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### Meyer-Reumann & Partners

P.O. Box 9353  
Dubai, U.A.E.  
Tel: 00971-4-331 7110  
Fax: 00971-4-331 3832  
dubai@meyer-reumann.com  
www.meyer-reumann.com

With offices in  
Dubai + Alexandria + Erbil +  
Muscat + Riyadh

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*United Arab Emirates*

## **M&P Announces the Launch of the New Website**

### **Guiding Principle**

*We are pleased to announce the launch of our new website highlighting our expertise and variety of legal services offered since 1981*

#### **A. German Legal Experience in the Middle East Since 1981**

Since the establishment of a law firm under German guidance and management 35 years ago, M&P has continuously developed the range of legal services offered.

The core of our legal services is related to commercial / corporate / companies laws of the Middle East as legally relevant to foreign companies and individuals operating in or with the Middle East. M&P's services by now also include real estate law, trademark- and patent registration worldwide, the formation of free zone and offshore companies in UAE and Middle East, as well as family and inheritance laws.

#### **B. Our Offices and the Team**

We currently have licensed offices in

- the United Arab Emirates;
- the Kingdom of Saudi Arabia;
- the Arab Republic of Egypt and
- the Sultanate of Oman.
- the Republic of Iraq

Our team includes highly qualified, experienced and well trained lawyers from different legal background and jurisdictions including Germany, Italy, Egypt, Syria and Saudi Arabia.

M&P provides legal services in English, German, Italian, Arabic, Spanish and French.

Visit us on [www.meyer-reumann.com](http://www.meyer-reumann.com)

*Elena Schildgen  
Meyer-Reumann & Partners,  
Dubai Office*

*United Arab Emirates*

## **Practical Aspects of the New Bankruptcy Law**

### **Guiding Principle**

*On 29 December, 2016, Federal Decree Law No. 9 of 2016 ("New Bankruptcy Law") has come into force. This article will provide you with an overview.*

#### **A. Previous Situation**

Up until the coming into force of the New Bankruptcy Law, insolvency proceedings in the UAE were dealt with by the Fifth Book of Federal Law No. 18 of 1993 ("Commercial Transactions Law"). The New Bankruptcy Law now repeals these provisions, as well as certain provisions in Federal Law No. 3 of 1987 ("Penal Code").

The insolvency related provisions in the Commercial Transactions Law have long been deemed outdated as they were, for example, focusing mainly on individual traders. The insolvency of corporate entities was dealt with too, but more or less just as an exception to the rule. As a matter of fact, the insolvency procedures under the Commercial Transactions Law were rarely applied in court. One reason may well have been that the costs associated with filing for the bankruptcy

of a debtor deterred most creditors from pursuing such action. Taking the comparatively high costs of court proceedings in the UAE into account, there was simply not much reason to pay such fees if doing so does not necessarily lead to an improvement of the applicant's financial position. It will be interesting to see if the New Bankruptcy Law will find broader acceptance.

## **B. The New Bankruptcy Law**

### **1. Scope**

The scope of debtors to which the New Bankruptcy Law applies, is broader than that to which the Commercial Transactions Law used to apply. While the Commercial Transactions Law applied to "commercial traders", the New Bankruptcy Law more specifically applies to all commercial entities governed by Federal Law No. 2 of 2015 ("Commercial Companies Law"), companies in most free zones (except DIFC and ADGM), general traders and even civil companies conducting professional business.

### **2. Procedures**

The New Bankruptcy Law describes mainly three different scenarios for businesses that face financial difficulties:

- Preventive composition;
- Insolvency with restructuring; and
- Insolvency with liquidation.

#### **a) Preventive Composition**

The preventive composition is a debtor initiated, court-sponsored process, designed to assist businesses that are facing financial difficulties, but are not yet insolvent.

Creditors are not allowed to initiate such preventive composition. Only the debtor may apply, in order to assist the debtor with finding a settlement with its creditors.

The preventive composition procedure ("PCP") is open to businesses who are either in a state of over indebtedness or have ceased payments for not less than 30 consecutive business days. Certain documents will have to be submitted to the court, together with the application for preventive composition. Following such application, the court will appoint an expert to prepare a report on the financial condition of the debtor applicant, determining whether the conditions are met for PCP to commence, and whether or not the debtor has sufficient funds to cover the cost of the PCP process. Once approved, the PCP will be announced publicly and creditors will be invited to submit proofs of their claims against the debtor. From this point onwards, a moratorium on creditor actions will immediately apply, thus protecting the debtor from claims that may worsen its financial position further.

During the PCP, the debtor will keep managing the business, albeit under supervision of a court appointed trustee, who is given wide-ranging powers to ensure that the debtor's assets are being preserved.

The next step is then for the debtor to devise a restructuring plan for the business. Such plan will need to be initially approved by the court, following which it will be presented to the creditors. The restructuring plan is approved if creditors representing not less than two thirds of the total

outstanding debt vote in favour of such plan. Creditors who did not approve the restructuring plan will be bound by it anyway, if the required two third majority approved the plan.

The debtor will be given a maximum of three years to implement the restructuring plan. Once all obligations contained in that plan have been discharged, the court, at the request of the trustee, the debtor or any interested third party, will publicise its decision, following which the protections of the PCP will cease to apply and the debtor is expected to continue normal business procedures.

b) **Insolvency with restructuring**

This process is designed for businesses that are technically insolvent, but show sufficient promise to be rescued.

The process is quite similar to the PCP, but with certain key differences:

- While the PCP can only be applied for by the debtor, also creditors holding an ordinary debt of not less than AED 100,000 may apply for the insolvency of the debtor;
- Once the insolvency filing has been accepted by the court, the debtor's business will be managed by a court appointed trustee, as opposed to the debtor itself (under supervision of the trustee) as during the PCP; and
- The trustee will produce a report, proposing whether the debtor's business is worth rescuing and a restructuring plan should be prepared, whether it is in the best interest of the creditors if the debtor's business

is being sold as a whole or whether the debtor should be sent into liquidation.

c) **Insolvency with liquidation**

In cases where neither PCP nor a restructuring plan are approved or where they are terminated, or if the debtor is acting in bad faith to evade its financial obligations, the court will order the insolvent winding up of the debtor.

**C. Conclusion and Outlook**

The New Bankruptcy Law is certainly a welcome modernisation of the Fifth Book of the Commercial Transactions Law. As mentioned above, however, the insolvency related provisions in the Commercial Transactions Law have hardly ever been tested. In our view, the main reason was that it did not seem to make much sense for a creditor to spend a substantial amount of money on court and legal fees just to apply for the insolvency of one of its debtors. Instead, such money would have been better spent on either finding an out of court solution or, if litigation could not be avoided, on claiming the total amount due to the creditor, as opposed to just a fraction, which the creditor would receive at most and only after the debtor has been declared insolvent.

Does this change with the New Bankruptcy Law? That certainly remains to be seen once the first attempts to test the New Bankruptcy Law have commenced. However, Art. 76 of the New Bankruptcy Law appears to limit the amount a creditor will have to spend on having its debtor declared insolvent to a maximum of AED 20,000 (presumably plus lawyers' fees). The Fifth Book of the Commercial

Transactions Law did not feature a comparable cap.

The UAE appears to have its fair share of commercial entities, which, despite being technically insolvent, keep trading. This poses a risk to commerce as such and should be fought. We will see if the New Bankruptcy Law will be capable of achieving this. It certainly does offer novel and welcome regulations, which would be useful not only to reduce the number of technically insolvent entities that keep trading, but also to offer those traders who do face financial difficulties a chance to achieve a turn-around of their fortunes.

*Dr. Michael Krämer  
Meyer-Reumann & Partners,  
Dubai Office*

*United Arab Emirates*

## **11th Edition of Nice Classification for Trademark Registration**

### **Guiding Principle**

*The latest edition of the International Classification of Goods and Services for the Purposes of the Registration of Marks (Nice Classification) entered into force on January 1, 2017, brings with it a number of significant additions and amendments.*

The World Intellectual Property Organization (WIPO) will apply the 11th edition of the Nice Classification to all applications for international registration received by an Office of Origin under the Madrid System from January 1, 2017

onwards. However, WIPO will not reclassify the list of goods and services under international registrations affected by renewals, subsequent designations or other changes filed after December 31, 2016.

It is worth noting that the Trademark Offices in Algeria, Cyprus, and Jordan already adopted the 11th Edition of the Nice Classification and are now ready to serve applications for goods and services in the said classes. Other Trademark Offices in the Middle East and North Africa have still not announced the adoption of the 11th Edition.

As for the GCC countries - Bahrain, Oman, Saudi Arabia and the UAE -, which have previously adopted the 10th edition of the Nice Classification, they are expected to adopt the 11th edition eventually. Kuwait is in process of moving from the 8th to the 10th edition, and Qatar still applies the 7th edition (with only 42 classes) with no news to date on a move towards the latest edition.

### **A. What is the Nice Classification?**

The International Classification of Goods and Services for the Purposes of the Registration of Marks was established by an Agreement concluded at the Nice Diplomatic Conference, on June 15, 1957, revised at Stockholm, in 1967, and at Geneva, in 1977, and was amended in 1979.

The countries which are party to the Nice Agreement constitute a Special Union within the framework of the Paris Union for the Protection of Industrial Property. They have adopted and now apply the Nice Classification for the purposes of the registration of marks.

The Nice Classification is a system used to classify goods and services for the registration of trademarks. Under the Nice Classification, related goods and services are grouped together under various categories or classes, each with their own unique heading.

A Committee of Experts usually revises the Nice Classification. A new version is published annually, and a new edition is published every five years.

Each new version of the Nice Classification includes all changes adopted by the Committee since the adoption of the previous version. Each new edition of the Classification includes all changes and amendments adopted annually by the Committee during the full five-year revision period.

The Nice Classification's changes consist of adding/deleting goods and services to or from the alphabetical list of terms, as well as modifying the wording of individual goods and services, class headings and corresponding explanatory notes.

Generally, amendments refer to any transfer of goods or services from one class to another or the creation of new classes.

### **B. What's New in the 11th Edition of Nice Classification?**

The changes approved by the Committee of Experts on 16 November 2016, include amendments to 15 class headings for classes 3, 6, 10, 14, 16, 17, 18, 20, 21, 22, 24, 26, 28, 31 and 45. Modifications were also made to the Explanatory Notes in these 7 classes: 5, 11, 29, 30, 35, 42 and 44.

The major revisions in the 11 Edition

include:

- Class headings affected by current revisions are those numbered 3, 6, 10, 14, 16, 17, 18, 20, 21, 22, 24, 26, 28, 31 and 45
- The addition of herbal extracts for cosmetic purposes under class 3
- The addition of herbal extracts and physiotherapy preparations for medical purposes under class 5
- All serving utensils are grouped under class 21 instead of class 8
- The addition of body composition monitors under class 10
- The addition of eyelash brushes and foam toe separators for use in pedicures under class 21
- The addition of several new goods under classes 29 and 30, including guacamole, onion rings, falafel, dulce de leche, almond, peanut and coconut milks, as well as nut- and chocolate-based spreads. Escamoles (prepared edible ant larvae) and edible insects have also been added under classes 29 and 31
- The addition of unlocking of mobile phones under class 42
- The addition of dog walking, kimono dressing assistance, and conducting religious ceremonies under class 45

It is important to note that the amendments has been applied to all international trademark and other mark applications and registrations that made on January 1, 2017. A majority of



trademark offices use the Nice Classification as the international standard for classifying trademarks. Therefore it may be worthwhile for all users of the trademarks system both nationally and internationally to familiarize themselves with the amendments in the 11th edition of the Nice Classification.

**Tarek Jairwdeh**  
**Meyer-Reumann & Partners,**  
**Dubai Office**

**Saudi Arabia**

## **Sukuk Markets, Challenges & Opportunities: An Account of the World Bank and Saudi-CMA Organized Conference on Islamic Securities (Sukuk)**

### **Guiding Principle**

*On December 6, 2016 the World Bank and the Saudi Capital Market Authority (CMA) organized a conference on Sukuk Markets in Riyadh, Saudi Arabia. Attended by ministers, bankers, prominent scholars and members of concerned international organizations, latest developments and future perspectives with regard to Islamic Securities (sukuk) were discussed. M&P had the privilege to be present at this event and would like to give some first-hand information about backgrounds, dynamics and trends in this area of Islamic banking and finance.*

### **A. Background for a Sukuk-Conference in Riyadh**

Visions in the Gulf area are a common phenomenon for a number of years. Amongst the recent ones is the Vision 2030 of King Salman in Saudi-Arabia. Despite the fact, that these visions mainly promote future ideas of the country, in frequent cases they are driven by an assessment of the current situation of the country. For many years, oil revenues have enabled the Saudi Economy to be sustained by a money abundant public sector, paying ongoing expenses and projects “cash on the table” at once. These times seem to be over. A continuously growing and very young population (More than a quarter of the population is below 14 years old.<sup>1</sup>), as well as low oil prices seem to be amongst the factors to not open a perspective for persistently soaring incomes of the country.

On the other hand, the population of Saudi Arabia has consistent needs for employment, education infrastructure, health etc. All of these investments to be made will have to be financed in the future.

Due to its very own Islamic nature, the kingdom first turns to Islamic perspectives, when trying to finance its outlined needs. Thus, Sukuk seems to be a promising perspective and the Kingdom tries to foster developments in this area from intellectual and economic

<sup>1</sup> Cf.. The World Bank: Data, <http://data.worldbank.org/indicator/SP.POP.0014.TO.ZS?end=2015&locations=SA&start=2015&view=bar> (viewed Feb. 12, 2017).

perspective. In this context it does not seem out of the ordinary, that the Saudi CMA and the World Bank lined up to organize a large scale conference in Riyadh in December 2016 to discuss the issue of Sukuk from various perspectives such as scholars, banks and financial institutions as well as government entities and lawyers. In order to stay updated on these developments, M&P Riyadh Office was present at this conference.

## B. Sukuk

In order to assess the topic of Sukuk a short overview on the background of Sukuk shall be given. Apart from a definition and some historic cornerstones in the development of this instrument, relevant institutions shall be presented, forms and feat of Sukuk shall be outlined, relevant markets shall be mentioned and challenges and relevant issues to be tackled shall be sketched.

### I. Meaning, History and Definition of Sukuk

The Arabic Word *ṣukūk* (سكوك) is a plural of the word *ṣakk* (سك) and its meaning in English is a debenture, or written acknowledgement of a debt of money or property, or of some other thing and a written statement of a commercial transaction, purchase or sale, transfer, bargaining, a contract, or the like, a sealed, or signed and scaled, statement of a judicial decision; a judicial record; or the record of a judge, in which his sentence is written and a written order for the payment of subsistence-money, or of a stipend, salary, pension, or allowance; which

some persons used to sell, but the selling of which is forbidden.<sup>2</sup>

In short and simple: a translation the word *ṣakk* is a certificate. Moreover, the same word is the origin of the modern word cheque as we use it today.

Historically the word *ṣakk* can be found in Islamic legal literature as early as in the book *al-Muwaṭṭa'* (الموطأ) of the prominent Islamic legal scholar Mālik b. Anas (مالك بن أنس) (d. A.D. 795)<sup>3</sup>, who writes:

“It was related from from Malik that he had heard that *ṣukūk* were given to people in the time of Marwān b. al-Ḥakam for the produce of food at al-Jār. People bought and sold the *ṣukūk* among themselves before they took delivery of the goods. Zayd b. Thābit and one of the Companions of the Messenger of God, may Allah bless him and grant him peace, went to Marwān b. al-Ḥakam and said, ‘Marwān! Do you make usury ḥalal?’ He said, ‘I seek refuge with God! What is that?’ He said, ‘These *ṣukūk* which people buy and sell before they take delivery of the goods.’ Marwān therefore sent a guard to follow them and to take them from people’s hands and return them to their owners.”<sup>4</sup>

The expression *ṣukūk* as used by Mālik bears many of the traits we use for contemporary Sukuk as well, yet it

<sup>2</sup> Cf. Lane, Edward William; *An Arabic-English Lexicon*; London 1872, Vol. 4, p. 1709

<sup>3</sup> Cf. *EP*, Vol. 6, p. 262.

<sup>4</sup> Mālik b. Anas; *al-Muwaṭṭa'*: as related by Yaḥya b. Yaḥya al-Laythī; ed. by Bashar ‘Awād Ma‘rūf; 2nd Edition 1997, Vol. 2, p 168.



should be considered, that modern day Sukuk underwent a considerable development until they were established as the financial instrument, we know today.

Milestones in the development of the modern Sukuk were the Resolution No. 30 (3/4) of the International Islamic Fiqh Academy (IIFA)<sup>5</sup>, which outlined major cornerstones of Sukuk, followed by Standard No. 17 of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), which entered into being beginning from November 2001.<sup>6</sup>

One of the most common definitions for Sukuk as a specific technical term in modern contexts comes from the AAOIFI standards and reads as:

‘Certificates of equal value representing undivided shares in the ownership of tangible assets, usufructs and services or (in the ownership of) the assets of particular projects or special investment activity’.

It shall be the definition relied upon in the context of this article.

## II. Relevant Institutions

As already mentioned under the previous heading two major institutions play a vital role in the definition and description of Sukuk: The IIFA and the AAOIFI.

The IIFA is a body set up in the framework of the Organisation of Islamic Cooperation (OIC) formerly

<sup>5</sup> Cf. <http://www.iifa-aifi.org/1713.html> (Mar. 05.2107)

<sup>6</sup> Cf. AAOIFI Standard 17AR p. 300.

known as Organisation of the Islamic Conference. The OIC is an International Governmental Organisation with 57 member states (Art. 3 Para 1 OIC Charter)<sup>7</sup> (including Palestine). The IIFA itself is an academic branch apparatus of the OIC with own legal personality (Art. 2 IIFA Charter), amongst its tasks is to strive collectively for new fiqh solutions (ijtihād [اجتهاد]) to contemporary life and its problems in complete independence (Art. 3 IIFA Charter).

The AAOIFI is a privately founded non-profit organisation that was founded on a conference in Algiers 1990 and is registered in Bahrain since 1991.<sup>8</sup> It is closely related to Islamic financial institutions and has the objective to set and harmonize standards in the Islamic Finance community.<sup>9</sup> Therefore, it issues standards in English and Arabic in order to set common rules amongst its members and for the respective markets. These AAOIFI standards often provide a common and commonly understood reference frame in the field of Islamic banking and finance. This is also due to a great number of prominent sharī‘a scholars to be found on the sharī‘a board of AAOIFI, who draft these frames and try to find a common, yet practical denominator for modern financial products.

In addition to these two main institutions, a number of other players

<sup>7</sup> [http://www.oic-oci.org/page/?p\\_id=53&p\\_ref=27&lan=en](http://www.oic-oci.org/page/?p_id=53&p_ref=27&lan=en) (Mar. 05, 2017)

<sup>8</sup> <http://aaoifi.com/our-history/?lang=en> (Mar. 05, 2017)

<sup>9</sup> Cf. <http://aaoifi.com/objectives/?lang=en> (Mar. 05, 2017)

are involved in the field of Sukuk such as Governments as legislators as well as obligors, banks and other financial institutions and finally yet importantly a number of academic institutions that provide the necessary research and background from legal, shari'a and economic sides.

### III. Forms and Features

After defining Sukuk and mentioning the institutional framework thereof, a closer look at the structure of the Sukuk itself shall be given and different Types of Sukuk shall be outlined in general.

#### 1. Basic and General Structure

In accordance with the given definition, certificates of equal value representing undivided shares have to be issued. This process happens for all Sukuk in a very similar way: The Obligor establishes a separate entity, the so called Special Purpose Vehicle (sharikat dhāt gharaḍ khāṣṣ [شركة ذات غرض خاص]) which then will issue the Sukuk and will operate the transaction in its name.

##### a) The Obligor

The obligor is the initial entity wanting to raise funds for a certain transaction by means of the Sukuk. In theory, it can be any kind of entity. In practice, these are mostly states or public institutions, private financial institutions or (large) companies.

##### b) The SPV

In order to issue the Sukuk the SPV (Special Purpose Vehicle sharikat dhāt gharaḍ khāṣṣ [شركة ذات غرض خاص]) is founded. It is a separate legal entity.

The SPV itself issues the Sukuk to the investors in return for their invested

capital.

Additionally all relevant assets for the transaction are transferred from the Obligor to the SPV.

SPVs in theory can take a number of legal forms such as corporations, limited partnerships, endowments or frequently declared an English law trusts, being declared over the capital and assets<sup>10</sup>. In addition, a combination of the aforementioned seems to be imaginable (e.g. an independent company with limited liability declaring a trust).

The setup of the SPV has a number of reasons. In many cases, only certain types of (legal) persons can hold certain types of rights. E.g. in many jurisdictions the ownership of real property is limited to national only and cannot be held by foreigners. Likewise, tax issues can be a major factor in these contexts. In this respect, it might be worthy to note, that a number of jurisdictions exempted Sukuk structures from certain default tax legislation such as the UK and Hong Kong<sup>11</sup> and some legislations do not tax in general. These taxation issues are regularly mentioned amongst the core reasons of Malaysia's success in Sukuk issues (holding accountable for over 60% of the Sukuk issued globally).<sup>12</sup> Thirdly, the SPV structures provide for an independence

<sup>10</sup> Cf. Linklaters; Shari'a-compliant Securities (Sukuk); 2012, p 7,9

<sup>11</sup> Cf. Latham & Watkins LLP; The Sukuk Handbook: A Guide to Structuring Sukuk; 2016, p. 4.

<sup>12</sup> Cf. Latham & Watkins LLP; The Sukuk Handbook: A Guide to Structuring Sukuk; 2016, p. 4.

of the Sukuk issuer from the Obligor.

c) The Transaction

The transaction or transactions done by the SPV has to be in accordance with the principles of Islamic finance.

In general, this includes that sharī'a prohibitions on transaction in particular the one of ribā are respected and that the objects of the transaction conforms to sharī'a requirements such as the prohibition of gharar or the prohibition of sale of unclean (e.g. pork or alcohol) or unusable goods.

Ribā (ربا) in short means exchange of certain types of goods (gold, silver or essential food items) either with a difference of quantity in them (ribā al-faḍl) or with a postponement in time (ribā an-nasī'a).<sup>13</sup>

Gharar (غرر) in a literary translation of the word would be "hazard" or "jeopardy". This concept is connected to the idea that the good and price of a sharī'a sales contract have to be defined and known (ma'rūf) as well as capable to be delivered (maqḍūr 'alā taslīmihī).<sup>14</sup>

As the Islamic sharī'a more or less contains a numerus clausus of established treaties, the AAOIFI in turn also outlined 14 types of Sukuk in its Standards based on the respective Islamic transaction.

<sup>13</sup> Cf. Al-Jazīrī, 'Abd ar-Raḥmān; al-Fiqh 'alā al-madhāhib al-arba; Beirut 2015, Vol. 2, p. 137 ff.

<sup>14</sup> Cf. Ibn Juzay, Abū al-Qāsim Muḥammad; al-Qawānīn al-fiqhīya; Kuwait 2010, p 392, 404 ff.

## 2. Different Types of Sukuk

In accordance with the aforementioned, the most common categorisation of Sukuk is modelled alongside the treaties of the pursued transaction. One of the most commonly spread labelling of Sukuk is the Separation into asset based and debt based Sukuk.

a) Asset Based Sukuk

In general, an asset based Sukuk is one, where the underlying assets are present during the whole time of the Sukuk. Examples here fore are ijāra Sukuk as well as wakala and Sukuk.

A simple ijāra Sukuk is a construction, where the SPV purchases an asset and leases it out to the Obligor. This can also take the shape of a sale-and-lease-back construction. In many cases, the Obligor also buys the underlying asset at the end of the lease period in a separate undertaking. The ijāra contract is one of the standard contracts of Islamic jurisprudence (fiqh) (فقه). In core, it is an exchange of money for the benefits or usufructs of an object. In accordance with different legal school of Islamic fiqh (madhāhib, sg. madhhab) definition and terminology may vary in detail. A standard ḥanafī definition for an ijāra would be e.g.: a contract that will give the ownership of known and intended benefits of the leased object in exchange for a compensation.<sup>15</sup> The malikī madhhab would sometimes even differentiate in terminology and call only the lease of manpower as ijāra, where it would call the lease of an object kira'

<sup>15</sup> Cf. Al-Jazīrī, 'Abd ar-Raḥmān; al-Fiqh 'alā al-madhāhib al-arba; Beirut 2015, Vol. 3, p. 51.

instead.<sup>16</sup> A common definition here could be: A contract that provides for the ownership of the benefits of a legally allowed object for a known period of time in exchange for a compensation which is not of the drawn benefits.<sup>17</sup>

A wakala construction would be a construction, where the SPV would have the gathered assets managed by the Obligor as its agent in exchange for a certain pre-determined fee, the SPV would pay to the Obligor as its agent.

A muḍāraba construction would be similar, but would be seen as a company founded by the two shareholders: the SPV and the Obligor. Whereas the SPV would contribute shares in capital, the contribution of the Obligor would be in expertise, management and effort, which it would undertake for the common project. In return profits would be shared and losses only be borne by the contributor of capital (the SPV). In comparison to the wakala arrangement outlined above, in a muḍāraba construction the Obligor would not receive a sum determined in advance, but would rather participate in the profits generated by the company.

#### b) Debt Based Sukuk

A debt based Sukuk is one, where the backing commodities are handed over to the Obligor with the permission to further transfer it to a third party to obtain cash. Therefore, where the asset

based Sukuk derives its profits from the performance of the underlying asset, the debt based sukuk derives its profit from the substance of the underlying asset. The prominent examples for such a Sukuk would be a murabaḥa, salam or istiṣna' Sukuk.

A muḍāraba Sukuk would be based on a concept, where the SPV would purchase an object for and in accordance with the specifications made by the Obligor for his use or further sale. The purchase price paid by the Obligor to the SPV will usually exceed the price initially paid by the SPV. It can be paid in installments or at one time, but in this way the SPV will generate profit, once it will finally pay out to the certificate holders. Very similar to the concept of muḍāraba would be the idea of mushāraka. Here the contributions of every party do not have to be different, but can be of the same kind (money, goods, work).

In an opposite way, a salam structure would be used. The word salam should not be confused with the frequently used word salām (meaning peace and being used in greetings). Salam rather means handover or transfer. One of the main features of a salam is the idea, that the purchased good in a sales treaty is being transferred to a new owner at a later stage, whereas the purchase price is paid at once. In the context of modern European laws such as the German Law with its principle of separation and abstraction between the purchase treaty and the transfer of ownership, this seem nothing extraordinary. However, shari'a works according to the consensual principle, where the purchase treaty itself transfers the legal ownership of goods and price. Therefore, in a way a

<sup>16</sup> Cf. Al-Jazīrī, 'Abd ar-Rahmān; al-Fiqh 'alā al-madhāhib al-arba; Beirut 2015, Vol. 3, p. 52.

<sup>17</sup> Cf. Al-Jazīrī, 'Abd ar-Rahmān; al-Fiqh 'alā al-madhāhib al-arba; Beirut 2015, Vol. 3, p. 52.

salam is an infringement to this principle, as the ownership of the purchased good is transferred only with delay. The exact opposite of a salam would be a bay' bi-thaman ājil, where the goods would be subject to transfer of ownership at once and the purchase price would be paid at a later stage.

An istiṣnā' structure would work in a very similar way to a salam, but focusses rather on the idea of contract to produce a work such as a German Werkvertrag or an Italian contratto d'opera. What resembles the structures of the salam before, is that in an istiṣnā' structure the contractual object does not exist in the ownership of the party obliged to deliver it. It is rather still to be produced by exactly this party and this obligation of the party to produce the work itself (or by subcontractors) is also the main difference between an istiṣnā' and a salam, the latter one placing no emphasis on the source of the transferred object.

### **3. The Investment and Its Return**

With regard to the investor, also the issue of investment and return on investment should be touched. This includes the first sale of Sukuk in the primary market, further tradability in the secondary market and finally the return on investment upon maturity of the Sukuk.

#### **a). Primary Market**

The Primary Market would be the one tapped, when the Sukuk is emitted.

In many cases, the primary market will be the securities market of the respective country. In Saudi Arabia thus, the issuance of Sukuk in the securities Market is governed by the Capital

Market Law and the respective Regulations issued based on it by the Capital Market Authority (CMA). Hence, a public offer would have to take place in accordance with the Offers of Securities Regulations. In accordance with Art. 8 of the aforementioned Regulations it would in turn be subject to a prior listing in accordance with the Listing Rules issued by the CMA.

As definitions and conditions may vary from country to country and jurisdiction to jurisdiction. Legal shapes and situations of Sukuk are always subject to the applicable jurisdiction and its rules. One of the factors e.g. made responsible for the success of Sukuk in Malaysia is the obligatory rating by a Rating Agency also for this kind of Securities.

The prospectuses issued for Sukuk in Saudi-Arabia for example contain short Biographies of the responsible sharī'a scholars. This underlines, that Sukuk must not only fulfill all requirements of an ordinary security from financial audit and legal side, but undergoes an additional check from its Islamic or sharī'a side.

#### **b). Periodic Distribution**

Sukuk is an asset linked certificate rather than a classical bond, which is based on a fixed interest return over an agreed period. Thus, Sukuk generate periodic income on a usually quarterly, half-yearly or annual basis, but the payout is linked to the performance of the underlying asset, which generates profit. After subtraction of the costs and expenses, these profits will be distributed to the Sukuk holders, as they have an undivided share in the underlying assets.

It is this periodic income that provides for a surplus on the invested capital. However, here also one of the main differences from interest becomes visible: Though paid periodically as interest, the distributed amount is not fixed as in an interest construction regardless of how the underlying assets perform. In a Sukuk structure, the risk and chance of the entrepreneur is forwarded in a large degree to the investor. In turn, this makes the investor more aware of risks as it causes the responsible entrepreneur to avoid these risks towards the shareholders.

c). **Secondary Market**

As many securities, Sukuk will often be designed to be traded in the secondary market as well. This has the main advantage that investors can liquidate their Sukuk at any time, without being bound to the payment originating from the periodic distribution or to wait until redemption upon maturity.

On the other hand, a number of shari'a requirements have to be met for a Sukuk to be approved as tradable in the secondary market. Again, the issue of riba comes into play in this context. It will be seen as riba al-faḍl, when the Sukuk traded for money will only contain the invested capital and no tangible assets. Thus, scholars require a certain percentage of the Sukuk's capital to be in the form of tangible assets rather than money, which is regarded as equivalent to a precious material by closely to all scholars. A number of different thresholds are named, when it comes to this point, but a frequently found figure is that of 1/3 of the capital to be present in tangible assets. Another major issue frequently discussed

amongst shari'a scholars with regard to tradability in the secondary market is that one of debt based Sukuk, because what is traded here is not a tangible asset, but rather an undertaking to pay at some point in the future. Thus, frequently debt based Sukuk structures are not traded in the secondary market.

d). **Maturity**

Once the Sukuk has reached maturity stage, the principal invested will be liquidated and paid back to the investors. In many cases the Obligor will repurchase the underlying asset and the sale price will be distributed amongst the Sukuk holders. This is of course the case mainly for asset based Sukuk, where the asset remains present.

Yet for some Sukuk the repurchase of the asset imposes a number of problems from a shari'a perspective. One of the most prominent examples is a mudaraba Sukuk. Here shari'a scholars see a difficulty, if the mudarib, (the Obligor) undertakes to repurchase the underlying assets at a pre agreed value prior to maturity of the Sukuk. The same type of Sukuk poses the problem of providing liquidity facilities from the Obligor. Here also problems with conformity to shari'a might be seen.

## **II. Issues to be Tackled**

Modern Sukuk can look back onto a successful yet short history in comparison to other securities. The shari'a conformity of the transaction or transactions seems largely assured. A clear indicator therefore is the standardisation of these transactions by the AAOIFI.

What has been left rather untouched by



sharī'a scholars to the present days are the SPV. It will become with a certain probability a next focus of attention. SPVs are used in many financial transactions and have been taken over by Islamic finance closely one on one from conventional finance structures. In many cases, structures of modern company law or English law trusts are utilized for Sukuk transactions. It seems to bear a little irony e.g. that the English law trust structures frequently used in Sukuk contexts actually originate in the time of the crusades, to protect a crusader's assets. Therefor this might be an argument for many Muslim customers to endorse more sharī'a-based structures for the SPV.

### **C. The Conference**

The conference organized by the World Bank and the Saudi-CMA focused on the development of Sukuk in general and in the Saudi context in particular. In several panels, current issues were discussed and a wide audience of local and international institution showed their presence. Aside bankers, brokers and financial analysts a number of representatives of international financial institutions such as the World Bank and the AAOIFI were present and presenting. Government representatives as the Minister of Housing underlined the Importance of financing and Islamic ways of it in the framework of future policies of the Kingdom. What was clearly outspoken was the ambition of the Kingdom of Saudi Arabia to become the leading country internationally with regard to Sukuk. In this regard, the current leadership of Malaysia was inevitably challenged. Of course a number of legal scholars were also

present (but as it appeared only Saudi) and a large number of sharī'a scholars contributed to the success of the conference.

### **D. Assessment**

As one of the few non-Saudi lawyers present, it had been an outstanding opportunity for M&P to get in contact with the Sukuk scene in the Kingdom of Saudi Arabia and beyond. Looking at the mentioned challenges for many oil-revenue-based Arabic countries it was an ideal opportunity to be informed about future trends with regard to financing and capital markets. It was obvious to see, that financing will become a future issue, when doing business in the Gulf region. With regard to the Kingdom of Saudi-Arabia, the distinct Islamic identity, the country continues to express also in the Vision 2030, raises the interest in Islamic forms of financing. The country also can provide a good number of intellectual resources to tackle this issue. Even sharī'a scholars present at the conference presented themselves in language and argumentation to be very familiar with the world of international finance and seemed to be well aware of problems issues and ambitions in this field of economy.

On the other hand, competition in this field is very apparent. The Development of the Dubai Islamic Economy Development Centre since 2013 and its underlining slogan of "Dubai the Capital of Islamic Economy" challenges openly the aspired lead in Saudi Arabia.

In consequence, the issue of Islamic financing and funding and the issue of Sukuk right at its core will be of major

importance throughout the region in the near future.

**Heinrich Köllisch**  
**Meyer-Reumann & Partners,**  
**Riyadh Office**

Saudi Arabia

## Basic Statutory Conditions of Labour Relations in Saudi Arabia

### Guiding Principle

*It is a common practice of non-Saudi and joint venture entities formed in Saudi Arabia not to observe strictly the local statutory conditions of labour relations. This happens as these entities either assume that the requirements are the same as in their home countries, or they act based on their experience from other Gulf country expecting it would be similar to the status in Saudi Arabia, or they merely do not bother to follow the developments of legislations in the Kingdom. In most cases, such practice indeed does not cause damage, as long as the labour relations are ongoing with no disagreements between its parties (the employer and the employee). However, serious consequences might occur in such case - for either party - if a dispute arises later. It is strongly advised to continuously keep an eye on the concerned regulations as amended and abide by its requirements. In this article, the basic statutory requirements are clarified concisely.*

### A. The Enforcement of Regulations in Saudi Arabia

Over the years, non-Saudi investors and their local partners in Saudi Arabia developed several approaches for practicing various activities, which violate some aspects of the concerned local regulations. This came as a result of the tolerance of the Saudi Government in enforcing the respective statutory requirements to allow these investors to try cooperating in the domestic market without many formalities.

However, this is not the case now as the Saudi Government changed its policy during the recent years. Several regulations including the companies<sup>18</sup> and the labour<sup>19</sup> laws were amended quite often to keep up with the developments in the country. The Saudi authorities are now applying all of the local requirements strictly and enforcing punishments on the violators when discovered.

This requires a commitment by the entities existing in the Kingdom to continuously observe the concerned local regulations as amended and abide by its requirements.

### B. The Governing Regulations

The labour relations in Saudi Arabia are mainly governed by the Saudi Arabian Labour Law No. M/51 (“SA-LL”) as

<sup>18</sup> The former companies’ law of 1965 was amended several times recently before the new law was issued on 2015.

<sup>19</sup> The labour law of 2005 was amended on 2013 and 2015 and there is talks now about amending it again.

amended<sup>20</sup> and its Implementing Regulation (“SA-LLIR”)<sup>21</sup>. Additionally, the Saudi Arabian Companies Law No. M/3 (“SA-CL”)<sup>22</sup> is governing some aspects of the relations concerning the employees at high management positions.

### C. The Statutory Conditions

The labour law has enforced several mandatory clauses that should be mentioned at the employment contracts. All the new contracts shall be concluded accordingly and the current contracts should be amended as well<sup>23</sup>.

#### I. Contract Term

The first thing to know that while the employment contract of a Saudi worker may be for a definite-term or indefinite-term, the contract of non-Saudi worker may only be for definite-term irrespective of the agreed period<sup>24</sup>. The

difference this condition makes that definite-term contract only ends at the expiration of its term<sup>25</sup> or by the mutual consent of both parties. On the other hand, either party may terminate indefinite-term contracts for valid reason to be specified in a written-notice to be served to other party at least sixty (60) days prior to the termination date for monthly-paid workers and no less than thirty (30) days for others<sup>26</sup>.

#### II. Contract Language

Arabic is language to be used for all documents, and shall prevail if it is used in addition to any other language.

#### III. Calendar

All periods are calculated according to Hegira calendar by default, unless it is stated in the employment contract that the used calendar is the Gregorian calendar. The Hegira year is less than the Gregorian calendar with 11 days. This could cause some disagreements if not already agreed upon, in particular for long periods services.

#### IV. Probation Period

Probation period, if any, should be stated at the contract, and shall not exceed ninety (90) days. The period may be extended by a written agreement to a period no more than one hundred and eighty (180) days.

#### V. Conditions Contradicting with the Law

Conditions at employment contract that deprive the worker from his/her rights as

<sup>20</sup> The Saudi Arabian Labour Statute (Law), promulgated by the Royal Decree No. M/51 dated 23.08.1426 A.H. corresponding to 27.09.2005, as amended by the Royal Decree No. M/24 dated 12.05.1434 A.H. corresponding to 24.03.2013, and by the Royal Decree No. M/46 dated 05.06.1436 A.H. corresponding to 25.03.2015; abbreviated (“SA-LL”).

<sup>21</sup> The Saudi Arabian Labour Law Implementing Regulation, promulgated by the Ministerial Resolution No. 1982 dated 28.06.1437 A.H. corresponding to 06.04.2016; abbreviated (“SA-LLIR”).

<sup>22</sup> The Saudi Arabian Companies Statute (Law) promulgated by the Royal Decree No. M/3 dated 28.01.1437 A.H. corresponding to 10.11.2015; abbreviated (“SA-CL”).

<sup>23</sup> Art. 52, SA-LL

<sup>24</sup> Art. 37, SA-LL and Art. 13, SA-LLIR.

<sup>25</sup> Art. 55, SA-LL and Art. 74 – Pt. 2, SA-LL.

<sup>26</sup> Art. 75, SA-LL.

granted by the labour law shall be deemed null and void<sup>27</sup>.

#### **VI. Changing the Profession of Non-Saudi Workers and Working for Other Employer**

The employer may not employ the worker in a profession other than the one specified in his work permit. Before following the legal procedures for changing the profession, a worker is prohibited to engage in a profession other than his<sup>28</sup>.

Moreover, an employer may not allow his worker to work for others, and a worker may not work for other employers. Similarly, an employer may not employ workers of other employers; without following the legal procedures<sup>29,30</sup>.

#### **VII. Terminating the Contract**

Employment contracts may be terminated by:

1. a mutual written consent of the parties;
2. the expiration of its term at definite-term contract;
3. the decision of one of the parties at indefinite-term contract for valid reason;

<sup>27</sup> Art. 8, SA-LL.

<sup>28</sup> Art. 38, SA-LL.

<sup>29</sup> Art. 39, SA-LL.

<sup>30</sup> This practice is further prohibited by the Saudi Arabian Anti-Concealment Statute (Law) promulgated by the Royal Decree No. M/22 dated 04.06.1425 A.H. corresponding to 22.06.2004; abbreviated ("SA-ACL")

4. force majeure.

#### **VIII. End of Service Benefit and Compensation**

The End of Service Benefit is given based on the last monthly salary, where it is calculated on the basis of half the monthly salary for each of the first five years and a full monthly salary for each of the following years<sup>31</sup>.

If the party who terminated the contract did not follow the statutory period for the notice, he shall compensate the other party with an amount equal to the worker wage for that period. If the termination was for invalid reason, the terminated party is entitled for a compensation equals to the worker wage for a period of fifteen (15) days for each of the service years of the worker at indefinite-term contracts, and for the rest of the contract period for definite-term contracts. The compensation shall not be less than two months wage.

***Hany Kenawi***  
***Meyer-Reumann & Partners,***  
***Riyadh Office***

<sup>31</sup> Art. 84, SA-LL.