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The Middle East Quarterly Bulletin

Winter 2013

Kingdom of Saudi Arabia – New Mortgage, Real Estate and Financing Laws

Locally Domiciled Funds in the GCC

Case Study: Jabal Omar, Makkah Al-Mukarramah, the Kingdom of Saudi Arabia

New Rules to Impact Banking and Investment Funds

Foreword

This issue of *measure* focuses on new legal developments within the GCC region.

We have dedicated a significant portion of this issue to a special article on the new mortgage, real estate and financing laws of the Kingdom of Saudi Arabia. These new laws are highly welcomed pieces of legislation that have been anticipated for more than a decade. I personally am looking forward to seeing the practical effect of these laws. As a firm, we anticipate a significant impact on the operations of both financiers and borrowers. These new financing laws will hopefully lay the groundwork for the further development of secured and structured financing deals within the Kingdom of Saudi Arabia.

I am pleased to note the growth of the GCC domestic funds industry, and one of our articles affords a snapshot of various local structures. We are particularly focused on this as we have one of the pre-eminent funds practices in the region and we are assisting our clients to develop new and innovative structures on an almost daily basis.

We have developed specialist knowledge of district cooling over the past few years, and we have included a case study on one of our most recent and interesting projects in the region.

We also go back to our US roots by including a brief article on FATCA, the new US certification, diligence and reporting rules that will affect virtually all non-US banks, investment funds, investment managers and insurers. This is recommended reading for anyone operating within the financial services industry.

Jawad I. Ali
Managing Partner – Middle East Offices and Deputy Practice Group Leader – Middle East & Islamic Finance Practice Group

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CO-EDITOR
Phillip Sacks
psacks@kslaw.com

CO-EDITOR
Sara Carmody
scarmody@kslaw.com

SUBSCRIPTIONS
Rachel Twomey
rtwomey@kslaw.com

DESIGN
Laura Owens
lowens@kslaw.com

Tashi English
tenglish@kslaw.com

James Hicks
jhicks@kslaw.com

COVER PHOTOGRAPHY
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Upcoming Events and Our Practice

In the *Chambers Global 2012* guide, King & Spalding lawyers received 68 listings, including eight of the firm's lawyers located in the Middle East. Twenty-eight of the firm's practices were recognized as leading practices globally.

Kingdom of Saudi Arabia – New Mortgage, Real Estate and Financing Laws

New legislative reforms for mortgages, the real estate finance industry in general and a new future for financing

On 13/08/1433H (corresponding to 2 July 2012), the Kingdom of Saudi Arabia (the Kingdom) enacted the 'real estate mortgage law'. This law, which has been debated for over a decade, was held up due to the global real estate market crises, the concerns about providing mortgages within the Kingdom in a *Shari'ah*-compliant manner and balancing the rights of both the borrower and the financier.

According to *Bloomberg*, less than 4 per cent of all home purchases in the Kingdom are financed through mortgages (compared with 17 per cent in the United Arab Emirates and 70 per cent in the United Kingdom). Currently the majority of mortgages are provided by the Kingdom's Real Estate Development Fund (the RED Fund), which provides interest-free loans to low-income owners.

The new laws are set to improve the Kingdom's overall real estate and financing market by introducing a system for the provision of mortgages and other financing arrangements by financial companies. We envisage that these laws will in particular have a significant impact on ensuring that the interests of both financiers and borrowers are protected and/or the further development of secured and/or structured financings in the secondary market.

What is the real estate mortgage law?

The real estate mortgage law is actually a package of five separate laws, collectively referred to as the Real Estate and Financing Laws:

1. The Real Estate Registered Mortgage Regulations No. 49, dated 13/08/1433H (the Mortgage Law).
2. The Financing Lease Regulations No. 48, dated 13/08/1433H (the Finance Lease Law).
3. The Law on Supervision of Finance Companies No. 51, dated 13/08/1433H (the Finance Companies Law).
4. The Real Estate Finance Regulations No. 50, dated 13/08/1433H (the Real Estate Finance Law).
5. The Execution Regulations No. 53, dated 13/08/1433H (the Execution Law).[1]

See Table 1: Summary (on page 06)of the Kingdom's new package of real estate and financing laws.

Why are the introductions of these laws significant?

The Real Estate and Financing Laws will overhaul the real estate and financing market and, although this may take some time, provide clarity on the process to be followed in order for financiers to obtain recourse to the assets. Specifically, the laws are trying to ensure that both parties to a financing transaction are of 'clean hands'. Financiers need to be qualified, honest and operate in an equitable manner, and borrowers need to have a credit rating and adhere to the agreed commercial terms.

[1] Fattah Z. "Saudi Mortgage Law Opens Kingdom to Home Lending Surge", *Businessweek*, 4 July 2012.

One key provision of the Real Estate and Financing Laws states that financing arrangements (be it real estate related or otherwise) need to be undertaken in a *Shari'ah*-compliant manner. Since all laws in Saudi Arabia must comply with the *Shari'ah*, this requirement is not unusual in the context of Saudi Arabia. While there is much dicta on what this could mean for the industry and what the implications in practice would be, the requirement of *Shari'ah* compliance should not be a deterrent for industry participants. In fact, the inclusion of such a requirement solidifies equitable transactions, requires upfront disclosure by parties and protects both parties' interests – building upon the very premise of *Shari'ah* principles. All five laws take into consideration the fairness of transactions.

The laws appear to deal with the concerns that have plagued the introduction of the Real Estate and Financing Laws for over a decade – that the mistakes that occurred in other jurisdictions that resulted in the global financial crisis do not occur in the Kingdom (noting that the Kingdom was fairly sheltered from the effects of the global financial crisis). Specifically, finance activities must not prejudice the safety of the financial system and fairness of transactions. To address this, the Finance Companies Law requires Finance Companies (defined herein) to diversify their risk, with limitations being imposed on the amounts a financier can lend to a borrower or its related entities. Details are expected to be forthcoming in the Implementing Regulations (defined herein).

The Saudi Arabian Monetary Agency (SAMA) and other Saudi Arabian authorities (including the Ministry of Finance and the Ministry of Justice) are entrusted with implementing, supervising and monitoring the Real Estate and Financing Laws.

Real estate financing is already available in the Kingdom; however, the Real Estate and Financing Laws are noteworthy because they will regulate and facilitate the creation of financial products secured against property and perfection of mortgages over assets (including real property). Further, the Real Estate and Financing Laws open the market for investors who wish to establish finance companies.

When do they come into force?

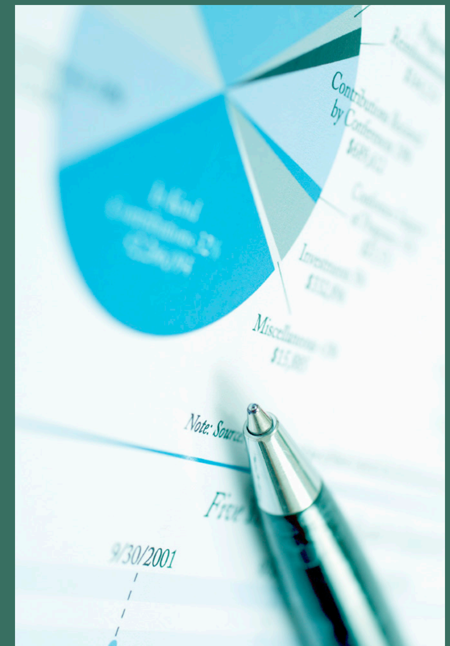
With the exception of the Execution Law, each of the laws became effective 90 days after publication in the *Official Gazette*. The Execution Law became effective 180 days after publication in the *Official Gazette*.

Except for the Mortgage Law, the laws provide that implementing regulations (in respect of the laws: the Implementing Regulations) should be issued within 90 days of the laws becoming effective, and in the case of the Execution Law, within 180 days. On 19 November 2012, SAMA released draft Implementing Regulations for review and comment.

Points for consideration

1. The laws do not deal only with real estate mortgages, they will also cover other types of financing arrangements and assets (including movable assets and intellectual property: see sections titled "Finance Lease Law" and "Finance Companies Law" for further discussion).

2. While the Real Estate and Financing Laws appear to be opening the door to the



possibility of a secured and/or structured financing industry, the laws specifically mention that foreign ownership restrictions apply and that securitization will be undertaken in accordance with the Capital Market Authority regulations.

3. While exemptions will apply for registration of mortgages in the context of a secured and/or structured financing (as detailed below), *zakat* (a form of Kingdom corporation tax) will still be payable.

4. It is unclear to what extent the rules and restrictions of the Finance Companies Law will apply to existing commercial banks in the Kingdom.

5. We understand that some banks would rather retain title to the real estate asset (which is currently common practice in the Kingdom) rather than take a mortgage over such property or asset. However, it is not clear if banks will be able to continue with their current practices, as there is a risk that a borrower may have the right to invalidate the bank's ownership of the asset, based on the Mortgage Law.

Specifically, Article 19 of the Mortgage Law provides that the agreement to own any mortgaged property by the mortgagor shall not be valid, and in that event the mortgage will be valid but the ownership right will be void.

Mortgage Law

What is this law about?

The Mortgage Law generally regulates the creation and recording of mortgages; the rights and obligations of the mortgagor, mortgagee and other related third parties; and the termination of mortgages.

Previous practice

Since the early 1980s, the public notaries, who are responsible for registering rights over properties in the Kingdom, have generally refused to record mortgages on real property in the name or on behalf of banks or other commercial lenders on the grounds that such banks and lenders charge interest in violation of *Shari'ah* principles and that notaries should not be involved at any level with such a violation.

> "If a registered property is mortgaged in favor of several mortgagees, the mortgagees will be ranked according to the registration number..."

Commercial lenders (including banks) therefore have typically either (i) recorded the mortgage in the name of a trusted lender employee or director; or (ii) more commonly, requested transfer of the title of the real estate in favor of the lender, with the agreement that the title would be reconveyed to the borrower upon payment of all amounts outstanding with respect to the related debt.

Due to developments in the real estate market in the Kingdom in the past ten years, it became necessary to regulate the mortgage of properties in a proper manner. It is therefore anticipated that the Mortgage Law will regulate mortgages and increase the comfort level for investors who wish to invest in this vital sector.

New procedures under the Mortgage Law

Essentially, the Mortgage Law requires that in order for a mortgage to be enforceable against third parties, the mortgage will need to be either registered in the Real Estate Register, which has not been fully implemented yet, or recorded in the records of a competent notary public. Such registration will give the mortgagee priority over all other creditors with respect to the mortgaged property and will be limited to the loan amount agreed in the mortgage agreement. If a registered property is mortgaged in favor of several mortgagees, the mortgagees will be ranked according to the registration number and date of the respective mortgage agreements.

The Mortgage Law invalidates any provision that allows the mortgagee to acquire the mortgaged property in the event of default. Mortgagees are therefore required to follow the execution procedures under the Execution Law to enforce mortgages against properties. It is not clear if financiers will be able to continue securing their rights by transferring ownership title to a property in the name of a trusted person (or a subsidiary). However, such practice may be considered a circumvention of the Mortgage Law.

A mortgagor may be the debtor himself or a real guarantor, whereby the latter may provide the property to be mortgaged even without the debtor's permission. Interestingly, the Mortgage Law provides that a mortgage can be taken over real property that exists or that will possibly exist. This may make it possible to record mortgages over off-plan properties. In the case of a property that does not exist, the Mortgage Law requires that the property be properly described in the mortgage agreement and that it can independently be subject to auction sale. The Mortgage Law further provides that utilization (i.e. usufruct) rights may also be mortgaged (such as the *musataha*). Unless agreed otherwise, the mortgage of a real property will include attachments to the property, including utilities and improvements, subject to the rights of third parties.

Debt, either payable or promised, serves as consideration of the mortgage, and the amount should be specified in the mortgage agreement. Unless otherwise agreed, every part of the mortgaged property shall be security for the whole debt, and every part of the debt shall be secured by the property.

Table 1: Summary of the Kingdom's new package of real estate and financing laws

What are the new laws? The Mortgage Law is actually a package of five separate laws. The package comprises the following:

The Mortgage Law	This law introduces a new framework for financiers to mortgage real estate (without taking title), including the ability to take second-ranking mortgages. This law is divided into four main sections dealing with various items, including: 1. the creation and registration of a mortgage; 2. the rights and obligations of a mortgagor and mortgagee; 3. the effect of registration of a mortgage; and 4. the circumstances in which a mortgage is terminated.
The Real Estate Finance Law	This law generally addresses: 1. the authority of SAMA in regulating the real estate mortgage market (including banks, finance companies, real estate refinancing companies and cooperative insurance companies); 2. additional liquidity support to be provided by the government through the RED Fund; and 3. the refinancing of transactions and the facilitation of structured financing and securitizations.
The Finance Lease Law	This law deals with Finance Lease Contracts in general and extends beyond leases provided regarding real estate to leases of immovable or movable assets, utilities, services, or other rights such as intellectual property. The law is divided into four main sections dealing with: 1. what constitutes a finance lease contract and the requirements for a valid finance lease contract; 2. the responsibility of parties to a finance lease contract; 3. the establishment of a registry that will create a platform for information relating to finance lease contracts; and 4. violations of the laws and disputes arising with respect to a finance lease contract. The key provisions of this law include the rules and processes regarding recovering an asset when a borrower defaults.
The Finance Companies Law	This law provides a framework for companies to provide financing including, but not limited to, real estate finance, general leasing finance, finance of credit cards and consumer finance in a *Shari'ah*-compliant manner. The law is divided into eight main sections dealing with: 1. the application of the law (i.e. that the law applies to licensed companies under this law); 2. the licensing of finance companies and the various requirements of such finance companies; 3. the activities of finance companies and restrictions imposed on the activities of finance companies; 4. the management of finance companies, specifically how a finance company's board will operate; 5. the supervision of finance companies by SAMA; 6. penalties for breach of the law and how disputes are to be resolved; 7. provisions relating to financing provided by finance companies in general; and 8. a grace period for companies established prior to the enactment of the laws to comply with the relevant provisions. The law provides for the establishment of a new committee formed specifically to hear disputes (excluding real estate ownership and securities disputes) arising under this law and the Finance Lease Law.
The Execution Law	This law complements the above four laws and, with the exception of judgments and decisions issued with respect to administrative and criminal claims, permits an enforcement judge to carry out and administer compulsory enforcement. This law will assist in the recovery of an asset for and on behalf of the financier upon a borrower's default. The law sets out, among other things, the procedures, rules and regulations under which an enforcement judge can operate and the ambit of the judge's powers.

> “The Mortgage Law further provides that utilization (i.e. usufruct) rights may also be mortgaged (such as the *musataha*).”

The Mortgage Law allows for the disposal of the mortgaged real property subject to the agreement of the parties.

The right of the mortgagee in the proceeds of the mortgaged property is not very clear under the Mortgage Law. The mortgagor of the property is entitled to the proceeds of the real property, unless agreed otherwise, including the proceeds derived from the mortgage. The Mortgage Law, however, allows the mortgagee to collect the proceeds but invalidates a provision that allows the mortgagee to use the proceeds.

The mortgagor is under obligation to maintain the mortgaged property, and the mortgagee will have the right to object to any action that may negatively affect the value of the property. If the value of the property is diminished, or any event occurs that may restrict the mortgagee from foreclosure of the property due to default or deceit of the possessor of the mortgaged property, the mortgagee may request the possessor of the property to provide additional securities or be subject to default under the Finance Companies Law.

If a debtor fails to make repayments, the mortgagee may, pursuant to the Execution Law, proceed toward compulsory expropriation of the property upon notice to the debtor and any possessor.

II. Real Estate Finance Law

What is this law about?

The Real Estate Finance Law sets out SAMA’s responsibilities in regulating and supervising real estate finance companies seeking to provide mortgages to customers and, in doing so, expands upon the current real estate financing laws in the Kingdom.

SAMA’s role

The Real Estate Finance Law sets out that SAMA will be responsible for, among other things:

1. allowing banks to own real estate for the purposes of undertaking real estate finance. Specifically, the law states that SAMA can exempt a company from Article 10(5) of the Banking Control Law, which currently restricts banks from owning real estate other than their business premises;
2. licensing of companies to undertake real estate finance activities;
3. licensing of “*one (or more) joint stock company (or companies) [dealing specifically with refinancing] to undertake real estate finance pursuant to the needs of the market in whose ownership the Public Investments Fund may contribute*.” We understand that a state-run refinancing company (referred to as the “Real Estate Refinancing Corporation”) will be established as part of this provision. Part of the shares of this company will be offered for public subscription in accordance with the provisions of the Capital Market Law;
4. licensing of cooperative insurance companies responsible for insuring real estate finance risk in accordance with the Cooperative Insurance Companies Control Law; and
5. issuing standards, rules, instructions and procedures relating to the real estate finance sector and the review of real estate finance forms issued by real estate financiers to ensure their conformity with required standards and procedures.

This particular scope of work is interesting because the law specifically states that the review process is aimed at ensuring the due protection of consumers. SAMA will also review the form of real estate finance contracts and will prescribe the minimum information required in such contracts. Industry participants will need to wait to see how this review process will work in practice.

Accessibility to information

Previously in the Kingdom, any information relating to a property and its respective financing arrangements was restricted. Only through a power of attorney from the owner of a property could information be accessed. One of the key provisions of the Real Estate Finance Law is accessibility of information relating to properties.

In particular, SAMA will be responsible for:

1. publishing data relating to the real estate finance market and sponsoring the development of real estate finance techniques, including techniques for facilitating flow of data between the primary market and the secondary market; and

2. identifying the principles of disclosure of the standards of financing costs and the method of their calculation to enable a consumer to compare rates.

The law obliges authorities responsible for registration of the real estate (i.e. courts and notaries public) to give real estate financiers access to information listed in the real estate registries. Details of the process will be set out in the forthcoming Implementing Regulations and will be in accord with the rules set forth by the Ministry of Justice.

Another key area of the law is that it requires the Ministry of Commerce and Industry, the Ministry of Justice, and the General Housing Ministry to each publish data relating to the real estate market periodically.

Balancing rights

Interestingly, the Real Estate Finance Law states that licensed real estate finance companies shall carry on the business of real estate finance "*without prejudice to the rules of Sharia as determined by the Sharia Committee referred to in Article (Three) of the Finance Companies Control Law and without prejudice to the safety of the financial system and the fairness of transactions.*" As mentioned above, such clauses are aimed at full disclosure by financiers about the details of the financing, their obligations and their payment requirements.

In return, the law guards financiers by ensuring that borrowers have some sort of credit record/rating before financing can be extended to them. As of this writing, SIMAH (the Saudi Credit Bureau) is the responsible entity for collating credit information. The Implementing Regulations to the Real Estate Finance Law and various directives to be issued by SAMA will provide further details regarding the minimum requirements that borrowers should meet (e.g. minimum credit history period) and the obligations of lenders in updating the credit information of the borrowers.

Secondary market - securitizations and refinancing

The law provides real estate finance companies with the ability to refinance through (i) another real estate financing company or (ii) the issuance of securities (including, but not limited to, securitizations) in accordance with the Capital Market Law. This is indeed a positive step in that the law is not only dealing with the primary market but also with the secondary market, which could develop into a very large and lucrative industry within the Kingdom.

Furthermore, the law addresses one of the key concerns faced by parties when structuring secured and/or structured financing transactions in that it explicitly states that the transfer of mortgages in the secondary market shall be exempted from registration fees in the real property registration system. In addition, the law provides the Council of Ministers with the ability to grant tax incentives for securities issued with respect to real estate financing.

III. Finance Lease Law

What is this law about?

The Finance Lease Law sets out the framework for finance lease contracts (defined below) entered into between financial institutions (in their capacities as lessors) and borrowers (in their capacities as lessees) and the responsibilities of parties under finance lease contracts.

What is a Finance Lease Contract?

A finance lease contract is defined widely as a contract in which a financier finances by way of a lease any leased assets (which is defined as immovable or movable assets, benefits, usufruct, services, and intangible rights (such as intellectual property)) to a third party (which we understand refers to the borrower).

A financier can lease the leased asset as (i) owner, (ii) owner of the benefit of such leased asset, (iii) a leased asset capable of being owned, or (iv) a leased asset capable of construction.

Details regarding the formalities of a finance lease contract will be set out in the Implementing Regulations to the Finance Lease Law; however, from a *Shari'ah* perspective, generally assets that do not exist are subject to a forward lease arrangement. Interestingly, out of the five Real Estate and Financing Laws, the Finance Lease Law has no specific

reference to *Shari'ah* principles, although we anticipate that the implementation of the various provisions will require parties to adhere to *Shari'ah* principles.

Formalities of a Finance Lease Contract
The law codifies the typical provisions found in standard finance lease contracts (such as a detailed description of the asset, the parties and other key information).

The law also permits the use of electronic finance lease contracts in addition to the typical written form of finance lease contracts. As with many developed real estate financing laws, the Finance Lease Law requires registration in accordance with the provisions of the law. Details of the process for registration will be forthcoming in the Implementing Regulations to the Finance Lease Law.

Who is responsible for what?
The law sets out the responsibilities of the financier (in its capacity as a lessor) and the borrower (in its capacity as a lessee) with respect to the leased asset. These are typical provisions that are commonly seen in standard *Ijara* contracts, including that the risk of the asset is that of the financier as "owner" of the leased asset (who would be responsible for major maintenance of the leased asset), while the borrower would be responsible for the day-to-day use of such leased asset.

Transfer of an asset
The law expressly states that the leased asset can then be transferred to a borrower in accordance with the terms and conditions of the finance lease contract. This includes transfers that are conditional upon (i) the payment of installments, (ii) a specified amount being paid, or (iii) a promise to sell the asset at a nominal price, a price agreed in the finance lease contract or the value of the asset on the day the finance lease contract was entered into.

Financier's protection
Financiers can take comfort in the following provisions:

Financier's protection against creditors: The law provides for the establishment of one or more joint stock companies, to be licensed by SAMA to organize registration of finance lease contracts onto a registry (the Contracts Registry). The shareholders of these companies will be limited to licensed finance companies, and the Implementing Regulations will detail the procedures of how this registry will operate, which documents are required, and what specific data will be collated and included. One of the key provisions for a financier is that title to the leased asset and any amendment to the finance lease contracts shall be enforceable against third parties only after registration of the finance lease contract onto the Contracts Registry.

Defaults: In summary, the law sets out the remedies and steps that may be taken when a borrower defaults on repayments. Specific remedies available include the ability to accelerate payments (e.g. rent) and, subject to various circumstances, direct recourse to the leased asset. Interestingly, Article 21 states that the recourse to the leased asset is carried out in a manner compliant with the Implementing Regulations and "in a way that achieves justice for both parties to the finance lease contract." It is unclear what this means and how "justice" is to be interpreted.

"The law also permits the use of electronic finance lease contracts in addition to the typical written form of finance lease contracts."

In a scenario where a lessee has defaulted, the financier is provided with two options whereby it may recover the leased asset. In the case of an immovable leased asset where such asset is not delivered to the financier, the financier may apply to the competent court for issuance of a judgment delivering the asset to the lessor, provided that such application is resolved within 30 days from the filing thereof. In the case of a movable leased asset, the law provides the financier with the right to recover such asset from the lessee in accordance with the terms and provisions of the law, the Implementing Regulations and the finance lease contract itself. The recovery process, however, would be supervised by the relevant authorities licensed by the Ministry of Justice.

It should be noted that financiers are required by the Finance Lease Law to sell the leased asset to a third party and recover any outstanding amounts through such sale.

“The Department of *Zakat* and Income Tax will be responsible for calculating the relevant *zakat* payments required to be paid by such Finance Companies.”

IV. Finance Companies Law

What is this law about?

The Finance Companies Law sets out the framework for the licensing, regulation and supervision of finance companies within the Kingdom by SAMA.

While released with the Mortgage Law, the Finance Companies Law is not limited to real estate financing and covers the financing and refinancing of other assets. Companies established prior to the enactment of the Finance Companies Law will be provided with a two-year grace period to comply with the provisions of the law and the Implementing Regulations.

Types of finance companies

Finance companies are defined as joint stock companies holding a license to carry on finance activities in accordance with the Finance Companies Law.

The activities of a finance company include (i) asset finance, (ii) finance leases, (ii) finance of credit cards, (iv) consumer financing and (v) any other financing activity approved by SAMA. Finance companies already exist in the Kingdom and are regulated by the Ministry of Commerce and Industry. The Finance Companies Law appears to be shifting the responsibility for such companies to SAMA.

The law restricts finance companies from undertaking various activities such as trading in real estate, accepting deposits, granting facilities or undertaking financing arrangements secured against the finance company’s shares. It also restricts finance companies from obtaining short-term financing without the approval of SAMA.

Financier’s obligations - licensing, supervision and management of Finance Companies

The Finance Companies Law sets out the steps companies must follow to apply for a license to operate, along with the requirements. Most of the processes and details will be set out in the Implementing Regulations; however, the law specifically requires finance companies to undertake their business in compliance with *Shari’ah* principles and requires that board members of such finance companies meet *Shari’ah* and legal eligibility criteria. Board members, executives and employees holding positions of “control” are also required to have both degrees and experience in the finance industry and no convictions under certain laws (including the Banking Control Law).

It appears that a finance company is expected to publicly list a certain percentage of its shareholders within two financial years of operation. The Implementing Regulations to the finance companies Law will also set out other requirements for Finance Companies (such as risk management, internal audit, corporate governance, etc.).

Licensing of finance companies appears to be a collaborative effort between SAMA and the Ministry of Commerce and Industry, with SAMA responsible for vetting individuals and approving licenses and the Ministry of Commerce and Industry responsible for the formation and registration of finance companies. Licenses issued by SAMA will be valid for five years.

The Department of *Zakat* and Income Tax will be responsible for calculating the relevant *zakat* payments required from such finance companies.

Securitizations and secured financings

The Finance Companies Law provides that a finance company may, in accordance with the provisions of the Implementing Regulations to the Finance Companies Law and other considerations (such as its asset size and financial position), issue securities and bonds in accordance with the Capital Market Authority laws and regulations.

Enforcement

SAMA is also able to suspend licenses and file claims before the courts, request liquidation of a company, and impose fines and penalties as necessary.

The Finance Disputes and Violations Committee

The royal decree pursuant to which the Finance Companies

Law was issued provides that a new judicial committee (and appeal committee) will be formed under the name of "The Finance Disputes and Violations Committee" (the Committee). The Committee will have jurisdiction over all matters pertaining to the application of the Finance Companies Law and the Finance Lease Law and any grievance against related resolutions issued by SAMA. However, the Committee will not have jurisdiction over disputes between financiers and borrowers when the subject matter of the disputes is a right in rem with respect to real property. Further, the Committee will have no jurisdiction over securities disputes arising out of the financing activities. Finance disputes will be subject to statutes of limitation of five years. The Committee (and the appeal committee) is formed on a temporary basis, and the royal decree provides that the duties of the Committee shall be transferred to a competent court in due course.

V. Execution Law

What is this law about?

The Execution Law is a complementary law to the above four laws that, with the exception of judgments and decisions issued with respect to administrative and criminal claims, permits an enforcement judge to carry out and administer compulsory enforcement. This law will assist in the recovery of an asset for and on behalf of the financier upon a borrower's default. The Execution Law sets out, among other things, the procedures, rules and regulations under which an enforcement judge can operate and the ambit of powers.

As with the Finance Companies Law and the Finance Lease Laws, the Execution Law is restricted not only to the enforcement issues pertaining to real estate but is a law dealing with enforcement in general.

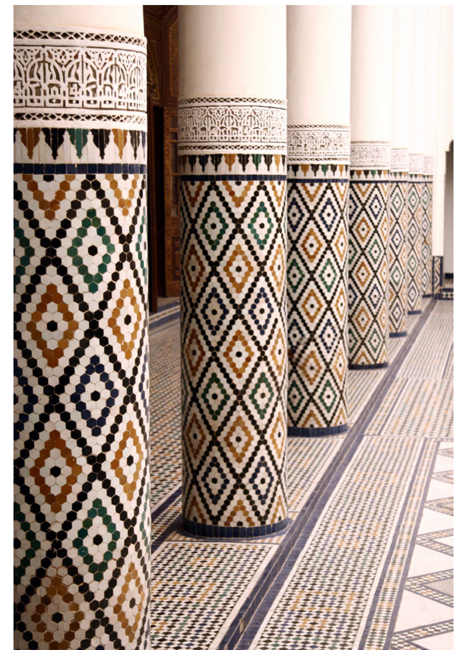
Conclusion

What does the future hold?

The introduction of the Real Estate and Financing Laws does not necessarily mean that there will be a multitude of tenants becoming homeowners or that foreign investors will automatically invest more in the Kingdom overnight. Instead, the Real Estate and Financing Laws are a significant milestone for the Kingdom's real estate sector that, in time, will open many new doors and bolster the economy, provide financiers with greater comfort when lending, and provide potential homeowners with the opportunity to own property in the Kingdom.

As set out above, in conjunction with various circulars and directives, the Implementing Regulations to each of these laws will contain most of the details on how the laws will operate. Furthermore, the laws are untested, and only time will provide understanding of their application and clarity as to the exact rights of financiers and borrowers.

Key areas of the laws to be tested include the enforceability of the financier's security upon the borrower's default (specifically the effectiveness of collateral), the courts' interpretation of the law, and the procedures and regulations to be established separately by SAMA, the Ministry of Finance and the Ministry of Housing. |

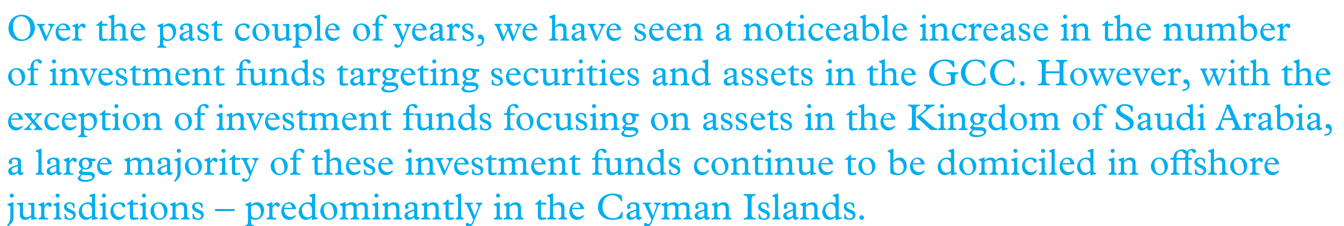


Mohammad Al-Ammar is a counsel in King & Spalding's Riyadh office. Mohammed is a transactional lawyer who specializes in corporate and finance matters in Saudi Arabia. He can be contacted at mal-ammar@kslaw.com or +971 4 377 9900.

Lidia Kamleh is a senior associate in King & Spalding's Dubai office. Lidia specializes in debt capital markets with a particular focus on *sukuk*. She can be contacted at lkamleh@kslaw.com or +971 4 377 9906.

Nabil Issa is a partner in King & Spalding's Dubai and Riyadh offices. Nabil is recognized as one of the market leaders in corporate transactions and investment funds in Saudi Arabia. He can be contacted at nissa@kslaw.com or +971 4 377 9909.

Locally Domiciled Funds in the GCC



Over the past couple of years, we have seen a noticeable increase in the number of investment funds targeting securities and assets in the GCC. However, with the exception of investment funds focusing on assets in the Kingdom of Saudi Arabia, a large majority of these investment funds continue to be domiciled in offshore jurisdictions – predominantly in the Cayman Islands.

In response to this, local regulators have overhauled funds regulations for locally domiciled vehicles in an attempt to attract more investments and maintain oversight of the offering and operations of funds. These regulations have had mixed results.

On the one hand, the regulations bring stability, some tax advantages and potential exemptions to certain regulatory requirements. In particular, due to the legal structure of most locally domiciled funds, the regulators have generally allowed local funds with non-GCC ownership to invest in certain sectors or real property that would otherwise be subject to foreign ownership restrictions.

On the other hand, some provisions are overly burdensome and create impracticable restrictions for many potential funds. Certain regulators have expressed willingness to waive provisions on a case-by-case basis. However, since many of the local fund regulations are relatively new, sponsors and fund managers may have to take a wait-and-see approach in some jurisdictions to see how accommodating the regulators will be.

Below we examine the regimes governing locally domiciled investment funds in the following jurisdictions: the Kingdom of Saudi Arabia (Saudi Arabia), the State of Qatar (Qatar) and the United Arab Emirates (UAE).

Saudi Arabia

Saudi Arabia is now home to a large majority of investment funds being domiciled in the GCC due to its relatively clear and predictable funds regime. The recent turmoil in Bahrain has also added to the popularity of the Saudi Arabian investment funds industry. The offering and operations of all funds in Saudi Arabia are governed by the Capital Market Authority (CMA) pursuant to the Investment Funds Regulations and Real Estate Investment Funds Regulations (together known as the Saudi Fund Regulations). An investment fund may only be formed, managed and offered by a company licensed by the Saudi CMA as an "Authorized Person". The fund itself is an unincorporated contractual vehicle formed between the fund manager and the investors pursuant to the "Terms and Conditions" of the fund. Accordingly, the fund must act and hold its investments through its fund manager, a CMA-licensed custodian or a special purpose vehicle (SPV) substantially owned by the fund manager or custodian.

Funds may be publicly offered or privately placed. All funds must be authorized by the Saudi CMA. There are no exemptions for funds being offered to sophisticated investors, financial institutions or high-net-worth individuals.

For a public fund, the offering documents must be prepared in Arabic and submitted to the Saudi CMA for formal approval. This process can take several months. There is no minimum investment amount for investors in a public fund, and there are no restrictions on the length of the offering period.

For private funds, only the Subscription Form and Terms and Conditions must be in Arabic. Other offering documents, such as a private placement memorandum, may be in English. Once the offering documents are submitted, if the Saudi CMA does not comment on the offering documents within 15 business days, the fund manager may begin offering the fund to up to 200 Saudi Arabian investors, who must be identified to the Saudi CMA as part of the submission. The minimum investment amount per investor is SAR 1 million. The offering of units is permitted only during the 12-month period following the end of the 15-business-day comment period. If the fund manager wishes to offer shares after such period has expired, the offering documents must be resubmitted to the Saudi CMA. If a fund manager wants to form an open-ended fund, it would be wise to offer the fund publicly to avoid the annually recurring Saudi CMA approval process.

The Saudi Fund Regulations require that each fund have a board that will oversee the fund manager and approve investments by the fund. At least one-third of the board, and no fewer than two members, should be independent. The Saudi CMA has allowed privately placed funds to have fewer independent members on a case-by-case basis.

Units in a Saudi fund entitle their holders to a proportional share of the profits of the fund. While the Saudi CMA has not permitted separate classes of units in a fund, it has allowed for a disproportionate allocation of profits. Also, often the fund manager receives a "performance allocation" from the profits of the fund. The Saudi CMA has also allowed a fund manager to enter into "side letters" with investors in certain circumstances, granting preferential rights or reducing or eliminating fees charged to such investors.

All funds are subject to a number of restrictions and requirements as to valuations, subscriptions, redemptions, diversification, etc. These restrictions would be inapplicable to or impracticable for the investment strategy for many investment funds. Accordingly, the Saudi CMA has shown a willingness to waive certain provisions on a case-by-case basis.

Units in a Saudi Arabian investment fund may be offered to foreigners. Under the Real Estate Investment Funds Regulations, real estate funds may be offered only to Saudi Arabian companies and nationals, other GCC nationals and foreigners who reside in Saudi Arabia. However, the Saudi CMA has on a regular basis allowed non-GCC nationals and companies to subscribe for units. Currently, non-GCC investors in a Saudi fund are not required to register with the Saudi Arabian General Investment Authority.

Saudi funds are extremely tax-efficient vehicles. The Department of *Zakat* and Income Tax (DZIT) has not assessed any taxes on Saudi funds, their investments or unit holders in a Saudi fund. However, the DZIT has reserved the right to tax funds in the future and on a retroactive basis.

There is no requirement for a fund manager to invest any amount in a fund it manages, although the Saudi CMA has expressed its preference for the fund manager to make such investments. The Saudi Fund Regulations imply that an investor should contribute the full amount of its capital when it subscribes for units; however, the Saudi CMA has regularly approved funds with capital commitment structures.

In general, the Saudi CMA has shown flexibility as to fund structures that most other regulatory

bodies in the region have been unable or unwilling to do. Additionally, we understand that the Saudi CMA is considering revamping its funds regime in the near future.

Qatar

The formation and offering of investment funds in Qatar is regulated by the Qatar Central Bank (QCB) pursuant to Law No. 25 of 2002 (the Qatari Funds Law). All funds domiciled in Qatar must be licensed by the QCB. There are no exemptions to the licensing process.

A fund may be established only by a Qatari–licensed bank or a QCB-licensed company and is formed upon entry of its name in the Commercial Register at the Ministry of Economy and Commerce. Foreigners may acquire units in a Qatari fund, although the QCB retains discretion to limit the extent of their participation. The Qatari Funds Law does not regulate the number of investors or diversification of a fund's investments. Qatari funds are subject to a 10 percent tax rate on profits sourced in Qatar.

"Unfortunately, the Qatari Funds Law is not comprehensive and, despite its 11-year history, is relatively unutilized. In our experience, most funds investing into Qatar still use offshore investment vehicles or SPVs."

Unfortunately, the Qatari Funds Law is not comprehensive and, despite its 11-year history, is relatively unutilized. In our experience, most funds investing into Qatar still use offshore investment vehicles or SPVs. Qatar is one of the only GCC jurisdictions that has not recently overhauled its fund regulations or announced its intention to do so.

However, the Qatar Financial Centre (QFC) recently introduced the Collective Investment Schemes Rules 2010 and the Private Placement Schemes Rules 2010 in an attempt to enhance the QFC's reputation as a prime jurisdiction in which to establish investment funds. Funds formed in the QFC are regulated by the Qatar Financial Centre Regulatory Authority. The primary advantage of a QFC fund is that it is exempt from all Qatari taxes.

UAE

Until 2012, investment funds in the UAE were regulated by the UAE Central Bank. However, new fund regulations were issued and implemented in 2012 by the UAE Securities & Commodities Authority (ESCA). These new regulations (the ESCA Regulations) are expected to be the first in a series of related regulations and were discussed in detail in our last issue of *measure*.

In summary, a UAE-domiciled fund can be established only with the approval of ESCA and the sponsor must be a UAE joint stock company or a UAE branch of a duly licensed foreign company.

The offering documents of a UAE-domiciled fund must be in Arabic. Any amendments to the offering documents must be approved by ESCA, and certain amendments require the approval of the investors in the fund. There are no express exemptions to the ESCA licensing and approval process.

The ESCA Regulations are silent on the corporate form of a UAE fund. We understand that a local fund is an unincorporated vehicle in which investors do not have an equity interest but instead have a contractual right to share in the profits and losses of the underlying investments of the fund. Given that a local fund does not have a corporate personality, the legal title to investments could be held by the fund manager (or a special-purpose vehicle affiliated with the fund manager) rather than the fund itself, similar to the structure that must be implemented for a Saudi-domiciled fund. We understand that eventually the UAE Companies Law may be amended to give a UAE fund its own legal personality, but there are no plans for such amendment in the immediate future.

The ESCA Regulations include several unusual restrictions for local funds, such as the maximum amount a fund can invest in any single company. Such restrictions would be impracticable in the context of private equity and real estate funds. However, we understand that ESCA intends to take a pragmatic approach in this regard and has the discretion to waive such restrictions under the regulations.

The ESCA Regulations do not contain a minimum investment amount for investors in a private or public fund. In practice, we understand ESCA will require a minimum initial investment of AED 250,000 for a private fund.

The fund manager of a UAE fund is required under the ESCA Regulations to invest at least 3 percent of the capital. The fund manager, together with its subsidiaries and affiliates, is restricted from investing more than 49 percent of the capital of the fund unless the fund is closed-ended and privately placed.

The ESCA Regulations provide that the offering period should be specified in the offering documents. Presumably, open-ended funds and mutual funds will not need to specify an offering period and can issue units for an indefinite period once the fund is approved by ESCA.

While the ESCA Regulations provide that units in a UAE fund confer upon their holders equal rights and entitle their holders to a proportional share of the profits of the fund, we understand that ESCA may allow certain investors to have different rights on a case-by-case basis. Additionally, the ESCA Regulations contemplate that all subscription amounts for units must be paid up front. We understand that it is not ESCA's intent to prohibit a capital commitment structure and such will be permitted if clearly set forth in the fund's offering documents.

Each UAE fund must have a board of directors. The board must include a representative of the fund manager and at least three members independent from the fund manager. All appointments and removals of directors are subject to the approval of ESCA.

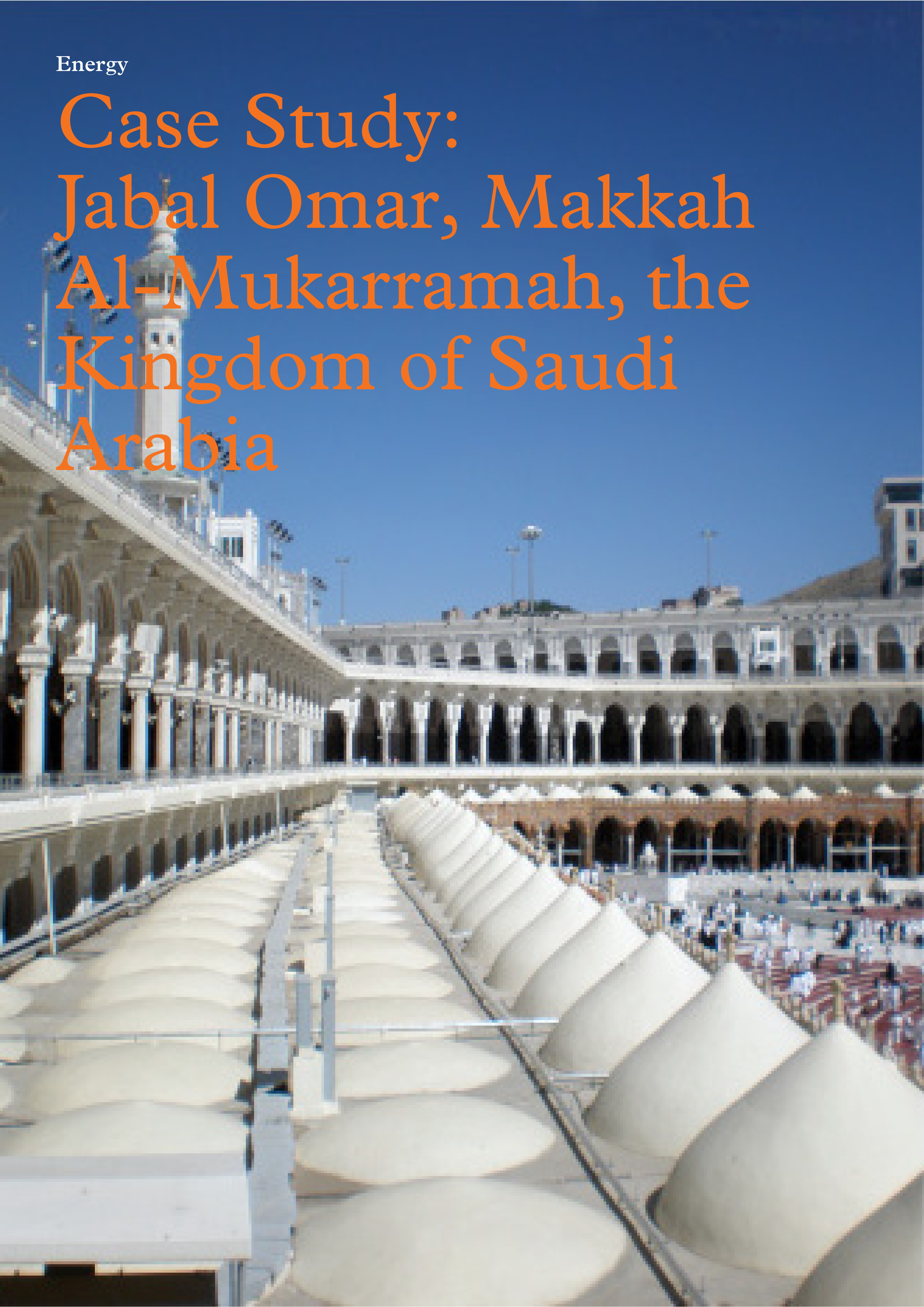
The investment funds regime in the Dubai International Financial Centre (DIFC) is one of the most developed in the region. However, despite its relatively clear and comprehensive regulations, the DIFC has not taken off as a regional destination for fund establishment, and most managers and sponsors still choose to domicile their investment funds in offshore jurisdictions, particularly in the Cayman Islands. Having said this, the DIFC is very popular for setting up licensed asset management entities and is arguably now the hub for fund managers in the GCC. There are also some very useful corporate vehicles available in the DIFC, including the "Special Purpose Company", which is commonly used as part of a fund structure, particularly when investing in Saudi Arabia and Kuwait.

How We Can Help

King & Spalding LLP is among the most active law firms in assisting clients establishing investment funds and structures. Over the past several years, King & Spalding has been ranked by *Chambers Global* and other publications as a top law firm for investment funds work in the Middle East. In 2012, lawyers in our Abu Dhabi and Dubai offices and our affiliated Riyadh office advised clients on forming and launching over two dozen funds targeting assets in the GCC and MENA regions. These funds ranged from private equity to real estate, infrastructure, distressed assets, credit and hedge funds and were structured on conventional and *Shari'ah*-compliant bases. We have extensive experience working with regulators in all of the major financial centers in the Middle East. |

James Stull recently relocated to King & Spalding's Dubai office after spending three years in the firm's New York office. James is an associate who regularly advises fund sponsors and managers on structuring and establishing investment funds that have a Middle Eastern focus. He can be contacted at jstull@kslaw.com or +971 4 377 9929.

Phillip Sacks is a senior associate in King & Spalding's Dubai office. Phillip regularly advises fund sponsors and managers on the structuring and establishment of investment funds of all types, including private equity, venture capital, real estate, infrastructure, credit and hedge funds. He can be contacted at psacks@kslaw.com or +971 4 377 9916.



Energy

Case Study: Jabal Omar, Makkah Al-Mukarramah, the Kingdom of Saudi Arabia

King & Spalding represented Jabal Omar Development Company (JODC) on its first PPP initiative in the Holy City of Makkah; a district energy project to service the USD5.5bn mixed-use Jabal Omar development.

Background

JODC is the largest developer in Saudi Arabia and is developing and constructing the Jabal Omar area located near the courtyard on the western side of the Grand Mosque; it also owns, develops, manages, invests, sells and rents real estate and plots of land in the area. The entire USD5.5bn mixed-use development will comprise up to 37 towers and many of the world's leading hotel brands to provide accommodation for 45,000 pilgrims. It is one of the largest hotel projects of its kind in the world.

King & Spalding have been advising on the district energy project that will serve the entire Jabal Omar area and, when complete, will be one of the largest project-financed deals of its type in the Kingdom of Saudi Arabia. The district energy project involves JODC granting a concession to a third-party special purpose vehicle (SPV) to design, build, fund, operate and maintain a district cooling system with a plant capacity of up to 55,000TR for a 25-year period (Term).

King & Spalding advised JODC on the project structuring, tender documents, drafting and negotiating the build, operate and transfer (BOT) agreement, and a suite of project agreements including project financing agreements through to financial close. Financing was provided by Saudi Hollandi Bank.

Summary of the transaction

The "concession" element of the transaction means that the SPV has the exclusive right to provide district cooling services to all "end users" within the Jabal Omar multipurpose development at Makkah, Al-Mukarramah, Kingdom of Saudi Arabia (Development), in return for payment of a tariff from each end user.

The project is made up of three key components:

(a) a district cooling (DC) plant that contains water and uses chilling technology to cool the water to 5 degrees Celsius, plus pumps to pump water out of the DC plant;

(b) a DC network that consists of two long pipelines—one to supply the chilled water throughout the Development area and one to bring the return water back to the DC plant; and

(c) energy transfer stations, which are rooms at the base of each building within the Development that have pipes and equipment to receive the chilled water and convert it into chilled air and to return the water back into the DC network.

The SPV will design, build, operate and maintain all these components. The SPV will also enter into various services agreements with "end users", in this instance, the companies that will function in the Jabal Omar complex, for the supply of chilled water for long-term air-conditioning needs. The SPV will charge certain "tariffs" to JODC under these services agreements. This is the SPV's revenue stream for the project, which will enable it to repay debt to the financiers, pay the concession fee to JODC, provide a return on equity for the shareholders of the SPV, and pay all costs and expenses to the EPC contractor and operator. The services agreements will operate for the duration of the Term and will require JODC and future third-party end users to pay a tariff to the SPV for the SPV performing certain "DC services" (mainly providing chilled water).

"The SPV will also enter into various services agreements with 'end users', in this instance, the companies that will function in the Jabal Omar complex, for the supply of chilled water for long term air conditioning needs."

JODC

Concession Agreement

Lease

Direct Agreement

Financiers

SPV

End Users

Financing/ Security Documentation

Direct Agreement

Direct Agreement

EPC Contract

O&M Contract

EPC Contractor

Operator

In order to secure project financing for the Development and ensure its "bankability", the lenders required the SPV and JODC to enter into a range of financial and security documents, including a direct agreement that afforded them the right to step in and cure any defaults of the SPV.

A diagrammatical representation of the proposed contractual structure for the Development is presented below, together with a description of each project document.

Conclusion

The deal is significant because it is the first project-financed district energy transaction in the Middle East under a new "end-user BOT concession" model. Future deals in the GCC have and will continue to follow this model. This model differs from traditional independent water and power projects (IWPP) and independent power projects (IPP) models, where a Government or quasi-Government concession grantor acquires the complete power or water "offtake", provided the facility is made available.

The model is currently being adopted by King & Spalding's clients on four additional project-financed district energy schemes across the Middle East.

Abu Dhabi-based projects partner Tim Burbury led King & Spalding's cross-border team on the deal. Fellow Middle East-based partners Benjamin Newland, Nabil Issa and Leroy Levy were also involved, as were counsels Tim Tucker (New York) and Mohammad Al Amaar (Riyadh). Associates on the transaction were Hoda Naghdy (Abu Dhabi), Simon Rahimzada (Abu Dhabi), Sara Carmody (Dubai), Khaled Dahlawi (Abu Dhabi), Asal Saghari (London), Mahynoor El Tahry (New York) and Lachlan Doyle (Abu Dhabi). |

Tim Burbury is a partner in the Global Transactions Group in the Abu Dhabi office of King & Spalding. He can be contacted at tburbury@kslaw.com or +971 2 596 7001.

Khaled Dahlawi is an associate in the Global Transactions Group in the Abu Dhabi office of King & Spalding. He can be contacted at kdahlawi@kslaw.com or +971 2 596 7005.

New Rules to Impact Banking and Investment Funds

FATCA is the acronym for new US certification, diligence and reporting rules that will affect virtually all non-US banks, investment funds, investment managers and insurers.

FATCA stands for the "Foreign Account Tax Compliance Act." Many people mistakenly believe that the rules apply only to banks or to entities with US investors.

Ostensibly aimed at locating investments by US taxable individuals, FATCA imposes a comprehensive new regime on non-US banks, funds and insurers that virtually every entity must take into account. These new US rules even impact entities that do not deal with US investments and do not have US investors.

FATCA operates by imposing a new 30 percent withholding tax on certain US-related payments made to foreign financial entities. FATCA overrides income tax treaties and other general US domestic withholding exemptions. A FATCA-compliant financial entity can avoid the new withholding tax only by following the new diligence and reporting rules. Thus, non-US financial institutions and funds with US assets or investments, including listed securities, will need to agree to comply with FATCA.

FATCA's reach goes beyond financial entities with US assets by imposing further withholding and diligence obligations on FATCA-compliant entities. Due to complex rules slated to come into force over the next few years, even some strictly in-country payments from a FATCA- compliant financial entity to another non-US financial entity could be subject to withholding. This "pass through" payment regime is intended to force as many financial entities as possible into the FATCA compliance regime.

Compliant financial entities will be seeking FATCA-type certifications from other foreign financial entities starting January 1, 2014. The FATCA rules require most affected parties to obtain a "global intermediary identification number" (GIIN) from the IRS. Large financial institutions with US exposure are likely to require FATCA certifications, and a GIIN, as a matter of course even when not strictly required. Thus, it is more and more likely that a "responsible officer" at an affected entity (including fund managers) will be required to obtain a GIIN and certify an entity's FATCA status even if the entity never has transactions with a US nexus.

The recently finalized FATCA rules contain limited exemptions, but these exemptions are not always automatic and may require changing policies, procedures and/or transaction documentation in order to qualify. For instance, even funds that prohibit sales to US investors will need to amend

> "FATCA overrides income tax treaties and other general US domestic withholding exemptions."

their review procedures and underwriting agreements to accommodate the new rules.

Complying with FATCA can be manageable. A bank, investment fund, fund manager or other financial entity first needs to determine its general status under FATCA. The entity may be eligible for an exemption, but this needs to be determined sooner rather than later. As noted above, some available exemptions may apply only after certain policies and procedures are adopted.

If a exemption is not available, the entity needs to prepare to obtain its GIIN.

> “As with many governmental regulations, it is not enough to ‘know’ that you have no US investors.”

Registration begins in July of this year. Diligence on potential direct or indirect US taxable account holders (which would include US expatriates, green card holders and certain other individuals taxable in the United States) needs to be performed. As with many governmental regulations, it is not enough to “know” that you have no US investors. You must perform the necessary diligence in accordance with the FATCA rules. It is important to adequately document the diligence in case it is ever questioned.

New procedures for handling investments/accounts need to be in place before January 1, 2014. FATCA applies to investment accounts and can also apply to debt or equity securities issued by a financial entity.

The United States has entered into agreements with several countries regarding FATCA. These “intergovernmental agreements” or IGAs streamline some of the diligence and other requirements imposed by FATCA for operations of financial entities in the country with the IGA. Some Middle Eastern countries are in talks with the United States over IGAs. It is important to note that the IGAs may lessen some of the FATCA burdens, but they do not eliminate the basic diligence and reporting requirements.

FATCA is here to stay. The United States government will push ahead with this compliance initiative regardless of the burdens it imposes on foreign financial entities. At best the IGAs will make some of these burdens more manageable, but they will not eliminate them.

The next couple of months will be critical. It is not just a matter of performing diligence on existing investors/account holders. Underwriting, fund management, and debt and equity documentation all need to be considered in light of FATCA compliance issues. |

John Taylor is a US tax partner in King & Spalding’s London office. John’s practice focuses primarily on international transactions. He can be contacted at jtaylor@kslaw.com or +44 20 7551 7553.

Upcoming Events

IFLR European Capital Markets Forum
9 April 2013
London
Presenter: Rizwan Kanji

Investment Funds - Onshore and Offshore
11 April 2013
Dubai International Financial Centre
Presenters: Jawad I. Ali, Nabil A. Issa, Phillip Sacks and James Stull

District Cooling Projects from a Saudi perspective: Principal structures and key legal, commercial and financing (Conventional and *Shari'ah*) issues
21 April 2013
Jeddah
22 April 2013
Riyadh
Presenters: Tim Burbury (key presenter), Jawad I. Ali and Phillip Sacks

About our Middle East Practice

With more than 20 lawyers in the Middle East, King & Spalding offers extensive experience in Islamic finance, construction, energy, real estate, private equity and international arbitration in the Middle East, North Africa and Asia. The firm has long been considered a leader in Islamic finance, having pioneered many of the *Shari'ah*-compliant financial products that exist today. Our energy practice is known worldwide for its oil and gas work, particularly in the area of liquefied natural gas, and also has a strong base in electric power, petrochemicals and renewable energy. Our corporate lawyers have advised on some of the most complex and high-profile private equity investments and M&A transactions in the MENA region and are consistently recognized in *Chambers Global* and *The Legal 500*. In the 2012 edition of the *Chambers Global* guide, King & Spalding was consistently ranked among the top law firms practicing in the Middle East.

About King & Spalding

Celebrating more than 125 years of service, King & Spalding is an international law firm that represents a broad array of clients, including half of the Fortune Global 100, with 800 lawyers in 17 offices in the United States, Europe, the Middle East and Asia. The firm has handled matters in over 160 countries on six continents and is consistently recognized for the results it obtains, uncompromising commitment to quality, and dedication to understanding the business and culture of its clients. More information is available at www.kslaw.com.

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Abu Dhabi
Level 15, Al Sila Tower
Sowwah Square
P.O. Box 130522
Abu Dhabi, UAE
Tel: +971 2 596 7000
Fax: +971 2 596 7077

Dubai
Al Fattan Currency House
Tower 2, Level 24
DIFC | Dubai International Financial Centre
P.O. Box 506547
Dubai, UAE
Tel: +971 4 377 9900
Fax: +971 4 377 9955

Riyadh*
Kingdom Centre
20th Floor
King Fahad Road
P.O. Box 14702
Riyadh 11434
Saudi Arabia
Tel: +966 1 466 9400
Fax: +966 1 211 0033

Affiliated Office