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LEGAL CONSULTANTS

Legal Bulletin

Issue 2, 2014

Sukuk and Corporate Bond Regulation

UAE Securities and Commodities Authority approve Sukuk and Corporate Bond Regulation

Following extensive market consultation and review by the UAE Central Bank, ending in December 2013, the board of directors of the UAE Securities and Commodities Authority (the "**SCA**") approved new regulations for the issuance of Sukuk (the "**Sukuk Regulations**") and amendments to the current existing regulations relating to corporate bonds (the "**Bonds Regulations**") (Sukuk Regulations and the Bond Regulations, together the "**Regulations**"). The Regulations were announced on the SCA website on April 26, 2014, and published in the Federal Gazette (No. 565, May 2015).

The Regulations aim to follow best market standards as observed in the world's advanced markets and are the latest step in implementing Dubai's ambitious programme of becoming the centre of the Islamic economy and capturing the ever expanding and lucrative Sukuk market.

The Sukuk Regulations provide a wider regulatory framework including rules regarding: (i) issuance and principal listing of Sukuk (for example, a principal listing of Sukuk requires, (a) Sharia committee approval from the issuer of the Sukuk (or from a Sharia committee approved and accredited by the relevant listing authority), and (b) a minimum nominal value of AED 10 million for the Sukuk issuance (unless SCA provides otherwise)); (ii) Sukuk trading, clearing and settlement (for example, (a) any trading, clearing or settlement (whether inside or outside the relevant market) must be done in accordance with the rules and regulations of the relevant market; (b) any trading in principally listed Sukuk that is conducted outside the relevant market must be recorded in a special register maintained by the relevant market (the "**Register**"), and (c) any trading outside of the relevant market that is not recorded in the Register within the timeframe stipulated by the relevant market shall be null and void); and (iii) applicant requirements relating to an issuance and listing of Sukuk (for example, an applicant applying to list Sukuk, (a) must not have any restrictions (in its memorandum and articles of association) which would prevent the applicant from discharging its responsibilities relating to the issuance and trading of the Sukuk, and (b) for the principal issuance of a retail Sukuk, the applicant must be established in the United Arab Emirates (or in a free zone within the United Arab Emirates).

The Bonds Regulations replace the old regulations governing the issuing of corporate bonds and, like the Sukuk Regulations, cover a broad range of regulatory issues including: (i) approval and listing (for example, corporate bonds (other than government corporate bonds), (a) shall not be offered for public subscription in the UAE without prior SCA approval, and (b) corporate bonds must be listed on a securities exchange licensed by the SCA to operate in the United Arab Emirates (after obtaining SCA approval)); (ii) issuance and listing approval (for example, if the issuer is a joint stock

Contacts

Dubai
PO Box 9371
Emirates Towers Offices, Level 35
Sheikh Zayed Road
Dubai, UAE
Tel: +971 4 330 3900
Fax: +971 4 330 3800
Contact: Ziyad Hadi
zhadi@afridi-angell.com

Abu Dhabi
PO Box 3961
Al Ghaith Tower, Level 8, Suite 806
Hamdan Street
Abu Dhabi, UAE
Tel: +971 2 627 5134
Fax: +971 2 627 2905
Contact: Gregory Mayew
gmayew@afridi-angell.com

Dubai International Financial Centre
PO Box 9371
Emirates Financial Towers
North Tower, N316
Dubai, UAE
Tel: +971 4 355 1414
Fax: +971 4 330 1400
Contact: Stuart Walker
swalker@afridi-angell.com

Sharjah
PO Box 5925
Al Safa Building, 2nd Floor
Al Boorj Avenue
Sharjah, UAE
Tel: +971 6 568 1062
Fax: +971 6 568 2336
Contact: Bashir Ahmed
bahmed@afridi-angell.com

www.afridi-angell.com

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company the issuance of the corporate bonds (a) must be approved by the general assembly, and (b) the subscription announcement must be prepared and presented according to the format approved by the SCA); and (iii) announcements (for example, to prevent any misleading announcements being made by the issuer (other than a government body), SCA approval must be obtained before publishing any document or making any statement in the UAE with the aim of publicizing approval for the listing of the corporate bond).

A summary of the regulations can be found at **http://www.sca.gov.ae/English/news/Pages/26-04-2014.aspx**. ■

Anti-Money Laundering

The UAE Federal National Council announced in April that it has approved amendments to the Law Regarding Criminalization of Money Laundering (Federal Law No. 4 of 2002). The draft changes the name of the law to *Federal Law No. 4 of 2002 on Confrontation of Money Laundering Offences and Combating the Financing of Terrorism*. The amendments intensify both the provisions and penalties under the existing law, although they still remain in draft form and await publication in the official gazette.

Significantly, the draft law expands the scope and definition of money laundering beyond its original language. The term "*Money Laundering*", wherever it appears in the original law, is replaced with "*Money Laundering or the Financing of Terrorism or the Financing of Unlawful Organizations*". The original definition (Article 1) limits money laundering to the "*transfer, conversion, or deposit of Property, or concealment or disguise of the true nature of the Property*", where the definition of money laundering and "Property" are restricted to a set of defined offenses listed in Article 2.

The reformulated definition expands the acts of money laundering under Article 1 to include the "*safekeeping, investment, exchange, or management*" of "*Proceeds*", where "*Proceeds*" is defined broadly as "***any** property that is directly or indirectly the outcome of the commission of **any** offence or felony*". Under the revised definition, money laundered property is characterized as such if it is associated with any offence or felony and the acts of investing in, dealing in, managing or harboring such property now come under the purview of the draft law.

The draft also has a broader impact on the regulation of items brought into the UAE (Article 6).

According to reports, the draft law was revised in light of the latest International Monetary Fund (IMF) report on the UAE and the intention is to bring UAE's anti money laundering legislation in line with the *International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation, (the FATF Recommendations).*

Please note that as the law itself has not been published, our update is based upon reports gathered from news and other sources. ■

New SME Law

Federal Law No. 2 of 2014 on Small and Medium Enterprises has been published in the Federal Gazette (No. 561, March 2014). The facilities and incentives available to SMEs under the law will be implemented through the "National Programme for Small and Medium Enterprises" (the "**Programme**"), which will be run by the SME Council, an agency under the Ministry of Economy that will be charged with coordinating and executing the law. An SME must be a member of the Programme to enjoy the benefits accorded under the law.

Significantly, in order to be a member, the SME must be wholly owned by a UAE national.

Benefits include: (i) eligibility to benefit from the commitments by federal entities to contract 10% of the aggregate price of their contracts to SMEs, and by private companies that are at least 25% owned by federal entities to contract at least 5% of the aggregate price of their contracts to SMEs; (ii) reduced licensing fees for land used by SMEs for agricultural or industrial purposes; (iii) tax exemptions on equipment and raw material, and (iv) concessions with respect to providing guarantees in relation to workers. Finance facilities are also to be provided by the Emirates Development Bank, which must dedicate at least 10% of its loans to SMEs.

The law will come into force three (3) months after its publication in the Official Gazette. ■

Conscription

The UAE has issued a law requiring mandatory military service for all Emirati males between the ages of 18 to 30, creating a national defence and reserve force (Federal Law No. 6 of 2014). The law encapsulates the draft law which was circulated and endorsed by the cabinet in January 2014. The law has been published in the Federal Gazette (No. 565, May 2014) and was in effect starting May 30, 2014.

Reports indicate that eligible men who have finished secondary school will be required to serve nine months of military service, while those who have not completed secondary school will be required to serve two years. Reports also indicate that Emirati males who fail to enlist for military service without valid reason will be subject to criminal penalties, including a jail term of between one month and one year, and/or a fine ranging from AED10,000 to AED50,000. They will also be required to serve in the military service, regardless of having reached the age of 30. There are indications that certain permanent and temporary exemptions have been carved out. Women are exempt from the law but may join voluntarily. ■

Case Note: CA 005/2013 and CA 006/2013 (1) Kenneth David Rohan, (2) Andrew James Mostyn Pugh, (3) Michelle Gemma Mostyn Pugh, (4) Stuart James Cox v Daman Real Estate Capital Partners Limited and Ahmed Zaki Beydoun v Daman Real Estate Capital Partners Limited and Asteco Property Management LLC

Judgment: 11 February 2014

Both real estate investors and developers should take note of this recent DIFC Court of Appeal judgment which dealt with two main substantive issues: (i) the protection of investor / purchaser rights where a developer seeks to exercise its own rights to extend the anticipated completion date of a project; and (ii) the importance of conforming with contractual requirements in giving proper notice.

The abovementioned appeals were dealt with together by the Court of Appeal as they concerned similar facts and issues. The Claimants before the Court of First Instance (the "**Purchasers**") purchased units in a development known as "The Building by Daman" located in the DIFC (the "**Building**"). The Building was due to be completed by 31 July 2009 but pursuant to the relevant sale and purchase agreements (the "**SPAs**"), the Appellant (the "**Seller**"), (i) had a right under the SPAs to extend at its sole discretion, unilaterally and for any reason, the Anticipated Completion Date ("**ACD**") by up to 9 months upon giving written notice to the Purchasers; and (ii) could rely on the Force Majeure clause to protect it from the consequences of default or breach of contract, to the extent that an event of Force Majeure prevented or delayed the Appellant in the performance of its obligations. The SPAs also gave the Purchasers the right to terminate for non-delivery after the lapse of 12 months from the ACD.

On 29 June 2009, the Appellant wrote to each of the Purchasers notifying them of a new ACD, also stating that it expected to complete the Building works "by the fourth quarter 2010 to the first quarter 2011" and that the change to the original ACD was "due to contractor related issues, delays and insufficient material supplies which are out of our control." This was an attempt to extend the ACD well beyond the 9 month period that the SPAs allowed. Thereafter, on 25 November 2010, the Appellant sent an email to the Purchasers, again notifying them of a revised ACD due to "continuing force majeure delays" causing "overall delay at approximately 33 months" and which would mean handover of the purchased units would commence "during the end of Q4 2011 to Q1 2012."

In 2011 and 2012, the Purchasers gave notice purporting to terminate the SPAs and initially filed claims before the DIFC Court of First Instance. The underlying issue was whether the Purchasers were entitled, in reliance on the notices which they served, and the relevant provisions of the SPAs, to treat those SPAs as terminated; and to claim damages, compensation and costs incurred against the Seller as a result of its failure. That turned on whether the termination notices were given by the Purchasers on dates after the expiry of 12 months of the ACD as defined in those agreements.

The trial judge, Justice Sir Anthony Colman, found that the Purchasers validly terminated the SPAs as the notices submitted by the Appellant failed to effectively extend the ACD, as per the contractual requirements. Although the SPAs reserved to the Seller the right, in its sole discretion, unilaterally and for any reason, to extend the ACD by up to nine months by giving written notice to the Purchaser, the Seller's letter of 28 June 2009 could not be treated as a valid exercise of the right to extend under the relevant contractual provision. First, there had been no reference in the letter specifically to the relevant contractual provision and, secondly, there had been no reference in it to the unilateral exercise in the Seller's sole discretion of a right to extend the ACD. Moreover, the purported period of extension was not a period for which the ACD could be extended pursuant to that right (which was limited to a maximum period of 9 months). Nor, for similar reasons, did the Seller's letter of 25 November 2010 satisfy the contractual requirements.

This decision has now been upheld by the Court of Appeal which found that although the Appellant had a right to extend the ACD pursuant to a contractual provision, such right is exercised by the giving of proper notice. The Court of Appeal provided significant guidance on how such right should be exercised:

> *"the Purchaser should know that the right (or power) to extend the [ACD] is being exercised by the Seller" and 'it is necessary, for that purpose, that the notice is in terms which inform the Purchaser (i) that it was given in exercise of the right reserved or power conferred by [the concerned contractual provision] and (ii) of the period for which the [ACD] has been extended pursuant to the exercise of that right or power."* (paragraph 17)

The Court considered it of the utmost importance that the Purchaser should know from the outset by exactly how much the ACD is sought to be postponed because he must be able to prepare in advance to either occupy the unit or know when the mechanism of the contract on the giving of notice by the Purchaser, (which can only be given at the end of 12 months precisely calculated from the last identified ACD), may be exercised.

With respect the Force Majeure clause in the SPAs, the Court of Appeal upheld the decision of the lower court but for differing reasons. It found that the relevant clause required the Seller, if it considered that an event of Force Majeure had occurred, to notify the Purchaser "indicating the nature and expected duration or effect on the Seller's performance of the Force Majeure in question…" However, the Court found nothing in the clause which supported the conclusion that failure to serve a notice prevented the Seller

from relying on Force Majeure; and nothing which supported the conclusion that the service of a notice enabled the Seller to rely on Force Majeure to an extent greater than the extent of the actual delay (as opposed to anticipated delay) which the event caused. Therefore, the Court held it was not intended that a notice served under the Force Majeure clause would of itself have the effect of extending the ACD. That was not the purpose of requiring the service of a notice under that provision. Rather, it was deemed important that a Purchaser should be put on notice that his rights to serve a termination notice might be effected by delay caused by Force Majeure - and a consequent extension of the ACD – "*so that he would not be caught by surprise if, when he did serve a termination notice, the Seller took the point that it was premature*" (paragraph 25).

The judgment alerts both developers and investors to the importance of providing proper notice in accordance with relevant contractual provisions in order for parties to exercise their rights effectively. In particular, the implications for investors and purchasers who seek to exercise their right to terminate and make consequential claims are significant if notices of termination are deemed defective owing to uncertainty over the timing of when such a right may be exercised. It is also advisable to be mindful of the purpose and intention behind providing contractual notices, and of the rights and remedies which may be affected as a result. ■

Afridi & Angell

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