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Changes to the implementing regulations for Saudi Arabia's Commercial Mortgage Law

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A mortgage or pledge of moveable property in the Kingdom of Saudi Arabia securing commercial indebtedness is governed by the Commercial Mortgage Law issued pursuant to Royal Decree M/75 dated 21/11/1424 H. (corresponding to 13 January 2004) (the Commercial Mortgage Law).

The Implementing Regulations pertaining to the Commercial Mortgage Law were originally issued by Resolution of the Minister of Commerce and Industry number 6320 dated 18/6/1425 H. (corresponding to 4 August 2004) and were recently reissued in amended form by Resolution of the Minister of Commerce and Industry number 267/8/1/1812 dated 19/2/1431 H (corresponding to 3 February 2010) (the Amended Implementing Regulations).

The main changes reflected in the Amended Implementing Regulations merit particular attention and are described below.

Establishment of the Unified Registration Center

The Amended Implementing Regulations provide for the establishment of a unified center for the registration of mortgages or pledges by the Ministry of Commerce and Industry (the Unified Registration Center). Upon establishment, the Unified Registration Center should address existing concerns amongst secured parties for ascertaining the existence of prior security interests. Where the mortgaged or pledged movable property is represented by a deed, the mortgagee or pledgee (or a trustee appointed by the parties to the mortgage or pledge agreement) will be required under Article 7 of the Amended

Implementing Regulations to provide the Unified Registration Center with a copy of the certificate confirming the registration of the mortgage or pledge with the deed's issuer.

In the absence of such issuer, direct registration of the mortgage or pledge with the Unified Registration Center will be required pursuant to Article 8 of the Amended Implementing Regulations. Upon termination of the mortgage or pledge, the mortgagor or pledgor will be required under Article 30 of the Amended Implementing Regulations to provide the Unified Registration Center with evidence of such termination.

It should be noted that the recently introduced registration provisions are in addition to the existing perfection requirements. In particular, in order for a mortgage or pledge to be enforceable against third parties, the Commercial Mortgage Law requires the mortgagee, pledgee or trustee to:

- (i) establish actual physical possession or control over the mortgaged or pledged moveable property; or
- (ii) obtain possession of a deed representing the mortgaged or pledged moveable property, provided such deed grants its possessor the exclusive right to receive the mortgaged or pledged moveable property.

Additionally, the perfection requirements applicable to the particular type of moveable property being mortgaged or pledged will also need to be satisfied. By way of an example, a mortgage or pledge of moveable property represented by a nominal deed (such as shares in a Saudi Arabian closed joint stock company) requires the following:

- (i) execution of a written mortgage or pledge agreement;
- (ii) recording the mortgage or pledge in the registry of the nominal deed's issuer;
- (iii) notation of the mortgage or pledge on the nominal deed;
- (iv) delivery of the nominal deed to the actual physical possession of the mortgagee, pledgee or trustee; and

(v) delivery to the Unified Registration Center of a copy of the nominal deed, reflecting the mortgage or pledge notation, pursuant to the Amended Implementing Regulations.

Priority in bankruptcy proceedings

The Amended Implementing Regulations have also responded to existing concerns amongst secured parties regarding the priority of a mortgage or pledge in the context of the bankruptcy of the mortgagor or pledgor. Article 25 of the Amended Implementing Regulations now expressly provides that, in the event that the mortgagor or pledgor is bankrupt, the mortgagee or pledgee will have priority to recover its entitlements from the proceeds of the sale of the mortgaged or pledged moveable property over other creditors preferred by law.

Trustee sales of mortgaged or pledged property

The Amended Implementing Regulations have introduced a mechanism allowing the mortgaged or pledged moveable property to be potentially sold through a trustee. In the event that outstanding commercial indebtedness is not satisfied when due, and provided that the mortgagor or pledgor approves the satisfaction of such outstanding indebtedness from the value of the mortgaged or pledged moveable property, Article 20(b) of the Amended Implementing Regulations provides that the mortgagor or pledgor and the mortgagee or pledgee may agree upon the sale of the mortgaged or pledged property through a trustee for purposes of satisfying such outstanding indebtedness.

Previously, the regulations addressed only the sale of mortgaged or pledged moveable property through potentially time-consuming and costly enforcement proceedings instituted before the Board of Grievances, the designated Saudi Arabian judicial forum for matters relating to the Commercial Mortgage Law.

Requirements for mortgaged or pledged property

The Amended Implementing Regulations have also clarified the requirements for moveable property that is proposed to be mortgaged or pledged. Specifically, Article 3 of the Amended Implementing Regulations now provides that the property which is the subject of a mortgage or pledge must be capable of being sold, must be clearly defined in an agreement and must be capable of being possessed.

Enforceability considerations

It should be noted that the enforceability of mortgages or pledges may be affected by several factors including, without limitation, the unenforceability of the underlying secured obligations, determinations regarding the lack of actual physical possession of the relevant property, the failure to satisfy any perfection requirements or the requirements of the laws relating to the ownership transfer of the relevant property, all of which should be carefully considered in the context of a mortgage or pledge agreement.

It should also be noted that, as of the date of writing this article, the Unified Registration Center had not yet been established and the effect of the absence of registration upon mortgages or pledges prior to its establishment has not, to the best of our knowledge, been tested before the Board of Grievances.

The provisions of the Commercial Mortgage Law and the Amended Implementing Regulations (including, without limitation, the priority in the context of bankruptcy proceedings and the sale of mortgaged or pledged property through a trustee as contemplated in the Amended Implementing Regulations) have also not, to the best of our knowledge, been considered by the Board of Grievances. However, it is hoped that the changes reflected in the Amended Implementing Regulations will ultimately strengthen the rights of secured parties in the Kingdom of Saudi Arabia.

Capital markets

Recommended firms

Tier 1
Al-Jadaan & Partners/Clifford Chance Legal Advisors/Baker & McKenzie
Tier 2
Abdulaziz Al Gasim/Allen & Overy Hatem Abbas Ghazzawi & Co Latham & Watkins in association with the Law Office of Mohammed A Al-Sheikh
Tier 3
Abdulaziz Al-Assaf/Norton Rose Abdulaziz H Fahad Salah Al-Hejailan/Freshfields Bruckhaus Deringer Feras Al Shawaf/Trowers & Hamblins Khalid A Al-Thebity Law Firm/Dewey & LeBoeuf Law Offices of Dr Mujahid M Al-Sawwaf

Banking

Recommended firms

Tier 1
Abdulaziz Al Gasim/Allen & Overy Al-Jadaan & Partners/Clifford Chance Legal Advisors/Baker & McKenzie
Tier 2
Hatem Abbas Ghazzawi & Co Law Offices of Dr Mujahid M Al-Sawwaf
Tier 3
Salah Al-Hejailan/Freshfields Bruckhaus Deringer Feras Al Shawaf/Trowers & Hamblins Latham & Watkins in Association with the Law Office of Mohammed A Al-Sheikh Law Office of Hassan Mahassni
Tier 4
Abdulaziz Al-Assaf/Norton Rose Abdulaziz H Fahad International Law Firm Mohammed bin Saud Al-Rasheed/Baker Botts

Mergers and acquisitions

Recommended firms

Tier 1
Al-Jadaan & Partners/Clifford Chance Legal Advisors/Baker & McKenzie
Tier 2
Abdulaziz Al Gasim/Allen & Overy Hatem Abbas Ghazzawi & Co Law Offices of Dr Mujahid M Al-Sawwaf Latham & Watkins in Association with the Law Office of Mohammed A Al-Sheikh
Tier 3
Salah Al-Hejailan/Freshfields Bruckhaus Deringer Feras Al Shawaf/Trowers & Hamblins International Law Firm Law Office of Hassan Mahassni Mohammed Al-Ammar/King & Spalding

Project finance

Recommended firms

Tier 1
Abdulaziz Al Gasim/Allen & Overy Al-Jadaan & Partners/Clifford Chance Legal Advisors/Baker & McKenzie
Tier 2
Hatem Abbas Ghazzawi & Co Law Office of Hassan Mahassni
Tier 3
Salah Al-Hejailan/Freshfields Bruckhaus Deringer Feras Al Shawaf/Trowers & Hamblins Latham & Watkins in Association with the Law Office of Mohammed A Al-Sheikh Law Offices of Dr Mujahid M Al-Sawwaf

Domestic banks are not as hesitant as neighbouring countries to lend and the Saudi market remains stable. There is, however, some shortage on the lending side. "There is no liquidity shortfall at all in Saudi Arabia. The liquidity is the same but the conditions have changed. Banks just feel that companies can't get funding as they did in the past, they are aware of this position so they are raising their margins," notes one partner.

Other legal practitioners attribute the lack of availability in lending to a lack in confidence in the market, one says: "The banks went through a phase where there was no issue of liquidity but an issue of nervousness."

One of the most dominant trend observed in the banking sector is a move towards Islamic finance. "We think this is because post-financial crisis there has suddenly been a lot of interest in Islamic products because they seem to have weathered the crisis well. There

are requests for Islamic finance and we expect that to continue possibly branching out into Islamic derivatives,” says one partner.

On the M&A side, activity has been consistent with previous years as this sector is described as being characteristically quiet in Saudi as compared with other regions. “There isn’t that much M&A movement, people tend to enter into joint ventures rather than outright buy. Not many M&A deals are closed and if there is one it’s usually the close of a minority share. Very often people don’t agree on price, there isn’t an industry like the private-equity industry that does M&A for business,” says one partner.

Partners describe the project finance sector as cautiously positive as they note activity in the power and energy sectors. “There is increased activity in project finance in Saudi and we are starting to move away, perhaps to some extent, from restructurings,” says one in-house counsel. Deals that seem to move forward are noted to be those involved in government driven work on the back of privatisations.

The energy sectors has been the most active in terms of project finance work and is expected to be the main source of work for law firms in coming years. “We’ve seen a shift towards projects which are very much looking at the long term, we see a lot of interest in renewables, alternative energy, and nuclear so we think the next generation of big projects will largely be in energy sector,” says a partner.

Abdulaziz Al Gasim/Allen & Overy

There is no doubt in the market that Allen & Overy is one of the most exceptional international firms in the country and is commended for its dedication to the region. The firm took a further step towards integrating its Saudi operations into the international network in August 2010 when it hired Zeyad Khoshaim, a lawyer at its Saudi sponsor firm Abdulaziz Al Gasim, as its first Saudi local partner.

“Allen & Overy is the most successful of the new comers in the Saudi market. They are doing so much better than other associations because most of them have a nominal presence and clients see through that. You really need to have the right resource and right personnel and Allen & Overy have achieved this,” says one peer.

Clients also praise the firm for its approach and solution-oriented approach, “I’ve dealt with Allen & Overy for quite some time and we always like dealing with them. They are right up there in our list and we continue work with them,” says one client, adding: “They have always been client focused and a solution provider.”

One of the most widely praised lawyers at the firm is Julian Johansen. He is singled out repeatedly by peers and is highlighted by clients equally. “In Saudi he is known as Julian of Arabia, he has blond hair and blue eyes and speaks Arabic fluently. He is the driving force behind the firm and a leading figure,” says one peer.

Clients also praise Johansen, one says: “He has been very helpful in providing valuable insight in export financing and financing related issues.”

Key matters the firm has been involved in include representing the ACWA/Kepeco consortium in connection with the financing of the 1,200MW Rabigh independent power project (IPP) project in Saudi Arabia. The deal involved financing in the sum of \$2.5 billion and reach financing close after nine months, a comparably short time frame. On a further banking deal, the practice represented financing sponsor in connection with the Petrochemical joint venture.

The firm has also been active on capital markets transactions including representing Saudi Electricity Company as the issuer on its second *sukuk* (Islamic Bond) public issuance amounting to SR7 billion (\$1.87 billion). This was the largest *sukuk* in the market up to 2009 and the only public issuance in that year for Saudi Arabia.

Another key transaction involved acting on behalf of News Corporation on the acquisition of a 9.09% stake in Rotanan Group, a Middle East media group owned by HRH Prince Alwaleed Bin Talal, for \$70 million.

“Banks all spoke positively about Allen & Overy,” says one peer. “They really came and set up a proper office and put two partners on the ground. Practically every bank said they are using Allen & Overy and they have definitely made an impact on the banking side.”

The competitor continues: “It shows that if you come here and do your homework and invest properly, you will get the reward. Allen & Overy have made such an impact nobody else has. Banks say that Allen & Overy has fantastic rates and are good value for money.”

Leading lawyers

Abdulaziz AlGasim
Julian Johansen

Al-Jadaan & Partners/Clifford Chance

“They are execution-focused and deliver on time so those are fantastic qualities,” says one international client, adding: “Overall they are a very good firm no doubt. I think they are a very good outfit, very good on the restructuring and debt capital market side.”

The firm is described by competitors as a solid operation with key practitioners, with Mohamed Hamra-Krouha singled out by peers as an outstanding lawyer. “He is very good on deal execution and is also bilingual which is helpful in this market and he has good market experience. He is approachable, reasonable and is an important person in the practice,” says one.

Hamra-Krouha advised Saudi Tabreed Cooling Company in relation the financing of the construction development of a district cooling plant and associated network on a build-own operate (BOO) basis. This was the first BOO district cooling project in Saudi Arabia. The SR361 million (\$96 million) deal closed in April 2010.

On a further deal, Hamra-Krouha acted on behalf of Zain Saudi Arabia in connection with its \$2.2 billion *shariah*-compliant profit rate swaps with a syndicate of hedging banks. The syndicate attracted domestic and international banks which provided hedging both on US dollar and Saudi riyal exposures. The deal closed in November 2009.

On the capital markets side, the firm worked in conjunction with Al-Jadaan & Partners Law Firm, advising Saudi Basic Industries Corporation (Sabic) on the issue of SR10 billion floating rate notes to the Public Investment Fund of Saudi Arabia. This was the largest floating rate note issuance to date in the country.

Leading lawyers

Mohammed Al-Jadaan
Mohamed Hamra-Krouha

Legal Advisors/Baker & McKenzie

Described as a leading firm by competitor and highly praised by clients, Legal Advisors/Baker & McKenzie is regarded as one of the country’s most prominent firms. “I’ve dealt with some lawyers who tell you can’t do things and then don’t give you a solution. The nice thing with Baker & McKenzie is that even if things are not doable, they still give you a solution,” says one client.

A leading individual singled out by clients is Karim Nassar. “He is very knowledgeable on capital markets and gives good advice on deal structuring,” says one.

Ian Siddell led a team advising Saudi Arabian Mining Company in connection with multi-tranche integrated project financings of an aluminium smelter and an aluminium rolling mill. Siddell is also advising Al-Ittefaq Steel Products in relation to the restructuring of the existing liabilities, conventional and Islamic, of over \$2 billion.

On the M&A side, George Sayen led a team advising Schindler Management, a Swiss elevator and escalator manufacturer, in connection with its acquisition of 100% of Saudi Elevator Company in February 2010.

In July 2009, Nassar advised National Petrochemical Company in relation to the IPO of 50% of the company's share capital. The deal value amounts to SR2.4 billion (\$640 million). Nassar also advised Herfy Food Services on its IPO of 30% of its share capital, raising SR413 million.

"Their on-the-ground presence is strong, and they combine both the international advice and the local legal advice in one firm which you don't find in most other international firms," says one client.

Leading lawyers

Karim Nassar
George Sayen
Ian Siddell

Hatem Abbas Ghazzawi & Co

The Jeddah-based firm has an established presence and remains a respected contender in the market. The firm is praised by clients as one says: "The reality is that when you get to the major project finance deals there are relatively few firms that have worked on major deals and Hatem is one of them, and that experience is reassuring to the international market from a banking perspective."

One of the leading figures to be singled out by clients is Ali Abedi, who heads the banking and project finance division, "He is responsive and understands both the commercial issues and constraints of Saudi law and he manages to marry those two things up very well," says one.

Abedi acted on behalf of a group of lenders, led by Jbic as preferred bidder for a \$3 billion 1,100MW power IWPP (independent water and power project). On a further transaction, Abedi advised a consortium of Acwa Power, the Binladen Group and Deutsche Bahn as preferred bidder in relation to its bid for a 30-year concession to construct and operate the Landbridge rail link between Jeddah, Riyadh and Dammam. The deal value amounts to \$5 billion.

Abedi also acted on behalf of Alcoa in relation to its joint venture with Saudi Arabian Mining Company for the development of a fully integrated aluminium complex. The joint venture is in its initial phase and will develop a bauxite mine, an alumina factory and an aluminium smelter. The \$10.8 billion deal is due to close in the last quarter of 2010.

Another significant figure at the firm who is praised by peers is Andreas Haberbeck. "He is well known in the Saudi market and is

excellent, he is one of the pillars of the practice. He is a top lawyer and deserving," says one competitor.

Haberbeck heads the M&A practice and has been visible on a range of transactions including advising Sadafoo, a Saudi Arabian listed company, in relation to the sale of its 51% shareholding in Saudi New Zealand Dairy Company to Fonterra, a New Zealand dairy marketing board. The \$36 million deal closed in the first quarter of 2010.

Heading the capital markets team is Asad Abedi who, together with Haberbeck, advised Al Alamiya Insurance Co, a Royal & Sun Alliance affiliate, in relation to an IPO of 30% of its share capital. The \$53 million deal reached financial closed in October 2009.

A further highlight saw Asad Abedi act on behalf of Red Sea Gateway Terminal and Red Sea Ports Development Company in relation to its first private share-swap arrangement involving a limited-liability company and joint-stock company. The deal closed in December 2009.

Leading lawyers

Ali Abedi
Asad Abedi
Andreas Haberbeck

Latham & Watkins in association with the Law Office of Mohammed A Al-Sheikh

Launched in April 2010, the newly formed association with the Law Office of Mohammed Al-Sheikh in Riyadh marks the firm's expansion of its Middle East operation.

Mohammed Al-Sheikh, the former sponsor of White & Case, has also been joined by partner Christopher Langdon as well as the majority of the associates from the White & Case Riyadh office.

The Latham & Watkins practice in Saudi is respected and has been welcomed by competitors as a solid newcomer. There is however some uncertainty as to how the firm will move forward and the extent of its strength in the market given that it is relatively new to the Middle Eastern region.

"There has been a lot of speculation as to what happened because Latham doesn't have the type of history in the region as White & Case had. Latham as a whole doesn't have a whole track record of Saudi experience so it's uncertain as to how it will affect the market," says one peer.

Nevertheless Al-Sheikh hit the ground running after joining Latham, teaming up with Harj Rai and Mahmoud Abdel-Baky to advise Saudi Electricity Company as well as HSBC and Samba Capital & Investment Management Company in relation to a SR7

billion (\$1.87 billion) *sukuk* issued by Saudi Electricity Company. This was the first public *sukuk* (Islamic Bond) issued by a Saudi entity in 2010.

Leading lawyers

Mohammed Al-Sheikh

Law Office of Hassan Mahassni

The firm, based in Jeddah, is highly regarded by competitors who describe the firm as one of the most established in the country with a longstanding presence. The firm is recognised as a strong finance-focused practice and is able to maintain solid relationships with its clients who report positively on their dealings with the firm.

"We have been dealing with them for decades, they have been our legal advisors for over 30 years and we are very, very happy with them because of the quality of their service and their knowledge of the local legal system," says one client, adding: "It's a matter of confidence and we feel that they have always been capable of providing legal services needed and have done a good job. We use them a lot for financing transactions, they are very good in Islamic finance."

In speaking of Basel Barakat, one client says: "He is excellent, I think the professionalism and knowledge that he has makes him excellent, plus his commitment." Barakat heads both the banking and finance and the project finance divisions and has been visible across a range of transactions.

On the project finance side, Barakat led a team acting on behalf of Acwa Power Projects and Korea Electric Power Corporation in relation to a \$2.5 billion Rabigh independent power project (IPP), Saudi Electricity Company's first IPP. The 1,200MW power project financing agreement was completed in September 2009.

On a further deal, Barakat took the lead in representing Al-Rajhi Banking and Investment Corporation and Banque Saudi Fransi. The deal involved advising on a \$458 million *shariah*-compliant financing arrangement for Red Sea Gateway Terminal Company for the third container terminal project in the Jeddah Islamic Port in Saudi.

On the banking side, Barakat led a team advising Saudi Binladin Group in relation to a high-profile SR4.8 billion (\$1.28 billion) *shariah*-compliant multi-option facility. The credit facility relates to the construction works for Princess Noura Bint Abdulrahman University for Women in Riyadh; the first women-only university in the country.

On a separate deal, Barakat advised the same client, Saudi Binladin Group, in connection with a \$5.5 billion *shariah*-compliant

multi-option facility relating to the construction works for King Abdullah Financial District in Riyadh.

Leading lawyers

Basel Barakat
Hassan Mahassni

Other ranked firms

The Salah Al-Hejailan/Freshfields Bruckhaus Deringer association formed this year when the former local sponsor Fares Al-Hejailan joined his father Salah Al-Hejailan's firm and brought Freshfields along with him. The firm also expanded its headcount this year with the transfer of emerging markets-focused finance partner Tobias Müller-Deku from Munich to Riyadh.

The firm has been involved in a range of deals over the past 12 months. On the capital markets side, Patrick Ko, Fares Al-Hejailan and Blake Harley acted on behalf of Sahara Petrochemical Company in relation to its ongoing SR1.03 billion (\$275 million) rights issue on the Saudi stock market in October 2009.

Ko together with Charles Hayes also advised Saudi Telecom Company (STC) on the listing of Maxis, in which STC holds a large minority stake. The \$3.3 billion deal closed in November 2009.

On the banking side, joint banking managers Tobias Müller-Deku and Fares Al-Hejailan led a team advising Samba Financial Group in connection with the bridge financing for Saudi Arabian Airline's new fleet.

Müller-Deku and Ahmed Arif also took the lead in representing Jabal Omar Development Company in relation to a *murabaha* (deferred sale) bridge facility transaction, which is ongoing.

In October 2009, Arif, Ko and Black Harley acted on behalf of STC in connection with the acquisition of 100% of the shares of Saudi Bell Company by way of content joint venture.

With a continued focus on the project finance area, the firm has been visible advising a range of clients. Müller-Deku was active in this area, advising The Saline Water Conversation Corporation of Saudi Arabia on its proposed privatisation of 30 cogeneration and water desalination facilities as well as 3,600 kilometre water transmission system.

King & Spalding in association with the Law Office of Mohammed Al Ammar is led by Isam Slaah and Jawad Ali.

The firm has been notably active in the field of M&A on a range of transactions. Benjamin Newland and Nabil Issa represented Arcapita Bank and Al Rajhi Capital in their acquisition of a grocery distribution ware-

house in Saudi Arabia from Savola Group. The deal also involved advising on the formation of an authorised real-estate fund which affects the acquisition. The deal closed in December 2009.

Issa and Fahad Al-Malki also represented Shuaa Capital Saudi Arabia in connection with its acquisition of land in Jeddah for the development of a Rotana hotel. The deal reached financial close in December 2010.

The firm was also involved on one of the few M&A transactions to be made by a strategic investor as opposed to a financial investor. In the deal, Issa and Al-Ammar acted on behalf of Fontera on its acquisition of Sadafco's shares in Saudi New Zealand Milk Products in November 2009.

Other notable firms

"Mohammed Al Sheikh is a very significant loss from a **White & Case** perspective," says a peer. There is no doubt that the firm's loss of Al Sheikh and a large number of associates in a huge blow to the firm's on-the-ground capabilities.

However given White & Case's extremely strong connection with the Saudi market, including a 50-plus year relationship with Saudi Aramco, it is still a key player, albeit from Abu Dhabi, New York and London instead of Riyadh. If (or when) it relaunches a Saudi practice its strong connections will most likely mean that it will once again be a force to be reckoned with.