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Bahrain introduces international best practice for corporate governance

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Effective risk management and corporate governance structures with suitable checks and balances remain priority issues for many regulators around the world. A number of Gulf states are keeping pace with changes elsewhere in the world and Bahrain has taken steps to introduce international standards of corporate governance in the Kingdom.

In March 2010, a new Corporate Governance Code (the Code) for Bahrain's public companies was issued which incorporates many of the standards found in other markets, such as director independence and training and the formation of audit, nomination and remuneration committees.

The Code was developed following a consultation period of more than a year and a review of more than 25 national and company governance codes from other countries and becomes effective on January 1 2011. All Joint Stock companies which are incorporated under the Bahrain Commercial Companies Law 2001 must adhere to the Code by the end of 2011 or explain to their shareholders why they are not doing so.

The Code states that initially it will apply only to public companies but is intended to be used as a model by all other companies to the extent that it applies to their circumstances. The Central Bank of Bahrain (CBB) has stated publicly that the Code will also apply to all CBB licensees that are incorporated as Bahrain companies.

The Code supplements the principles of corporate governance which already exist within Bahrain's legislative framework, such as rules on board and shareholder meetings and dealing with company shares and establishes a minimum standard of best practice through

the adoption of an FSA-style principles-based approach to corporate governance.

Each principle is applied by a directive, and both should be complied with. Non-mandatory recommendations supplement the principles and directives. The Code requires a company to explain non-compliance with a specific recommendation (or other aspects of the Code) in a comply-or-explain report to shareholders at the annual shareholders' meeting.

Features of the Code

The Code contains a number of interesting features.

Directors' independence

Directive 1.3 states that, "No individual or group of directors should dominate the board's decision making" and includes a recommendation that "the board should review the independence of each director at least annually." Further, the Code recommends that the chairman of the board and the CEO should not be the same person, and that at least 50% of the board of directors be non-executive directors.

Clear separation between the board, the management and the shareholders is an important aspect of corporate governance and this feature of the Code will further enhance the CBB's reputation for regulation to improve transparency within the management of companies.

Loyalty to the company

Directive 2.1 addresses accountability and makes it clear that every director and officer should understand that they are personally accountable to the company and its shareholders and can be sued if they breach their duty of loyalty owed to the company.

Induction and training of directors

In an attempt to ensure that boards contain directors with appropriate levels of understanding of the business (which will ultimately

help shareholders), Directive 4.5 provides that each new director shall receive a formal and tailored induction. The induction shall include meetings with senior management, visits to company facilities, presentations regarding strategic plans, significant financial, accounting and risk management issues, and compliance programs. The directive also highlights the importance of directors obtaining continuous education throughout their term on the board.

Directors' remuneration

Directive 5.1 of the Code seeks to address concerns over board members receiving substantial remuneration packages that may not be adequately linked to performance by requiring the establishment of a remuneration committee which shall:

- make recommendations and obtain shareholder approval for the board of directors and senior management remuneration policies;
- remunerate board members based on performance and attendance; and
- exercise its judgment free from personal interests.

Shari'a Supervisory Board

Directive 9.1 of the Code states that companies who refer to themselves as Islamic will be subject to additional governance requirements and disclosures to provide assurance to stakeholders that they are following shari'a principles. The directive dictates that each such company should establish a Shari'a Supervisory Board (SSB) of at least three *shari'a* scholars who will be tasked with ensuring compliance with *shari'a* principles.

Interestingly, a requirement that these criteria should also apply to companies that offer Islamic financial services or products does not appear in the Code, despite being included in earlier drafts.

Conclusion

The Code is a positive development for Bahrain and should enhance effective corporate governance in the Kingdom. The Code imposes international standards on the companies to which it applies and introduces what can only be described as international best practice in Bahrain.

Banking and capital markets

Recommended firms

Tier 1

Baker & McKenzie
Norton Rose

Tier 2

Hatim S Zu'bi & Partners
Trowers and Hamblins

Tier 3

Charles Russell
Hassan Radhi & Associates
Qays H Zu'bi

Tier 4

Ahmed Zaki Yamani
Haya Rashed Al Khalifa

Mergers and acquisitions

Recommended firms

Tier 1

Norton Rose
Trowers & Hamblins

Tier 2

Freshfields Bruckhaus Deringer
Hassan Radhi & Associates
Hatim S Zu'bi & Partners
Qys H Zu'bi

Tier 3

Ahmed Zaki Yamani

Project finance

Recommended firms

Tier 1

Freshfields Bruckhaus Deringer
Norton Rose

Tier 2

Baker & McKenzie
Hatim S Zu'bi & Partners

Tier 3

Hassan Radhi & Associates
Haya Rashed Al Khalifa
Qays H Zu'bi

Stable but quiet, the Bahraini market is characterised by caution which has, in turn, affected the level of activity. "The market is very quiet in the Gulf because of the repercussions of the global financial crisis," says one partner. "Generally the market is quiet especially after the Dubai news, everybody in the Gulf is very cautious and keeps their capital rather than spending in capital markets and M&A."

Bahrain, like most of the Gulf region, has remained protected from liquidity shortfalls that have devastated economies around the world. Despite this, the market has been a cautious one with financial institutions imposing greater restrictions on lending, leading to an absence in large-scale projects.

"Projects are very slow to continue, we see a lot of buildings waiting for cash, commercial and real-estate projects; there will be a lot of empty offices and no-one to occupy them," says one partner. "The market has started moving but everyone is still very cautious."

The partner adds: "One thing that is different for the Gulf region generally is that liquidity is there, but because of the fluctuation and uncertainty in the market, new investments and deals are not happening. There is also an issue of security and guarantees."

Given the Dubai crisis, the Bahraini government hopes to step in and raise the country's profile by making Bahrain the financial hub of the Middle East. "Bahrain is trying to, because of the Dubai situation, take the lead as the financial centre of the Gulf. This is very much what Bahrain would like to push for," says a partner. "They already have this financial harbour which they have completed and they have taken steps to liberalise the banking sector."

For the time being, Bahrain continues to recover from the downturn in lending, while the M&A market remains resilient with a steady deal flow despite a reduction in the valuation of assets. One partner says: "We saw a trending downward of banking facilities, there will be good news soon as we've seen improvements in the latter part of 2010."

Another partner adds: "In early 2009 we saw very few banking facilities being offered, nobody had the cash to lend and the people who did have money weren't lending, they were going out and acquiring things."

The partner continues: "There were distressed companies that were still profitable so we saw an uptick in acquisitions. It doesn't really seem that it has to be a trade off of one for the other but it seemed that was the trend."

Privatisation is another area that is expected to be a source of work for law firms following the privatisation of Al Ezzel, the first power plant to be built under the government's privatisation scheme. One partner

notes: "The government wants to disburden itself of all these major things, this trend to privatisation has been visible in the past 12 months and I think we'll see a lot more of it as time goes by."

The 2030 vision will see the establishment of a commercial and industrial centre, and such projects are expected to increase banking transactions and place Bahrain alongside other financial centres.

Baker & McKenzie

Described as a highly competent firm by competitors, Baker & McKenzie has had a strong year in the field of corporate work and continues to be a dominant player in the market.

The firm is praised by clients for its level of professionalism. One international client says: "We have used them in many jurisdictions, overall I can say they give a very professional service and are very responsive and we are absolutely satisfied. That is the reason we have extended our corporation with them."

Clients also praise Martin Argente for his handling of transactions. "He has good preparation and handles matters in a timely manner," says one.

The practice, led by Ian Siddell, this year represented First Energy Bank in relation to a 40% acquisition of Arab Drilling and Workover Company, a Libyan company providing oil and gas drilling services. This cross-border transaction was led by James Reed and closed in December 2009.

On another transaction, Julie Alexander advised the same client in connection with its participation in a consortium that acquired an equity interest in Al Dur, a power generation and water desalination plant. The deal closed in July 2009.

The firm also advised Gulf International Bank in connection with its asset sale and capital restructuring. The \$4.8 billion deal was led by Caroline Long.

Leading lawyers

Julie Alexander
Ian Siddell

Freshfields Bruckhaus Deringer

Freshfields is distinguished as a leader in project finance work. The practice is led by Harnek Shoker who has been involved across a range of deals.

Freshfields continues to be the government's preferred international counsel and takes the lead on a number of key project deals. The practice has had a successful entry into the market and has established a strong practice after just three years of investing in the region.

This year Shoker led a team advising the Bahraini government in the first deal to close following the financial downturn. The \$2 billion Al Dur independent water and power project closed in June 2009 and was the first time the government had agreed to a 25-year term for a Power and Water Purchase Agreement in Bahrain. The power scheme involved a combination of financing involving commercial bank debt, export credit direct loans and Islamic financing instruments.

The firm also advised the Bahraini government in relation to a waste to energy plant. The \$300 million deal involved an agreement between the government and Construction Industrielles de la Mediterranée.

Leading lawyers

Joseph Huse
Harnek Shoker

Hassan Radhi & Associates

Hassan Radhi & Associates holds its position as one of the leading local practices in the region. Led by Hassan Ali Radhi, the practice is highly respected and has been involved in a number of deals over the past 12 months.

The firm is praised by clients, with one saying: "They work to an exceptionally high standard, they are recognised for their excellent work." When speaking of Radhi, a client says: "He is a distinguished lawyer who is thorough and precise. He is an exceptional lawyer and is highly respected."

On the banking and capital markets side, the firm acted for the managers in relation to the issuance of *sukuk* trust certificates by CBB International Sukuk Company. Valued at \$750 million, the certificates were issued by a company incorporated by the Central Bank of Bahrain. The deal, which closed in June 2009, was led by Radhi and Raju Alagarsamy.

The firm also represented the joint lead managers on a \$1.25 billion bond issued by the Kingdom of Bahrain. The deal, which closed in March 2010 was led by Radhi and Alagarsamy and involved the handling of certain issues around immunity since the issuer was a sovereign entity.

On the M&A side, the firm handled the due diligence in relation to MetLife's acquisition of the Bahraini branch of American Life Insurance Company, a subsidiary of AIG. The deal closed in March 2010 as was part of the worldwide acquisition of AIG by MetLife.

The firm was also involved in the exit of shareholders and the subsequent acquisition of an insurance company. The \$15.6 million deal was led by Jalil al Aradi.

Leading lawyers

Raju Alagarsamy
Hassan Ali Radhi

Other ranked firms

Charles Russell has expanded its presence in Bahrain and it recognised by competitors as a firm of growing prominence. The firm is highly regarded by peers who highlight Clive Hopewell as a key figure. "They are one of the biggest firms in Bahrain and works closely with the central banks. Clive Hopewell is their leading lawyer, he specialises in M&A." says one peer. Hopewell also heads the firm's energy and natural resources group.

In June 2010 the firm hired Nicholas Polley, a banking and finance lawyer with expertise in *shariah* financing, and Sherif Hampton, a corporate commercial lawyer.

Haya Rashed Al Khalifa has been highlighted by a number of market players as a successful firm with a growing prominence and a growing client base. "The practice is becoming more and more active," says one partner. The firm is praised for its strong capabilities in the banking and capital markets sector and is led by Shalkha Haya Al Khalifa.

Other notable firms

Headquartered in Kuwait, Asar - Al Ruwayeh & Partners has been involved in a number of transactions in the Bahraini market over the past 12 months.

The firm wins positive praise for the quality of its services. "They were extremely responsive and always available. Very thorough and we found them to be excellent," says a client. "We have worked with a couple of firms in Bahrain and they were definitely the better firm."

Michael Durgavich is also singled out by clients for his dedicated approach. "He is excellent and always makes himself available, he is very commercial and pragmatic and it was a pleasure dealing with him," says one. "Nicolas Gallopin is another person who had been extremely helpful to deal with. We were generally very pleased with the firm."

The practice is led by Durgavich and has been across a range of deals. The firm represented Tomkins USA on its acquisition of a controlling stake in a Bahraini company. The deal, led by Durgavich and Ali A Sheikh, involved advising on the share acquisition, due diligence and review of the share purchase agreement from a Bahraini law perspective. The deal closed in March 2010.

On the banking and capital markets side, Durgavich has acted on behalf of Siraj Capital on the formation of an equity participation vehicle for a high net-worth investment. On

another deal Durgavich and Sheikh worked alongside Norton Rose advising Royal Capital MENA in relation to the incorporation and registration of a fund company to be domiciled in Bahrain. The deal closed in March 2010.

On the project finance side the firm advised Kuwait Finance House and AREF Investment Group on the Islamic financing in relation to the acquisition of three planes by Bahrain Air in December 2009.