuance of a commercial registration certificate.

Prior to the set-up of a foreign branch in Qatar, the foreign head office must be awarded a contract with a governmental or quasi-governmental entity. Approval for the set-up of a foreign branch rests entirely at the discretion of the MCI and is issued through a ministerial decision. The more the government contract is deemed to relate to a public benefit facility, the more probable it is that the entity will obtain the requisite approval.

Registration as a branch will entitle an entity to obtain a commercial registration in Qatar, which allows it to enter into lease agreements, open bank accounts and carry out business in Qatar. However, the registration only permits carrying out business in relation to the performance of the contract for which it was granted.

Key points for foreign branches

- Do not have separate legal persona. As such, any claims against branches are per se against the foreign head office.
- Subject to 10% income tax on their profits.
- May only operate as long as their public contracts are still in force.
- May sponsor their own employees in accordance with the labor quota granted by the Ministry of Interior.
- Do not have shareholders – the shareholders are the same as those of the mother company.
- Directors may be of any nationality.
- Are subject to the Commercial Registration Law, under the supervision of the MCI.

Free zones

The presence of free zones in Qatar was originally established by Law No. 34 of 2005, which has been amended by Law No. 21 of 2017 (the Free Zones Law). The amendments include removal of restrictions on the nationality of capital and allowing full foreign ownership; freedom to choose the legal form of projects, the prices of products and the proportion of profit share as between project partners; and allowing 100% foreign ownership.

According to the Free Zones Law, the Free Zones Authority has responsibility for regulating free zones in Qatar. In connection with this mandate, in 2018 the Free Zones Authority published a set of Companies Regulations and a set of Licensing Regulations. The Companies Regulations provide that any one or more persons may apply to incorporate a company with limited liability for carrying out "Permitted Activities," which are set out in a Schedule of Permitted Activities published by the Free Zones Authority from time to time. The suitable industries for two anticipated free zones are as follows:

- Ras Bufontas: logistics, consumer products, light manufacturing, technology and applications, services and pharmaceuticals; and
- Umm Alhoul: maritime industries, heavy manufacturing, industrial sectors, emerging technologies and logistics hubs.

Qatar Science and Technology Park (QSTP)

Overview

The QSTP is a free zone, accelerator, and incubator for tech-product development in Qatar. Any company may join QSTP, provided its main activity relates to the development of technology. An initial application is required for assessment of eligibility to establish a corporate presence in the QSTP. The application should satisfy the QSTP's Entry Criteria & Permitted Users (ECPU), which requires that the tenant's predominant activities must relate to the development or transfer of technology.

Key points for QSTP

- QSTP-LLCs are regulated by the Free Zone management and are subject to the Free Zone Regulations of 2020.
- Shareholders enjoy limited liability.
- Physical presence may only be established within the QSTP Free Zone park.
- QSTP-LLCs are exempt from taxes.
- Foreign ownership of up to 100% is permitted.
- Activities of a QSTP-LLC must be predominantly related to the development of technology.

Oman

Jamie Gibson
Partner
Muscat, Oman
D +971 4 402 0800
jamie.gibson@dentons.com

Darshi Sanganee
Senior Associate
Muscat, Oman
D +968 9137 3675
darshi.sanganee@dentons.com

Doing business in Oman

A foreign entity can do business in Oman by providing goods and services from outside Oman, establishing an Omani commercial company, appointing an Omani agent, establishing a representative office (for marketing purposes only), or by setting up a branch office (pursuant to a contract with the government or, less commonly, the US Oman FTA). The Omani Commercial Companies Law promulgated by Royal Decree 18/2019 (CCL) governs company formation and key corporate governance measures. Furthermore, the CCL prescribes several forms of commercial companies, with limited liability companies (two or more shareholders), single person companies and joint stock companies (three or more shareholders) being generally more popular and common as commercial investment vehicles chosen by foreign investors in Oman.

Comparison of key features

Limited Liability Company (LLC)

An LLC consists of at least two shareholders and not more than 50 shareholders (except for a single person company, which can be wholly owned by one shareholder) with no minimum capital requirement. The shares of an LLC are not represented by transferable instruments but rather by a percentage interest in the capital of the company, and all shares must be of the same class. According to the CCL, all shares must be fully paid upon subscription. However, this is not the current practice adopted by the Omani Ministry of Commerce, Industry and Investment Promotion (MOCI). Instead, current MOCI practice usually allows for an LLC to be incorporated and issued with a commercial registration certificate – the LLC, at a later stage if requested by the MOCI (most usually when the LLC is updating its commercial registration information held by the MOCI), is then requested to show evidence of capitalization. Capital contributions may be in cash or in kind, but may not consist of services or labor from any person. In-kind contributions are subject to a specified valuation process.

All share transfers to third parties of an LLC (other than transfers to heirs of shareholders on their death) are subject to the statutory right of pre-emption in favor of the other shareholders, and shareholders of LLCs must participate in profits and losses.

LLCs are usually managed by one or more managers who are natural persons and who may or may not be a shareholder in the LLC. Managers are appointed pursuant to the constitutive contract of the LLC (which is the equivalent of a company's articles of association), or by a shareholders' resolution. The duties and responsibilities of managers are specified in the CCL. Furthermore, the powers of each manager can be included in the constitutional documents of an LLC and registered with the MOCI.

The advantages of incorporating an LLC is that this corporate vehicle is relatively easy to manage, founder shareholder(s) may dispose of shares at any time (unless restricted to do so by a shareholders' agreement), and that statutory pre-emption rights may prevent a shareholder from transferring interest to an undesirable third party. In contrast, however, one of the disadvantages is that the right of pre-emption may be used to block a shareholder from selling its interest to a particular third party. Another disadvantage is that shareholders are not able to pledge shares as security for personal loans and other financial obligations.

Joint Stock Companies (SAOC/SAOG)

SAOG/SAOCs must consist of at least three shareholders (unless established by the Omani government, either solely or with others). The minimum capital requirement of an SAOC is OMR 500,000 (but subject to higher specific requirements depending upon the nature of an SAOC's business), and OMR 2 million for SAOGs (except if converted from an SAOC to an SAOG, where capital must be at least OMR 1 million). Shares issued on incorporation must be paid up.

SAOGs/SAOCs are managed by a board of directors. The exact number of board members is usually determined by the articles of association of the company. However, the statutory minimum for SAOCs is three and the maximum is 11. In comparison, for SAOGs, the statutory minimum number of board members is five and the maximum is 11. The board must be made up of an uneven number of members, as per the CCL, presumably to prevent deadlock of board decisions. The maximum period of office for a board member is three years – this may be extended if a member is re-elected.

Directors of SAOGs/SAOCs are appointed through a complex election process known as a "cumulative voting system." SAOGs/SAOCs have more effective corporate governance with a formal board of directors, and it is mandatory for them to appoint a legal advisor and internal auditor.

The advantages of incorporating an SAOG/SAOC company is that such companies can issue preference shares to their shareholders. Furthermore, the shareholders of such companies are able to pledge shares as security for personal loans and other financial obligations.

The disadvantages of incorporating an SAOG/SAOC company is that there is a higher minimum capitalization requirement. Furthermore, shareholders of SAOG/SAOCs cannot control the transfer of another shareholder's shares (i.e. there is no pre-emption right), unless of course there is an agreement in place (i.e. a shareholders' agreement) which requires an agreed transfer process to be followed. In addition, SAOG/SAOC companies are subject to a further tier of supervision and direction from the relevant regulatory authorities. For example, each general meeting of an SAOC requires the agenda to be approved by the MOCI, together with officials of the MOCI also being invited to attend the meeting. In comparison, LLC shareholder meetings do not require the attendance of MOCI officials, nor does the MOCI need to approve the relevant agendas.

Branch office

A branch of a foreign company is permitted to operate in Oman as a permanent establishment without Omani participation, subject to certain conditions. In practice, the branch must:

- hold a contract with a governmental or quasi-governmental body (such as Petroleum Development Oman); or
- be granted special permission to establish by the Council of Ministers (based on deemed benefit to Oman).

Foreign investors under the Oman/US Free Trade Agreement may establish a branch without satisfying these conditions, as may nationals from other GCC member states.

Once registered, a branch may contract with others, own assets and incur liabilities, submit its own tax returns, obtain visas and work permits for its personnel, open and operate bank accounts and effect imports, all in connection with its government/quasi-government contract(s).

Defense contracting in Oman

In practice, the current defense procurement structure in Oman consists of government units and private sector entities. The government units are the Ministry of Defense (MOD), Royal Oman Police (ROP), Royal Office, and the Internal Security Service. Defense contracts between a US entity and a government entity are primarily governed by the US-Oman FTA (depending on the government entity), and PFD/offset regulations. As for the private sector, this consists of entities that provide security services, and such entities would be usually governed by their own internal tendering policy and the US-Oman FTA (to the extent relevant).

The Oman Tender Law promulgated by RD 36/2008 as amended by RD 19/2011, RD 120/2011 and RD 60/2013 (the Tender Law) governs procurement of contracts by government ministries and other public bodies in Oman. Each government unit has its Internal Tender Committee (ITC) that evaluates tenders. Except for defense procurement, government units are required to continue to apply the Tender Law and its regulations until internal procurement rules and regulations are approved by the "competent authorities".

As far as defense procurement by the government is concerned, registration with the tender board of the relevant security authority is usually the first step. Tenders issued by the MOD and its units are published on their respective websites.

US-Oman FTA

The FTA came into effect on 1 January 2009 and provides benefits such as relaxation in custom duties on exportation of US goods, relaxation in offset requirements (only for government entities listed therein), and national treatment. Barring a few exceptions contained in the FTA, almost all forms of investments are now covered for both Oman and the US. As far as the defense sector is concerned, the ROP can restrict the supply of investigation and security services to Omani nationals and enterprises owned by Omani nationals only.

Regardless of the sector-wise Omanization requirements, wholly-owned American companies in Oman are required to have up to 80% of their "employees" to be Omani nationals (for example, if the sector-wise Omanization requirement is 90%, a reduced rate of 80% will be applicable to wholly-owned American companies in Oman). Note that this 80% threshold does not include managers, members of the board of directors, or specialty personnel. This means that American companies may employ as many non-Omani nationals for the position of managers, members of the board of directors, or specialty personnel.

A "covered procurement" by a "procuring entity" listed in the FTA is exempt from offset requirements. Ministries, public authorities, other government bodies and some commercial companies that are government owned are listed therein. MOD and ROP are not included.

PFD Regulations (offset)

Oman adopted an "offset" regime for the defense industry in 2001. This was replaced with the Partnership for Development Regulations (PFD Regulations) issued by the Oman Authority of Partnership for Development (which has now been closed and its mandate transferred to the Ministry of Finance).

The PFD Regulations expanded the offset program to apply to government contracts relating to the supply of goods and services for infrastructure projects, contracts for supply of weapons, military and security equipment, the value of which is equal to or exceeds OMR 5 million (approximately US$13 million) (single or cumulative over a 24-month period).

In summary, the PFD Regulations apply to:

Contracting Entity	The government or a state-owned entity (defined as more than 50% stated owned)
Contractor (or subcontractor)	Foreign entity not registered in Oman
Type of contracts	Supply of goods and/or services from abroad
Projects	Virtually every military and civil project in Oman
Threshold	Contracts with a value of more than OMR 5 million (approximately US$13 million)

PFD obligation

Level of obligation

- For foreign contractors → 50% of the value of the supply agreement (contract value)
- For nationally/locally-registered contractors → 50% of the value of the imported content (i.e. content sourced from outside Oman)

The Contracting Entity would generally be required to sign a supply agreement setting out the PFD objectives and timelines. The party is usually expected to complete the agreed PFD obligation within eight years from the effective date of the supply agreement in accordance with the following milestones:

- end of year 2 (20%);
- end of year 5 (60%); and
- end of year 8 (100%)

Eligible PFD activities

- Economic diversification and support of strategic sectors through technology
- Enhancing defense and security capabilities
- HR development
- Private sector development

Foreign investment and government procurement are constantly evolving in Oman and the exact procedure may be different from what is set out in this high-level guide.

Jordan

Saif Al Saryreh
Associate
Amman, Jordan
D +962 6 577 7400
saif.al-saryreh@dentons.com

Introduction

Jordan is located in a perilous region plagued with conflict. Despite regional unrest from conflicts in neighboring countries such as Syria and Iraq, the massive influx of refugees and its lack of resources, Jordan has managed to persevere and maintain political and economic stability. This was in large part due to the emphasis placed on strengthening military power and increasing defense spending.

Although Jordan's location has historically been a disadvantage (more so in recent years), its location has conversely also appealed to foreign powers for its potential as a political deterrent against regional threats, which has given rise to foreign aid in many sectors including, most notably, the defense sector.

In light of the above, and the country's precarious security environment, Jordan has aimed to expand and modernize its defense industry.

Defense contracting in Jordan

Jordanian legislation does not allow for Jordanians and non-Jordanians to serve as commercial agents and intermediaries in importing, selling or repairing weapons, their spare parts, complementary parts, enhancing parts or any other parts of such kind. Additionally, it is not permissible for a non-Jordanian investor to own or contribute wholly or partly in the trade, import and maintenance of firearms and ammunition.

This does indeed limit the options with regards to foreign investments for defense contracting. However, Jordan has, as shall be evident by the end of this chapter, in many ways established its own unique approach to defense contracting which propelled it to the forefront of the field in the region.

There are two possible ways to engage in defense contracting in Jordan, either by: (i) selling military equipment directly to the Jordanian Armed Forces through engaging its Defense Resources Authority and Investment Management Committee; or (ii) entering into partnerships and joint ventures with the King Abdullah II Design and Development Bureau (KADDB) as part of the country's offset policy.

The Jordanian Armed Forces (JAF)

The Defense Resources Authority and Investment Management Committee is a special committee formed within the JAF (JAF Defense Committee) to regulate and act on the JAF's behalf in investments for the purposes of achieving the JAF's goals, including defense contracting. The Committee also regulates bidding and tender processes on behalf of the JAF.

The Chief of Staff of the JAF appoints a Chairman of the Committee which is also the representative of the JAF and the Chief of Staff with regards to any investment prospects and tender processes, including any representations before any third party.

Various foreign entities (including governments) have sold the JAF equipment such as, inter alia, military aircraft, tanks and vehicles through contracts, engagements and arrangements with the JAF Defense Committee.

In this case, the JAF would benefit from military exemptions: Custom Law No. 33 of 2018 states that exemption from the customs duties and other fees and taxes shall be put into effect with regard to the import of armed forces and any Arab forces stationed in Jordan. This exemption covers ammunition, weapons, equipment, clothes, vehicles and their spare parts, and any other items which the Council of Ministers determines upon recommendation of the Minister.

Disadvantages of entities pursuing this route would typically include going through lengthy administrative procedures/approvals and encountering vague internal policies which sometimes impose unwarranted hindrances.

KADDB: a philosophy of defense development

In 1999, HM King Abdullah II issued a Royal Decree to establish the KADDB as an independent military/civilian institution operating under the umbrella of the Jordanian Armed Forces, to be a leading bureau in research, development, design and manufacturing in multiple defense systems fields and to spearhead the Kingdom's offset policy.

The KADDB operates as a trade fund and is tasked with operating in accordance with best commercial practice to achieve pre-determined performance targets and aims to harness science and technology to fulfill the Kingdom's defense needs, as well as assisting it in creating a more developed and sustainable defense industrial base. However, the KADDB's stated goal is not to develop an indigenous capacity to secure the domestic supply of defense material, but to export its products and services to neighboring states in order to generate revenue.

Seeking to expand the KADDB's scope of activities, in 2010, the KADDB established a subsidiary, KADDB Investment Group (KIG), to act as its commercial arm. KIG aims to establish new businesses in the defense, security and automotive industries, along with all services that would complement these industries.

Jordan's offset policy

While most other countries' defense offsets obligate firms supplying arms to directly invest money back into the procuring country in some way, Jordan's offset policy takes the form of a quid pro quo for selling defense equipment to Jordan achieved through the KADDB. That is, foreign firms must agree to shift some degree of technology and/or production to the KADDB in order to qualify as a seller (the KADDB being the designated partner for offset ventures).

For example, in 2003, Jordan purchased six KA-226 helicopters. Subsequently, the manufacturer of the Russian-made helicopters, Oboronprom, signed an agreement with the KADDB to establish a facility in Jordan for the production and maintenance of the helicopters.

Similarly, after Jordan purchased a number of F-16 fighter jets from the Netherlands and Belgium, a logistics firm, Strategem, operating in Belgium and the Netherlands, contracted with the Dutch Agency for Economic Development to conduct a study investigation into the feasibility of constructing a maintenance facility for the F-16 fighter jets. Consequently, the KADDB and the Jordanian Aeronautical Systems Company (JAC) partnered with Daedalus Aviation Group, allowing Jordan to further develop its aviation business, as well as its engineering, scientific, educational and manufacturing military and civil aviation capabilities in the field of MRO and, in general, to contribute to the development of Jordan's indigenous capabilities.

This approach to defense offsets would not burden firms with the pressure of investing back into the country and would, instead, give them more flexibility, making the KADDB a highly attractive business partner.

On the other hand, Jordan would benefit from domestic security in a number of ways. Under licensing or co-production arrangements, Jordan would benefit from:

- the transfer of weapons technologies, capital equipment, manufacturing facilities and related infrastructure, such as roads, power generation stations and worker housing;
- the employment provided to the engineers and trained managers who emerge from the region's military-technical colleges, as well as to the vast pool of laborers among the armed forces;
- the earnings generated by exports of co-produced weapons components;
- the ability to use the manufacturing facilities and trained labor in the production of other, non-military goods and services produced by the armed forces; and
- the prestige associated with being chosen to partner with multinational firms that build technologically sophisticated products.

Additionally, the KADDB's success along with Jordan's geographical proximity to regional unrest makes it an even more attractive business partner. Ever since the start of the Iraqi war, several big firms have sought partnerships with the KADDB to exploit Jordan's proximity to Iraq, resulting in a dramatic increase in the export of Jordan's military equipment, with a significant share of the exports going to Iraq. A prime example is the partnership made between the KADDB and ITT whereby an agreement was made to refurbish US military vehicles to sell to the Iraqi army.

Notwithstanding the aforementioned, such requirement to enter into a joint venture with the KADDB is not codified under Jordanian law, as codifying this requirement under law is problematic due to certain exceptions. These exceptions manifest in the following form: as Jordan's defense budgets are primarily financed through US aid, it is prohibited from formally demanding offsets from US companies or from paying premiums to co-produce with foreign firms. Nonetheless, this restriction has not impeded its ability to expand its defense industrial base through collaborative ventures.

KADDB: domestic affiliates

The KADDB manufactures a wide range of military products including, inter alia, military clothing and armor, several types of unmanned vehicles, sidearms and ammunition, and numerous types of defense electronics and infantry combat vehicles. According to the KADDB's own promotional literature, the military products it is involved in producing result from joint venture partnerships with 26 different foreign defense firms/companies from Australia, Austria, Belgium, Canada, Germany, Italy, the Netherlands, Russia, Saudi Arabia, South Africa, South Korea, Sweden, Switzerland, Turkey, the UAE, the UK and the US, as well as a project with a commercial firm from Malaysia.

The following is a brief description of the KADDB's main affiliates:

- Jordan Light Vehicle Manufacturing Co. (JLVM): JLVM is a joint venture between the KADDB and the Jankel Group Ltd of the UK to design, develop, produce and market military vehicles. Operational since 2008.
- Jordan Manufacturing and Services Solutions (JMSS): JMSS is 100% owned by the KADDB. Its activities include: (i) batch manufacturing of medium and heavy vehicles; (ii) up to depot level maintenance including rebuild, upgrade, modification and refurbishment of various vehicle types; (iii) armor design, development and upgrade; (iv) steel fabrication and manufacturing (railway, potash, cement and phosphate industries); (v) armored booth design and build; and (vi) design, development and building of live firing shooting ranges.
- Jordan Advanced Machining Company (JordanAMCO): JordanAMCO's objective is to establish a location for precision manufacturing in Jordan to support the country's developing industrial base, as well as exploring regional and international export opportunities. JordanAMCO's intention is to be at the forefront of advanced manufacturing in Jordan and, as well as providing machining services on a direct supply basis, it will also be providing technical assistance to other local manufacturers with tooling selection, heat treatment, training requirements and assistance with understanding material properties and their machining characteristics etc.
- Jordan Ammunition Manufacturing Services (JORAMMO): Established in 2008, JORAMMO is a joint venture between the KADDB, MECAR (a Belgian ammunition manufacturing company) and DMV (a holding company from the US). JORAMMO aims to become one of the largest centers in the Middle East and North Africa for

the design, development and production of ammunition, as well as for conducting testing and qualification of its products and dematerializing ammunition. It caters for the ammunition needs of the Jordanian Armed Forces, as well as other armed forces, both regionally and worldwide.

- Jadara Equipment and Defence Systems Co PSC: A Jordanian military-industrial company established in 2005 by the KADDB and Specialized Technical Services. It manufactures a variety of carried weaponry, including RPG-32, PG-32V and TBG-32V.

Other notable KADDB affiliates include:

- Jordan Armament and Weapon Systems Co.;
- The Jordanian Company for Manufacturing Special Boots;
- Arab Ready Meals;
- NP Aerospace Jordan;
- Raytech Jordan;
- Aerial Survey & Photography (ASP);
- Seabird Aviation Jordan (SAJ);
- The Jordan Russian Electronic Systems Company (JRESCO);
- Design Jordan;
- Prince Faisal Information Technology Center (PFITC);
- Jordan Armament & Weapon Systems (JAWS);
- Jordan Electro-Optics Company (JEOC); and
- SOFEX.

HM King Abdullah II played a significant role in promoting Jordan's defense industry among the global defense community. In 1999, HM King Abdullah II established SOFEX, now recognized as the world's fastest-growing and the region's only special operations and homeland security exhibition and conference. SOFEX is usually held biannually in Jordan under the patronage of HM King Abdullah II and features the largest fully-integrated and innovative Special Operations Forces equipment and solutions from around the world.

SOFEX's success has been steady and continuous since its establishment. In 2018, SOFEX's gathering has seen more than 9,000 military and business attendees from 72 countries, in addition to 116 foreign military delegations and 82 exhibitors from 37 countries.

Growth indicators

According to data recorded and indicators published by different sources such as, inter alia, the World Bank and TheGlobalEconomy.com, Jordan's defense spending has steadily grown from around US$0.5 billion in 1999 to US$2.03 billion in 2020. The most dramatic growth was recorded between 2005 and 2010 – from US$0.5 billion in 2005 to around US$1.56 billion in 2010, an increase of more than 50%.

Tax considerations

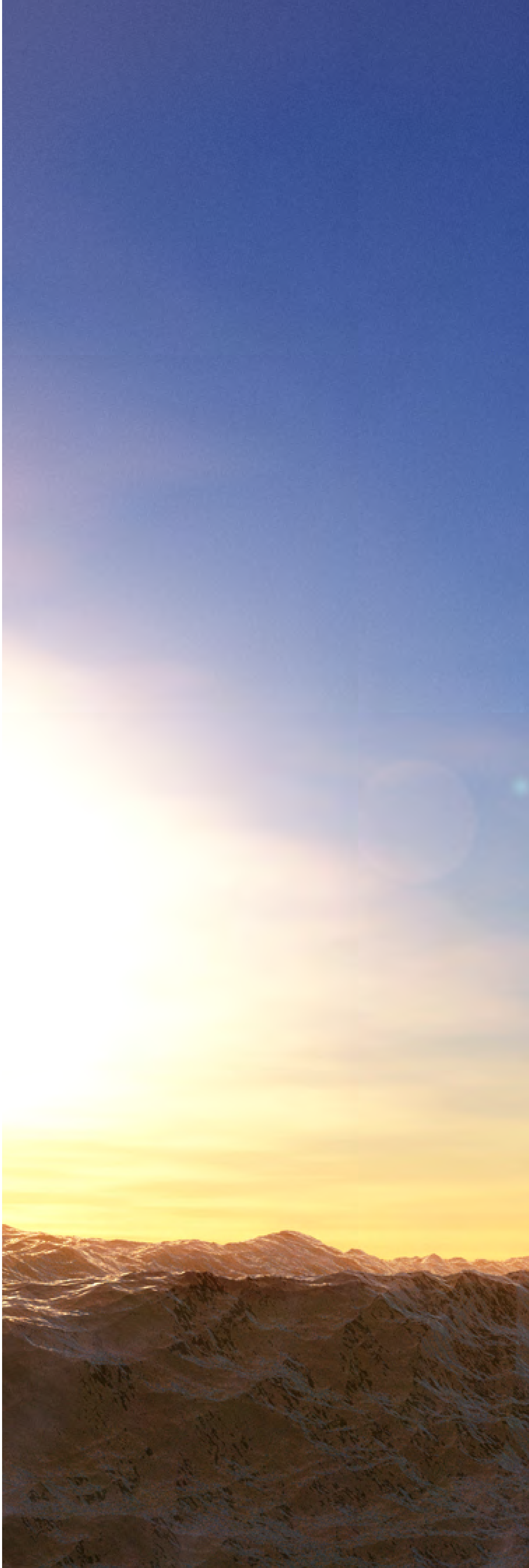
Tax implications will differ depending on the nature of the investment and commercial activity. Direct contracting with the JAF through its investment committee for the sale of defense equipment and machinery would grant benefits of exemptions from Jordanian tax. In the case of weapons manufacturing, establishing a company in Jordan and doing business with the KADDB will subject an investor to normal tax regimes by virtue of their legal presence in Jordan (i.e. the established Jordanian company) including the possibility of any tax exemptions granted by the Jordanian Investment Commission.

Moreover, imports of the Military Consumer establishment shall be exempted from customs duties and other fees and taxes in accordance with type, quantities and values determined by the Council of Ministers.

Conclusion

Improving Jordan's defense industry and building cooperation with defense contractors is a priority for HM King Abdullah II. Furthermore, Jordan's proximity to a deeply troubled region along with its evolving innovative strategies and flexible defense offset approach makes it a very appealing prospect for defense contractors and interested parties across the globe.

In light of the above, the philosophy of defense development adopted by Jordan has proved to be a successful approach and is not likely to subside or change anytime soon. On the contrary, it seems that it is likely to grow and develop new and exciting avenues.



Lebanon

Elias Chedid
Partner
Beirut, Lebanon
D +961 70 079 179
elias.chedid@dentons.com

Assessing business opportunities for defense contracting via direct sales to the Lebanese government requires a quick overview of the defense sector in Lebanon based on the needs of this sector and on the funding possibilities in light of the country's resources and defense spending capabilities.

Despite clear national security risks, Lebanon did not recently adopt a defense policy or security strategy and the Lebanese Armed Forces do not conduct regular military operations.

Thus, defense spending and arms import are relatively limited, and Lebanon cannot be considered as a significant defense importer.

Nevertheless, Lebanon's defense sector was assessed in November 2019 by *Transparency International* in its Government Defense Integrity Index assessment for the MENA region to be the second most transparent in the region after Tunisia, despite the fact that it continues to face high risks of corruption.

Main reasons that have obstructed the development of the defense sector

Economic and political impediments are the main reasons that have obstructed the development of the defense sector in Lebanon.

Political disagreements, wars and chronic unrest, as well as the presence of foreign forces on Lebanese territory from 1975 to 2005 resulted in the Lebanese Armed Forces being ill equipped (their equipment being outdated) and underfunded.

In addition, the defense budget is included in the national budget, and the passing of the latter experienced delays during the past 15 years, with its approval being postponed for economic and financial reasons, with calls for spending reductions.

In 2017, the country passed its first budget since 2005. Nevertheless, off-budget military expenditure still occurs, due to the lack of resources in the defense budget (which is primarily dedicated to staff salaries), noting that the Lebanese Armed Forces alone comprise 80,000 active personnel.

Military expenditure

The main source of the Lebanese Armed Forces' funding consists of military assistance from foreign countries and allies who support, equip and train Lebanese military personnel.

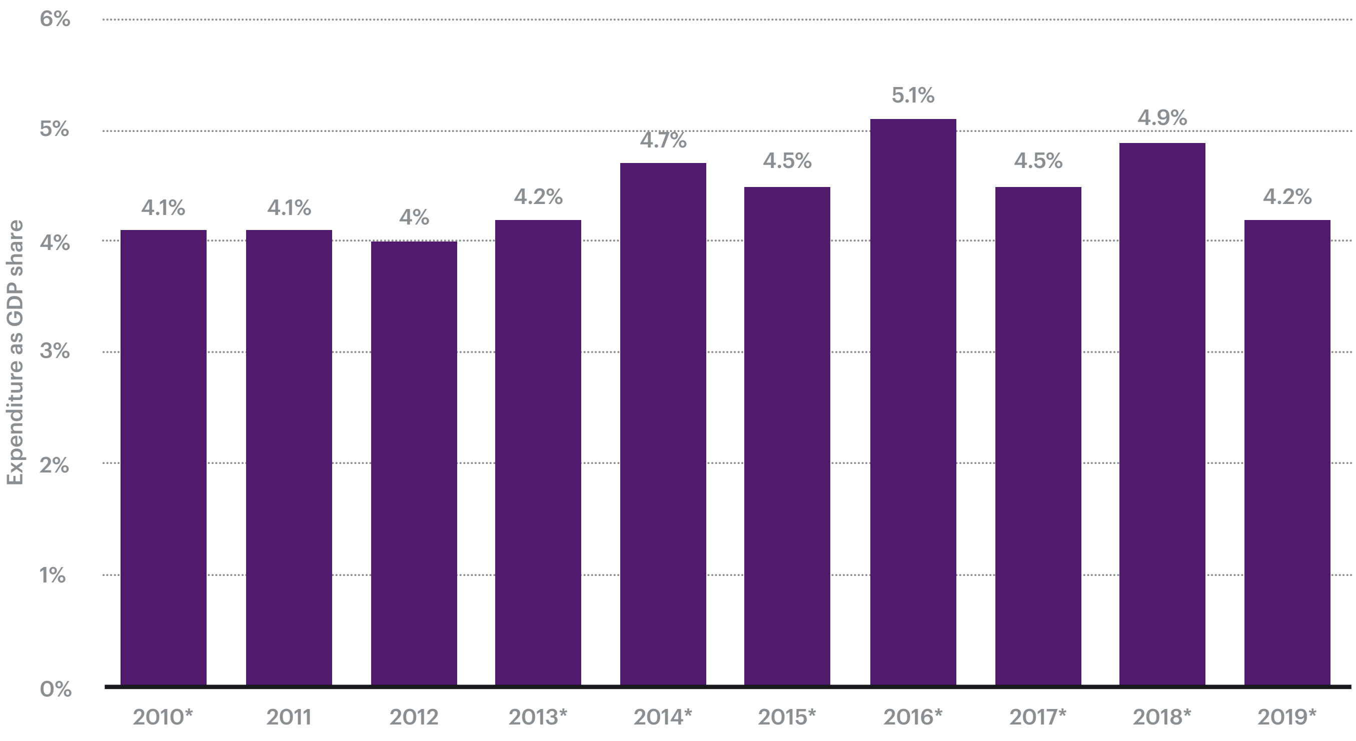
In 2019, military expenditure for Lebanon reached US$2.521 million, of which only US$67 million accounted for arms import (i.e. the supply of military weapons through sales, aid and donations, including armored vehicles, artillery, radar systems and excluding small arms and light weapons, trucks, small artillery, ammunition). Before that, it reached a low of US$37 million in 1987.

Military expenditure in Lebanon, which includes all current and capital expenditure relating to the armed forces, was reported at 4.2422% of the gross domestic product in 2019, according to the World Bank collection of development indicators, compiled from officially recognized sources.

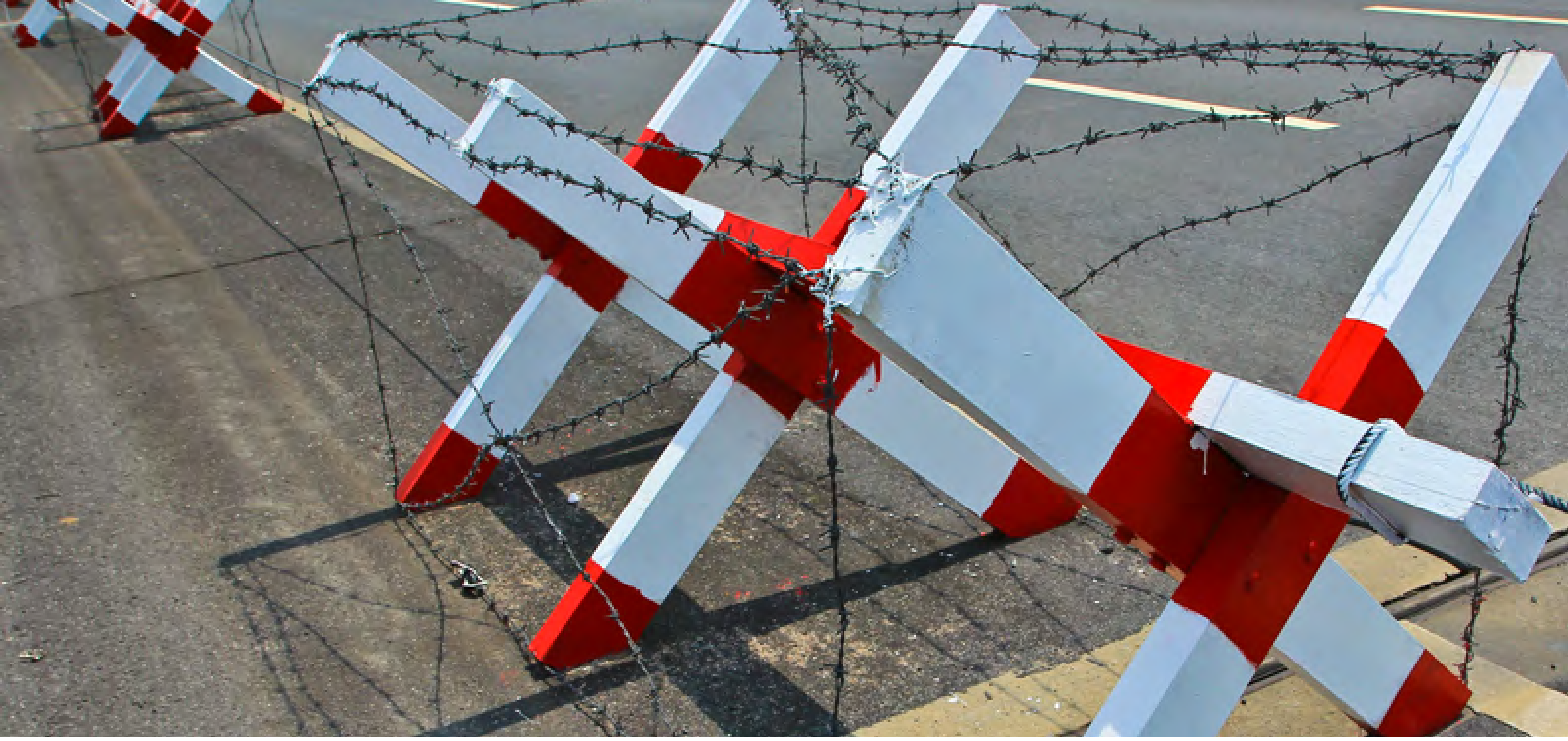
Below is a chart showing Lebanon's military expenditure as a share of the gross domestic product from 2010 to 2019.

It is worth noting that access to information related to the armed forces is very limited and restricted due to the high degree of secrecy in the defense sector, despite the Access to Information Law adopted in 2017, which does not exclude the defense sector from its scope.

Military expenditure as share of the domestic product in Lebanon from 2010 to 2019



Source: SIPRI © Statista 2020



Foreign military sales (FMS) between the US government and Lebanon

Throughout the years, in support of its foreign policy and national security, the US government has sought to improve Lebanon's capability to meet local and regional threats, regarding Lebanon as a partner country on a wide range of regional security issues and as an important force for political stability in the Middle East.

The US's security assistance to the Lebanese government has exceeded US$1.82 billion since 2010, and has averaged US$224 million annually since 2015.

In addition, the US has US$894 million in active government-to-government sales cases with Lebanon under the FMS system.

Furthermore, the US is the Lebanese government's top security partner. Around 85% of the Lebanese Armed Forces' equipment is US-made (with the remainder being UK, French, and Russian).

Recent and significant prior sales notified to the Congress include: A-29 Super Tucano light attack aircraft, Huey II helicopters, AGM-114 Hellfire and TOW 2A missiles. The full complement of six A-29s was delivered in June 2018.

Public procurement

As a general matter, the public procurement framework in Lebanon is provided by the Public Accounting Law (Decree Law No.14969 dated December 30, 1963) which sets out the principles of public budget preparation, budget execution and management of public funds, and devotes a special chapter to the terms of Authorization of Expenditures.

This law provides special procurement provisions which apply to military administrations (Articles 219 to 231). These benefit from a special regime when it comes to the rules of contracting. Under this regime, they are allowed (in certain instances) to award contracts consensually by mutual agreement without the necessity of running open public tenders.

Subcontracting opportunities in the defense sector and joint ventures

The concept of subcontracting is acknowledged, familiar and widespread across all sectors in Lebanon, whether in connection with private or public contracts. As a general matter, the legal framework for subcontracting is an enabling one and is provided by the Lebanese Code of Obligations and Contracts.

However, this concept is not applied in the defense sector in Lebanon, due to the absence of any defense, arms or automotive industry in the country, and not due to any legal impediments.

Joint ventures are commonly used in Lebanon in connection with specific projects in several sectors and industries, such as the construction industry. They can consist either of locally established companies that are jointly owned, or of elaborate agreements that govern the parties' relationship and are widely upheld, acknowledged and enforced by Lebanese courts.

Applicable tax

Lebanon has not entered into any double taxation agreement/treaty with the US. Nevertheless, there have been agreements between both countries that relate to technical cooperation as well as to trade and investment, such as the General Agreement for Technical Cooperation entered into on May 29, 1951; the Technical Cooperation Program Agreement entered into on June 26, 1952; the MoU with USAID in the field of energy and water dated November 11, 2002; and the Trade and Investment Agreement dated November 26, 2006.

In general, non-resident entities and individuals are only taxed at a rate of 2.25% for withholding tax on the sale of goods, and at a rate of 7.5% for withholding tax on the provision of services, while resident entities are subject to corporate income tax at a rate of 17% and to withholding tax on distributions at a rate of 10%. That said, any person who spends more than 183 days in Lebanon within a continuous period of 12 months will be deemed a resident of Lebanon.

Anti-corruption legal framework

The anti-corruption legal framework is provided by Law No. 189 dated October 16, 2020 relating to the declaration of assets and the repression of illicit enrichment, and Law No. 175 dated May 8, 2020 relating to anti-corruption in the public sector and the creation of a National Commission to combat corruption.

Law No. 189 of October 16, 2020, which mainly relates to the disclosure of assets by certain categories of civil servants (elected or appointed), repeals Law No. 154/1999 (relating to illicit enrichment) and brings about a number of changes in the provisions that govern illicit enrichment.

As a matter of fact, this law adopts a broad definition of illicit enrichment, which applies regardless of whether or not the civil servant is subject to a disclosure obligation. The law also refers to any increase in assets that cannot be justified.

In addition to this, Law No.189 of October 16, 2020 has innovated by introducing more flexible prior conditions for taking legal action and hence has facilitated complaints. First, the deposit that is required as guarantee when a complaint is lodged with the courts is reduced to LBP 3 million (instead of the LBP 25 million required under Law No. 154/1999). Second, initiating proceedings before the anti-corruption committee is free and does not require making any guarantee deposits. Third, complaints and legal proceedings are no longer subject to any statute of limitations. However, and perhaps most importantly, Law No. 189 of October 16, 2020 focuses on the person that ends up being held guilty of illicit enrichment and on this person's punishment rather than on the person that files the complaint.

For its part, Law No. 175/2020 defines corruption and the general principles of law relating to corruption offenses, and establishes the anti-corruption committee which is to play a role in the effective implementation of the Whistleblower Protection Law, the Access to Information Law or the Illicit Enrichment Law (replaced by Law No. 189 later in the same year). The members of this committee now need to be appointed and the effectiveness of the new legal framework will largely be based on the committee actually playing the role that the law assigned to it.

Egypt

Muhammad Abdelnasser
Associate
Riyadh, Saudi Arabia
D +966 11 200 8678
muhammad.abdelnasser@dentons.com

Constitutional background

Articles 200 to 204 of the Egyptian Constitution govern the organization, role and leadership of the Egyptian Armed Forces (EAF). The Egyptian Constitution establishes the National Council for Defense (NCD), headed by the President of the Republic and comprised of the Prime Minister, Speaker of Parliament, the Minister of Defense, Minister of Foreign Affairs, Minister of Finance, Minister of Interior, Chief of General Intelligence, Chief of Staff of the Armed Forces and the chief officers of the Navy, Air Force and Air Defense, head of the Armed Forces Operations Authority and the Director of Military Intelligence. The main role of the NDC is to manage all affairs related to the safety and security of the country, discuss the budget of the EAF and study mechanisms for the procurement of resources for the continuous supply of the armed forces. The Constitution also establishes the budget of the EAF as a first priority in the state's budget.

Legislation governing defense contracting

Law No. 182 of 2018 (the Public Procurement Law) applies to ministries, public corporations, committees and other government agencies. It allows the Ministry of Defense, Ministry of Interior and their agencies in cases of necessity required by considerations of national security, including procurements for the requirements for the EAF, to conclude all contracts deemed appropriate, including concluding contracts by way of direct agreement alongside other ordinary means such as public or limited tenders. The law also grants these bodies the right to delegate to third parties in any of those powers determined in this regard.

In addition, the law allows government agencies in general, including those working in the field of defense supplies, such as the Military Production Authority (MPA) and General Intelligence (GI), the right to deal with each other directly without the need to follow tender procedures. The law may also assign contracts to affiliated MPA and GI units or entities, such as public institutions and their affiliated companies.

In practice, and in addition to arms contracts, the EAF concludes many transactions with several local vendors for various activities and projects carried out by the EAF, including but not limited to construction, industrial projects, food and beverages, etc.

Tax exemption

Under the provisions of Law No. 204 of 1957, governments and foreign entities that conclude contracts with the Ministry of Defense regarding the supply of equipment, tools and machinery necessary for armaments and other military equipment are exempt from all taxes and fees.

This law has been amended by Law No. 147 of 1964 to include the tax exemption for construction contracts and services necessary for the purposes of armament, in addition to the supply of equipment and machinery. The amendment also stipulates that the tax exemption does not apply to foreign institutions that have branches in Egypt, if the contract was concluded with that branch.

Doing business in Egypt

Types of corporate entities under the Egyptian Companies Law

The establishment of a company in Egypt is mainly governed by Law No. 159/1981 as amended (the Companies Law) and its executive regulations, issued by virtue of Ministerial Decree No. 96 of 1982, as amended (the Companies Law ER).

In view of the provisions of the Companies Law, the Egyptian legal system recognizes three types of companies that could be established by a foreign entity as follows:

- Joint stock company (JSC);
- Limited liability company (LLC); and
- Sole proprietorship (SP).

Key differences between JSC, LLC and SP companies

The table below summarizes the main characteristics of: (i) JSCs; (ii) LLCs; and (iii) SPs in Egypt under the provisions of the Companies Law and the Companies Law ER.

	JSC	LLC	SP
Name	The name of the company should indicate the activity or objects of the company.	The name of an LLC may refer to its activities and may include one or more of its shareholders' names.	The name may refer to its activities and may include the founder's name.
Purpose of the company	There are no restrictions on the purposes of a joint stock company, provided that it does not conflict with public order or morality in Egypt.	May not engage in insurance, banking, savings, deposit taking, investment funds or securities brokerage activities, investment for others, as well as any activity that is limited to any type of entity.	May not: i. incorporate other sole proprietorship company; ii. offer its shares for public subscription; iii. divide its capital to transferable/ traded shares; iv. borrow through issuing tradable securities; and/or v. commence insurance or banking activities, or collect money for investment.
Head office	Must be located in Egypt.		
Duration	The normal practice is 25 years.		The normal practice is 25 years. However, an SP company will be dissolved by law and its legal personality shall lapse in case of, inter alia: (i) the loss of half of the capital unless the owner decides to continue the business of the SP; and (ii) the dissolution / bankruptcy / insolvency of the juristic person of the SP (if the owner is a juristic person).
Shareholding/ Formation	Minimum three shareholders with no maximum number of shareholders.	Minimum of two persons (whether natural and/or juristic) and not more than 50 shareholders.	One person (whether natural and/ or juristic).
Foreign shareholders	Shareholders of foreign nationality may wholly own the company.		
Rights/ liabilities of the shareholders/ founder	The shareholder(s) liability is limited to the value of shares to which the shareholder(s) has subscribed.		The shareholder liability is limited to the value of the capital. As an exception, the founder may be held personally liable for the SP's actions or debts, if: i. in bad faith, the owner/founder has liquidated the SP or suspended its activities before its expiry date or before performing its objectives; ii. the owner/founder did not separate its own funds from the SP's funds; and iii. the owner/founder entered into contracts in the name of the SP before the SP's incorporation, where such contracts are not required for its incorporation.
Management	At least three board members (either natural persons and/or juristic persons).	At least one manager.	
Foreign employees ratio	The number of Egyptian personnel employed by an Egyptian entity shall be no less than 90% of its total workforce, nor shall their wages be less than 80% of the total wages paid by the Egyptian entity.		
Auditor	Must have a qualified auditor and a legal advisor eligible to stand before the appeal court.		

	JSC	LLC	SP
Minimum capital requirements	The minimum capital required is EGP250,000 (for close trading companies whose shares are not offered for public subscription). 10% of the capital must be paid by the shareholders at the time of the incorporation. An additional 15% of the capital must be paid within a maximum of three months, starting from the date of registration of the company in the commercial registry extract. The remainder of the capital must be paid within five years, starting from the date of registration of the company in the commercial registry extract.	No minimum capital required. The capital shall be determined by the shareholders (although GAFI may request from the shareholders certain minimum capital that matches potential activity). The capital must be fully paid in an authorized local bank and in any currency.	Minimum of EGP50,000. Must be fully paid at the time of the incorporation in a local bank, subject to the supervision of the Central Bank of Egypt.
Minimum par value per share	Minimum EGP1 and maximum of EGP1,000.	To be determined by the shareholders.	N/A
Transfer of ownership	Generally, there are no restrictions on the transfer of shares, unless otherwise specified in the statutes of the Joint Stock Company. However, shares of a company's founder may not be transferred to a third party before the publication of the company's balance sheet and profit and loss account for two full fiscal years, each of no less than 12 months from the company's incorporation date.	Shareholders wishing to transfer their shares must offer them to existing shareholders, who have one month within which to purchase such shares on a pro rata basis, based on statutory pre-emption rights.	In the event the founder transfers the capital of the SP to another natural and/or juristic person: the founder must notify GAFI prior to the sale within 15 days and obtain their approval; the sale of the SP shall not affect the obligations of the SP towards its creditors and/or a third party; and the founder must amend the articles of association of the SP and its commercial registry extract within a maximum of 90 days from the date of the sale (otherwise, the SP will be deemed dissolved by law). In the event the SP's founder intends to sell the SP to more than one person (either natural and/or juristic), the shareholders of the SP must resolve to amend the form of the SP to any other form within a maximum of 90 days from the date of the sale (otherwise, the SP will be deemed dissolved).
Profit distribution	If the shareholders in a general assembly meeting decide to distribute profits to the shareholders, the company must distribute profits to its employees of not less than 10% and not in excess of the aggregate annual salary of such employees. Where the shareholder(s) convened in a general assembly meeting approved the distribution of profits to the shareholders, an LLC and/or SP whose capital is equal to or more than EGP250,000 must distribute profits to its employees of not less than 10% and not in excess of the aggregate annual salary of such employees.		

<table>
<tr><th></th><th>JSC</th><th>LLC</th><th>SP</th></tr>
<tr><td>Formation timeframe</td><td colspan="3">Two to three working days from the date of submitting all the required documents to GAFI.

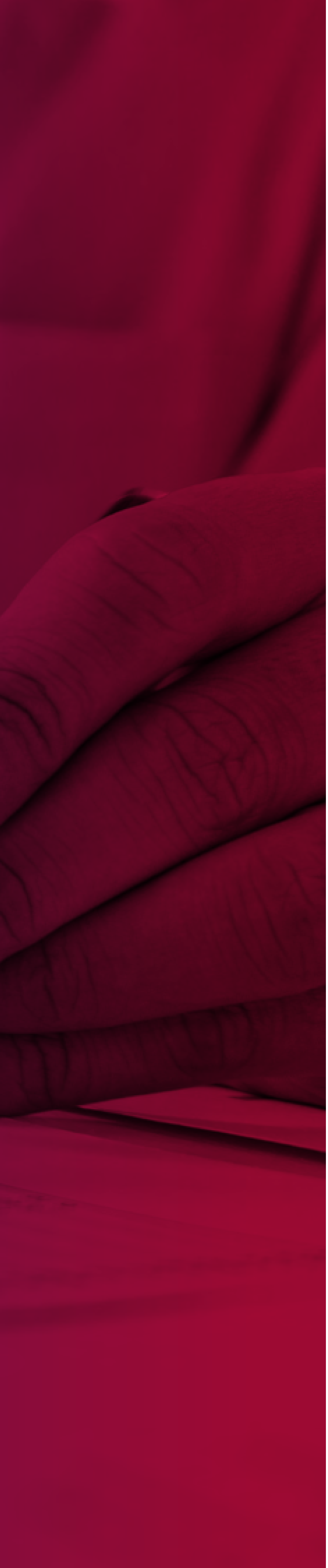
Two working days from the date of submitting all the required documents when using the VIP service at GAFI (that costs EGP10,000).</td></tr>
<tr><td></td><td colspan="3">1. Fees certifying non-confusion of trade names: EGP114
2. Incorporation fees: payable to the General Authority for Investment and Free Zones (GAFI), equivalent to 0.1% of the issued capital with a minimum of EGP100 and maximum of EGP1,000;
3. Services fees: 0.1% of the issued capital with a minimum of EGP1,000 and maximum of EGP10,000 + EGP100 for FRA certificate (not applicable on LLC);
4. Central depository registration fees: 0.05% of the issued capital capped at EGP10,000;
5. Issuing of shares fees: 0.05% of the issued capital capped at EGP10,000;
6. Articles of Association ratified copy: EGP600 per copy;
7. Lawyers' syndicate: 1% of the issued capital with a maximum of EGP25,000 and a minimum of EGP250, plus EGP50 lawyers' stamp;
8. Ratifying the Articles of Association: 25% of the issued capital with a maximum of EGP1,000 and a minimum of EGP10;
9. Registration in the commercial register: EGP63.25 (when there is another office to be reflected in the commercial register, the fees for the registration of such office are EGP297.75);
10. Practicing certificate: Annual membership in amount of two in 1,000 of the paid capital with a maximum of EGP2,000 and a minimum of EGP24, plus EGP200 for practicing certificate copy and EGP100 trade category fees; and
11. Trade union: EGP125 if the capital is less or equivalent to EGP500,000 or EGP250 if the capital is equivalent or more than EGP500,000.</td></tr>
</table>

In view of the presumed sensitivity of carrying out defense contracts in Egypt, establishing a defense company is subject to the approval of the competent security authorities in Egypt, according to their absolute discretion.

Tax

Michael Camburn
Partner, VAT leader for Saudi Arabia
Deloitte, Riyadh
D +966 11 282 8400
mcamburn@deloitte.com

Farhan Farouk
Senior Director
Deloitte, Jeddah
D +966 (0)50 535 7075
ffarouk@deloitte.com



Introduction

The defense sector in the Middle East is witnessing major changes. Governments are focused on developing their own home-grown defense capabilities that allow for local job creation and economic diversification. In particular, both the Kingdom of Saudi Arabia (KSA) and the United Arab Emirates (UAE) have announced various initiatives to develop their defense industry, allowing for foreign investors to also participate in such ventures, which inevitably brings into focus the role of taxation, as this has a major impact on foreign and direct investment.

Direct taxes in the Middle East

Direct taxes are becoming much more prevalent as government reliance on public sector oil revenues begins to shift towards the private sector economy.

There is a lot of ongoing reform with tax authorities under pressure to increase tax revenues, investing in new digital systems and headcount, and dealing with new areas of taxation such as transfer pricing.

Corporation tax and withholding taxes are currently enacted in KSA, Qatar, Iraq, Kuwait, Oman and Jordan. In Bahrain and the UAE, only foreign banks and foreign oil companies are subject to corporation tax.

In KSA, given that the tax landscape is evolving at a fast pace, the tax authorities have increased their activity dramatically over the past couple of years as they have become increasingly sophisticated in their approach to tax audits.

Value Added Tax (VAT) in the Middle East

Amongst other taxes, VAT is a relative newcomer and plays an important role in shaping the fiscal policy in the region. The GCC 2016 VAT Framework Treaty was agreed between the members more than five years ago and sets out some of the basic parameters through which VAT will be applied and how exemptions can be used. VAT is generally charged at the standard rate of 5% (15% in KSA) unless the goods or services are exempt or zero-rated. It is important to note that, generally, supplies or sales to governmental bodies or entities do not typically qualify for any exemptions from VAT. Such entities are required to pay VAT like most commercial entities and, therefore, the starting point for most defense projects would be to assume that VAT will be payable in most circumstances. That said, there are some exceptions to this rule and, in many cases, it should be possible to minimize the impact of VAT on the supply chain.

Tax implications on the defense sector

Defense contractors have different supply chain models, although they generally will follow certain parameters around how they will interact with their customers. These models range from the simple sale of exported goods into the GCC, where the customer acts as the importer of record, to the more complex supply chains that envisage sales of both foreign and locally sourced products, coupled with installation, training, support services and similar. Throw the likelihood of royalties and/or intellectual property payments into the equation, and the position can suddenly become much more complicated. The unwary contractor, therefore, can easily find themselves having to fund additional tax costs unless these have been carefully thought through and factored into the contract.

There are a few golden rules to follow with respect to defense contracting in the Middle East. The following list is not meant to be prescriptive but sets out what ought to be considered across the GCC. It bears mentioning that VAT in the GCC is now active and live in the UAE, KSA, Bahrain and most recently Oman. With the exception of KSA, the standard rate of VAT is 5% and will apply to imports of goods (and services) and local sales.

"Government departments don't pay taxes"

Actually, they do. And they get treated in many cases like other taxpayers when it comes to dealing with the tax authorities. A common mistake often perpetrated by the procurement functions in government departments is to make an assumption that, somehow, taxes do not apply to them. In other words, it is not unusual to hear pushback concerning the payment of invoices which may be subject to VAT (this was certainly our experience in KSA in the first couple of years following the introduction of VAT in the Kingdom). Strong legal and commercial language, in addition to a robust taxation clause, must be used in all contracts.

What about exemptions?

There are certain exemptions from both customs duties and VAT that will normally apply to military hardware. Zero-rating on the importation of military goods into the GCC is normally a feature of the local VAT regime. In these cases, it is likely that the entity that benefits from the zero-rating and exemption from customs duties will be the end customer (normally the government customer). Therefore, it is preferable where contractual circumstances allow to ensure that the customer acts as the importer of record. There are two main advantages to this: (i) from an import licensing perspective, the contractor can avoid the obstacles to attain the relevant import license (in many cases, it may simply not be possible in any event); and (ii) it can, in many cases, avoid the need for the contractor to have to register for VAT in the jurisdiction concerned.

Local supplies and subcontracting

As ever, the world does not revolve around simple supply chains. The level of technical complexity, as it appertains to defense industry contracting, is both deep and can be fiendishly complicated when a major project is being undertaken, with multiple players involved in fulfilling a contract. Stating the obvious, the foreign prime is, in many cases, probably unlikely to have all the requisite in-country resources to be able to deliver a program by themselves. As such, they may be reliant upon local subsidiaries, branches and third party contractors to fulfill certain parts of the contract. Unless careful thought is given to how these aspects are to be incorporated into the main contract, tax leakage can and does occur. When it is "only" 5% VAT, that may not seem so bad; however, in KSA that VAT rate is now 15%. Penalties are up to 50% of underpaid tax and a punitive interest rate of 5% applies per month. Even a small mistake can quickly add up to a painful number.

Services

The provision of services presents a very difficult area to navigate. This is largely down to the manner in which the rules are applied, which can mean in many cases that the foreign prime needs to consider becoming VAT or tax registered in the underlying jurisdiction. This will be influenced, inter alia, by the following factors: (i) Does the service provider have an "establishment" in the country? (ii) What services will be performed? Are there likely to be any tangible goods? (iii) Are the services likely to be rendered remotely? (iv) What is the duration of the contract? The above questions all feed into what can be a complex equation – when you also put other factors into the mix, such as visa sponsorship or secondments of personnel, detailed advice will often be needed. The underlying issue, notwithstanding any obligations that the prime might have, is that VAT and such tax costs can often end up "baked" into the contract. In other words, it simply becomes a cost component which no one realizes until too late.

Withholding taxes, at rates ranging from 5% to 20% depending on the type of payment, can become a cost in service contracts (or where such services are embedded in supply contracts), where double tax treaty benefits are not available to reduce this and there is no provision in the contract to gross up.

Procurement

The GCC member states follow some fairly challenging rules in the context of procurement. In particular, allowing for an increase in price due to changes in taxation is not something that is typically a feature of most contracts that we see, but we strongly recommend that any contracts allow for future-proofing of possible taxation changes, and not just increases in existing rates, but also in relation to new taxes. Stating the obvious, once the contract price is fixed, allowing for additional costs is extremely challenging. We make this point, particularly where the VAT regime may only be reasonably new, and where the transitional rules need careful consideration in how they are applied.

Common tax challenges faced by entities in the defense sector

Failure to understand the nature of defense contracts

Common queries from the tax authorities involve lengthy defense contracts which are structured across multiple years. The expenses for such contracts are amortized across several years, but the tax authority may question the expenses because they cannot see an exact invoice and contract matching the expense recorded for a particular year, and may find it difficult to understand the underlying nature of the accounting treatment.

In addition, where there is a difference between when such contracts are paid and when the expenses are recorded, the tax authority may not understand the timing of any related withholding tax consequences. This becomes more challenging where transactions are between related parties.

This risk may be mitigated by ensuring that there is underlying supporting documentation which clearly reconciles between expenses recorded each year and contracts.

Permanent establishment

Notices are being sent to foreign entities to register for Corporate Income Tax (CIT) even though there may only be a VAT registration requirement for them.

The local permanent establishment rules, as well as the double tax treaty definitions, are generally based upon the permanent establishment definition in the OECD model tax convention. The structure of contracts and invoicing is particularly important because any evidence of local presence of staff from foreign companies, change of title taking place in KSA or invoices between the local entity and foreign companies can create a risk of a CIT registration requirement.

Profit repatriation

Withholding taxes may be applicable on dividends paid as well as payments for services received. These withholding taxes may be avoided through double tax treaty benefits available in certain tax treaties.

Contracts of supplies with embedded services

Withholding taxes are applicable on services provided. For supplies of components, care should be taken to clearly segregate the value and description of any embedded services in the supporting documentation, such as the contract, invoices and accounting records; otherwise, there is a risk of withholding tax being applied on an excessive value.

Reconciling revenue in VAT returns

The accruals basis for recording accounting revenue is different from the basis used to report revenue in VAT returns. As VAT is a relatively new tax in the region, the tax authorities may not always appreciate this difference in approach and use such differences to try to assess additional taxes. This risk may be mitigated by maintaining internal reconciliations for the differences.

Reconciliations with records of other government departments

Tax authority systems are now being linked with information in other government systems. Tax authorities are using this to ask taxpayers to reconcile between the information reported in the CIT return and the records of other government departments records (for example, reconciling salary expenses to government social security records and reconciling foreign purchases to customs records). Where any differences cannot be reconciled, then there may be tax consequences for any differences, such as the disallowance of excess expenses or imputing or additional deemed revenues in the tax returns.

Tax law changes and uncertainty

There have been numerous developments in the GCC region recently, with the introduction of digital systems for risk assessment, and both VAT and transfer pricing in recent years. These developments often result in complications and can create problems during a tax audit.

In addition, the changes made can be sudden and unexpected. Recently VAT in KSA was raised from 5% to 15% with very little notice given of the change. In addition, there are unofficial suggestions that a new CIT law is due to be enacted in KSA in the near future. Contracts should ensure that there are appropriate clauses to protect defense contractors from any such unexpected changes in tax rates, particularly VAT and withholding tax rates.

In KSA, there is an advance tax ruling process available. It is not binding on either the tax authority or the taxpayer even though the ruling request is on a name basis. However, it would still provide a base for the tax authority's view, which may be useful to avoid any surprises during a tax audit.

The decisions of tax appeal committees are published in KSA. However, a decision made against the tax authority does not necessarily mean a change in the practice of the tax authority, as each case is decided on an individual basis on its facts rather than relying on any precedence.

Anti-corruption and bribery

Sara Holzschuh
Partner
Kansas City, United States
D +1 816 460 2631
sara.holzschuh@dentons.com

When engaging in government tenders and procurement in jurisdictions across the Middle East, defense contractors must heed the local anti-corruption and bribery regulations in their respective jurisdictions. In addition to local law, multinational companies must heed the anti-bribery regulations of their countries of origin. This chapter will specifically examine the US Foreign Corrupt Practices Act (FCPA) and the UK Bribery Act, given their breadth of extraterritorial jurisdictional reach.

US FCPA

Multinational companies bidding on government contracts in the Middle East may come under the jurisdictional reach of the FCPA, which, as discussed further below, applies not only to US nationals and companies organized under US law, but also to "issuers" registered on US exchanges, to "domestic concerns," defined to include a wide range of natural persons and business organizations, and any other person who acts in furtherance of a corrupt payment while within US territory.

What is the FCPA?

The US Foreign Corrupt Practices Act (FCPA)[1] is the most significant US anti-corruption law in US investigative and law enforcement agencies' civil and criminal enforcement toolkit. While this is a US domestic law, its application is international and targeted at preventing the supply side of bribery (e.g. the payment of bribes to non-US government officials). The FCPA has two components: the anti-bribery provisions and the accounting provisions. The US Department of Justice (DOJ) has authority to pursue criminal and civil charges, and the US Securities and Exchange Commission (SEC) has authority to bring civil charges and seek equitable remedies under the FCPA.

1 15 U.S.C. §§ 78dd-1, et seq.; 15 U.S.C. § 78m.

To be liable under the FCPA, US enforcement authorities must prove five elements:

- offering, promising or authorizing the giving of "anything of value" (directly or indirectly);
- to a foreign official, political party, candidate, or to any other person while knowing that the payment or promise will be passed on to a foreign official;
- with corrupt (dishonest) motive, or intent "to induce the recipient to misuse his official position";
- for the purpose of (a) influencing an official action, inaction or decision, (b) inducing an unlawful act, (c) inducing official influence over government action, or (d) securing an improper advantage;
- in order to obtain or retain business, contracts or work.

These elements can be interpreted broadly by US authorities. For example, acting corruptly includes "willful blindness." Willful blindness is a firm belief that circumstances exist which may result in a bribe and/or ignoring red flags – people also call this the "ostrich" or "head in the sand." Such blindness may come with thoughts or words like "they're probably going to pay a bribe, but it's not my problem, I hired them to get the job done." If there is a suspicion of bribery but nothing done about it, this might be enough to find conduct illegal under a willful blindness standard. The FCPA also does not require US authorities to prove that someone intended to pay a bribe. Rather, a company or individual need only be aware of a high probability of illicit conduct, or red flags that such conduct is occurring, to have sufficient knowledge under the FCPA. Willful blindness is not a defense.

The anti-bribery provisions apply to:

- US "issuers" (companies listed on a US stock exchange or required to file certain reports with the SEC) and their officers, directors, employees, agents and shareholders.
- "Domestic concerns" whether individuals or corporates (US citizens, nationals, residents, companies organized under US law, or companies with their principal place of business in the US), and their officers, directors, employees, agents and shareholders.
- "Any person" acting in the US.

Thus, US nationals employed by non-US companies anywhere in the world are subject to the anti-bribery provisions, as are US subsidiaries of non-US companies. Non-US persons and entities, regardless of nationality, which directly or through an agency relationship cause any act within the territory of the US in furtherance of a violation, are likewise subject to the anti-bribery provisions, as are officers, directors, employees, agents, or stockholders/shareholders acting on behalf of such persons or entities. A foreign national or company may also be liable under the FCPA if it engages in certain types of conduct which involves an entity or individual that is subject to FCPA jurisdiction. For example, a foreign national or company may be liable under the FCPA if it aids and abets, conspires with, or acts as an

agent of an issuer or domestic concern, regardless of whether the foreign national or company itself takes any action in the US.

The second component of the FCPA are the accounting provisions, which include two separate sets of provisions:

- the books-and-records provisions; and
- the internal controls provisions.

The books-and-records provisions require issuers to make and keep accurate books, records, and accounts that, in reasonable detail, accurately and fairly reflect the transactions and disposition of the assets of the issuer. The FCPA defines "reasonable detail" as a level of detail that would "satisfy prudent officials in the conduct of their own affairs." "Books and records" definitions are also broad and include "virtually any tangible embodiment of information." As a result, US issuers can be subject to liability for poor accounting or record-keeping practices of their subsidiaries and other entities whose financial records are incorporated into the books of the issuer.

The internal controls provisions require issuers to "devise and maintain a system of internal accounting controls" sufficient to provide reasonable assurance that:

- transactions are executed in accordance with management's authorization;
- transactions are recorded appropriately;
- access to assets is permitted only with the proper authorization; and
- accounting records reflect existing assets.

US authorities have not identified specific controls that issuers are required to implement. Instead, issuers have the "flexibility" to develop internal controls appropriate to their particular "needs and circumstances" while taking into account "operational realities and risks attendant to the company's business." Thus, control frameworks can require an in-depth understanding of the company's operations and risks, frequent adjustment for new risks, and testing to ensure functionality. Further, even seemingly minimal record-keeping or accounting errors can be a foundation for liability.

Existing since the 1970s, the FCPA is the grandfather of international bribery laws, driving the creation of international analogues in countries around the world. With increasing enforcement, and mirror enforcement styles and expectations to those established by the DOJ and SEC, international enforcement agency counterparts are growing in sophistication, funding and appetite to bring their own international anti-corruption investigations. With more enforcers obtaining and sharing information, and bringing more sophisticated enforcement actions, they create a heightened enforcement risk environment for global companies.

Why does the FCPA matter in the defense contracting space?

Corrupt conduct can result in serious consequences for companies and individuals. These consequences can include:

- imprisonment of up to five years for each violation;
- hefty fines (in 2020, an aerospace manufacturer agreed to pay US$3.9 billion in global penalties (US$2.9 billion for US portion) and a global financial institution agreed to pay US$3.3 billion);
- cancellation of customer, supplier or business partner contracts for breaches of covenants;
- breach of financing agreements and acceleration of debt;
- debarment from public contracting;
- cancellation of operating licenses;
- reputational harm and subsequent loss of future opportunities; and
- social and human costs (corruption accounts for 5% of annual global GDP, and costs human lives).

Not only are the consequences of a violation severe, but defense contractors also often find themselves at a heightened risk of enforcement. This is because defense contractors, by definition, target government agencies as their primary customers. Thus, there is increased interaction with government officials. Further, interaction with government officials occurs more frequently due to additional levels of bureaucracy, oversight and restrictions surrounding defense articles and defense contractors. Finally, countries that invest heavily in defense spending are often politically unstable and, as such, corruption may be more systemic and frequent in these countries.

Common justifications that are not legal defenses

There are few valid defenses under the FCPA; those without a firm understanding of the law perceive many more red herrings are defenses than what actually exist.

For example, facilitation payments are technically an affirmative defense to a bribery charge under the FCPA. "Facilitation payments" are small payments to a government official to facilitate or expedite regular government administrative actions or services. However, facilitation payments should not be used as a crutch by government contractors—they are in fact bribes, and most countries' bribery laws do not exempt facilitation payments from prosecution. Many other justifications tossed about are also not defensible to bribery charges, including:

- I am not an American.
- Everybody does it, it is the culture here.
- This is what we have always done.
- My boss does it.
- The person before me did it.
- But it was a small bribe.
- No one will find out.
- I am using an agent, so it is not our problem if she is paying bribes.
- Why should we be disadvantaged?
- Who am I to question their way of conducting sales in their own country? They know what works.
- This is a US concept that is not applicable here.

None of these defenses matter if you find yourself sitting across the table from a DOJ or SEC attorney. Even far-flung and seemingly minimal conduct outside the US can add up to a serious US enforcement action and grave consequences for the individual and their employer.

Key areas of risk, particularly third parties

Third parties and influencers acting on a company's behalf may be deemed the company's "agents" and thus treated as extensions of the company. This means that parties not wholly under your control and for whom you may not have full operational and financial visibility may be treated the same as one of your employees when engaged in corrupt conduct. Scope of agency is construed very broadly under US law, and does not have to be explicit.

To find agency, the government must show that:

- each element of the crime charged against the corporation was committed by one or more of its agents;
- in committing those acts, the agent(s) intended, at least in part, to benefit the corporation; and
- each act was within the scope of employment of the agent who committed it.

While an agent's act must relate directly to the performance of the agent's general duties for the corporation, it is not necessary that the corporation authorize the act itself. Further, benefit to the corporation does not have to be a bad actor's sole purpose. The fact that the agent's act was illegal, contrary to his employer's instructions or against the corporation's policies also will not relieve the corporation of responsibility for it. Even where an act was not committed within the scope of an agent's engagement or with intent to benefit the corporation, a corporation can still ratify that act by words or conduct (e.g. explicitly or implicitly), and establish corporate liability.

The following types of third parties often carry higher risks of corruption, because of their role interfacing with government officials:

Governance Related

- Third party joint venture partner
- Tender & bidding partner (intermediary & subcontractor)
- Entity where company provides management services

Business Stakeholders

- Nominee shareholder under representative governance models
- Non-company employee appointed to any company board
- Non-government license/permit approver
- Entity providing management services to company facilities

Sales and Distribution

- Commercial agent
- Distrubutor/ wholesaler/ re-seller
- Sales/business development consultant
- Sales/marketing agent

Government Interface

- Customs broker
- Lobbyist
- Outside tax/ accounting/ financial/ legal advisor
- License/permit facilitator
- Travel/Visa permit agency

Service Providers

- Event organizer
- Investigator
- Transportation/ logistics provider
- Procurement consultant

The scope of agency, accessory, and conspiracy theories of liability under the FCPA are topics presently before US courts. For example, the recent Second Circuit *Hoskins* case[2] precluded the government from using conspiracy or accomplice liability to charge FCPA anti-bribery violations against a non-resident foreign national acting outside the US when the FCPA anti-bribery provisions did not directly cover that individual. However, an agency liability theory remained viable. Hoskins was a UK citizen, working in France as Vice President for the UK subsidiary of a French company that was not publicly traded on a US exchange. While in that role, he paid bribes to government officials in Indonesia for a project there. He was not a US person, was not employed by a US company, and never set foot in the US while working for Alstom. The jury found agency and convicted Hoskins on FCPA counts. The federal District Court Judge overturned the verdict via a post-trial judgment of acquittal, finding insufficient evidence of agency, but upheld a conviction on a money laundering count.[3] The DOJ is appealing this ruling and argues its inapplicability to the FCPA's accounting provisions or outside the Second Circuit.[4]

Successor liability is also a significant trigger for FCPA enforcement actions. Generally, when a company merges with or acquires another company, the successor company assumes the predecessor company's liabilities—these can include FCPA liabilities. Liability is not created where it did not exist before. However, even when there is not direct successor liability, poor culture or corrupt acts by employees of an acquired entity often continue after an acquisition. New bribery acts post-acquisition are fair game for prosecution.

FCPA risk mitigation techniques

Companies interested in reducing risk of an FCPA enforcement should consider investing in prevention and detection as a value add to the company in the form of reduced FCPA enforcement risk, other related legal risks such as fraud, but also enhanced corporate reputation and corporate social responsibility scores by having an effective compliance program.

To implement a compliance program, a company should first define and prioritize its risks. An effective program should not be something off the shelf, but instead be tailored to the company's operations and unique risks. Efficient investment of corporate funds occurs by defining where the company's operations create the most significant risk of an enforcement action, and targeting policies, trainings, controls and risk prevention investment in those areas. Further, companies that allow for reassessment and agility as the enforcement environment changes in countries where they operate (or the company's operations themselves change) have more effective programs.

Once a company has created a compliance program, or while establishing a program, it should benchmark that program to determine whether it remains relevant and effective. Benchmarking can include comparing a program to regulatory expectations, described in enforcer guidance and recent enforcement actions (not just US, but local too). Benchmarking can also include comparing a program to those of peers.

Establishing internal controls allows companies to trigger detection of misconduct and can prevent misconduct when exercised appropriately. Internal controls are most effective when married to policies, procedures, and other risk mitigation techniques—when carried out correctly, financial controls can support compliance objectives and vice versa while preventing misconduct. Policies and controls, however, are meaningless without support and enforcement. Trainings and communications can create a corporate environment that fosters a culture of compliance and where people feel safe reporting perceived misconduct or asking questions before acting.

2 *United States v. Hoskins*, No. 3:12cr238(JBA), (D. Conn.); Nos. 20-842(L), 20-1061(Con), 20-1084(Con).

3 *See* February 26, 2020 Ruling on Defendant's Rule 29(c) and Rule 33 Motions.

4 *See* Brief for the United States, *United States v. Hoskins*, Nos. 20-842(L), 20-1061(Con), 20-1084(Con), at ix (2d Cir. July 13, 2020); United States Response and Reply Brief, *Id*. (2nd Cir. January 12, 2021); FCPA Resource Guide.

Finally, when misconduct may have occurred, companies should plan for and conduct investigations. A tailored and well-planned investigation, staffed by the right team, can be an effective way to quickly detect and remediate misconduct. A key step to prevent recidivism, where an issue has occurred, is remediation following an investigation. When these components are connected, companies can significantly reduce the legal risk associated with an FCPA enforcement action.

UK Bribery Act

Awareness of the provisions of the UK Bribery Act of 2010 (c.23) is essential for multinational companies doing business in the Middle East. The Bribery Act, deemed to be the most far-reaching criminal legislation in the UK, applies not only to UK companies, citizens and residents, but also to any company that has a close connection with the UK (e.g., that carries on business in the UK).

The Bribery Act has significantly greater breadth than the FCPA, prohibiting both offering and receiving a bribe, the carrying out of facilitation (routine governmental) payments and the failure to prevent bribes. For the purpose of companies bidding in the Middle East, the main prohibitions to be aware of are the bribery of any person (Section 1), the bribery of a foreign public official (Section 6) and the failure to prevent bribery (Section 6).

Unlike the FCPA, the Bribery Act does not limit its application to bribes of governmental officials or other public officials only; the bribery of *any* person can be deemed an offense. Section 1 prohibits promising or giving any person a financial or other "advantage" (broadly defined as anything of value) with the intention of inducing or rewarding such person to improperly perform a relevant activity (any function relating to his employment, business or public office that is a position of trust or expected to be performed impartially or in good faith). Therefore, even a success fee given to an agent that is not a foreign public official and that does not employ foreign public officials or pass fees on to them can be deemed a violation of the Act, if the success fee is paid in order to induce or reward the person for improperly performing a relevant activity.

Even if a company is unaware of an agent's improper performance of a relevant activity or payment of a bribe, the company can be liable for the agent's act under Section 7 of the Bribery Act, which deems the foreign company to have committed the wrongful act itself, unless adequate preventative procedures were in place. As a strict liability offense, building a prima facie case does not require a showing of intent, knowledge or foreseeability of an offense by its agents; the company is strictly and vicariously liable for the act. As a defense, the company may argue that it had adequate procedures in place to prevent bribery.

Business and human rights in contracting

Catherine Gilfedder
Senior Associate
London, United Kingdom
D +44 20 7246 7232
catherine.gilfedder@dentons.com

John Balouziyeh
Senior Legal Consultant
Riyadh, Saudi Arabia
D +966 (0) 11 200 8678
john.balouziyeh@dentons.com

The business and human rights landscape is changing fast. With expectations of corporate behavior shifting and a renewed focus on sustainability and ESG issues an unexpected effect of the pandemic, human rights have never been higher on the agenda.

New measures enforcing the standards in the UN Guiding Principles on Business and Human Rights are being introduced across the globe. The EU plans to table a directive making environmental and human rights due diligence mandatory, building on similar legislation in countries such as France. Negotiations also continue towards a global UN treaty on business and human rights that would require signatory states to impose legally binding obligations on corporations in the human rights arena.

At the same time, the domestic courts of numerous jurisdictions are clarifying and expanding their reach over claims of corporate human rights violations, both at home and abroad. Business human rights arbitration mechanisms are being crafted, and investment treaties increasingly require respect for human rights if they are to be relied upon.

As ever more revelations surface of violations across almost every segment of the economy, it is no surprise to see businesses and their stakeholders taking action based on legal advice in order to prevent regulatory infringements and reputational damage.

Significance of assessing human rights risk

There are a myriad number of reasons why respecting human rights is critical for businesses in today's society:

- **Legal and regulatory requirements:** Many states have introduced concrete obligations requiring businesses to respect human rights (for instance, legislation introducing mandatory due diligence of supply chains, statutes addressing specific issues like the Modern Slavery Act in the UK).
- **Civil liability/litigation risk:** We are seeing lawsuits in almost all major jurisdictions based upon corporate involvement in human rights violations. Indeed, in the UK courts, a series of judgments (including two Supreme Court judgments) have expanded the potential for a parent company to have liability for the violations by foreign subsidiaries, including human rights related violations.
- **Reputational risk:** Obviously shareholders do not welcome media and NGO campaigns, and many simply will not continue to invest if there is perceived to be risk in this area.
- **Conflict with corporate values and voluntary commitments:** Most enterprises, including those in the defense industry, have adopted ethics policies and committed to voluntary initiatives in the human rights sphere. Having done so, striving to comply with these values becomes a key part of corporate compliance.

So why are the above contractual issues? A business's exposure in any of these areas can potentially arise from human rights violations in its supply chain, or in its business partners' activities. As such, all businesses should consider human rights due diligence when selecting local business partners and assessing what contractual protections might help alleviate the risk of the partner violating human rights.

The UN Guiding Principles on Business and Human Rights

Many businesses have been using formal voluntary initiatives – such as the UN Global Compact – to structure their human rights efforts for years. Now, the leading international instrument is the UN Guiding Principles on Human Rights, or "UNGPs". These were endorsed in 2011 by the UN Human Rights Council, having been drafted under the leadership of Professor John Ruggie. They are a framework rather than a binding treaty – but they offer generally accepted guidelines to help states and companies prevent, address and remedy human rights abuses committed in business operations.

The UNGPs are organized under three "pillars":

- the state duty to protect human rights;
- corporate responsibility to respect human rights; and
- access to remedy.

The key "pillar" for corporate entities is therefore the second: the responsibility to respect human rights. That responsibility applies to businesses globally, of all sizes. It is crucial to considering human rights implications when contracting to understand that the responsibility is not limited to risks inherent in a business's own activities. Principle No. 13 provides:

> "The responsibility to respect human rights requires that business enterprises:
>
> - (a) Avoid causing or contributing to adverse human rights impacts through their own activities, and address such impacts when they occur;

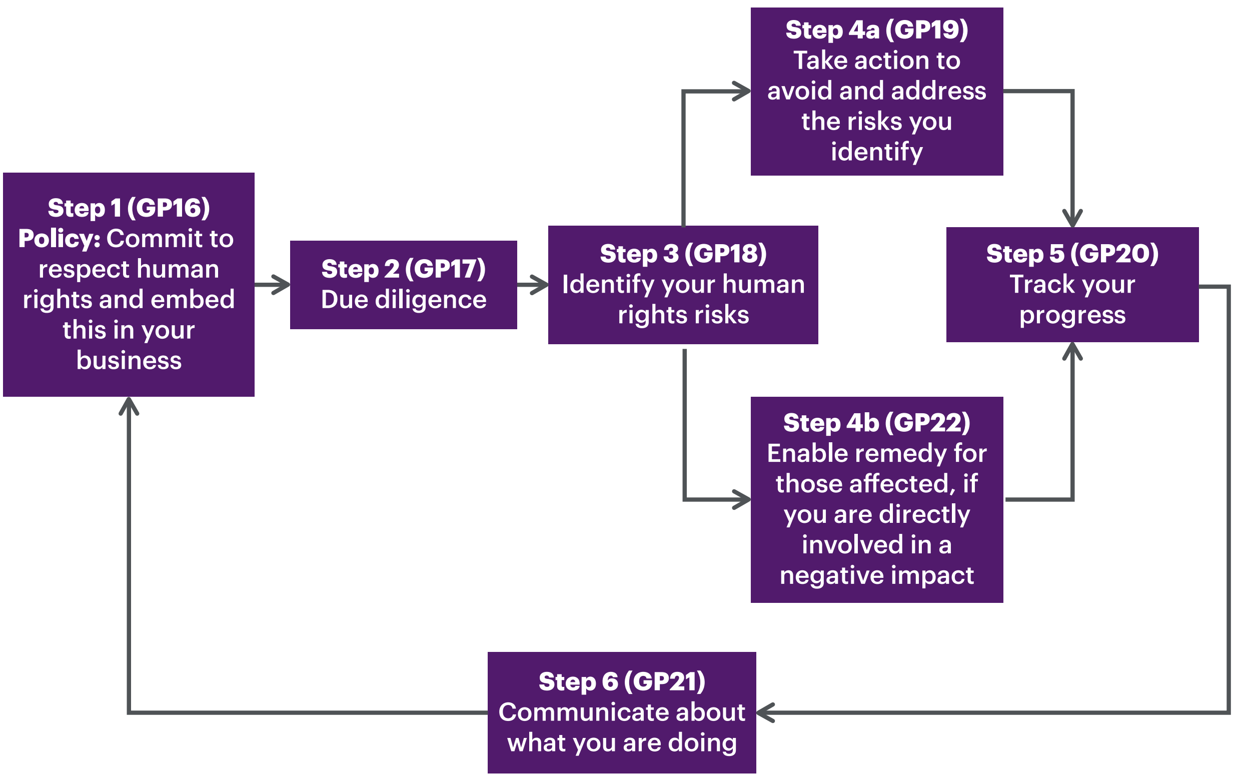
- (b) Seek to prevent or mitigate adverse human rights impacts that are directly linked to their operations, products or services by their business relationships, even if they have not contributed to those impacts."

The key aspects of the corporate duty to respect are:

- **A human rights policy:** This must be approved at the most senior level of the business enterprise, be publicly available and communicated internally and externally to all personnel, business partners and other relevant parties, and reflected in operational policies and procedures that are necessary to embed it throughout the business enterprise.
- **Human rights due diligence:** This should cover adverse human rights impacts that the business enterprise may cause or contribute to through its own activities, or which may be directly linked to its operations, products or services by its business relationships.
- **Remediation:** Where business enterprises identify that they have caused or contributed to adverse impacts, they should provide for or cooperate in their remediation through legitimate processes.

Each of these aspects are elaborated in some detail in the UNGPs and their commentary. As the below flowchart demonstrates, all of these aspects are interrelated and must be fulfilled and monitored on an ongoing basis.

Implementing the UN Guiding Principles – the corporate responsibility to respect human rights



Contractual protection mechanisms

All of this means that human rights risks and alleviation mechanisms should be at the forefront of parties' minds when contracting. Whilst pointing to clauses addressing human rights risks and how to prevent adverse impacts is unlikely to absolve a business from legal or regulatory liability, such provisions can nevertheless be effective in making clear the parties' mutual expectations as to how such incidents are to be avoided, and addressed when they do arise.

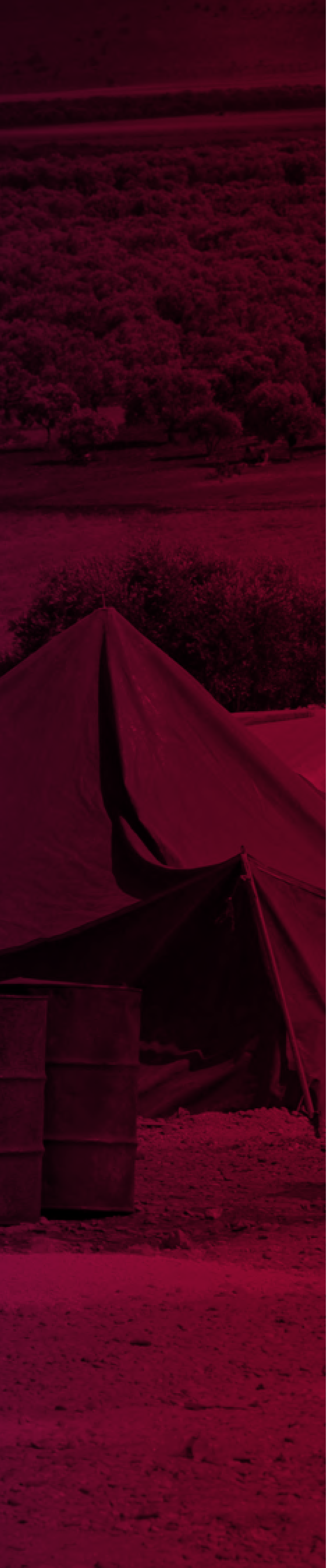
Of course, what provisions are necessary and suitable will take careful consideration, and addressing human rights in contracts gives rise to a number of issues. For example, what do we mean by "human rights"? To distill this, it may be helpful to tie any contractual definition to a particular international instrument or identify rights of particular significance in the context of the operation or project.

What will the consequences be of human rights violations, and who will determine when particular thresholds have been met? Are the existing audit rights sufficient to help in this context or are more invasive monitoring abilities required? Termination rights may well be necessary, but responsible businesses might also give thought to whether remaining in the relationship even in the event of adverse impacts gives them greater potential to drive good practices across their sector.

In an area of such evolution and where the legal and reputational stakes are high, we expect the body of case law in this area to continue to grow and businesses would be well advised to bear this changing landscape in mind when concluding and reviewing their agreements.

International humanitarian law

John Balouziyeh
Senior Legal Consultant
Riyadh, Saudi Arabia
D +966 (0) 11 200 8678
john.balouziyeh@dentons.com



Introduction

War is an inherently chaotic clash of wills between two or more forces where violence is employed to achieve political goals. The intensive interaction of armed forces during war with two or more sides gives rise to chaos and collateral damage, including unintended consequences on civilians and civilian objects. The inherent uncertainty in military operations demands an approach to war that seeks to limit unnecessary human suffering. In an attempt to prevent this suffering and to uphold principles of humanity, virtually all human civilizations have sought to govern military conduct via rules of engagement, laws of war, and moral, religious, and ethical codes of conduct during armed conflict.

The principle of humanity that international humanitarian law seeks to uphold is expressed in the so-called "Martens Clause" contained in the Preamble of Hague Convention (II) of 1899 with Respect to the Laws and Customs of War on Land and its annex: Regulations concerning the Laws and Customs of War on Land. The Martens Clause states as follows[5]:

> "Until a more complete code of the laws of war is issued, the High Contracting Parties think it right to declare that *in cases not included in the Regulations adopted by them*, populations and belligerents remain under the protection and empire of the principles of international law, as they result from the usages established between civilized nations, from the laws of humanity, and the requirements of the public conscience."

This same principle was expressed in more or less the same form in Hague Convention (IV) of 1907 respecting the Laws and Customs of War on Land and Protocols Additional I and II to the Geneva Conventions of 1949.

5 The original French of the Martens Clause states as follows:
«En attendant qu'un code plus complet des lois de la guerre puisse être édicté, les Hautes Parties Contractantes jugent opportun de constater que, dans les cas non compris dans les dispositions réglementaires adoptées par Elles, les populations et les belligérants restent sous *la sauvegarde* et sous *l'empire des principes du droit des gens*, tels qu'ils résultent des usages établis entre nations civilisées, des lois de l'humanité et des exigences de la conscience publique.»

Principles of international humanitarian law

International humanitarian law developed to provide a set of principles and clear guidelines to limit the effects of armed conflict on civilian populations and civilian objects and reduce human suffering. These guidelines seek to strike a balance between military necessity and humanitarian imperative. International humanitarian law therefore sets standards for the humanitarian treatment of victims and prisoners of war, seeks to limit the effects of armed conflict on civilians and restricts the means and methods of warfare through four overarching principles: (i) distinction (or discrimination); (ii) proportionality with respect to civilian losses; (iii) military necessity; and (iv) humanity (or unnecessary suffering). These principles restrict the operations that militaries may undertake, the types of weapons that may be manufactured and the means and methods that may be utilized in armed conflict.

Distinction (discrimination)

The principle of distinction is arguably the most important principle of international humanitarian law. Rule 1 of the ICRC's Customary International Humanitarian Law defines the principle as follows:

> "The parties to the conflict must at all times distinguish between civilians and combatants. Attacks may only be directed against combatants. Attacks must not be directed against civilians."

In its Advisory Opinion on the Legality of the Threat or Use of Nuclear Weapons (1996), the International Court of Justice held that the principle of distinction is[6]:

> "aimed at the protection of the civilian population and civilian objects and establishes the distinction between combatants and non-combatants; states must never make civilians the object of attack and must consequently never use weapons that are incapable of distinguishing between civilian and military targets."

Following this framework, states may not, as a general rule, intentionally target civilians and civilian objects during military operations.

Proportionality with respect to civilian losses

Under Additional Protocol I of the Geneva Conventions of 1949, an attack violates the principle of proportionality if it (Art. 51.5(b) AP I):

> "may be expected to cause incidental loss of civilian life, injury to civilians, damage to civilian objects, or a combination thereof, which would be excessive in relation to the concrete and direct military advantage anticipated."

Along these lines, those who plan military operations must take into consideration the extent of civilian destruction and probable casualties that will result and, to the extent consistent with military necessity, seek to avoid or minimize such casualties and destruction. While civilian losses must be proportionate to the military advantages sought, this principle must be consistent with the allowable risk to the attacking force; the attacker need not expose himself to excessive risk merely in order to minimize civilian losses.

6 *Legality of the Threat or Use of Nuclear Weapons, Advisory Opinion of July 8, 1996, ICJ Reports 1996*, p. 257, available at http://www.icj-cij.org/docket/files/95/7495.pdf

Military necessity

Military necessity permits the application of only that degree of regulated force required for the partial or complete submission of the enemy with the least expenditure of *life*, *time* and *resources*. While many treaties have acknowledged the role of military necessity, the principle arises predominantly from customary international law.

Military necessity requires belligerents to meet the following elements in their military operations:

- a military requirement to undertake a certain measure, which
- is indispensable to achieve a military objective and a swift termination to a conflict; and
- is not forbidden elsewhere by the laws of armed conflict.

Humanity (unnecessary suffering)

International humanitarian law limits the right of parties to a conflict to employ certain types of weapons and means of injuring their enemies. Also known as the "principle of unnecessary suffering," the principle of humanity requires military forces to refrain from inflicting gratuitous violence on the enemy and prohibits the employment of any degree of force that causes unnecessary loss and excessive suffering. It thus serves as a counterbalance against the principle of military necessity.

Rule 70 of the ICRC's Customary International Humanitarian Law ("Weapons of a Nature to Cause Superfluous Injury or Unnecessary Suffering") summarizes the principle of humanity as follows:

> "The use of means and methods of warfare which are of a nature to cause superfluous injury or unnecessary suffering is prohibited."

As articulated by the ICRC, the principle applies to both means and methods of warfare and can therefore potentially prohibit not only weapons that per se create unnecessary suffering, but also the use of otherwise permitted weapons if they are employed in a way that produces unnecessary suffering, as well as methods of war such as starvation and sexual violence.

Restrictions on weapons and methods of warfare

The Hague Conventions

The Hague Conventions are a group of international treaties aimed at regulating the conduct of war and limiting certain types of military technology. The Hague Conventions of 1899 on the Laws and Customs of War prohibit means and methods of warfare that cause unnecessary human suffering, such as asphyxiating gases and expanding bullets. The Hague Conventions of 1907 on the Laws and Customs of War prohibit projectiles and explosives from balloons.

Later treaties came to prohibit the manufacture, stockpiling and use of chemical and biological weapons. The Geneva Protocol to the Hague Conventions of 1899 and 1907 (also known as the "Geneva Protocol" of 1925) prohibits the use of poisonous gases and other chemical and biological weapons. It is supplemented by the Biological Weapons Convention of 1972, which prohibits the development, production, stockpiling and use of biological and toxin weapons.

Other treaties that restrict the development and use of weapons and methods of war include the following:

- the Convention on Certain Conventional Weapons (1980), which prohibits conventional weapons that may be excessively injurious or have indiscriminate effects, including weapons whose primary effect is to injure by fragments that escape X-ray detection; landmines and booby traps; incendiary weapons; blinding laser weapons;
- the Chemical Weapons Convention (1993), which bans the use of all chemical weapons "as a method of warfare";
- the Ottawa Convention ("Mine Ban Treaty") (1997), which bans all anti-personnel mines; and
- the Convention on Cluster Munitions (2008), which prohibits bomblets and submunitions that dispense over a relatively large area.

Methods of warfare: the tactics of fighting

International humanitarian law prohibits certain methods of warfare, such as tactics that cause undue harm to the environment or that target cultural objects.

The protection of cultural property

The Convention for the Protection of Cultural Property in the Event of Armed Conflict (1954) protects cultural property of great importance to cultural heritage, such as monuments of architecture, art or history, whether religious or secular; archaeological sites; groups of buildings which, as a whole, are of historical or artistic interest; works of art; manuscripts, books and other objects of artistic, historical or archaeological interest; as well as scientific collections and important collections of books or archives. The Convention requires states parties to (Art. 4.1):

> "respect cultural property situated within their own territory as well as within the territory of other High Contracting Parties by refraining from any use of the property and its immediate surroundings or of the appliances in use for its protection for purposes which are likely to expose it to destruction or damage in the event of armed conflict."

The protection of the environment

The United Nations Convention on the Prohibition of Military or Any Hostile Use of Environmental Modification Techniques (1976) (ENMOD) prohibits the use of environmental modification as a weapon in armed conflict. It states as follows (Art. 1.1 ENMOD):

> "Each State Party to this Convention undertakes not to engage in military or any other hostile use of environmental modification techniques having *widespread, long-lasting or severe effects* as the means of destruction, damage or injury to any other State Party."

"Long-lasting" has been interpreted as lasting for a period of months.

In addition to ENMOD, which seeks to prohibit the use of the environmental modification as a weapon in armed conflict, Additional Protocol I to the Geneva Conventions of 1949 seeks to protect the environment as a victim of armed conflict. Article 35.3 states:

> "It is prohibited to employ methods or means of warfare which are intended, or may be expected, to cause widespread, long-term and severe damage to the natural environment."

Prohibitions on sexual violence

Sexual violence is prohibited as a means and method of warfare under both treaty law and customary international law. Under Rule 93 of the ICRC's Customary International Humanitarian Law, "[r]ape and other forms of sexual violence are prohibited" in both international and non-international armed conflicts.

This same principle can be found in modern treaty law. Common Article 3 to the Geneva Conventions and Additional Protocol II, both of which largely reflect customary international law, prohibit sexual violence. Common Article 3 forbids "violence to life and person," "cruel treatment" and "outrages upon personal dignity, in particular humiliating and degrading treatment," while Additional Protocol II prohibits "at any time and in any place whatsoever ... rape, enforced prostitution and any form of indecent assault" (Art. 4.2 AP II). Under Geneva Convention I of 1949, "[w]omen shall be treated with all consideration due to their sex. The Party to the conflict which is compelled to abandon wounded or sick to the enemy shall, as far as military considerations permit, leave with them a part of its medical personnel and material to assist in their care" (Art. 12 GC I). With respect to female prisoners of war, "[w]omen shall be treated with all the regard due to their sex and shall in all cases benefit by treatment as favourable as that granted to men" (Art. 14 GC III). Civilian women detainees "shall be confined in separate quarters and shall be under the direct supervision of women" (Art. 76 GC IV).

The Rome Statute of the International Criminal Court criminalizes sexual violence, including outrages against personal dignity, rape, sexual slavery, enforced prostitution, forced pregnancy, and enforced sterilization. It defines the following acts as war crimes in international armed conflict (Art. 8.2(b) SICC):

> "Committing rape, sexual slavery, enforced prostitution, forced pregnancy ... enforced sterilization, or *any other form of sexual violence* also constituting a grave breach of the Geneva Conventions."

The Rome Statute defines the following acts as war crimes in non-international armed conflict (Art. 8.2(e) SICC):

> "Committing rape, sexual slavery, enforced prostitution, forced pregnancy ... enforced sterilization, and *any other form of sexual violence* also constituting a serious violation of article 3 common to the four Geneva Conventions."

Arms sales and supply chains

States have an obligation to not only respect, but also to ensure the respect of international humanitarian law "in all circumstances" (see Common Article 1 of the Geneva Conventions of 1949). The duty to "ensure respect" of the Geneva Conventions has many dimensions. It effectively means that states not involved in an armed conflict must call upon states and armed groups that *are* involved in conflict to ensure that they respect the rules. It also requires states to ensure that any weapons manufactured in their territories or sold via government-to-government sales or by companies licensed within their jurisdictions are not used in a way that violates international humanitarian law. This requires due diligence of global supply chains and arms suppliers to ensure that armaments do not fall into the hands of state or non-state actors that flout international humanitarian law, such as terrorist groups.

In the Final Declaration adopted by the International Conference for the Protection of War Victims, participants urged all states to "ensure the effectiveness of international humanitarian law and take resolute action, in accordance with that law, against States bearing responsibility for violations of international humanitarian law with a view to terminating such violations."[7] Moreover, the Draft Articles on the Responsibility of States for Internationally Wrongful Acts provide that "a State which aids or assists another State in the commission of an internationally wrongful act by the latter is internationally responsible for doing so" (Article 16).

In response, governments are increasingly tightening export controls for the sale of armaments and other military equipment to third party states or armed groups. Given the proliferation of lawsuits in recent years based on theories of state responsibility for violations of international humanitarian law, many states are exercising increasing caution in arms exports. In some cases, they have altogether banned the sale of military equipment to certain actors. In other cases, they have suspended sales pending reporting from purchasers on a commitment to respect and ensure the respect of humanitarian law, including by widely disseminating the Geneva Conventions, rigorously training commanders and soldiers on international humanitarian law and implementing enforcement mechanisms to bring perpetrators of humanitarian law to justice.

Dentons has advised a wide range of actors, including governments, companies, international organizations and NGOs on international humanitarian law and compliance with international standards, international human rights law, customary international law and treaty law relating to military operations, the embedding of private contractors into state armed forces, the protections afforded by humanitarian law to marine and aircraft crews of parties to armed conflict, the rights and obligations of supply contractors and other persons who accompany the armed forces and sales of military equipment.

7 Part II, Final declaration of the International Conference for the Protection of War Victims (September 1, 1993).

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