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UAE – Law & Practice

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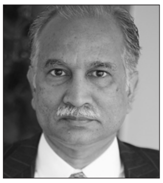
Authors



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1. Loan Market Panorama

1.1 Impact of Economic Cycle and Regulatory Environment

The United Arab Emirates (the UAE) financial market continues to recover from the 2008 financial crisis and has seen a steady increase in bank and company appetite for lending. However, banks have tended to be more cautious in lending to the private sector, particularly retail and off-plan real estate lending (where some market commentators expect a correction in real estate prices in 2015).

Whilst lending to government-related projects is expected to remain robust for the foreseeable future, this position could change if oil prices continue to drop. Banks that have relied heavily on government businesses and funds for cheap deposits may feel the effect, in the event of a further drop in oil prices.

The lending market has seen a growing trend for acquisition, refinancing, project and working capital financing through dual-tranche (conventional and Islamic finance) structures. Islamic finance products have become particularly popular amongst borrowers, particularly the Ijara financing structure (similar to the conventional sale and leaseback financing structure), which has enabled borrowers to use existing assets (usually real estate) to fund working capital requirements, whilst continuing to have use and access to the relevant assets. We have also seen increased instances of UAE and overseas companies approaching UAE financial institutions to fund their overseas construction projects and expansions plans (e.g. financing retail outlets overseas).

In the aftermath of the 2008 financial crisis, the UAE Central Bank (the Central Bank) implemented a number of changes to the bank supervision regime, including:

In January 2009, the Central Bank announced that all banks in the UAE must provide details of each loan in excess of AED10 million to the Central Bank to enable the Central Bank to scrutinise the asset quality of the banks.

In February 2009, the Central Bank created an online unit to settle disputes among banks. Banks may now lodge a complaint directly with the Central Bank through this online process. Upon receipt of a complaint, the Central Bank will investigate the complaint and notify the disputing banks of its decision within eight weeks. However, matters that are already before a judicial process and major financial problems or criminal cases would be outside the purview of this online complaint system. The Central Bank believes that this initiative will help them to better monitor the issues faced by banks in the UAE.

In March 2009, the Central Bank announced that it would set up a joint task force comprising representatives of the Central Bank and the country's banks to discuss further measures to face the global crisis.

1.2 The High Yield Market

Whilst UAE borrowers have sought to diversify their sources of funding beyond investment grade loans, they have found alternatives in the form of Islamic financial products. In particular, companies have sought to issue sukuks in order to meet part of their funding needs. Whilst the trend in the Western markets may have reversed from loans to bonds as the major vehicle for funding, in the UAE conventional loans continue to retain the lion's share of the financing market.

1.3 Alternative Credit Providers

Although alternative credit providers have always been a fixture in the local financial landscape (particularly in financing the SMEs market), their prominence has not grown as substantially as in the Western markets. Whilst the recent dip in bank lending has left a substantial gap in funding needed to support growth, it is the cash-rich Islamic banks and financial institutions that have filled this gap by aggressively expanding their share of the SME market.

1.4 Evolution of Banking and Finance Techniques

There is an ever growing demand for Shari'a-compliant financing products, both from businesses and the sizeable Muslim population in the Gulf Co-operation Council (GCC). Islamic financial institutions are expanding their catalogue of financial products in an effort to attract a wider (non-Muslim) customer base. In particular, Islamic financial institutions have been particularly successful in promoting the Ijara structure (sale and leaseback), which has been popular with business customers.

We have also seen an increase in big-ticket multibillion-dirham syndicated financing and refinancing, particularly within the construction industry.

1.5 Recent Developments

The UAE recently entered into the Model 1 intergovernmental agreement (IGA) with the government of the United States, in order to facilitate the implementation of US Foreign Account Tax Compliance Act (FATCA). Banks in the UAE (including wealth managers falling within the scope of the IGA) will be required to:

(i) identify accounts that qualify as 'US Reportable Accounts'; and
(ii) submit reports on such accounts to the Central Bank, which shall share this information with the US Internal Revenue Service. Commercial banks in the UAE will comply with the reporting requirements under FATCA and have already taken steps to ensure that they are able to identify those accounts and customers to which FATCA reporting obligations may apply. This may potentially be a cause for concern for those individuals and businesses to which FATCA applies. We note that a number of GCC banks have already declined to open accounts for US citizens, in light of the administrative burdens associated with implementing FATCA.

The new UAE Federal Law No. 2 of 2015, on commercial companies (the Companies Law), which came into effect at the end of June 2015, also places certain restrictions on financial assistance by UAE companies (see section **4.4** below).

2. Authorisation

2.1 Requirements and Procedures

Licensing requirements in the UAE

The principal governmental and regulatory policies that govern the UAE banking sector (except in the Dubai International Financial Centre (DIFC), where the regulatory authority is the Dubai Financial Services Authority (DFSA)) are UAE Federal Law No. 10 of 1980 concerning the Central Bank, the Monetary System and the Organisation of Banking (the Banking Law), UAE Federal Law No. 18 of 1993, as amended (the Commercial Code), UAE Federal Law No. 6 of 1985 concerning Islamic banks, financial establishments and investment companies (the Islamic Banking Law) and the various circulars, notices and resolutions issued by the board of governors of the UAE Central Bank, from time to time (which deal with various aspects of banking including bank accounts, maintaining of certain reserve ratios, capital adequacy norms and reporting requirements to the UAE Central Bank).

Whilst the Central Bank is the principal financial services regulator for banks and financial institutions in the UAE, such entities are also subject to additional registration and licensing requirements at the federal and emirate levels. The Companies Law also governs all commercial companies incorporated in the UAE and all foreign companies with branch offices in the UAE. The Securities and Commodities Authority (SCA, also commonly referred to as ESCA) also has some oversight functions in certain specific areas, particularly in relation to listed securities, and ESCA's role with regard to fund regulation is expanding.

The Banking Law is the primary legislation giving the Central Bank the authority to regulate financial services in the UAE. The Banking Law provides that the Central Bank has the power to license and regulate a wide variety of financial institutions, including those seeking to provide financing in the UAE. In particular, those institutions are as follows:

commercial banks, which include institutions that customarily receive funds from the public for granting loans and which issue and collect cheques, place bonds, trade in foreign exchange and precious metals, and carry on other operations allowed by law or by customary banking practice;

- investment banks, which include institutions conducting similar activities to commercial banks, with the notable exception that they do not accept deposits with a maturity of less than two years;
- investment companies, which manage portfolios on behalf of individuals or companies, subscribe to equity and debt instruments, prepare feasibility studies for projects, market shares, and debt instruments, and establish and manage funds;
- finance companies, which provide corporate and consumer credit facilities, but may not accept deposits from individuals;
- Islamic banks, which undertake all the activities of a commercial bank and additionally can own assets financed by them;
- Islamic finance companies, which may provide personal, consumer, property, vehicle and trade financing, issue guarantees, enter into foreign exchange contracts with corporate entities, subscribe to shares, bonds and certificates of deposits, accept deposits from corporate entities, and manage investment vehicles; and
- real estate finance companies, which are finance companies that specialise in funding real estate projects on a conventional or Shari'a-compliant basis.

Each of the entity structures listed above, if incorporated in the UAE, requires a UAE national to hold at least 51% of its shares; however, for finance companies, commercial banks and investment banks, the minimum UAE national shareholding is 60%. All commercial banks incorporated in the UAE must be established as public shareholding companies under the Companies Law and must be majority-owned by GCC nationals.

Branches of foreign banks may engage in commercial banking in the UAE but must be licensed by the Central Bank and must maintain separate accounts for their UAE operations. The Banking Law also provides for the establishment and regulation of financial and monetary intermediaries (i.e. foreign exchange dealers and securities broker-dealers), and representative offices of foreign banks. The licence issued to a bank or other institution specifies the particular types of banking business it is licensed to do. Foreign banks operating in the UAE may have no more than eight branches.

Branches of foreign banks are licensed as commercial banks and routinely provide financing to local entities.

Non-resident banks grant bilateral credit facilities and also participate in non-dirham syndications in the UAE. They are not deemed to be resident, domiciled or carrying on business in the UAE, and are not liable to pay tax in the UAE merely on account of such bilateral facilities or participation in syndications. The confidentiality of customer information by banks is not specifically provided for under the Banking Law, but the principle is recognised as a customary banking practice and, implicitly, under certain regulations issued by the Central Bank. The Central Bank has wide powers to obtain information.

The large number of foreign and local banks caused the Central Bank of the UAE more than 30 years ago to establish a virtually complete moratorium on new banks, both foreign and local, although the moratorium has been relaxed slightly in recent years to allow a few GCC banks to establish branches in the UAE. Furthermore, a number of Islamic banks and financial companies have been set up.

Licensing requirements in the DIFC

To provide any financial service from within the DIFC, an individual or entity must be authorised by the DFSA. In particular, a lender must seek a licence for arranging credit in order to offer financing from the free zone and must be structured as any one of the following entities:

- limited liability company;
- company limited by shares;
- limited liability partnership;
- protected cell company;
- investment company;
- branch of foreign company or partnership; or
- special purpose company.

Unlike the rest of the UAE, the DIFC imposes no requirement for majority ownership by a UAE national, and 100% foreign ownership is permitted. However, as with the entities incorporated in the UAE, a regulated lender in the DIFC must appoint directors and make periodic filings regarding, among other things, its capital adequacy.

The DFSA has adopted a regulatory approach modelled, at least in part, on the Financial Services Authority in the United Kingdom. The DFSA does not grant banking licences per se; it authorises financial service providers to undertake specific financial services. The relevant financial services in respect of banks would include providing credit and accepting deposits. There are approximately 100 international banking institutions with a registered presence in the DIFC. Of these, a substantial number of institutions have not applied for the authorisation to accept deposits. This reluctance on the part of various institutions to be a 'true' bank can be traced back to two reasons. First, DIFC entities were historically not able to deal with retail customers. This restriction was lifted several years ago, but the business model of the vast majority of institutions within the DIFC has been to focus on corporate clients or high net worth individuals. Secondly, banks have been reluctant to apply for the 'accepting deposits' authorisation is that they remain unable to deal in dirhams or accept deposits from the UAE markets. Most of the banks that have set up in the DIFC have done so as branches of overseas companies; this has been done for capital adequacy reasons. Recently, it has been the policy of the DFSA to encourage banks to incorporate new subsidiaries within the DIFC and capitalise those subsidiaries to an acceptable level.

3. Structuring and Documentation Considerations

3.1 Foreign Lender Restrictions: Granting Loans
There are no restrictions on cross-border lending.

3.2 Foreign Lender Restrictions: Granting of Security
There are no restrictions on guarantees from domestic and foreign-registered companies. Guarantees must be in writing and specify the amount secured by the guarantee.

Security over immovable property cannot be granted to foreign banks unless they have a commercial banking licence in the particular emirate where the immovable property is located, with the exception of the DIFC (see below). In practice, foreign banks lending to UAE borrowers normally appoint a local bank as its security agent to hold the UAE security. Security over movable property can be granted to non-resident foreign banks, except in the following cases:

A business mortgage, whether under the Commercial Code or in relation to assets in the Jebel Ali Free Zone (JAFZ), can only be granted to banks or financial institutions with a commercial banking licence.

A pledge over funds in a bank account can only be granted to the account-holding bank. In practice, foreign non-resident banks normally appoint an onshore security agent to hold the security on their behalf.

Foreign lenders can hold security in the DIFC. Foreign lenders can be mortgagees on vessel mortgages.

3.3 Foreign Currency Exchange Restrictions
There are no exchange controls restricting payments to foreign lenders, except for restrictions on transactions involving Israeli parties or currency. The UAE dirham (AED) is fully convertible and there are no restrictions on the movement of funds (denominated in dirhams, US dollars or otherwise) into or out of the UAE. The dirham is pegged to the US dollar.

3.4 Agent and Trust Concepts
The concept of the facility and security agent is recognised in the UAE. The facility agent acts on the instructions of (and on behalf of) the lenders and/or the instructions of the majority lenders (as per standard Loan Market Association). The security agent can enforce the security in the courts of the UAE, as agent of the lenders.

The UAE is a civil law jurisdiction that does not provide for the creation of trusts.

3.5 Loan Transfer Mechanisms
Debt can be transferred through participation agreements. Under a participation agreement, a pledgee or registered mortgagee continues as the pledgee or registered mortgagee but transfers all or part of the loan, on a funded or unfunded basis. Participation may be disclosed or undisclosed, depending on the terms of the participation agreement.

3.6 Debt Buy-back
There is no restriction against conducting a debt buy-back in the UAE. In practice, a borrower is permitted to buy back the outstanding debt in conventional financing. In Islamic facilities, debt prepayment generally only proceeds with the consent of the Islamic financiers.

3.7 Public Acquisition Finance
Neither the Companies Law nor the rules and regulations applicable in the UAE's exchanges (i.e. the Abu Dhabi stock exchange, the Dubai Financial Market and NASDAQ Dubai) provide a separate set of rules governing the acquisition of public companies in the UAE. Accordingly, there is no express requirement that certain funds must be used in acquisitions.

In the DIFC, a financial free zone in the Emirate of Dubai, acquisitions are governed by the Takeover Rules Module of the DFSA Rulebook, which also does not prescribe the use of certain funds.

Although an offeror does not need to confirm that funds are in place for an acquisition, Central Bank Circular 25/2005 (as amended by Circular 2418/2006) restricts the amount of debt financing that may be used to acquire shares. In particular, it provides that, in an initial public offering, any debt financing provided to the subscribers cannot exceed 10% of the nominal value of the shares to be acquired, unless either the company or the bank receiving the subscription funds agrees to refund excess subscription funds to the lending bank (in which case, the lending limit would be 50% of the nominal value of the shares). Also, loans extended against the pledge of allotted shares in a public subscription of a newly established company may not exceed 70% of the book value of the shares. Finally, borrowers may utilise debt financing to acquire up to 50% of founder shares in a private company and 80% of the shares in a company that has been operating for at least five years.

4. Tax

4.1 Withholding Tax

There is no withholding tax in the UAE.

4.2 Other Taxes, Duties and Charges

Tax

The principal difference in the treatment of local and foreign commercial banks is that local banks are not subject to any taxation on their income, whereas foreign banks are subject to tax at the emirate level. Additionally, a foreign bank may not establish more than eight branches in the UAE. The tax paid by banks varies from emirate to emirate and also within each emirate where certain banks are allowed to make annual payments of an agreed sum without reference to the level of profits or losses. Generally, banks are required to pay a tax of 20% on net profits arising in the particular emirate.

The government of Dubai issued Regulation No. 2 of 1996 (Regulation No. 2) setting out guidelines to be used by branches of foreign banks in calculating income tax due to the government of Dubai from taxable income arising from the conduct of business in the Emirate of Dubai.

Foreign banks operate in the Emirate of Dubai pursuant to special arrangements with the government. Generally, foreign banks are required to pay 20% of their net profits to the government of Dubai as income tax. Regulation No. 2 enumerates the permissible deductions that foreign banks may take in determining taxable income. For example, a foreign bank may not deduct more than 2.5% of its total revenue in any year for head office charges and regional management expenses combined. Furthermore, centralised or shared expenses (including regional management expenses) of foreign branches of banks operating in Dubai may be deducted on a prorated basis. Head office expenses must be reflected in the Dubai branch's books and certified by the external auditors of the bank's head office.

The guidelines also set out acceptable methods for calculating 'doubtful debts', losses, amortisation of assets and capital expenditures. Losses may be carried forward and set off against taxable profits in the next tax year. Losses, however, may not be deducted from a previous year's tax obligation.

Branches must file an annual tax declaration together with audited financial statements. The financial year for foreign banks operating in Dubai must be 1 January to 31 December. Taxes are due and payable to the Dubai Department of Finance no later than 31 March of the following year. The penalty for late payment has been fixed at 1% for each 30-day period that such payment is in arrears.

Fees

Registration fees are payable to the local emirate authority to register the security. Fees vary, depending on the authority, and form a percentage of the secured amount (for example, 0.25% of the value of the loan, for a real estate mortgage). These fees can be costly.

Enforcement of a security interest triggers court fees, prescribed by the relevant courts. If a secured asset is sold by public auction, a public auction fee is also payable.

Notarial fees for documents required to be notarised are 0.2% of the secured amount, up to a maximum of AED15,000.

4.3 Limits to the Amount of Interest

There no laws limiting the amount of interest. However, the courts of the UAE generally permit the charging of interest of up to 12% per annum.

5. Guarantees and Security

5.1 Assets Available and Forms of Security

The creating of security interests in the UAE (outside the free zones) is principally governed by: UAE Federal Law No. 5 of 1995 relating to the law of Civil Transactions (Civil Code) The Commercial Code

There are several free zones in the UAE and each free zone has its own regulations for creating security interests by entities licensed within that zone and/or over property located within it. However, in relation to free zones, we have restricted our review to the creation and enforcement of security interests in the JAFZ, the first free zone in the UAE, around which the laws and procedures of most other free zones are modelled. For security interests created in the DIFC, see below, 'Security in the DIFC'.

The general forms of security over assets include:

(i) real estate;
(ii) tangible movable property;

(iii) financial instruments;
(iv) claims and receivables;
(v) cash deposits; and
(vi) intellectual property. These forms of security and related formalities are outlined below.

Real estate
Real estate constitutes land and permanent structures on land that cannot be moved without suffering damage or alteration.

The most common categories of real estate and real estate interests over which security can be granted are:

- Freehold land
- Buildings and construction on freehold land Leasehold interests in land
- Buildings and construction on leasehold land
- Usufruct (that is, the right to use (including develop), enjoy and occupy land or property belonging to another person for a fixed term)

Mortgages over freehold land are generally registered with the land department in the relevant emirate (for example, in Dubai, this would be the Dubai Land Department). In addition, some free zones provide their own mechanism for registering a mortgage over freehold/leasehold interest relating to property located within that free zone.

There are three types of mortgage over real estate in the UAE – a mortgage over:

- Land and buildings
- A leasehold interest in real property
- A building constructed on leased land

A mortgage is defined in the Civil Code as a contract by which a creditor acquires the right to be satisfied from the proceeds of the sale of the mortgaged real estate in priority to unsecured creditors and other secured creditors of the debtor. To have effect, a mortgage must be registered. The time of registration of the mortgage determines priority among mortgages over the same real estate.

The mortgagor must be the owner of the mortgaged property. It is not essential that the mortgagor be the principal obligor of the debt that is secured by the mortgage; the mortgagor can be a guarantor of the debt.

Legislation now exists in Dubai that, among other things, governs the registration of property and security interests by expatriates in certain demarcated zones. The Dubai Land Department has exclusive jurisdiction to register the following three types of title in the name of foreign nationals and foreign-owned companies in certain demarcated areas:

- Freehold
- Long-term lease (99 years)
- Usufruct (musataha), to receive the benefit from the property (up to 50 years)

The developer must register any disposition of an off-plan property in the Interim Register, which is maintained by the Dubai Land Department. The disposition of a completed property must be registered in the Real Property Register, also maintained by the Dubai Land Department. Both parties must attend the Dubai Land Department to complete registration. A disposition that is not registered in the Interim Register or the Real Property Register is invalid. Each unit owner (defined as a person who is registered with the Dubai Land Department as the owner, including the tenant under a long-term lease, of a flat, villa, house or other real estate) can create a mortgage over that unit in favour of a bank or financial institution.

The following are permitted:

- For UAE nationals: to own freehold title to land anywhere in Abu Dhabi
- For nationals of the GCC: to own freehold title to land in certain demarcated areas

Law No. 19 of 2005 was amended in February 2007 to permit non-UAE nationals to:

- Own buildings in certain demarcated areas (but not the underlying land)
- Enter into a long-term lease agreement (up to 99 years) for real property in those demarcated areas under agreements
- Enjoy usufruct rights over real property under agreements of up to 50 years. Holders of usufruct rights in excess of ten years can sell or mortgage their interests without seeking the permission of the landowner.

In the JAFZ, a mortgage can be created over a building constructed on leased land.

Formalities – real estate
Mortgages over real property must be both:

- In writing
- Registered with the appropriate real estate authority in each emirate. The registered mortgage deeds are generally preprinted documents prescribed by the relevant authorities.

In the JAFZ, all land is owned by the Government of Dubai. The JAFZ Authority (JAFZA) leases land for construction of office premises and warehouses. Under the provisions of the standard lease agreement between the JAFZA and a lessee, the lessee can assign its rights under the lease in favour of a lender. All assignments of lease rights must be registered (using prescribed forms) with JAFZA.

Security in the DIFC
The DIFC is unique among the free zones as it has an entirely separate body of laws and regulations. The relevant security laws include:

- The Law of Security (DIFC Law 8 of 2005, as amended), which, subject to certain exclusions, applies to all transactions, regardless of their form, that create a security interest in personal or real property by contract
- The Real Property Law (DIFC Law 4 of 2007), which specifically covers mortgages over land
- The DIFC Security Regulations (Security Regulations)

To perfect a security interest in the DIFC, it must be filed in the Security Registry. If the security holder is a natural person, he must submit the following information to the registrar:

- His identity
- His residence and domicile
- Any other information required under the Security Regulations, for example, a financing statement

The Security Regulations also govern attachment, perfection and enforcement of a security interest in financial property.

Account holders can pledge eligible securities held in the Central Securities Depositary (CSD) of Nasdaq Dubai by submitting a pledge instruction to the CSD in favour of a pledgee. The CSD designates pledged eligible securities as being held to the order of and controlled by the pledgee. Nasdaq Dubai will not accept any instructions from the account holder unless otherwise instructed by the pledgee.

Tangible movable property
Tangible movable property includes:

- Machinery
- Trading stock (inventory)
- Aircraft and ships

Under the Commercial Code, all property that is not classified as immovable is considered to be movable property. Tangible property includes goods, inventory, stores and machinery. The Commercial Code provides for the creation of the following types of security interests over tangible (and intangible) movable property.

Business/commercial mortgage
A business/commercial mortgage is a mortgage of movable assets of an entity. It can only be created in favour of banks or other financial institutions. The definition of a business mortgage/commercial includes:

- All of a company's tangible movable property comprising:
  - goods
  - stores
  - machinery
  - tools

- All of a company's intangible movable property, such as:
  - contract rights
  - goodwill
  - trade name
  - intellectual property
  - licence rights

The mortgaged assets must be described in as much detail as possible. If they are not, only the following intangible property is deemed mortgaged (Commercial Code):

- Trade name
- Contract rights
- Goodwill

Real estate owned by the business is not covered by a business mortgage. However, the landlord of the premises has a lien over the mortgaged assets in the leased premises for unpaid rent (subject to a maximum of two years' rent) in priority to the mortgagee's rights.

Chattel mortgage
Unlike the business/commercial mortgage, the chattel mortgage, also known as a commercial pledge cannot either:

- Be perfected through registration; or
- Mortgage intangible assets of a company

A chattel mortgage is a pledge over movable property. A chattel mortgage can be created over: Stock in trade or inventory Movable plant and machinery ReceivablesNegotiable instruments

Other mortgages
In addition to the above, mortgages can be granted and registered over:

- Vehicles
- Vessels
- Aircraft

The UAE is a signatory to:

- The Convention on International Interests in Mobile Equipment (Cape Town, 2001) (Convention)

- The Protocol to the Convention on Matters Specific to Mobile Equipment (Cape Town, 2001) (Protocol)

Security over movables in the JAFZ
A business/commercial mortgage can be created by a JAFZA-licensed entity over its business and/or specific assets can be registered with the JAFZA.

Formalities – tangible movable property
Business/commercial mortgage
To be valid and effective, a business mortgage must be registered in the Commercial Register (only the Emirates of Dubai and Abu Dhabi currently register business mortgages in the Commercial Register). Once registered, the mortgage is valid for five years.

Chattel mortgage
To create a chattel mortgage, possession of the pledged asset must be transferred to the pledgee or a third party (that is, the bailee).

A mortgage over a vessel can be created by a notarised instrument that must be registered in the register of ships (in the jurisdiction where the vessel is registered). Vessel mortgages in the UAE are created under the Commercial Maritime Law No. 26 of 2981 (as amended by Law No. 11 of 1988) (Maritime Law). The Maritime Law permits the mortgage of a vessel if its total tonnage exceeds ten tonnes. A vessel being mortgaged in the UAE must be registered with the National Transport Authority (NTA). A UAE vessel mortgage must be created once both:

- A notarised vessel mortgage agreement is registered with the NTA; and
- The NTA has issued a new vessel registration certificate noting the mortgage registered in favour of the mortgage

A mortgage over an aircraft registered in the UAE can be created by submitting a copy of the executed aircraft mortgage agreement to the UAE General Civil Aviation Authority (GCAA). However, the UAE Federal Act No. 20 of 1991 promulgating the Civil Aviation Law (Civil Aviation Law) does not specify the formalities for the creation and registration of mortgages over the UAE-registered aircraft. However, in practice, the GCAA notes a mortgagee's interest over a UAE-registered aircraft. Once the mortgage is perfected, the GCAA issues a certificate of registration confirming the details of the owner, the operator and the financing bank as mortgagee. In addition to the registration of the mortgage with the GCAA, banks and financial institutions also require the registration of an additional security over the aircraft (airframe and engines) at the International Registry pursuant to the Cape Town Convention on International Interests in Mobile Equipment 2001 as adopted under UAE law. Such registration is effected through the GCAA, which acts as an Authorised Entry Point in relation to the International Registry for the UAE.

Financial instruments
Shares are the most common financial instruments that may be pledged as security. It is now possible to mortgage shares in a UAE limited liability company.

Commercial pledge
A commercial pledge can be granted over both:

- Negotiable instruments
- Nominative instruments (that is, documents with specified obligees)

Security over shares under the Companies Law
The Companies Law regulates the creation of mortgages and pledges over shares of public shareholding and private shareholding companies.

Under the Companies Law the shares of a private shareholding company may be pledged and perfected through registration. However, as at the date of this chapter the UAE governmental authorities have not created a register for such share pledges.

Pledge over shares in the JAFZ
The Implementing Regulations No. 1/92 (Free Zone Establishment Regulations) and Implementing Regulations No. 1/99 (Free Zone Company Regulations) provide for the creation of a pledge over shares of free zone establishments and companies respectively.

Formalities – financial instruments
A commercial pledge is created by endorsing the relevant instrument indicating that the instrument has been pledged and perfected by delivery of the relevant instrument to the pledgee.

Claims and receivables
The most common types of claims and receivables over which security is granted are receivables, income and insurances.

Formalities – claims and receivables
Under UAE law, an assignment of rights requires only notification from the assignor to the third party, confirming the assignment to the assignee. Where this is not possible or practical (for example, the assignment of income for a retail business), the banks may require such income to be deposited into a collection account (which will be covered by a pledge of the account).

Cash deposits
The most common form of security over cash deposits is a pledge.

Formalities – cash deposits
The UAE does not recognise the concept of a floating charge; therefore, a pledge over an account relates to the sums standing in the pledged account on the date of the pledge agreement. Consequently, banks usually require the pledge to be amended on a periodic basis or at the request of the bank, so as to pledge the new sums standing in credit in the pledged account.

Intellectual property
It is not common to grant security over intellectual property (IP) in the UAE. IP rights are generally only pledged by a commercial mortgage.

5.2 Floating Charges and Other Security Interests
The concept of security over future assets does not exist in the UAE. Therefore, a floating charge is not permitted. The assets to be pledged must be in existence at the time of the creation of the pledge.

As the UAE does not recognise the concept of a floating charge, a pledge over assets such as raw material stock in a warehouse that will be used to manufacture end products (for example, plastic pellets used in the manufacture of plastic products) may become indistinguishable. In these circumstances, the bank requires an assignment over income generated from the sale of the end products and may ask for any pledge over such assets to be amended on a periodic basis or at the request of the bank, so as to cover any changes in the quantity of the pledged assets. This would result in a new fixed charge over the revised quantity of the pledged assets.

5.3 Downstream, Upstream and Cross-stream Guarantees
- A parent company can guarantee, or grant a security in respect of, a loan given to a related company (that is, a company in the same corporate group), subject to two conditions:
- The parent company's constitutional documents contemplate a grant of this type of security.

Necessary corporate approvals (that is, board resolution and, where necessary, shareholders' resolution) are obtained.

A subsidiary can also guarantee, or grant a security in respect of, a loan to its parent, subject to the conditions above and the provisions outlined in section **5.4** below).

5.4 Restrictions on the Target
Under the Companies Law it is not possible for a target (whether a limited liability company or public joint stock company), or any of its subsidiaries, to provide any financial aid (e.g. loans, guarantees, etc) that would assist a purchaser in acquiring its shares. The Companies Law has just become effective and there is uncertainty regarding the mechanism for enforcement of this prohibition, and on how the UAE courts will view agreements that violate this prohibition.

Within the DIFC a company cannot provide financial assistance for a person to acquire shares in the company or a holding company of that company unless the financial assistance falls within certain exemptions provided for in the DIFC Companies Law.

The Companies Law prohibits:
(i) a company from making a loan of any kind to a director of the company and from guaranteeing the payment to a director of a loan made by any person to that director (including his spouse, children or relatives up to the second degree) and
(ii) a company from making a loan to another company, if a director of the lending company holds (including any shares held by his spouse, children or relatives up to the second degree) over 20% of the share capital of the borrowing company.

5.5 Release of Security
Most unregistered securities, particularly movable assets, are generally released by passing possession of the security asset back to the security provider, but can also be released with a release and discharge letter from the secured party. For registered securities (such as a land mortgage or vehicle charge) it may be necessary to follow the procedure of the relevant regulatory authority. There may also be additional requirements for securities registered with free zones.

5.6 Rules Governing the Priority of Competing Security Interests
Generally a lender that perfects its security (either through physical possession (in the case of moveable assets) or registration) shall have priority over other creditors in insolvency.

The two common methods of subordination are:

Contractual subordination: Subordination of debt is possible under UAE law. It is usually achieved by a subordination agreement between the senior and junior creditors.

Intercreditor arrangements: Intercreditor arrangements are common for syndicated financing. The parties to the intercreditor agreement would include the borrower, lenders, facility agent, security agent, lead arranger (if applicable) and obligors.

Please see **7.4** regarding survivorship of subordination agreements following insolvency.

6. Enforcement

6.1 Enforcing Collateral

The creation, registration and enforcement of various types of securities such as pledges, mortgages over real estate and chattels, assignments and guarantees are determined by provisions contained in both federal (UAE) and local emirate laws. At the federal level, the creation and enforcement of various types of securities is contained in the UAE Civil Code (the Law of Civil Transactions promulgated under Federal Law No. 5 of 1985), the UAE Commercial Transactions Code (Federal Law No. 18 of 1993) and other security-specific laws of the UAE, for example, the recently enacted UAE Companies Law (Federal Law No. 2 of 2015) contains provisions relating to pledges over shares, the UAE Federal Maritime Law (Law No. 26 of 1981) contains provisions relating to mortgages over vessels, etc. At the emirate level, each emirate has its own practices and procedures, the most developed of which are in the Emirate of Dubai. For example, several Dubai laws have been enacted with regard to the creation, registration and enforcement of real estate in Dubai (which provisions are not applicable in the other UAE emirates). The various free zones in the UAE and the Dubai Investment Financial Centre (DIFC) have specific laws and rules applicable in the relative free zone/DIFC. Under UAE law, security can only be created over assets that are in existence or can be clearly identified at the time of creating the security. Accordingly, it is not possible to create a floating charge over assets. The closest security to a floating charge is a commercial or business mortgage over the business assets of a UAE company which can be registered with the local Department of Economic Development. It is not possible to assign future unidentified receivables as security but receivables from an existing and identifiable source may be assigned. The UAE does not have a uniform real property law. Each emirate has its own laws in relation to real property. In Dubai, a freehold interest can be mortgaged and the security registered with the Dubai Land Department. Dubai also has special laws allowing enforcement of land mortgages. Emirates such as Sharjah restrict foreign ownership to certain Arab nationalities. Abu Dhabi allows foreign ownership in certain designated zones but not all nationalities can own an interest in the underlying land (only UAE nationals and nationals of the GCC states are allowed to own full freehold title). Abu Dhabi has yet to implement the necessary procedures to complete mortgage registration formalities in the designated zones. The UAE has a number of commercial registers where security interests may be recorded depending on the type of asset or entity against which the charge is recorded. There is no centralised system to search for a registered charge over an asset or against any person or entity. Furthermore, the authorities do not generally allow general public searches of the available register and such information is only provided to the grantor of the charge.

With regard to enforcement, as mentioned above, a suit in the relevant court in the UAE will have to be filed and a UAE court order obtained. The relevant court procedures will be applicable; with regard to the filing of a plaint, defence and other pleadings, documents in support and compliance will be required with any orders made by the court with regard to time limits, the appointment of an expert to investigate questions of fact and other relevant procedures. The court will have to be satisfied that all relevant requirements contained in the security document and/or the relevant laws have been complied with (for example the serving of relevant notices) by the party seeking enforcement. Although remedies are available in principle, enforcement in practice can sometimes take a long time and court decisions can be unpredictable.

6.2 Governing Law, Submission to Foreign Jurisdiction and Waiver of Immunity

With regard to a choice of governing law provision in a contract, UAE law recognises the principle that the parties to a contract may choose the governing law of the contract. Article 19 of Federal Law No. 5 of 1985 (the Civil Code) provides, in pertinent part, as follows (this unofficial translation):

"(1) The form and the substance of contractual obligations shall be governed by the law of the state in which the contracting parties are both resident if they are resident in the same state, but if they are resident in different states the law of the state in which the contract was concluded shall apply unless they agree, or it is apparent from the circumstances that the intention was, that another law should apply."

In practice, however, if an agreement with a foreign governing law provision is presented to a court in the UAE for interpretation or enforcement, such court may well apply UAE law, regardless of any contrary choice of law by the parties.

With regard to a choice of jurisdiction provision in a contract, UAE law recognises the principle that the parties to a contract may agree on the jurisdiction of a certain court to hear a dispute. For example, Article 31(5) of Federal Law No. 11 of 1992 (Civil Procedure Law) (as amended) provides that with the exception of certain cases (for example, real estate actions under Article 32 and other specified actions under Articles 34 to 39), the parties may agree on the jurisdiction of a certain court to hear the dispute.

There are, however, certain cases which are reserved exclusively for the jurisdiction of UAE courts. For example, under Article 6 of Federal Law No. 8 of 1980 (Labour Law), labour disputes must be referred to the UAE courts (if initial mediation proves to be unsuccessful). Similarly, Article 6 of Federal Law No. 18 of 1981 Concerning the Regulation of Commercial Agencies provides that any disputes between a principal and an agent regarding a commercial agency agreement must be heard by the UAE state courts, and that any agreement to the contrary will be considered invalid.

The Civil Procedure Law also provides for cases which are reserved for the jurisdiction of UAE courts. For example, Article 20 states that with the exception of cases related to real estate located outside the UAE, the UAE courts shall have jurisdiction over actions related to a party (foreigner or citizen) who has residence or domicile in the UAE. Article 21 defines certain circumstances in which the UAE courts will have jurisdiction over actions against foreigners who do not have residence or domicile in the UAE, provided that the action has certain minimum ties to the UAE, such as, inter alia, actions involving real estate in the UAE, actions related to an obligation that was made, performed or supposed to be performed in the UAE, or related to a contract to be attested in the UAE, and actions where one of the defendants has a residence or domicile in the UAE. Article 24 provides that any agreement that is inconsistent with these articles will be considered invalid.

Accordingly, whether or not a UAE court will enforce a foreign jurisdiction provision in a contract will depend largely on whether such a provision is consistent with the laws described above.

With regard to waiver of immunity, the doctrine of sovereign immunity does not expressly apply under UAE law. Foreign governments are therefore not immune from being the subject of a lawsuit in the UAE.

Although UAE law does not expressly provide for the immunity of UAE government entities, there may be preconditions that must be satisfied prior to filing a lawsuit against a government entity. For example, Dubai Law No. 3 of 1996 (the Government Actions Law) outlines the procedure that must be followed to file a civil action against the Government of the Emirate of Dubai or any of its departments. For example, under Article 3(d), the claimant must first submit the details of the dispute in writing to the Office of the Legal Advisor of the Government of Dubai.

At Federal level the ability of government departments to sue and be sued is recognised. Article 91 of the Civil Code, for example, provides that the State, the Emirates, municipalities, administrative units and public administrations shall be considered juristic persons unless otherwise provided by law. As juristic persons, these government entities can be sued as any other corporation, and are also provided with the right to sue under Article 93(2)(c).

It should be noted, however, that recovery against UAE government-owned assets is prohibited under UAE law. Article 247(1) of the Civil Procedure Law states that it shall not be possible to confiscate the public properties owned by the state or to one of the emirates. In addition, Article 3 of the Government Actions Law provides that no debt or obligation due by the Ruler or the Government may be collected through seizure or sale of state-owned assets, regardless of whether a conclusive judgment was issued on such debt or obligation or not.

6.3 Judgments and Arbitral Awards by Foreign Courts

Enforcement of foreign judgments in the UAE is governed under Federal Law No. 11 of 1992 (as amended) (Civil Procedure Law). Article 235 thereof provides for some prerequisites for the enforcement of a foreign award. Such conditions include, inter alia, that the UAE courts did not have jurisdiction to deal with the matter; that the foreign court which delivered the decision was authorised to do and did so in accordance with law; that the litigating parties were summoned to attend and were properly represented; and that the judgment of the foreign court does not conflict with a decision of the state courts, and does not breach morals or public order. Article 236 applies the same enforcement prerequisites to arbitration decisions delivered in a foreign country to the extent that the decision was rendered on an arbitrable subject matter (i.e. a subject matter capable of being arbitrated under UAE law).

UAE law provides that certain disputes cannot be arbitrated. UAE courts consider arbitrability to be a matter of jurisdiction. A tribunal that issues an award on a matter that is non-arbitrable under UAE law is considered to have acted outside the scope of its jurisdiction. Therefore, whether a foreign arbitration award can be enforced in the UAE will depend largely on the subject matter of the dispute, and whether it is arbitrable under UAE law.

For example, Article 203(4) of the Civil Procedure Law provides that it shall not be possible to arbitrate in matters in which reconciliation is not possible. That would generally include criminal matters, bankruptcy and matters of public policy. Under Article 3 of Federal Law No. 5 of 1985 (the Civil Code), public policy includes matters related to personal status such as marriage, inheritance and lineage, and matters relating to systems of government, freedom of trade, circulation of wealth, rules of individual ownership and other rules and foundations upon which society is based, in such a manner so as to not conflict with the fundamental principles of Islamic Shari'a. Article 733 provides more subjects, which mostly pertain to Islamic Shari'a and potentially usurious transactions, on which compromise cannot be reached as a matter of law, which include, inter alia, usury on credit granted and other credit and debt related subjects.

UAE law also provides for other subjects which are reserved exclusively for the UAE courts, and are therefore non-arbitrable. For example, under Article 6 of Federal Law No. 8 of 1980 (Labour Law), labour disputes must be referred to the UAE courts (if initial mediation proves to be unsuccessful). Similarly, Article 6 of Federal Law No. 18 of 1981 Concerning the Regulation of Commercial Agencies provides that any disputes between a principal and an agent regarding a commercial agency agreement must be heard by the UAE courts.

Therefore, any foreign arbitral award rendered on such subjects is unlikely to be enforceable in the UAE. Put another way, any foreign arbitration award rendered on such subjects can be challenged and possibly annulled in the UAE.

The UAE is, however, a party to several international treaties and conventions regarding the recognition and enforcement of arbitral awards. These include the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention); the Riyadh Convention on Judicial Co-operation between States of the Arab League; the GCC Convention for the Execution of Judgments, Delegations and Judicial Notifications; and the ICSID Convention on the Settlement of Investment Disputes between States and Nationals of Other States (1965).

The UAE ratified the New York Convention in 2006 without making any declarations or reservations. The New York Convention provides a mechanism which allows state parties to enforce arbitration awards made in one country in another country that is also a signatory to the Convention. Accordingly, under Article III of the Convention, UAE courts are required to "recognise" foreign arbitral awards (if issued in another country that is also a signatory to the Convention) "as binding and enforce them", unless the limited grounds to resist enforcement provided under Article V(1) can be proven by the party against whom enforcement is sought.

Enforcement of foreign judgments under DIFC law is possible under Article 7(4) of DIFC Law No. 12 of 2004 (Judicial Authority Law), which provides that judgments from jurisdictions other than the DIFC may be enforced by the DIFC courts in a manner prescribed by DIFC laws. Article 24(1)(a) of DIFC Law No. 10 of 2004 (DIFC Court Law) adds that DIFC courts have jurisdiction to ratify the judgments of recognised foreign courts. Furthermore, Article 24(2) states that if the UAE has a treaty agreement involving the mutual enforcement of judgments, the DIFC Court of First Instance shall comply with the terms of the treaty. Article 7(2) of the Judicial Authority Law No. 12 of 2004 provides that judgments of DIFC courts are to be enforced through the Dubai courts. The DIFC courts can therefore, subject to the above requirements, ratify a foreign judgment which can then be enforced through the Dubai courts. Whether there will be a retrial on the merits or not will depend on several factors including whether there is a treaty agreement with the country in which the foreign court sits, whether it provides for the mutual enforcement of judgments and the exact wording of the treaty.

With respect to enforcement of foreign arbitral awards, Article 24(1)(c) of the DIFC Court Law provides that DIFC courts may ratify a recognised arbitral award. This is confirmed in Article 42(1) of the DIFC Arbitration Law of 2008, regarding "Recognition and enforcement of awards", which provides that an arbitral award shall be binding on DIFC courts irrespective of the jurisdiction in which it was made. However, Article 44 provides various "Grounds for refusing recognition or enforcement" of an arbitral award, which include, for instance, the decision was not valid under the law governing the arbitration, one of the parties was not given proper notice, the arbitral procedure was not in accordance with the agreement of the parties, or enforcement of the award would be contrary to the public policy of the UAE.

The ability and willingness of DIFC courts to enforce foreign arbitral awards was confirmed in the two recent cases of Banyan Tree v Meydan Group LLC (Case No. ARB 003-2013) and X1 and X2 v Y1 and Y2 (Case No. ARB 002-2013).

6.4 Other Matters Impacting a Foreign Lender's Ability to Enforce its Rights

There is no distinction between a local and a foreign lender with regard to their ability to enforce their rights under a loan or security agreement, as long as the foreign lender has an office or branch in the particular emirate where it wishes to enforce its rights. Otherwise, the foreign lender would normally appoint a local security agent to hold the UAE-located security on their behalf. See **3.2**, **Structuring and Documentation Considerations**.

7. Bankruptcy and Insolvency

7.1 Company Rescue or Reorganisation Procedures

The UAE provides a framework for the restructuring and insolvency of commercial companies and traders, which is contained in UAE Federal Law No. 18 of 1993 promulgating the Code of Commercial Practice (the Commercial Code). As an alternative to a declaration of bankruptcy, the Commercial Code contemplates a voluntary restructuring of an insolvent company's debts, referred to as a composition or an arrangement. A composition can be agreed by creditors in the context of an ongoing bankruptcy proceeding, or an application for a composition may be made prior to a declaration of bankruptcy. A composition can only take place with the agreement of the creditors that participate in such arrangement and the fulfilment of the conditions prescribed by the Commercial Code. A composition may be concluded on condition of payment if the debtor becomes solvent within five years of the date that the composition takes effect. The composition may include granting to the debtor periods of grace for payment of debts and waiver towards a debtor of a part of the debt. The creditors may demand that one or more guarantors be offered to guarantee the implementation of the conditions of the composition. All the effects of bankruptcy are removed with the pronouncement of the court decision to ratify the composition; however, this does not affect any criminal prosecution.

In the case of a company, proposals for a composition or arrangement must be approved by a majority of partners in general and limited partnerships, and with the approval of the extraordinary general meeting of shareholders in other types of companies.

7.2 Impact of Insolvency Processes on Lenders Right's to Enforce

The pronouncement of the bankruptcy judgment results in the suspension of individual proceedings and actions brought against the bankrupt by ordinary creditors or preferred creditors. When a bankruptcy judgment is pronounced, all monetary debts owed by the bankrupt become payable, whether ordinary or secured by a general or particular charge. However, any interest on ordinary loans due to the group of creditors ceases when the bankruptcy judgment is pronounced. Interest may not be claimed on loans secured by a mortgage or lien, except in respect of sums arising from the sale of the assets on which the loans are secured.

The names of creditors of the bankrupt who have debts secured by a chattel mortgage or lien, or by mortgage over real property, are entered in the group of creditors with reference to the mortgage or lien, and such creditors enjoy priority of repayment from the proceeds of sale of the mortgaged assets. At the proposal of the trustee in bankruptcy, the judge supervising the bankrupt's estate may, where necessary, order that the first funds entering the bankrupt's estate (regardless of whether it is from the proceeds of sale of the mortgaged assets) be used to pay the sums due to creditors with debts secured on the chattels of the bankrupt (provided that their names are included in the final list of uncontested debts). If a mortgage chattel is sold at the request of the mortgagee (i.e. the mortgage creditor) and the price exceeds the debt, the trustee in bankruptcy must receive the surplus for the account of the group of creditors. If the price is less than the debt, the mortgage creditor shares in the bankrupt's estate for the remaining amount as an ordinary creditor, provided that the debt arose in accordance with the provisions of law. The mortgaged chattel may also be sold at the request of the trustee, with the consent of the judge overseeing the proceedings, and the allocation of proceeds from such sale will be as above.

The same applies to the sale and use of proceeds of real property.

7.3 Payment of Creditors

In the course of bankruptcy proceedings, preference is given to the following:

- wages and salaries due to workers and staff for the period of 30 days prior to the declaration of bankruptcy;
- amounts due to a trustee in bankruptcy where the trustee in bankruptcy pays a debt of the bankrupt from his or her own funds or, if the debt is paid by another person, the debt is paid from the first monies to enter the bankrupt's estate;
- payment of government taxes due from the bankrupt for the two years preceding the pronouncement of the bankruptcy judgment; and
- certain rent payments to the owner of premises leased to the bankrupt.

7.4 Risk Areas for Lenders

Transactions entered into by the insolvent debtor during the "preference" or "suspect" period (under the Commercial Code) before the announcement of bankruptcy can be set aside by the court or trustee in bankruptcy. The duration of the preference period, however, is unclear.

The Commercial Code refers to a suspension of payments date, which is a notional date before the court's declaration of bankruptcy. Transactions by the insolvent debtor after this date can be challenged. The Commercial Code does not specify the date of suspension of payments and appears to leave determination of this date to the bankruptcy court. Therefore, a bankruptcy court determines the date on a case-by-case basis, subject to the following bases:

- If the bankruptcy judgment does not specify the date of suspension of payments, the date of the bankruptcy judgment is deemed to be the date of suspension of payments.
- If the debtor has died, gone out of business or lost his legal capacity before pronouncement of the bankruptcy judgment, the date of the debtor's death, going out of business or loss of legal capacity is deemed to be the provisional date of suspension of payments.
- The court can amend the provisional date for suspension of payments to a date "ten days after the date on which the verified list of debts is deposited with the court clerk's office".
- The cut-off date (that is, the date of suspension of payments) cannot precede the date of the bankruptcy judgment by more than two years.

However, it should be noted that the critical date is the date of the "bankruptcy judgment". Bankruptcy judgment appears to mean the court's determination that the relevant party meets the statutory bankruptcy criteria (set out in Article 645(1) of the Commercial Code), as opposed to the final decision regarding the distribution of assets to creditors.

In the bankruptcy judgment, a civil court must state that the relevant party "fails to pay his commercial debts by their due dates because his financial status has deteriorated and his credit undermined". Considering the nature of civil court proceedings in the UAE, this statement will take a substantial amount of time after the filing of a voluntary or involuntary bankruptcy petition. Interested parties (that is, creditors) will therefore have the opportunity to present evidence regarding:

- The substantive question as to whether the relevant party should be declared bankrupt.
- The date of suspension of payments.

A bankruptcy court in the UAE therefore appears to have discretion to set aside certain actions by a grantor of security during a period of up to two years before the declaration of bankruptcy under the circumstances set out in the Commercial Code or if the court determines that both:

- Such actions were harmful to the creditors of the grantor of security.
- The lenders were aware at the time that the grantor of the security was insolvent.

However, the following actions are not binding on the insolvent debtor's creditors if they are taken during the suspect period:

- Donations, with the exception of small customary gifts.
- Payment of any term facilities before the due date.
- Payment of immediate debts other than in the form agreed.
- Granting a mortgage or any other charge on the insolvent debtor's assets to secure a prior debt.

Further, an insolvent debtor's transaction (subject to Article 696) during the suspect period can be ruled as unenforceable against the creditors if the following requirements are met:

- The transaction is harmful to the creditors.
- The party to whom the disposal was made was aware, at the time, of the debtor's insolvency. An insolvent person is someone who "uses extraordinary or illegal means to settle his debts, thus indicating that his financial situation is bad".

8. Project Finance

8.1 Introduction to Project Finance

Project finance is generally defined as the development of a capital-intensive infrastructure project, which is typically structured on a limited recourse financing basis. In a limited recourse financing structure, the borrower is a special purpose vehicle created for the specific purpose of the project, repayment is achieved through the cashflows generated by the project itself, and security is guaranteed principally by the project assets. These structures are found in markets where the local government requires private capital for development of infrastructure projects.

The parties involved in a standard project finance deal include: the project company itself, which serves as the vehicle to borrow, hold equity interests, and carry out the project; the project developer and main sponsor, which leads the role of developing the project; the other sponsors that take an equity interest in the project; the lender(s) that provide debt financing for the project; and the contractor(s) that execute the project.

Most infrastructure projects in the UAE are carried out by wholly or partially government-owned entities, and to the extent that a government entity is serving as the project developer, the project is typically self-financed. This is the case with almost all of the public-works projects, oil and gas projects, and power plants, including renewable energy. As a result, there is limited scope for pure "project finance" plays within the local market (with certain exceptions), and such structures may be found where there is a policy to develop a capital market (as opposed to a budgetary constraint).

The exceptions to this standard include some power, water and infrastructure facilities structured through public-private partnerships (PPP), and other privatisation initiatives, which are discussed later in this chapter. Most privately funded real estate and tourism projects are funded on a corporate or full-recourse basis, and are therefore not discussed in this chapter.

The UAE is a highly regulated market, where the legal framework regulates the activities of each stakeholder in a project finance deal. The regulations differ, depending on the nature of the project and its sponsors. Where the project developer is a government-owned entity, it must comply with the relevant enacting legislation. In the case of a private entity, the project must comply with local licensing requirements. Furthermore, commercial project lending must comply with standard banking and financial regulations. Contractors, regardless of the public or private nature of the project, are also subject to local licensing and operating requirements.

This chapter will focus on the relevant legal framework applicable to project developers, sponsors and lenders in privately funded and PPP-style projects, and to contractors in both government and private projects, with an emphasis on the special considerations that foreign entities need to consider when operating in the region.

8.2 Public-Private Partnership Transactions

PPPs and IPPs are not common structures in the UAE, and there is no applicable federal legislation, though there are emirate-level laws in Abu Dhabi and Dubai.

In Abu Dhabi, the Abu Dhabi Water and Electricity Authority (ADWEA) has used PPP initiatives in transport and other infrastructure sectors, and it has been implementing a long-term programme of privatising the electricity sector. Independent water and power producers (IWPPs) have been established in Abu Dhabi as joint venture arrangements between ADWEA and various international power companies on a build-own-operate (BOO) basis, where the long-term contractual arrangements commit the IWPPs to sell their production to ADWEC (a subsidiary of ADWEA).

The major IWPPs include Al Mirfa Power Company, Arabian Power Company, Emirates CMS Power Company, Emirates SembCorp Water and Power Company, Fujairah Asia Power Company, GulfTotal Tractebel Power Company, Ruwais Power Company, Shuweihat Asia Power Company PJSC, Shuweihat CMS International Power Company, Shams Power Company PJSC and Taweelah Asia Power Company.

The structure of the IWPP ownership is split between ADWEA and the foreign investor, where the majority ownership typically vests with ADWEA. Project companies are usually structured as joint-stock companies incorporated in Abu Dhabi, in accordance with local licensing requirements, which are discussed later in the chapter. The most common ownership structure is one where ADWEA incorporates an intermediate holding company to own a 60% stake, which in turn is held 10% by ADWEA and 90% by the Abu Dhabi National Energy Company PJSC (also known as TAQA), though some project companies have other structures.

The Shuweihat S2 power plant was commissioned in October 2013, adding a further 1,510MW to Abu Dhabi's power generation capacity, and 100 imperial gallons of potable water daily. The electricity and water supply from Shuweihat S2 plant will be purchased by ADWEC under a 25-year power and water purchase agreement.

Dubai recently passed its Dubai Electricity Privatisation Law, which allows the private sector to participate in energy generation. The law authorises the Dubai Electricity and Water Authority (DEWA) to establish project companies, by itself or with third parties, to generate electricity. The only independent power project launched to date is Al Hassyan 1 IPP, which is a 1,600MW gas-fired power plant, for which bids were solicited in December 2011. DEWA plans to retain a 51% ownership stake in the project, which is one of six planned IWPPs in Dubai forming part of a power and water complex with total projected capacity of 9,000MW.

There are also laws in Dubai empowering the Dubai Roads and Transportation Authority to create PPP arrangements.

8.3 Government Approvals, Taxes, Fees and Charges

Part of the legal framework for a project finance transaction in the UAE involves: obtaining government approvals for the project; complying with registering and filing requirements for the transaction documents; and for foreign sponsors, meeting local corporate ownership requirements.

Given that the UAE is a federal structure, with powers divided between the federal government and each of the seven constituent emirates, government approvals may be required at both the federal and local level. Relevant federal ministries include the Ministry of Public Works, the Ministry of Energy and the Ministry of Environment and Water. At the emirate level, there are different authorities involved. For example, in Dubai, the relevant authorities, depending on the project, include the Dubai Electricity and Water Authority (DEWA), the Dubai Road and Transport Authority, and the Dubai Telecommunications and Regulatory Authority.

Foreign sponsors that do not have a local presence must take into account that the project company will likely have to be a UAE company, subject to UAE law. UAE companies must be majority owned by a UAE citizen (a UAE national(s) or a company wholly owned by UAE nationals), under the UAE Commercial Companies Law (Federal Law No. 2 of 2015, which recently replaced Law No. 8 of 1984). The law dictates that a UAE company can only have a maximum of 49% foreign ownership, with the majority 51% stake to be owned locally. However, it is not uncommon for foreign investors to hold more than 51% of the beneficial interest in local companies through side agreements with the local majority-owning partners, whereby management power and economic interest in the shares is transferred to the foreign investor.

PPP structures, however, will clearly define the ownership interest in a project, as such structures will be formed in accordance with a direct government policy in such regard.

Free-zone companies can be 100% foreign owned, but are not allowed to conduct business outside the free zones and within UAE proper. Use of such entities as project companies is therefore presently not conducive.

Contractors also must take into account local licensing requirements. In addition to the basic corporate structuring requirements discussed above, contractors, whether local or international, must be licensed to carry out their activities in the relevant emirate. This licensing requirement applies to all UAE companies, regardless of their activity. The application for construction-related licences is a more cumbersome procedure with different requirements in each emirate. This applies to contractors, subcontractors, architects, civil engineers, project managers and engineering consultants.

The licensing process will begin with an application that includes, among other things, proof of experience (past projects, length of experience), demonstration of minimum capital requirements, and corporate documentation. Approvals will then be required from the relevant authorities regulating the particular activity, and licences to carry out government projects require additional layers of approval. Additional requirements will apply if there is an environmental impact (discussed later in the chapter). After the entire procedure is complete, the licence will be issued, and the types of licences cover the standard types of construction activities, including building contracting, road contracting, marine contracting, electrical power station contracting, and others. In some case, however, licences will not be issued to foreign contractors at all. In these cases, arrangements can be made with existing local contractors to work together on a partnership basis.

Transaction documents in a project finance deal consist primarily of the contractual arrangements between the shareholders, such as the shareholders' and subscription agreement, the construction documents and the security package.

The contractual arrangements between the shareholders for a local UAE project company will include a Memorandum and Articles of Association, which must be filed with department of economic development in the relevant emirate. In the context of companies with foreign investors, due to the nature of the arrangements described above, the substantive provisions of this document have minimal impact. Instead, it is the side agreements and the shareholders' and subscription agreement that have importance, and these are not filed. These documents, to the extent that they are between the foreign shareholders, and not the UAE national or UAE national company, can be subject to foreign law; however, it is important to note that if brought before a UAE court, the court may elect to exercise jurisdiction.

The security package taken by lenders in the UAE is typical of the norm in other jurisdictions, and will be subject to UAE law. It will likely include a commercial mortgage over plant, machinery and other company assets, which will be a fixed charge, as UAE law does not recognise the concept of a floating charge, and a legal mortgage over the land or site, which may take the form of a sub-usufruct, which is the right to use, enjoy and occupy land or property belonging to another entity for a fixed term.

The construction documents in a project finance deal in the UAE are, like other jurisdictions, commonly based on one of the International Federation of Consulting Engineers (Fédération Internationale des Ingénieurs-Conseils) (FIDIC) forms of contract. However, where contractors are working with a government-owned entity as the sponsor, there may be exceptions. For example, in Abu Dhabi, contractors must work with the Abu Dhabi Government Conditions of Contract for construction or design and build contracts, which were introduced in 2007, and are based on the 1999 FIDIC Red and Yellow Books respectively, with shifts in the risk allocation upon the contractor. In Dubai, many government departments, including the Roads and Transport Authority and the Dubai Municipality, have their own conditions of contract, which again are based on the FIDIC form with increased risk transferred to the contractor. Finally, it is not uncommon to have contracts that are not based on the FIDIC template.

8.4 Responsible Government Body

As discussed, project finance deals are subject to the regulatory oversight of the relevant government bodies. The UAE is a federal system composed of seven individual emirates, and the division of power between the federal and emirate governments is enumerated in the State Constitution of 1971. To that end, there are federal authorities and individual emirate authorities that play roles in any given project.

By way of example, the generation, transmission and distribution of electricity in the UAE is regulated and requires specific licences from the relevant government authorities. In Abu Dhabi, private sector participation in the electricity sector is regulated by Law No. 2 of 1998 Concerning the Regulation of the Water and Electricity Sector, as amended by Law No. 19 of 2007 and Law No. 12 of 2009. Pursuant to this law, the Electricity Regulation and Supervision Bureau of Abu Dhabi has the power to:

(i) issue licences to conduct regulated activities,
(ii) monitor licences and ensure compliance with terms of licences issued, and
(iii) make regulations as it sees fit for the regular, efficient and safe supply of electricity in the emirate. As part of the licensing process, there are fees, charges, and registering and filing requirements.

As discussed, there is a history of state ownership for most infrastructure projects.

8.5 Structuring the Project Company

For privately funded projects with foreign sponsors, other than PPPs (whose structure will be formed in accordance with a direct government policy in such regard), a structure needs to be created that complies with local majority ownership requirements (as discussed), and financing arrangements are typically on a corporate or full-recourse basis.

Foreign sponsors have different options for structuring their investment into the project. A foreign investor can become a direct shareholder in the UAE project company, and if there are multiple investors, they can create a holding company above the project company level that will serve as the shareholder in the project company. The advantage of the latter structure (for either individual or multiple investors) is that the holding company can be incorporated in a foreign jurisdiction (e.g. a straightforward offshore jurisdiction such as the British Virgin Islands), which will enable a smoother process, compared to that of the UAE, for share transfers and other corporate actions, and if agreed between the parties, disputes regarding the shares can be adjudicated outside of the UAE.

Foreign contractors can enter into joint ventures with local contractors, where the foreign contractor and the local contractor can either set up a holding company to hold their interests in a UAE company that will be licensed to carry out the construction work, or contractual arrangements can exist outside of the framework of the UAE company. The advantage of the former position is that the foreign contractor will have a direct interest in the local company. Joint ventures can also be based on partnership arrangements. Smaller projects can also be carried out by a single established local entity, where a foreign contractor is the sole shareholder.

The financing arrangements for privately funded projects are typically financed on a corporate or full-recourse basis. This is in contrast to the large PPP-style projects that are typically seen in the power and water sector (discussed above), where traditional project finance limited-recourse financing is used. Lenders can be local, international, or a syndicate of both, and they generally follow the precedents of the Loan Market Association. The unique aspect of project finance in the UAE is the use, in some projects, of Islamic financing structures, such as the sukuk, which is a hybrid debt-equity product. As discussed, government projects are largely self-financed.

8.6 Acquisition and Export of Natural Resources

The major natural resources in the UAE are oil and gas. The UAE is one of the world's leading producers and exporters of oil, and has the world's fifth largest gas reserves. The Emirate of Abu Dhabi is home to the largest gas production and the vast majority of the country's oil reserves.

According to the State Constitution of 1971, the acquisition and export of natural resources in the UAE is governed on the emirate level, and not the federal level. Therefore, the individual emirates have the authority to determine how to exploit the natural resources within the emirate.

In Abu Dhabi, oil affairs are governed by the Supreme Petroleum Council in Abu Dhabi, and by the individual Ruler's Office in each of the other six emirates. Oil production in the UAE today is a public sector activity engaged in by government-owned entities and holders of government concessions, which include the traditional oil majors (BP, ExxonMobil, ConocoPhillips, etc).

The regulation of oil in the UAE is largely addressed by the individual concession agreements and other agreement with the major oil companies, and not general laws and regulations. Some of these agreements date back to the 1930s.

A recent development in this regard is that Abu Dhabi's 75-year-old onshore oil concession expired on 10 January 2014, ending its existing partnership with BP, Royal Dutch Shell, ExxonMobil, Total and Portugal's Patex Oil and Gas.

These oil majors are now somewhat at risk, as they no longer have direct interests in the onshore oil deposits of Abu Dhabi.

Like oil, in Abu Dhabi, gas affairs are governed by the Supreme Petroleum Council as well, and in the individual emirates, by the Ruler's Office. Gas is produced by the three major operating companies in Abu Dhabi, all of which are majority-owned by the Abu Dhabi National Oil Company.

Gas is regulated at the emirate level and all activities involving natural gas require permits issued by the authorities in the relevant emirate.

8.7 Environmental, Health and Safety Issues

As with other laws and regulations in the UAE, health, safety and environmental laws exist at the federal and emirate level. Federal laws are meant to prevail over emirate laws in the event of conflict; however, this is not always observed in practice. Most health and safety laws are found in the UAE Labour Law, and some are also contained as criminal offences under the UAE Penal Code.

The relevant health and safety laws are standard provisions that require adequate safety measures to be taken at site, access to safe drinking water and hygienic facilities, and hazardous conditions. An example of emirate-specific legislation is Dubai's Code of Construction Safety Practice (Guidelines for the Construction Industry in the Emirate of Dubai).

An entity pursuing a project in the UAE must consider if there is an environmental impact and, if so, apply to the Ministry of Environment and Water (a federal authority) to seek a licence. The relevant federal legislation is Law No. 24 of 1999 for the Protection and Development of the Environment (Environment Law). There are other federal laws on the books as well. The local authorities, such as the Dubai Municipality, also have their own rules and regulations.

9. Islamic Finance

9.1 Overview

Although the modern Islamic financial industry has only been in existence for the past 40 or so years (compared to the 300 years plus for the conventional finance industry), it has gained a substantial foothold in the global market and is a major component of the financial industry in the UAE. Whilst the use of Islamic financial products has rebounded following the 2008 market downturn, with certain financial products (e.g. sukuks) seeing double-digit annual growth, Islamic finance still represents less than 1% of the global financial market.

Realising the potential growth in the Islamic finance industry, in October 2014 the Government of Dubai set itself the goal of becoming the global capital of Islamic finance, goods and services within three years, and has appointed a team of its own leading executives to achieve this goal. Various parts of the economy have played a part in establishing Dubai as the leader of the Islamic finance industry, including:

- governmental bodies (e.g. the Insurance Authority (issuing regulations on takaful products), Central Bank (issuing regulations on issuance of sukuks) and the Dubai Land Department (which has issued separate rates for registering interest under Islamic financing products);
- UAE capital markets (e.g. Nasdaq Dubai and the Dubai Financial Market – both issued rules and guidance on sukuk documentation and issuance procedure, on their respective markets); and
- free zones (e.g. the DIFC has implemented regulations for the provision of Islamic finance products within the DIFC).

9.2 Regulatory and Tax Framework

See section **9.3** below regarding regulatory framework for Islamic finance and takaful operators.

Whilst certain governmental entities, free zones and capital markets in the UAE have issued rules and regulations in connection with the provision of Islamic financial products (see section **9.1** above) and certain organisations have established non-binding guidance on Shari'a compliance of Islamic financial products, there is still no universal set of binding rules and regulations relating to Islamic financial products. In practice, Islamic financial institutions will still seek guidance from their internal Shari'a supervisory board (see section **9.3** below); this can be problematic when arranging syndicate financing amongst Islamic banks/financial institutions, as there may be differences of opinion between the Shari'a boards on the application of Shari'a principles to the financing structure.

In the short term, cash-rich Islamic banks and financial institutions have been successful in expanding their market share in the GCC. However, the medium to long-term prospects of the Islamic finance industry, both in the GCC and internationally, will hinge on, amongst other things, its ability to:

(i) implement cross-border recognition of Islamic finance products (including legal/tax status and actions on liquidation);
(ii) reach a consensus on market standards applicable to Islamic finance products/documentation; and
(iii) secure sufficiently qualified professionals. Whilst Dubai has taken steps to address these issues at the local level, it still needs to take the lead and work across borders to secure regional and eventually global agreement on the above issues.

The sukuk market has been growing exponentially and is expected to dominate Islamic capital markets for the foreseeable future. However, a number of issues remain, particularly around potential enforcement action, in the event of a default under the sukuk certificates. The fact that:

(i) the originator (i.e. entity seeking funding under the sukuk issuance);
(ii) the sukuk issuer (usually an SPV (based in a tax-efficient jurisdiction) which issues the sukuk certificates);
(iii) the arranger (i.e. the Islamic bank arranging the sukuk issuance);
(iv) the actual assets that are being acquired/invested under the sukuk programme;
(v) the investors; and
(vi) the issuer's manager; may all be in separate jurisdictions could create a considerable amount of confusion for the investors, in the event that there is a default under the sukuk certificates and the investors need to enforce their rights under the sukuk certificates. This is in contrast to the position under conventional bonds, which provide a market standard mechanism for enforcement of the investors' rights, in the event of a default under the bond.

9.3 Islamic Bank and Takaful Operator Regulation

Islamic banks

The Islamic Banking Law (see section **2.1** above) contains provisions relating to the establishment and operation of Islamic banks.

With respect to Islamic banks, permissible activities are not specified in the Islamic Banking Law, which provides that Islamic banks means those whose memorandum of association includes a commitment to abide by the provisions of Shari'a and conduct their activities in accordance therewith. Islamic banks have the right to carry on all or part of banking, commercial, financial and investment services and operations. They have the right to engage in all types of services and operations practised by banks and referred to in the Banking Law whether those operations and services were conducted for the Islamic bank's own account or for or in partnership with a third party. Islamic banks also have the right to establish companies and participate in enterprises provided that activities of the latter are in conformity with Shari'a. The Islamic Banking Law provides that Islamic financial institutions and investment companies shall have the right to carry out lending, credit and other financial operations. They may also participate in enterprises, invest their funds in moveable assets and receive deposits for investment thereof in accordance with the provisions of Shari'a. In terms of the Islamic Banking Law, Islamic banks are subject to the provisions of the Banking Law (see section **2.1** above).

Each Islamic bank, financial institution and investment company must appoint a Shari'a Supervisory Board (the Shari'a Board) consisting of at least three Shari'a scholars specialised in Shari'a law and finance, to ensure that its operations and products comply with the rules and principles of Shari'a. The Shari'a Board will review all proposed financial product and related documents, and issue a fatwa (opinion) on the Shari'a compliance of the same. Once the financial product has received the approval of the Shari'a Board, it can be offered by the Islamic bank/financial institution to the public in the UAE.

Takaful companies

Under Federal Law No. 6 of 2007 regarding the Establishment of the Insurance Authority and Organisation of its Operations (the Insurance Law), the UAE Insurance Authority (the Insurance Authority) was identified as the regulator for the insurance industry in the UAE (outside of the free zones), including takaful insurance, and tasked with promoting the role of the insurance industry to indemnify persons, property and liabilities against risks to ultimately protect the national economy; accumulate and grow national savings and invest them to support economic development in the UAE; encourage fair and effective competition; provide the best insurance services with appropriate coverage at affordable rates, and achieve job emiratisation (i.e. job creation for Emiratis) in the UAE insurance market.

The Insurance Authority issued Decision No. (4) of the Insurance Authority's Board of Directors for the year 2010 regarding the Takaful Insurance Regulations, which outlined rules designed to regulate the work of takaful insurance companies and can be summarised as follows:

- All insurance and investment transactions by the takaful insurance company must be compliant with the provisions of Shari'a.
- Takaful products may not be offered through an "Islamic window" of a conventional insurance company.
- Risk management operations and investment business shall be conducted by the company on wakala or wakala and mudaraba together.
- Family takaful insurance and general insurance may not be combined in one takaful insurance company. The existing takaful insurance companies currently engaged in both types were given a specific deadline to adjust their positions.
- The shareholders' fund is committed to provide a qard hasan (i.e. interest-free loan) to the participants' fund in case of a deficit in the assets of this fund.
- The maximum amount of qard hasan is the sum of shareholders' equity.
- The amount of wakala fees and how it is calculated, as well as the takaful insurance company's share of mudaraba, must be stated in advance.
- A Shari'a supervisory committee must be formed in each takaful insurance company.
- The Supreme Committee for Fatwa and Shari'a Oversight was formed within the Insurance Authority.
- It is necessary to appoint a Shari'a controller within each takaful insurance company.

Decision No. 26 of the Insurance Authority's Board of Directors for the year 2014 regarding the Financial Regulations for Takaful Insurance Companies outlined various financial standards required from takaful insurance companies, including:

(i) the solvency margins and guarantee fund,
(ii) basis of calculating the financial provisions,
(iii) determining the takaful operator's assets that meet the accrued insurance policies,
(iv) the accounting standards adopted by the takaful operator and
(v) the records and documents to be maintained by the takaful operator, which shall be made available to the Insurance Authority upon request.

Takaful insurance companies are required to comply with the provisions of the Insurance Law and the above takaful regulations must be read in conjunction with the Insurance Law.

9.4 Framework for Shari'a-compliant Bodies and Transactions

From the perspective of financial institutions, Shari'a compliance can be achieved in various ways, including by way of adopting national regulation, voluntary Shari'a-compliant standards and the directives and resolutions of the firms' internal Shari'a supervisory boards.

Voluntary standards are issued by standard-setting bodies such as the Accounting and Auditing Organisation for Islamic Financial Institutions and the Islamic Financial Services Board. In practice, Islamic banks and financial institutions maintain an internal Shari'a supervisory board (generally consisting of three to five Shari'a scholars) to ensure that their practices are in line with the requirements of Shari'a. The role of the Shari'a supervisory board is to review the practices and financial products offered by an Islamic financial institution and issue fatwas (legal opinions), confirming that the Islamic financial institution's products and services are in compliance with the principles of Shari'a.

In determining whether or not a financial instrument is compliant the Shari'a scholars generally adhere to the following process:

- reviewing the product concept description created by the product development team;
- reviewing the market conditions identified by the product development team;
- reviewing the product development team's views on the Islamic principles on which the transactions will be based; and
- reviewing the product development team's proposals and issuing legal opinions (fatwas).
- The opinion of the scholars is then reviewed by the product development team and can be followed by a discussion between the scholars and the product development team to finalise the product.

In the majority of countries (including the UAE) where Shari'a-compliant financial services are offered, each Islamic financial institution has its own Shari'a supervisory board making individual decisions for the institution. In some countries, however, such as Malaysia and Sudan, Shari'a compliance is centralised in the central bank.

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