Proceedings of the Third Harvard University Forum on Islamic Finance: Local Challenges, Global Opportunities
Cambridge, Massachusetts. Center for Middle Eastern Studies, Harvard University. 1999. pp. 111-131

A *Rahn-ᶜAdl* Collateral Security Structure for Project and Secured Financings

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ABSTRACT

This paper summarizes the principal elements, development, and implementation of the *rahn-ᶜadl* collateral security structure for the Saudi Chevron petrochemical project financing. The structure was developed with particular sensitivity to the requirements of the Hanbali school of Islamic jurisprudence. The paper describes: (a) the primary transactional participants; (b) the primary loan and *rahn* documentation; and (c) institutional requirements of the project participants. Three economic and financial trends in Saudi Arabia promoting and supporting the financing are identified. General legal considerations influencing development of the structure are discussed, and then the development and substantive elements of the *rahn-ᶜadl* structure are detailed. The structural model was developed from *sharīᶜa* precepts, with English law adaptations added to the *sharīᶜa* model (opposite to the approach usually taken). The developmental process is described, from early models to the final models for the petrochemical project. Major issues and related Saudi Arabian law are discussed in detail. Finally, the paper notes how the *rahn-ᶜadl* structure has been refined in subsequent financings and where the structure is being used in other types of financings.

I. SUMMARY

This paper summarizes the principal elements, development, and implementation of the *rahn-ᶜadl* collateral security structure for the Saudi Chevron petrochemical project financing, which was the first limited recourse project financing in Saudi Arabia. The structure was developed with particular sensitivity to the requirements of the Hanbali school of Islamic jurisprudence, but has been used (with modifications) in a variety of Middle Eastern project, structured, and other limited recourse financings. The paper describes: (a) the primary transactional participants (Saudi Chevron Petrochemical Company and its equity participants; the international, regional and local banks providing financing; and the offshore and onshore *ᶜadlān*); (b) the primary loan and *rahn* documentation; and (c) institutional requirements of the project participants, including collateral security and other credit requirements of the banks, as well as sponsor needs to reduce borrowing costs and limit recourse to the project assets in accordance with the principles of a limited recourse project financing. Economic and financial trends in Saudi Arabia promoting and supporting the financing are identified as: (i) industrial diversification; (ii) access to a broader financial base by involvement of Saudi Arabian investors, internationalization of the financing process, and the use of project financing techniques; and (iii) reduction of the governmental role in the provision of financing. General legal considerations influencing development of the structure are: (A) the primacy of the *sharīᶜa*; (B) the absence of statutory or other published law in respect of collateral security; and (C) the *sharīᶜa* precept that the agreement of the parties is binding absent a prohibition in the *sharīᶜa*. The development and substantive elements of the *rahn-ᶜadl* structure are detailed. In general, the structure needed to satisfy the credit policies of the banks, the operating and financing parameters of the developers, and both *sharīᶜa* precepts and English legal principles. The structural model was developed from *sharīᶜa* precepts, with English law adaptations added to the *sharīᶜa* model (the opposite approach to that usually taken). The scientific method for development of the *rahn-ᶜadl* model was the assembly of a group of Islamic scholars, *sharīᶜa* advisors, lawyers practicing in Saudi Arabia, and Saudi Arabian jurists. The interactive developmental process is described as it moved from early models (involving the *rahn* of a camel, land, and equipment) to the final models for the petrochemical project. Exemplary major issues and related Saudi Arabian law are discussed, including that pertaining to: (1) location of assets and choices of governing law; (2) revocability of powers of attorney and principal-agent relations; (3) *sharīᶜa* precepts applicable to an *ᶜadl*; (4) substantive law relating to a *rahn* and the nature, rights, and responsibilities of an *ᶜadl* (particularly concepts of possession, revocability, after-acquired property, subsequent advances, and actual notice to third parties); (5) the documentation used in the Saudi Chevron project financing; (6) the jurisdictional ambits of the major Saudi Arabian enforcement entities; (7) the extent of examination of underlying documentation by each such Saudi Arabian

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enforcement entity; and (8) enforcement of foreign judgments and arbitral awards in Saudi Arabia. Finally, the paper notes how the *rahn-ᶜadl* structure has been refined in subsequent financings and where the structure is being used in other types of financings, including general secured lending transactions, project financings, and financial products in the capital markets.

II. INTRODUCTION[i]

The essential participants in any financing of a large scale industrial or infrastructure project are one or more equity investors (often the sponsors of the project) and the availability of debt financing, or an Islamically acceptable alternative to the debt portion of the financing.[ii] The determination by a lender as to whether to participate in a given industrial or infrastructure loan centers on the project economics and, particularly in a limited recourse project financing, the collateral package that is made available to secure the loan. Project sponsors and their affiliates have a strong aversion to guaranteeing a project loan or otherwise incurring a balance sheet liability in respect of a project. This is particularly true of companies that may have to reflect the guarantee liability on, or consolidate project debt onto, a parent company balance sheet under generally accepted accounting principles. Thus, in addition to careful tax and ownership structuring, project sponsors and their parent companies also have a strong interest in providing the lenders with a strong collateral security package. In addition, they want the collateral for the project to be, and to be limited to, the assets comprising the project and the cash flows from operation of the project.

In fact, these needs and preferences of the equity and the debt provide the core of the definition of "project financing": financing of an economic unit in which the lenders look initially to the cash flows from operation of that economic unit for repayment of the project loan and to those cash flows and the other assets comprising the project and the economic unit as collateral for the loan.[iii] It is an "off balance sheet" method of financing. Collateral security is the essence of a project financing.

This paper presents a case study for the first limited recourse project financing in Saudi Arabia, the Saudi Chevron petrochemical project in late 1998. In particular, it focuses on the development of the *rahn-ᶜadl* collateral security structure for that financing. This collateral security structure has been used as a model for, and has found a much broader implementation in, other secured financings throughout the Middle East.

III. THE SAUDI CHEVRON TRANSACTION: PARTICIPANTS; STRUCTURE; INSTITUTIONAL REQUIREMENTS

A. Participants and General Structure

The Saudi Chevron petrochemical project is a benzene and cyclohexane project located in Madinat Al-Jubail Al-Sinaiyah, The Kingdom of Saudi Arabia. The project company, which owns and operates the project, is Saudi Chevron Petrochemical Company, a Saudi Arabian limited liability company (the Project Company). Equity in the Project Company is held by a Chevron Corporation affiliate (Chevron) and Saudi Industrial Venture Capital Group (SIVCG). Loans for the project are made to the Project Company by a consortium of international, regional and local banks (the Banks) led by Chase Investment Bank Limited, Gulf International Bank B.S.C., The Industrial Bank of Japan Limited, United Saudi Bank, and The Saudi Investment Bank as Arrangers. Additional loans, not governed by the agreements discussed in this paper, were made to the Project Company by Saudi Industrial Development Fund (SIDF).

In summary, construction and long-term multi-tranche loans are made by the Banks to the Project Company pursuant to a Facilities Agreement (the Facilities Agreement) and certain related documents and are evidenced by promissory notes (the Notes) (collectively, the Financing Agreements). Such loans are secured by essentially all the cash flows from the operation of the project, all the assets comprising the project,[iv] and all assets owned or held by the Project Company pursuant to a numerous mortgage (*rahn*) (the Mortgage (*Rahn*)) and pledge (*rahn*) and assignment agreements (the Pledge [*Rahn*] Agreements) (collectively, the Security Documents). The primary categories of assets of the Project Company include various contracts (including feedstock and other input and off-take agreements), the site lease for the land on which the project is built, other real property rights and interests, approvals and licenses, and intellectual property rights (including technology rights and licenses) (collectively, the Project Documents), cash, bank accounts, accounts receivable, immovables, the assets comprising the project itself, computers, office equipment and other personal property (collectively, with the Project Documents, the Collateral or the *Marhūn*).

In addition, certain loans are made to the Project Company by SIDF pursuant to a loan agreement (the SIDF Loan Agreement) and those documents are secured by a mortgage and pledge of certain assets of the Project Company pursuant to the SIDF Mortgage and Pledge.[v]

Two entities act as *ᶜadlān* for the transaction, one for assets of the Project Company that are located outside Saudi Arabia (the Offshore Security Agent), and one for the assets of the Project Company that are located within Saudi Arabia (the Onshore Security Agent). Collectively, the Offshore Security Agent and the Onshore Security Agent are referred to as the Security Agents. The offshore assets of the Project Company are principally cash receipts from offshore sales of benzene and cyclohexane. The onshore assets are principally the project itself and all related rights, titles, and interests.

B. Institutional Requirements

Financing for the project is provided by a group of international, regional, and local Banks. In accordance with their credit policies, the Banks have particular expectations as to the type of collateral and the nature of the collateral security interests that secure the loans. The international Banks, and some of the regional Banks, are intimately familiar with a variety of collateral security systems in different countries. They are accustomed to advanced statutory collateral security systems in which there are precise, but easily understood and implemented, systems for recordation of mortgages, pledges, and other security interests. Many of those Banks have precise requirements as to the nature of the security interest that is permissible in a lending transaction, particularly a project financing, involving that Bank—namely, perfection of the security interest must be obtainable and the priority of the security interest must rank ahead of all competing creditors, a first prior protected security interest, and the security interest must cover all the assets comprising the project and those of the Project Company. Obviously the requirements are more stringent in a project financing because the Banks do not have recourse to the sponsors or any other parties or assets.

Some regional Banks and most local Banks in Saudi Arabia have a somewhat different view of collateral security, particularly in light of the absence of a recordation system in the Kingdom and due to the absence of a Saudi Arabian statute pertaining to collateral security. While many attempts have been made over the years to achieve recordation and some type of perfection of a security interest in Saudi Arabia, most have been unsuccessful, for both legal and political reasons. For example, as discussed below, "possession" of an asset is necessary for perfection of a security interest under the *sharīᶜa* (unlike American and English systems in which recordation of the nature and extent of the security interest is the touchstone for perfection, without regard to any concept of actual physical possession). Actual possession is a difficult concept to achieve for many types of assets (consider intellectual property rights) and for an operating plant. Thus, local Saudi Arabian banks have focused more on lending transactions involving recourse to a third party, such as a guarantee by a parent company or individual shareholders in the project company or its parent. To each of the Banks, maximization of an effective collateral security interest was and is essential.

Chevron and SIVCG, like most project equity participants, desired a true limited recourse financing, with recourse limited to the Project Company and its cash flows and other assets. Neither wanted to put the credit of its affiliates or shareholders behind the financing obligations. Thus, both equity participants desired to provide to the Banks the strongest possible collateral security package—a project financing will not be undertaken by the lenders without an adequate collateral security package.

A sound security structure decreases transactional risks, with a resultant decrease in financing costs for project financing in the relevant jurisdiction. Such a cost decrease is desirable to all project sponsors and developers because of the direct effect on profitability. It is also desirable to the financing Banks because of enhanced project economics and increased ability of the Project Company to repay financing obligations.

IV. THE ECONOMIC AND FINANCING ENVIRONMENT

The economic and financing environment in Saudi Arabia prior to, and at the time of consummation of, the Saudi Chevron financing involved a focus on diversification of the industrial base in the Kingdom. There was a trend toward accessing a broader financing base, with greater involvement of Saudi Arabian investors, internationalization of the financing process, and the use of project financing techniques rather than personal and corporate guarantees. Concurrently, the government and local businesses were considering and attempting to implement methods of reducing the role of government in the provision of financing.

In the initial stages, industrial diversification proceeded most rapidly in the petrochemicals industry, particularly where affiliates of Saudi Arabian Basic Industries Corporation (SABIC) were involved. Among the early petrochemical projects which obtained financing were expansions by Saudi Yanbu Petrochemical Company (Yanpet), a joint venture between SABIC and Mobil Yanbu Petrochemical Company, Saudi Petrochemical Company (Sadaf), United Jubail Fertilizer Company, a joint venture among SABIC and five SABIC companies, Al-Jubail Petrochemical Company (Kemya), and Eastern Petrochemical Company (Sharq). Financings by these and

other companies involved some degree of recourse to project sponsors or their affiliates. They also involved some element of collateral security for the financiers of such projects. However, these projects did not fall within the "limited recourse project financing" concept that is being considered in this paper and none of those projects involved the use of the type of collateral security structure that was developed for the Saudi Chevron petrochemical project.

These projects illustrate broader involvement of Saudi Arabian investors, with each involving significant or exclusively Saudi Arabian equity, and some involving joint stock companies that may eventually seek stock exchange listings. In addition, Saudi Chevron and many SABIC projects, such as Yanpet, involve a combination of local, regional, and international lenders. Notably, 1998 also saw the first international lending transaction in the electricity sector when Saudi Consolidated Electric Company in the Eastern Province executed a "dedicated receivables" financing for its Ghazlan II project.

The health and liquidity of local and regional banks was a significant factor in industrial and infrastructure finance in Saudi Arabia in that period. Local banks reported profits in each of the years preceding the Saudi Chevron financing. Those banks experienced substantial liquidity and low loan-to-asset ratios. Profits were based more on investment income than interest, and loan growth had been low. This encouraged banks to increase lending to all economic sectors. To spread risks and increase the borrowing base, banks sought to join regional and international lending groups, particularly for large projects such as Saudi Chevron, Ghazlan II, and Yanpet.

Governmental evaluations were ongoing regarding restructuring of the electricity sector, with initial consideration given to financing the Shoaiba project as an independent power project using a build-own-operate (BOO) structure. Privatization of the telecommunications sector, Saudi Arabian Airlines, and port operations, maintenance, and management were all being actively considered. A public offering of SABIC shares was also being considered at the time. Regarding capital markets development, in April 1998 the Saudi Arabian Monetary Agency (SAMA) issued a new binding draft of the Investment Business Regulations which regulate, among other things, the distribution of securities and the management of mutual funds. Accession to the World Trade Organization was also a frequently considered topic, together with its effects on brokerage, insurance and commercial banking activities, as well as export/import markets.

Each of these developments, and others, worked to expand the capital markets, permitting greater access to foreign funds and a strengthening of the economy over the longer term. The aim was to free up Saudi Arabian capital, allowing it be spread over a broader risk base within the economy. This, in turn, would have the effect of a reduced burden on government and an allocation of risks to those willing and most able to bear them. It was anticipated that increased foreign equity investment would result in further technology transfer into the industrial sector. As completed financings illustrate, the time frame for implementation of individual projects was reduced as businessmen sought to avoid additional costs of delays and other inefficiencies in implementing their projects. Privatization, where determined appropriate, would allow governmental risk sharing with the private sector, cost reduction, and governmental management of the pace and depth of movement of functions to the private sector.

The Saudi Chevron petrochemical project financing exemplifies all of the foregoing trends and developments: extensive local equity (SIVCG, one of the two equity participants); international equity (Chevron affiliate); local (Al Bank Al Saudi Al Fransi, The Saudi British Bank, United Saudi Bank), regional (Gulf International Bank), and international (Chase Manhattan Bank) lenders; loans by SIDF; limited recourse financing techniques; and industrial diversification in the petrochemical industry. As noted in this paper, the structural implications of that financing are even broader.

V. THE LEGAL ENVIRONMENT: GENERAL CONSIDERATIONS

The fundamental and paramount body of law in The Kingdom of Saudi Arabia is the *sharīᶜa* as construed by the Hanbali school of Islamic jurisprudence. Certain matters are dealt with "statutorily," by Royal Decrees with respect to that matter. Where such a statutory body of law has been promulgated, such law is ultimately subject to, and may not conflict with, the provisions of the *sharīᶜa*. Unlike other Middle Eastern countries, there is no statutory body of law in Saudi Arabia with respect to collateral security, mortgages and pledges, recordation of security interests or related matters.[vi] Thus, financiers and legal practitioners must look directly to the *sharīᶜa* in structuring and applying legal principles relating to collateral security matters. This, in addition to the factors discussed immediately below, render it difficult to provide definitive advice as to how collateral security arrangements similar to those contemplated by the Security Documents can be effected or would be interpreted by adjudicative bodies in Saudi Arabia. It is noteworthy, however, that under the *sharīᶜa*, absent a prohibition in the *sharīᶜa*, the agreement of the parties will control.

In addition, under the principles of law applicable in Saudi Arabia, previous decisions of Saudi Arabian courts and other adjudicative authorities are not considered to establish binding precedents for the decision of later cases, and the principle of *stare decisis* (binding precedent) is not accepted in Saudi Arabia. Also, Royal Decrees, ministerial decisions and resolutions, departmental circulars and other governmental pronouncements having the force of law, and the decisions of the various courts and adjudicatory authorities of Saudi Arabia, are not generally or consistently collected in a central place and are not necessarily available to the public.

Specific legal principles affecting the collateral security structure are discussed in detail in Section 6 of this paper, entitled "Exemplary Major Issues and Resolutions."

VI. DEVELOPMENT OF THE COLLATERAL SECURITY STRUCTURE

A. General Approach

The challenge that was presented to the lawyers by both the Banks and the Project Company was to develop a collateral security structure that met the project financing and related credit requirements of all the Banks and was satisfactory to the Project Company. A structure had to be developed that met the traditional requirements of New York and English financings but was consistent with the *sharīᶜa*. In developing such structures in other jurisdictions, lawyers and financiers begin with the New York or English (i.e., Western) model as the base structure. They then attempt to implement that model within the framework of the host country's laws by adding to such model a variety of procedures and structures from the host country's practice. Those host country practices often have to be modified to fit the pre-existing Western model. This often has the effect of jeopardizing the effectiveness of the host country procedure or structure, which, in turn, weakens the entire collateral security structure.

The approach taken for the Saudi Chevron financing was the opposite: The determination was made to build the base model structure from the point of view of the host legal system, the *sharīᶜa*. Thereafter, additions and modifications would be made to incorporate procedures and structures from the Western model more familiar to the international Banks.

The adoption of this approach was the direct result of discussions with the various *sharīᶜa* advisors, Saudi Arabian lawyers and, in particular, Saudi Arabian jurists. Through those discussions, it became apparent that the Western conception that there was greater certainty in using Western collateral security structures was incorrect where legal interpretation might be had in Saudi Arabia. For example, Saudi Arabian jurists are accustomed to thinking in terms of *sharīᶜa* precepts and to operating within the *sharīᶜa* system. Our discussions revealed that they did not consistently interpret Western legal language and structures. Greater consistency and predictability was obtained in their interpretations of *sharīᶜa* precepts. In addition, it was thought to be a much more advisable course because there is greater flexibility in the New York and English legal systems as regards collateral security and there is greater certainty as to the implementation of certain relevant legal structures (particularly Western elements of the structure) in those offshore jurisdictions. In addition, and in light of the necessity of asset possession under Islamic law but not New York or English law, we anticipated that we would be able to move certain of the assets (such as cash from offshore product sales) to an offshore jurisdiction, using those assets as "first-line" collateral, and then feed cash back into the onshore jurisdiction for use in conjunction with the assets comprising the "second-line" or "ultimate" collateral.

When a project experiences difficulties, calls on collateral are often sequential and predictable. Lenders rarely foreclose on all the collateral, although they almost always have the right to do so. Rather, they attempt to minimize their intrusion into the operations of the borrower and they proceed against the assets in a definable sequence (beginning, in most cases, with cash and other liquid assets). To give effect to those realities, the Financing Agreements and Security Documents were structured to allocate cash to problem areas without resorting to the more drastic step of calling upon other assets. The security interest in the cash is held, in the first instance, in an offshore jurisdiction with which the international Banks are familiar and which meets the credit requirements of those international Banks. This satisfies the Banks' standards for first-line calls on collateral and as to the nature and extent of the security interest itself. In the Saudi Chevron transaction, England was chosen as such a jurisdiction (New York would have worked equally as well).

The remaining task was to demonstrate to the Banks that a satisfactory security interest could be obtained under the *sharīᶜa* in Saudi Arabia. As anticipated, it was not an easy task to convince the Banks that such a security interest was satisfactory under their Western-focused credit policies. There was a perception that collateral security is difficult to obtain under the *sharīᶜa* and even more difficult to obtain in Saudi Arabia and that the nature of the security interest is uncertain. The perception was strongest among those unfamiliar with the *sharīᶜa* (which was most of the people involved in the transaction). Few completed project financings have joined Islamic and American/European security concepts, and it was our challenge to effect that joinder.

B. Scientific Method

The structure was developed from first principles under relevant *sharī*^{c}*a* precepts, particularly under the Hanbali school of Islamic jurisprudence predominant in Saudi Arabia. Our first task was to achieve both a comprehensive understanding of the relevant *sharī*^{c}*a* principles and a precise understanding of how those principles compared, point by point, with similar Western concepts. We enlisted a group of legal scholars and *sharī*^{c}*a* advisors to supplement the team of lawyers. We provided the scholars, advisors, and lawyers with a detailed description of how a transaction would be structured under a Western model, including descriptions of the importance and legal effect of each structural element. They, in turn, provided a similar description of how a transaction would be structured under the *sharī*^{c}*a*, with similar explanatory materials. There was considerable back and forth in arriving at a comparative outline of the two different structures and in achieving a basic understanding of that model.

We then began to probe the legal principles pertaining to each element of the structure in the context of a construction and long-term financing for an operating plant. We began with a series of general questions: How do you get a security interest under the *sharī*^{c}*a* with respect to a given type of collateral? What is the nature of the security interest? What degree of certainty can we have with respect to any given security interest? What is necessary to retain that security interest? How is the security interest enforced? What are the respective rights and responsibilities of each of the involved parties? Why was a given element present? Why was it structured as suggested? What if the facts changed in this way or that way? What is the Islamic equivalent of a given Western element, if any? What is the Western equivalent of any given Islamic element? Would a different procedure or technique under the *sharī*^{c}*a* better serve the requirements of the project participants? As we moved from the general to the specific, the list of questions ran into the thousands and the process was repeated a number of times as the answers, and the model, were refined.

As an example, we examined each category of assets (*marhūn*) comprising a project or held by a project company and relevant *sharī*^{c}*a* precepts for granting a *rahn* (mortgage and pledge) or assignment with respect to each such category. Categories included: real estate interests (site leases, easements); immovable property (the plant); movable property (computers, equipment); cash (from sales, investments, and insurance); bank accounts; contracts; accounts receivable; intellectual property; technology licenses; and permits. Certain types of property fall into multiple categories and were appropriately analyzed.

As the model developed, we expanded our participant list from transactional lawyers, legal scholars, and *sharī*^{c}*a* consultants to include judges from the Board of Grievances of The Kingdom of Saudi Arabia. We wanted to achieve an understanding of how *sharī*^{c}*a* precepts pertaining to each element of the structure (and the developing documentation) might be applied in specific factual situations. And, as noted above, our discussions were leading us to the conclusion that greater certainty and predictability would be achieved if our structure was *sharī*^{c}*a*-based.

Given the complexities of a project financing of a large industrial project, we began with a much simpler analogy. We posited a simple loan from one person to another that was secured by a *rahn* of a camel. Our questions were retailored to this analogy. Can a *rahn* be granted with respect to the camel? What are the necessary elements of a valid and enforceable *rahn*? Who is responsible for feeding the camel? Who is responsible for caring for the camel? Who is responsible for the security of the camel? Can the camel be milked? Can the milk be sold? Who is entitled to the cash received from the sale of the milk and how should that cash be applied? What are the respective rights and obligations with respect to care of the camel during the period of the *rahn*? What are the rights and responsibilities of the parties if the camel becomes ill? Can a subsequent loan be made that is also secured by the camel? Will that security interest come into effect automatically or will other steps have to be taken to ensure the effectiveness of the new security interest? What if the camel delivers a calf? Does the creditor automatically obtain a *rahn* over the calf? How and when can the *rahn* be enforced?

We then repeated the process on a comparative basis for a loan secured by land and equipment. As the understanding of the precepts and their application developed, we expanded the inquiry to include other types of *marhūn*.

This list of detailed questions became lengthy, and the conversations even more intricate. The discussions were penetrating, fascinating, and enlightening for all persons involved. Despite the intellectual rigor of the undertaking, humor permeated the entire process. As the model got refined in accordance with *sharī*^{c}*a* precepts, we achieved a more precise understanding of the type of structural bridges that would have to be constructed to the relevant Western concepts so as to maintain familiarity to the international Banks and ensure the effectiveness of the entire collateral security structure.

As discussed below, the primary bridge between the *sharī*^{c}*a* structure and the Western concepts familiar to the international Banks was the incorporation into the collateral security structure of an ^{c}*adl*. American and European financings usually involve a trustee that holds collateral on behalf of lenders. The *sharī*^{c}*a* does not

provide for trustees, at least in a Western sense. However, the *sharīᶜa* has long experience with a similar concept, the *ᶜadl*. In brief, an *ᶜadl* is a trusted and honorable person selected by both the lender and the borrower, a type of "trustee-arbitrator" having certain fiduciary responsibilities to both parties. In addition to providing the necessary structural bridge, incorporation of the *ᶜadl* into the structure also solved or minimized numerous difficult issues under Saudi Arabian law, some of which are discussed in the next section of this paper.

VII. EXEMPLARY MAJOR ISSUES AND RESOLUTIONS

The structure that was developed involved the grant of a *rahn* with respect to the *marhūn* to one or more *ᶜadlān*. A *rahn* is a type of mortgage (with respect to real property) and pledge (with respect to personal property) of property (*marhūn*) meeting certain requirements. The *ᶜadlān* are the Onshore Security Agent and the Offshore Security Agent.

Implementing the structure involved addressing a variety of legal and financial issues, some of which are noted in this paper. This paper first discusses certain Saudi Arabian legal principles bearing on choices as to governing law and the location of assets. Then, we consider the issue of "certainty" of a grant of a *rahn* (and with respect to the taking of various actions by the holder of the security interest). Resolution of these issues led to incorporation of the *ᶜadl* into the collateral security structure. Thereafter, we outline various factors pertaining to the nature of a *rahn* with respect to different categories of collateral. Next, we focus on issues pertaining to enforcement aspects of the Saudi Arabian legal system, in particular jurisdictional issues and document review issues arising with respect to different courts and adjudicatory authorities and issues pertaining to enforcement of foreign court judgments and arbitral awards in Saudi Arabia.

A. Location of Assets; Governing Law

One of the initial structural determinations was to use both an offshore and an onshore security agent. A security interest in the cash proceeds from the sale of benzene and cyclohexane produced by the project would be deposited in the first instance in an English bank account held with the Offshore Security Agent pursuant to English law and a security interest would be taken in that bank account. As and when needed, cash would then be transferred to an onshore bank account held by the Onshore Security Agent pursuant to Saudi Arabian law. Similarly, in light of Saudi Arabian and *sharīᶜa* possession concepts, certain other assets (such as executed original copies of certain contracts and negotiable instruments) were also located in England with the Offshore Security Agent, and a security interest was obtained in those assets pursuant to English law.

Concurrently, decisions were taken as to what law should govern the various documents to the transaction. It was determined that, to the extent possible and practicable, English law would govern the Facilities Agreement and certain other Financing Agreements and those collateral security agreements that pertained to assets located in England (most notably, the cash receipts account). The remaining documents would be governed by Saudi Arabian law. As a result, two separate sets of documents were constructed, each harmonious with the other. This structure resulted in careful drafting as to procedures for contemporaneous operation under each set of documents and cooperation between the two *ᶜadlān*, particularly as regards cash movements and any possible exercise of remedies.

B. Certainty: Powers of Attorney; Agency; The *ᶜAdl*

Characterization of a given grant of rights (such as in respect of collateral) is somewhat uncertain under Saudi Arabian law. For example, various security arrangements may be characterized as "powers of attorney" given by the Project Company to the Banks, with the Banks (and the Security Agents) being characterized as mere "agents" of the Project Company.

Many, if not most, judges in Saudi Arabia take the position that such powers of attorney and most agency arrangements are revocable at will by either party under the *sharīᶜa* and other Saudi Arabian law.[vii] If so, the Project Company would be in a position to revoke the power of attorney and the agency arrangement, and thus the security interest given to the Banks, at the will of the Project Company. To the extent that the Banks derive their rights indirectly, through a security agreement, rather than directly, as a party to a contract, the Project Company may therefore be able to terminate the rights of the Banks. However, even under construction of relevant *sharīᶜa* precepts by jurists applying the Hanbali school of Islamic jurisprudence, the use of a *rahn-ᶜadl* structure confers a degree of irrevocability not otherwise found.

Further, there is an exception to the irrevocability rule under certain schools of Islamic jurisprudence. That exception is that grants of agency power, and powers of attorney, when coupled with an interest of third parties, are irrevocable when such irrevocability is relied upon by the third party. There is some debate among jurists in the

Hanbali school as to the extent to which such an exception exists in Saudi Arabia. In any event, jurists of the Hanbali school would likely give the narrowest reading to the exception to revocability.[viii]

Notwithstanding the strict mandates of the law, however, there is a trend in Saudi Arabian legal practice toward a recognition of irrevocability in certain situations. For example, the Saudi Arabian courts have recently indicated that an agency relationship or a power of attorney may not be revocable if there is a specified term for the existence of the agency relationship or the duration of the power of attorney. In addition, the SAMA Committee (as hereinafter defined) attempts to interpret contracts in accordance with the expressed agreement of the parties, even where there is a seeming conflict with the *sharīᶜa*.[ix]

In addition, under Saudi Arabian agency law, the principal (i.e., the Project Company) is always entitled to act whether or not the agent (i.e., the Security Agents and the Banks) is also entitled to act. The actions and directions of the principal will supersede those of the agent: a most undesirable outcome in a project financing.

Saudi Arabian law, however, acknowledges a type of mortgage/pledge arrangement, *al-rahn*, which is of particular relevance to this financing. *Al-rahn* is making a designated property a security for a debt, which may be partially or totally recovered from such property or the price thereof.[x] In a *rahn*, the definite property that is made a security for a debt, *al-marhūn*, may be deposited with a type of trustee-arbitrator, a trusted person mutually agreed upon by the parties, *al-ᶜadl*.[xi] This device is similar in some ways to a bailment arrangement under New York or English law. The practice in Saudi Arabia is that either or both of the *rahn* documents and the *marhūn* may be deposited with the *ᶜadl*.[xii] The nature of the *rahn*, and the rights and powers of an *ᶜadl*, with respect to the exercise of contractual rights under third party contracts that are the subject of a pledge is not well developed.

However, it is established that the *marhūn*, and/or the *rahn* documents, may be placed with the *ᶜadl* and may not be removed from the *ᶜadl*'s possession without the agreement of both the mortgagor/pledgor and the mortgagee/pledgee,[xiii] and possession may not be returned to the mortgagor/pledgor without the consent of both such parties in interest. The *ᶜadl* may not sell the property given as security without the consent of both such parties in interest, although that consent may be provided in the *rahn* documents that are executed at the commencement of the *rahn* transaction, and such consent will not be treated as a revocable power of attorney.[xiv] There are various other requirements that must be met in connection with a valid *rahn* with an *ᶜadl*.

The implications of the foregoing for the Saudi Chevron project financing were considerable. First, the structure included two *ᶜadlān*, one offshore and one onshore. Irrevocable grants were made to the *ᶜadlān*, and the Project Company, as mortgagor/pledgor, explicitly and irrevocably authorized the *ᶜadlān* to do various things and take various actions from time to time on the occurrence of specific conditions (such as sales of the items of collateral upon the occurrence of an event of default and the exercise of other remedies in connection with an event of default). These authorizations were substantially more specific and detailed than would have been the case in a document governed by New York or English law where there is a substantial body of determinable interpretive precedent and the principle of *stare decisis* is applicable. The nuances of these doctrines under the *sharīᶜa* were also addressed in detailed drafting.

The use of recitals to an agreement governed by New York or English law has diminished greatly in recent years. In some cases, the recitals continue to provide some evidence of the legal consideration for the agreements embodied therein. Although there is no equivalent body of law with respect to legal consideration under the *sharīᶜa*, the use of detailed recitals is important for other reasons. This is particularly true in a financing such as the Saudi Chevron transaction. Thus, detailed recitals, and substantive provisions of the agreements, were constructed to make it clear that an agency relationship is not contemplated and that the rights afforded the Security Agents, on behalf of the Banks, are irrevocable and coupled with an interest. The nature of the interest, as well as the reliance of the Banks and the Security Agents on the *rahn* and their irrevocability, was addressed in detail.

To render even greater certainty to the structure, the Banks, directly in certain documents, and through the Security Agents in other documents, became parties to agreements that they might have to enforce in the exercise of their rights under those agreements or under any of the Security Agreements. This resulted in the Banks becoming direct parties to more documents than would have been the case in a transaction governed by New York or English law and the Security Agents becoming direct parties to certain other undertakings and guarantees that may otherwise have been unilaterally executed by the Project Company or other grantor. Such a structural modification allows the Banks, directly, to enforce the Security Agreements should it be determined that they are unable to act through the Security Agents with respect to a given matter.

Another device that was used included having the Security Agents become "parties" to various underlying Project Documents. This was accomplished by virtue of having the parties to the Project Documents execute relatively standard "direct agreements" or "acknowledgments and consents" (the Consents). In the usual case, these Consents contain an acknowledgment by the third party that the Project Company has granted a security interest in the referenced contract to which the Consent relates. They also contain a consent to the pledge of the referenced

Project Document. In Saudi Arabia, however, the Consents contained an explicit acknowledgment by the Project Company and the third parties that the Security Agents will have the irrevocable right to enforce the underlying Project Document upon certain events (such as an event of default under the Financing Agreements). Most of the other requirements for such direct enforcement are included in standard consents of this type. These arrangements were designed to effect an "amendment" to each of the underlying Project Documents with respect to which a Consent was or is executed, making the Security Agents direct "parties" to those agreements, to a limited extent. This element of the structure helped alleviate certain of the revocability issues and other Saudi Arabian legal limitations pertaining to collateral assignments of contracts: the Security Agents will be able to enforce the various Project Documents in their own right upon the occurrence of events of default under the Financing Agreements, without having to proceed under the various collateral assignments.

Specific substantive issues arising under the *sharīᶜa*, and which would not be addressed in detail in a document governed by New York or English law, were also the subject of precise drafting. For example, the Security Documents expressly delineate the rights and powers of the *ᶜadlān* in a variety of situations, including a power and right of occupation, use and operation of the *marhūn* upon the occurrence of an event of default and as to the application of the proceeds of occupation, use and operation to satisfaction of the outstanding indebtedness.[xv] The Security Documents specify that the parties intend the grants of rights and powers to the Security Agents to be coupled with an interest, that they be irrevocable, and that such grants and the irrevocability have been relied upon by the Banks in entering into the transaction. Grants of powers and rights to the Security Agents are structured to be exclusive of powers and rights in the Project Company during the continuance of an event of default, with significantly more separation of rights than would otherwise be the case. The general language which is found in New York and English security agreements will likely be unavailing in Saudi Arabia, which interprets such grants literally based on express language.

In light of recent Saudi Arabian court decisions, the duration of the grant of a security interest was expressly stated as a quantifiable measurement of time. This should provide for irrevocability in the event of recharacterization as a power of attorney. For example, the term was set as some period of years beyond the term of the debt (to allow for enforcement upon default), with an earlier termination if all obligations of the Project Company under the Financing Agreements and the Security Documents are paid and performed in full.

C. *Rahn* Principles in Saudi Arabia

The land on which the Saudi Chevron project is constructed is owned by the Royal Commission for Jubail and Yanbu of The Kingdom of Saudi Arabia (the Royal Commission). The land is leased to the Project Company pursuant to a type of land lease agreement (the Site Lease). In the traditional structure, such leasehold interest of the Project Company would then be mortgaged to the Onshore Security Agent pursuant to a leasehold mortgage agreement to secure the obligations of the Project Company under the various Financing Agreements, in particular the Facilities Agreement and the Notes.

Under Saudi Arabian law, a mortgage of real property is treated, in most respects, identically with the treatment of a pledge of personal property.[xvi] Real property may be made the subject of a mortgage and used as collateral to secure indebtedness.[xvii] Personal property may also be made the subject of a pledge and used as collateral to secure indebtedness.[xviii] Increases in the value of the *marhūn*, additions to such property, and products from the operation of a project are automatically subject to the *rahn* under *sharīᶜa* precepts as applied by some schools of Islamic jurisprudence; under such precepts as applied by other schools, they may be made subject to the *rahn* by some definitive action or agreement; in each case, interpretations and applications of these precepts vary.[xix]

The indebtedness may be totally or partially recovered from the *marhūn*,[xx] and the entirety of the *marhūn* will remain subject to the *rahn* until payment in full of the indebtedness.[xxi] The *marhūn* must be something that can be validly sold. As such, it must (i) be in existence at the time of the execution of the contract of *rahn*, (ii) have a quantifiable value, and (iii) be saleable and deliverable.[xxii] Accordingly, a *rahn* of "after acquired" (including "subsequently constructed") property is invalid.[xxiii] The "benefits" of a property may not be mortgaged or pledged separately from such property. Thus, rent generated by, or the sales proceeds of products produced by, a property may not be mortgaged or pledged without a corresponding *rahn* of such underlying property.[xxiv] Uncertain sums may not be mortgaged or pledged.[xxv] An existing *rahn* may not be valid with respect to future advances or loans in the view of some Islamic jurists, particularly in Saudi Arabia.[xxvi] Finally, assets that are "borrowed" for use by a borrower may not be mortgaged or pledged.[xxvii]

Under the *sharīᶜa*, the mortgagee/pledgee is responsible for all expenses incurred in connection with the preservation of the *rahn*, such as the erection of the fence around the property, the wages and fees of the Security Agents, the wages of the guard posted at the property, the cost of erection of the signs and the like.[xxviii] The mortgagor/pledgor is responsible for all expenses in connection with the improvement and maintenance of the

marhūn, including repairs and operation and maintenance expenses.[xxix] Any agreement modifying these allocations is void. If either the mortgagor/pledgor or the mortgagee/pledgee should of their own accord pay the expenses that are rightly paid by the other such party, such payment is in the nature of a gift and no subsequent claim may be made for such amounts.[xxx]

Under the *sharī*^{c}*a*, a *rahn* is, by definition, possessory. The Qur'ān refers to the idea of mortgages as "mortgages with possession" (*fa rihānun maqbūḍa*). Thus, in order for the security interest purported to be created by a *rahn* agreement to be perfected (i.e. to be enforceable against third-party creditors), the mortgagee/pledgee must have "possession" of the *marhūn*. If the mortgagee/pledgee ceases to have "possession" of the *marhūn*, such mortgagee/pledgee will be treated as an ordinary creditor, and would have the same rights as other creditors in the collection of their debts, *i.e.* a *pro rata* share in the proceeds of the sale of those properties of the debtor that have not been mortgaged or pledged.

In the absence of a clear practical definition of what constitutes "possession," most jurists in Saudi Arabia appear to have taken the position that what is required is actual physical possession by the mortgagee/pledgee of the *marhūn*. However, a principle of the *sharī*^{c}*a* is that "possession is in accordance with the nature of the property to be possessed" (*qulu shay'in yuqbadhu bi hasabihi*), and in many instances physical possession is an impossibility.

Perfection of a *rahn* on real property or a real property interest in Saudi Arabia would be normally effected by (a) the preparation of a *rahn* agreement (in the form of a deed) and (b) the recordation of such *rahn* agreement on the title deed evidencing ownership of the relevant real property or real property interest.

Recordation of the *rahn* agreement has been deemed in Saudi Arabia to be a type of "constructive possession" of the *marhūn*.[xxxi] Since 1981, Saudi Arabian Public Notaries have refused to record mortgages of real property in the name of banks as mortgagees on the grounds that such mortgages secure an indebtedness which is most likely related to a transaction which is interest-based and therefore inconsistent with the *sharī*^{c}*a*.[xxxii] Thus, recordation of the Mortgage (*Rahn*), as a substitute for, and determinative indictor of, possession by the mortgagee is not presently available in Saudi Arabia for commercial banks as mortgagees.[xxxiii] Recordation is available to a very limited and identifiable group of lenders, including SIDF. Other indicators of "possession" include "bills of possession," fencing, signs, the presence of an employee or agent of the Onshore Security Agent exercising dominion and control, and similar factors.[xxxiv]

Provided that a mortgagee/pledgee has possession of the *marhūn*, such mortgagee/pledgee has priority, under the *sharī*^{c}*a*, over all other creditors of the debtor in the collection of the secured amounts owed to such mortgagee/pledgee from the value of the *marhūn*. The *marhūn* may not be separately mortgaged or pledged to another mortgagee/pledgee (unless such other mortgagee/pledgee is a partner of the original mortgagee/pledgee and the *marhūn* is mortgaged or pledged to them jointly) because, if such property is mortgaged or pledged to the second mortgagee/pledgee with the consent of the first mortgagee/pledgee, the first *rahn* becomes void.[xxxv]

Neither the mortgagor/pledgor nor the mortgagee/pledgee may sell the collateral without the consent of the other.[xxxvi] If the secured debt becomes due and the debtor/mortgagor/pledgor does not satisfy the debt obligation, the mortgagee/pledgee will not obtain title to the *marhūn*.[xxxvii] Rather, a judicially directed sale of the *marhūn*, initiated at the request of the mortgagee/pledgee, would take place.[xxxviii] The mortgagee/pledgee would have priority with respect to those sale proceeds in satisfaction of the secured amounts owed to such mortgagee/pledgee by the debtor/mortgagor/pledgor. In the event that the proceeds from the sale of the *marhūn* are less than the amount of the debt secured by the *rahn*, the mortgagee/pledgee has the right to share with other creditors in the value of the debtor's remaining property.

Prior to a judicially directed sale of the *marhūn*, it may be necessary for the banks to hold such property. The rights of the banks to occupy, use, and operate such property are unclear in Saudi Arabia due to lack of precedent. In current practice, banks avoid exercising their rights to occupy, use, and operate property in Saudi Arabia. Rather, banks are inclined to sell the *marhūn* and apply the proceeds of such sale to the indebtedness due the Banks. However, the *sharī*^{c}*a*[xxxix] and other elements of Saudi Arabian law[xl] contemplate that banks may hold the property for some time prior to a sale, whereupon they will have responsibility for the safekeeping of the *marhūn* during such period, and that the banks may apply the proceeds from the *marhūn* to the reduction of their indebtedness. These principles, while existent in Saudi Arabia, are largely undeveloped.

Although there is no prescribed form of *rahn* in Saudi Arabia, there are, based on general principles of the *sharī*^{c}*a*, various requirements under Saudi Arabian law regarding specificity of the description of the *marhūn* and the indebtedness secured thereby. The *rahn* agreement must include an accurate designation and description of the *marhūn*. In the case of a *rahn* of real property, the location and description of the real property, as specified in the deed pertaining thereto, should be included. A *rahn* of real property may also specify that it covers fixed assets located on the land, such as buildings and immovables (fixtures).[xli] The *rahn* will not be valid to the extent that it

covers property that does not exist at the time of the execution of the *rahn* agreement. Despite the validity issue, the practice of SIDF in Saudi Arabia is to include "after acquired" property within the scope of the *rahn*.

The *rahn* agreement must also identify the debt being secured thereby. There does appear to be agreement that a reference to the loan agreement pursuant to which the secured debt is incurred is necessary and that the exact amount of the debt is required to be specified in the agreement.[xlii] There should be separate detailed specifications of amounts constituting each element of indebtedness, i.e., principal, interest, and other amounts. In the event that the *rahn* agreements are reviewed for compliance with the *sharīᶜa* and are determined to secure interest, the practice in Saudi Arabia is that such agreements would be unenforceable only as and to the extent that they secure interest; the remainder of the provisions would remain enforceable.

The *rahn* agreement should also include the terms under which it may be exercised and the remedies of the mortgagee/pledgee to occupy, use, and operate the *marhūn*, and to sell such assets, and, in each case, to apply the proceeds thereof to pay off the debt secured. All other customary remedies should also be set forth in greater detail than would be the case where New York or English law is applicable.

It is important to note that Saudi Arabian law is somewhat less developed as it pertains to pledges of certain personal property, such as contract rights and permits, than it is with respect to immovables, land, and other tangible assets. For example, it is unclear whether and to what extent contract rights and permits are "saleable" under the *sharīᶜa* as applied in Saudi Arabia and thus whether they can be subject to a pledge. In addition, it is more likely that a pledge of contract rights or permits would be characterized as a power of attorney or agency relationship and thus terminable by either party at will.

A final issue under Saudi Arabian law relates to the ability of the banks to exercise remedies upon the occurrence of an event of default that is not a payment event of default. The weight of authority under Islamic jurisprudence, and in Saudi Arabia, appears to be that a party would be entitled to exercise remedies for non-payment defaults. It is less certain, however, that the banks would be entitled to accelerate the loans and exercise the full panoply of remedies in such a situation; a Saudi Arabian court or other adjudicatory authority, in applying equitable principles, may limit the available remedies.

D. *Rahn* Documentation in the Saudi Chevron Project

As noted above, in order to address the applicable *sharīᶜa* precepts, the collateral security structure was developed by dividing the available collateral into different categories. The general categories of collateral and the related *rahn* and assignment agreement were as set forth in the following table.

TABLE 1. CATEGORIES OF COLLATERAL AND AGREEMENTS

Type of Collateral	Agreement
General	Onshore Master Security Agreement
General	Onshore Common Agreement
General	Deed of Possession
General	Security Trust Deed
General	Offshore Security Deed
General	Announcement and Notification
General	Sign Language
Immovables, Real Property Interests, and Related Contracts	Onshore Mortgage (*Rahn*) Agreement

Type of Collateral	Agreement
Accounts	Onshore Pledge (*Rahn*) and Assignment of Accounts
Accounts	Offshore Accounts Assignment
Accounts	Offshore Accounts Trust Deed
Contracts	Consents
Contracts	Onshore Pledge (*Rahn*) and Assignment of Contracts
Proceeds, Available Receipts, and Accounts Receivable	Onshore Pledge (*Rahn*) and Assignment of Proceeds, Available Receipts and Accounts Receivable
Intellectual Property	Onshore Pledge (*Rahn*) and Assignment of Intellectual Property
Approvals and Permits	Onshore Pledge (*Rahn*) and Assignment of Approvals
General Personal Property	Onshore Pledge (*Rahn*) and Assignment of Personal Property
Equipment	Onshore Pledge (*Rahn*) and Assignment of Equipment
General Intangibles, Chattel Paper, Documents, and Instruments	Onshore Pledge (*Rahn*) and Assignment of General Intangibles, Chattel Paper, Documents, and Instruments
Technology Licenses	Onshore Pledge (*Rahn*) and Assignment of Technology Licenses
Technology Licenses	Offshore Assignment of Technology Rights
Letters of Credit and Performance Bonds	Onshore Pledge (*Rahn*) and Assignment of Letters of Credit and Performance Bonds
Letters of Credit and Performance Bonds	Offshore Assignment of Letters of Credit and Performance Bonds

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Each type of Collateral was independently analyzed with respect to all relevant factors, such as the nature of possession of that type of Collateral. In the recitals and in the relevant substantive provisions, each Security Document addresses each necessary element of a permissible *rahn* with respect to each category of Collateral. Those elements include marketability, value, and deliverability. A Bill of Possession was drafted to address possession issues with respect of each type of Collateral.

The Onshore Master Security Agreement and the Common Agreement were designed to unify all the Collateral and all rights and remedies in respect of each type of Collateral. This allows the Security Agents, among other things, to proceed against the entire Collateral package, if necessary, and to coordinate rights and actions in respect of each type of Collateral with all other rights and actions in respect of all other types of Collateral. In addition, separate Security Documents were drafted with respect to each individual type of Collateral.[xliii] Among other things, this allows the Security Agents to proceed on a more limited basis where such an approach is appropriate. The Security Agents could then proceed in respect of only a portion of the Collateral and minimize interference with the ongoing operation of the project. As discussed in a later section, such differentiation also allows the Security Agents greater flexibility in choosing an enforcement entity in any given situation. Each of the

Security Documents incorporated elements intended to insure that the relevant grants were irrevocable. The structure was designed so that the *Marhūn* could be placed in the possession (for *sharīᶜa* purposes) of the Security Agents.

Each of the Security Documents incorporated traditional representations, warranties, covenants, and events of default for a limited recourse project financing. These were then tailored specifically to incorporate *sharīᶜa* requirements. Particular attention was paid to keeping the *Marhūn* free of competing liens, maintaining the liens of the Security Documents, including in respect of after-acquired or after-constructed property and in respect of loans made after the date of execution of the Security Documents (i.e., subsequent advances under the Financing Agreements), placing possession of the *Marhūn* with the Security Agents, minimizing costs payable by the Security Agents as *ᶜadlān* and bailees of the Banks, preventing the Project Company from incurring indebtedness other than pursuant to the Financing Agreements and the SIDF Loan Agreement, and bankruptcy proofing the Project Company.

The Mortgage (*Rahn*) was drafted in conventional form for recordation in Saudi Arabia, notwithstanding that it cannot be so notarized and recorded under current practice. Substantive modifications were made to the Mortgage (*Rahn*) and to each of the Pledge (*Rahn*) Agreements to incorporate and harmonize with other elements of the collateral security structure. The types of modifications that were considered for the Mortgage (*Rahn*) included: (a) requirements that the Project Company (and the Royal Commission) make a notation on the Site Lease providing adequate notice of the mortgagee rights of the Onshore Security Agent; (b) recognition, in the Site Lease, of the fact that the site is mortgaged in connection with the financing; (c) obtaining the agreement of the Royal Commission to make a notation on its deed pertaining to the mortgaged property to the effect that such property is subject to the Mortgage (*Rahn*) in favor of the Onshore Security Agent;[xliv] and (d) obtaining a Consent from the Royal Commission that contained an agreement that the Royal Commission would not obtain a replacement deed for, or enter into any other lease with respect to, the mortgaged property without the consent of the Onshore Security Agent.

Various structural elements address the issue of providing adequate actual notice to competing creditors of the existence of the *rahn* in favor of the Security Agents for the benefit of the Banks. For example, notices and signs were posted and are to be maintained on the site and certain items of Collateral to provide public notice of the *rahn* on the project and other assets of the Project Company. In addition, to provide notice, it is appropriate to publish a notice of *rahn* in the *Official Gazette* (the *Umm Al-Qura*). It is not clear, however, that the *Official Gazette* would agree to publish such a notice. However, other notices were provided by virtue of "tombstone" announcements in various financial publications, including those directed at potentially competing creditors, in order to give actual notice of the existence of the security interests.

Each of the Security Documents is structured such that it is updated and amended (i) through the advance request, on each drawdown to reflect construction completed, and property acquired, since the date of the most recent previous update, and (ii) periodically throughout the term of the financing to reflect any property acquired by the Project Company since the most recent previous update. The property descriptions are detailed. For example, the Mortgage (*Rahn*) includes a precise description of the real property itself, the Site Lease, and all "fixtures" and other items of property that might, under Saudi Arabian law, be considered "immovable" property. The descriptions are subject to periodic updating. Each of the Security Documents also described with particularity the indebtedness secured thereby. Additionally, a mechanism was included in the advance request and at periodic intervals to update each of the Security Documents to reflect continuing drawdowns and an increasing amount of indebtedness.

The remedies provisions of each of the Security Documents expressly permit the Security Agents to possess, use, and operate the *Marhūn*, including as an operating entity, and to utilize the proceeds of operation to repay indebtedness and other amounts due under the Financing Agreements. Other customary remedies, including power of sale, were included in each of the Security Documents in greater specificity than would be the case under New York or English law. Given the lack of clarity in Saudi Arabian law, each of the Security Documents clearly and unequivocally indicates that the Onshore Security Agent is entitled to exercise remedies, including remedies other than judicial sale, upon the occurrence of events of default which are not payment events of default. The Security Documents stipulate that non-payment remedies are integral to the transaction, that the failure to perform with respect to non-monetary matters is likely to have a material adverse effect on the nature of the Collateral (indicating the limited recourse nature of the financing), and that the existence of such non-payment events of default was relied upon by the Banks in entering into the transaction.

Because of the provisions of the *sharīᶜa* requiring that the Banks maintain responsibility for expenses relating to preservation of the *rahn*, among other reasons, the Facilities Agreement contains covenants to require the Project Company, as part of the project design, to include features that maximize the value, utility, useful life and secure status of the Collateral. These provisions have the ancillary effect of minimizing the cost exposure of the

Banks. For example, the Project Company is required to erect a fence and the pertinent notices of existence of the *rahn* in the construction contract and is required to at all times maintain a security force, acceptable to the Banks, which security force acts under the direction of the Onshore Security Agent if an event of default has occurred. Other documentary provisions were fashioned to require that the expenses in connection with the "possessory" interest of the Banks be included in various other agreements. In certain instances, the Project Company is able to act as agent for the performance by the Security Agents of their responsibilities in respect of the Collateral. In addition, traditional reimbursement obligations with respect to these expenses were included in the Facilities Agreement.[xlv]

Each of the Security Documents also contains provisions that lay the basis for asserting the jurisdiction of the different Enforcement Entities (as hereinafter defined) in Saudi Arabia. And each Security Document affords the Security Agents, on behalf of the Banks, the widest possible latitude in choosing an Enforcement Entity.

E. Jurisdiction of Enforcement Entities

Considerations of choice of forum are critical in every financing and in every jurisdiction in the world. Different enforcement entities have different areas of expertise and different sensitivities to issues. Each enforcement entity has a different array of remedies that it can apply, particularly in a jurisdiction such as Saudi Arabia. Rights to appeal from each Enforcement Entity (as hereinafter defined) are different. And, given varying dockets and procedures, the dispute resolution period can and does vary dramatically from one Enforcement Entity to another.

There are a number of different courts, committees, offices, and boards (collectively, Enforcement Entities) that might have jurisdiction over a matter in Saudi Arabia in which a Bank could be involved. Three of these Enforcement Entities were of particular relevance in the context of the Saudi Chevron financing: the Banking Disputes Settlement Committee (the SAMA Committee) of the Saudi Arabian Monetary Agency (SAMA); the Office of the Settlement of Negotiable Instruments Disputes, also known as the Negotiable Instruments Offices (the NIO), which is under the jurisdiction of the Ministry of Commerce;[xlvi] and the Board of Grievances (*Qiwan Al-Mazal'im*) under The Board of Grievances Law (the Board of Grievances). In summary:

1. the SAMA Committee has jurisdiction over matters and disputes involving banks and their customers—that is, "settling" disputes between banks and their customers "in accordance with the agreements concluded between them." Under the regulations constituting the SAMA Committee, all disputes between banks, including foreign banks, and their customers (other than those involving negotiable instruments) are to be referred in the first instance to the SAMA Committee;[xlvii]
2. the NIO has jurisdiction over actions, matters, and disputes involving negotiable instruments (such as the promissory notes used in the Saudi Chevron financing of this type), and in the context of such disputes, the NIO has jurisdiction superior to that of the SAMA Committee;[xlviii] and
3. the Board of Grievances has jurisdiction over commercial disputes (by implication, other than banking disputes and negotiable instruments disputes), including the enforcement of foreign judgments and bankruptcy matters.[xlix]

The jurisdiction of the various Enforcement Entities is, in certain respects, unclear and arguably overlapping. Numerous questions arise as to which Enforcement Entity would have jurisdiction in various matters involving one of the financing banks. For example, although the Board of Grievances has jurisdiction with respect to enforcement of foreign judgments and awards generally, the SAMA Committee has jurisdiction with respect to all matters involving banks (other than in respect of negotiable instruments). Does this mean that the SAMA Committee should assert jurisdiction with respect to a foreign award obtained by a bank? Would this be true despite the express provisions of the various official pronouncements regarding enforcement of foreign awards, particularly those rendered in foreign arbitrations? In the bankruptcy context, although the Board of Grievances generally has jurisdiction, if there is a bank creditor should the SAMA Committee take jurisdiction? Which Enforcement Entity has jurisdiction where the foreign judgment or award is in on a negotiable instrument? These are questions of first instance in Saudi Arabia, which will be determined by each Enforcement Entity, and it is not possible to determine in advance the decision which will be made.

Given the foregoing situation and issues, among others, it was important to structure the transaction, particularly the collateral security package, in a manner that would afford the Banks the Enforcement Entity of their choice in any given situation and to raise these jurisdictional issues with such Enforcement Entity.

F. Examination of Underlying Documentation under the *Sharīᶜa*

Creditors involved in disputes to be resolved through the SAMA Committee or the NIO are afforded certain advantages over creditors who pursue their claims before the Board of Grievances. Although the SAMA Committee is in theory obliged to apply the *sharīᶜa* and its precepts, including the prohibition on interest, to banking disputes, in practice the SAMA Committee has generally shown a willingness to force a recalcitrant debtor to honor the terms of the agreement creating the indebtedness, regardless of whether the agreement requires the payment of monies in the nature of interest or is otherwise variant from the principles of Saudi Arabian law. The SAMA Committee does examine the various underlying documents and will make inquiry as to whether these arrangements are in accordance with Saudi Arabian law, but makes all reasonable efforts to respect the agreement of the parties even in the face of conflicts with the *sharīᶜa*.

It is noteworthy that review by the SAMA Committee is comprised of a legal review and an accounting review. The accountants of the SAMA Committee perform independent determinations, based on their calculations, of the amount of interest payable in respect of a given dispute. Interest is payable only to the date of commencement of the action with the SAMA Committee. Thus, no interest is payable in respect of periods after such date and no interest is payable in respect of overdue amounts. In practice, it is the author's understanding that most actions before the SAMA Committee take from six months to one year.

Remedies available to the SAMA Committee include (i) prohibition of the debtor from leaving Saudi Arabia and (ii) putting the debtor on a "notice list" which is circulated to banks in Saudi Arabia. The second alternative can be a very effective remedy, as banks in Saudi Arabia will decline to conduct banking business with the debtor so listed.

Where the SAMA Committee, acting as a mediating body, is unable to bring about a settlement of a dispute, its implementing regulations require that the matter be submitted to the court of competent jurisdiction (i.e., the Board of Grievances) for a *de novo* hearing. Notwithstanding the express requirements of such implementing regulations, however, under present practice the Board of Grievances will generally decline to hear cases that fall under the jurisdiction of the SAMA Committee.[l]

In resolving actions, matters, and disputes within its jurisdiction, the NIO will generally enforce a debt obligation as evidenced by a negotiable instrument without looking to the substance of the transaction giving rise to such instrument, including whether such indebtedness includes amounts in the nature of interest.[li] The NIO will, however, consider general defenses such as whether or not a debt was actually incurred or a negotiable instrument properly formed. Thus, the NIO does not undertake an inquiry into whether the documents underlying a negotiable instrument comply with the *sharīᶜa* and certain other principles of Saudi Arabian law.[lii] Actions before the NIO are resolved in less time that those before the SAMA Committee.

The Board of Grievances will undertake a fulsome examination of any matter presented to it, and this examination will include a rigorous inquiry into matters of public policy (including the compliance of all documentation with the *sharīᶜa* and other principles of Saudi Arabian law). Thus, if a foreign judgment or award is obtained and enforcement is sought in Saudi Arabia, the Board of Grievances may examine the underlying documentation and make what is essentially a *de novo* determination as to whether the documentation underlying the judgment complies with the *sharīᶜa* and Saudi Arabian law. In the context of considering the position of the Board of Grievances, it should be noted that the Board of Grievances generally does not recognize provisions of agreements with respect to choice of foreign law or submission to the jurisdiction of foreign courts. Actions before the Board of Grievances often take from two to ten years, although the author has been informed by Saudi Arabian legal practitioners that actions for enforcement of foreign judgments are likely to take approximately one year if the order or award, on its face, does not contravene the *sharīᶜa* or Saudi Arabian law.

G. Enforcement of Foreign Judgments and Awards; Arbitration

As noted above, large industrial and infrastructure projects are increasingly international in scope. Thus, they frequently involve the law of two or more countries. A critical set of legal and financial issues involve the enforcement of a foreign (e.g., American, English or French) arbitral award or court judgment against the project company or its assets in the country in which the project is located (in this case, Saudi Arabia). The court with jurisdiction over applications seeking enforcement of foreign judgments is the Board of Grievances. There is an unresolved jurisdictional issue where the foreign judgment or arbitral award is obtained by a bank because of the jurisdiction of the SAMA Committee over disputes involving banks. The author is aware of only one case where a foreign bank has sought to enforce in Saudi Arabia a decision of a foreign court or arbitral body.[liii]

There is little precedent for the recognition and enforcement of foreign judgments by the Saudi Arabian courts.[liv] Indeed, other than a small number of 1989 cases involving judgments of courts in member states of the Arab League, the author is aware of no instance where the Board of Grievances has afforded final recognition and

enforced a judgment of a foreign court or foreign arbitral award. The author has been informed of a single recent case in which a bank sought enforcement of a foreign judgment or award.[lv] In that case, the Board of Grievances reportedly declined to exercise jurisdiction because of the involvement of a bank. Presumably, enforcement would be sought from the SAMA Committee in such an instance.[lvi]

Nevertheless, Saudi Arabian law does give the Board of Grievances the power to issue a judgment recognizing a foreign judgment for enforcement in Saudi Arabia if the state of origin would afford reciprocal recognition to the judgments of the Saudi Arabian courts and provided that nothing in the foreign judgment contravenes the *sharīʿa*.[lvii] In the only recent cases of which the author is aware which sought enforcement of decisions of the courts of England, the Board of Grievances declined to enforce the judgments because no showing had been made that the English courts would afford reciprocal treatment to a Saudi Arabian court decision.[lviii] As noted above, the Board of Grievances is said to have recently declined to exercise jurisdiction in the case of a foreign court judgment or arbitral award obtained by a bank.

In 1994 Saudi Arabia filed an instrument of accession to the New York Convention on the Recognition and Enforcement of Arbitral Awards of 1958 (the New York Convention). The authorizing decree incorporates the requisite reciprocity requirement and specifies that jurisdiction over actions seeking enforcement of foreign arbitral awards shall lie with the Board of Grievances.[lix]

To date, the Board of Grievances has not issued procedural rules for actions seeking enforcement of international arbitration awards. The author understands from Saudi Arabian legal practitioners that have consulted Board of Grievances officials that no such rules will be issued in the near future. This being the case, it appears that an application for the recognition of a foreign arbitral award would be submitted and would proceed in accordance with the procedures specified for applications in respect of the recognition of foreign judicial awards.

The author also understands that only one application seeking recognition of a foreign arbitral award under the New York Convention has been filed to date. In that case, the Board of Grievances declined to exercise jurisdiction because the foreign court judgment or award was obtained by a bank. Presumably, the bank must then make application to the SAMA Committee for enforcement of the judgment or award. Since any such application to the Board of Grievances would be quite rare at this point in time, it would be reasonable to anticipate that the Board of Grievances would consider such an application, as well as any objections filed with respect to the application, carefully and deliberately. *De novo* Board of Grievances proceedings normally last from two to ten years, with the long duration being in large part due to *sharīʿa* rules of procedure which allow a defendant considerable ability to delay the final resolution of the proceeding. The author understands from Saudi Arabian legal practitioners that a proceeding before the Board of Grievances to enforce an arbitral award which, on its face does not contravene the *sharīʿa* or other Saudi Arabian law, should take approximately one year.

Assuming that it can be demonstrated to the Board of Grievances that the party against whom enforcement is being sought has been afforded the requisite due process (such as appropriate summons and opportunity to defend), then a foreign default judgment should, at least in theory, be as enforceable as a contested judgment.

However, officials of the Board of Grievances also indicated that they would review arbitral awards brought for enforcement under the New York Convention to ensure compliance with the *sharīʿa*, on public policy grounds. Although it is clear that decisions which are contrary to the *sharīʿa* will not be enforced on public policy grounds, it is unclear how broadly the Board of Grievances will review an award or the legal basis for the issuance of the award to ensure compliance with the *sharīʿa*. For example, it is possible that the Board of Grievances would decline to recognize an award if it is based upon underlying contractual commitments which would not be enforceable under the *sharīʿa*, such as where the underlying contractual commitment is prohibited, or *muharam*, under Islamic jurisprudence. Similarly, it also possible that the Board of Grievances would decline to recognize an award of damages where the damages are of a type which would not be available under the *sharīʿa*,[lx] or where an element of an award would not be available under the *sharīʿa*. For example, generally speaking, in judicial proceedings in Saudi Arabia, the courts will only award actual, proven, out of pocket damages. Damages which are deemed by Saudi Arabian jurists to be speculative in nature, such as lost profits, are generally not available under the *sharīʿa* as interpreted in Saudi Arabia. Recognition of an award containing an element deemed to be speculative may therefore be declined.

From conversations with Saudi Arabian jurists, it is the author's understanding that the wording of the judgment or award may be critical. Many jurists believe that the Board of Grievances will not look beyond the face of the award, particularly in the case of an arbitral award. If the award, on its face, does not contravene the *sharīʿa* or other Saudi Arabian law, it is felt that the Board of Grievances will not look beyond the award to substantive documentary provisions, although it will examine jurisdictional matters.

The fact that a foreign judicial decision contains an element that violates the *sharīʿa* may not necessarily be fatal to the enforcement of the decision, however. For example, the party seeking recognition of the decision in

Saudi Arabia could, as a part of its recognition application, expressly disclaim any right to recovery based upon the contravening element. For example, the party could disclaim any right to recover the interest component of the award. Furthermore, in the event that the recognition of an English arbitral award or judicial decision in Saudi Arabia is the only means by which the Banks could obtain satisfaction with respect to claims under the Facilities Agreement, it might be possible to fashion the claims, and thus hopefully the decision, in such a way as to maximize the probability of the decision being recognized by the Board of Grievances.

H. Dispute Resolution in the Saudi Chevron Financing

Decisions were taken in the Saudi Chevron financing, as they are in any international financing, as to whether arbitration should be a mandatory or permissible remedy. Numerous transactions have been structured to allow the financing banks the choice of remedies, court actions, or arbitration, as well as the choice of forum. In some instances, the remedies vary with the nature of the dispute—providing for court resolution as a possibility in some disputes and mandatory arbitration with respect to other types of disputes. The provisions of the Security Documents and the Financing Agreements for the Saudi Chevron transaction contain complicated and carefully negotiated remedies provisions incorporating a variety of mechanisms for dispute resolution. On the whole, they allow the Banks, at times through the Security Agents, maximum flexibility as to choice of forum in Saudi Arabia (and outside Saudi Arabia, where appropriate) and the provisions include Enforcement Entity, court, and arbitral board options, although the range of options varies with the type and subject matter of the dispute.

VIII. DEVELOPMENT OF THE *RAHN* AND *ᶜADL* CONCEPTS IN FINANCINGS

The Saudi Chevron structure is now the basis for a wide variety of project financings and other secured lending transactions in Saudi Arabia. Lending transactions of all types are incorporating the possessory concepts relating to a *rahn* of a *marhūn*, even where additional collateral is available to secure the loan. Various business groups, as well as banks, are considering ways in which to use the *rahn-ᶜadl* structure to promote residential housing finance. The *rahn-ᶜadl* structure has been implemented in the collateralization of large equipment leases and fleet leases. Proposals are being discussed for the establishment of a private security interest recordation system to achieve the broadest possible notice. As lender comfort increases, there should be decreased reliance on personal and corporate guarantees and greater use of secured financing techniques. This would allow individuals and companies to deploy assets over a wider investment base and banks to make loans of longer tenor, increasing capital investment throughout the economy.

The *ᶜadl* structure is also being implemented in a wide variety of transactions. These range from employee stock participation programs to securitizations to debt instrument issuances to project financings. The increased certainty and stability of *ᶜadl* arrangements will insure that its use becomes commonplace in capital market transactions as well.

[i] The development of the collateral security structure entailed study of many written sources and discussions with *sharīᶜa* advisors, Saudi Arabian judges, and lawyers practicing in Saudi Arabia. Many of the written sources are available only in Arabic. The most widely available summary of *sharīᶜa* precepts in English is the *Majalat Al-Ahkam Al-Adliyah*, a summary of certain principles of the *sharīᶜa* as applied by the Hanafi school of Islamic jurisprudence in the former Ottoman Empire and countries that were formerly part thereof; it was officially adopted in the Ottoman Empire. The *Majalat Al-Ahkam Al-Shar'iyah* is a summary of certain principles of the *sharīᶜa* as applied by the Hanbali school of Islamic jurisprudence in the Kingdom of Saudi Arabia. It has not been officially adopted in Saudi Arabia. It is not as detailed as the *Majalat Al-Ahkam Al-Adliyah.* English-language translations of relevant portions of the *Majalat Al-Ahkam Al-Shar'iyah* were prepared for the author expressly for the development of the collateral security structure for the Saudi Chevron transaction.

Throughout this paper, footnote references are made to the *Majalat Al-Ahkam Al-Adliyah*, most often without further reference to the *Majalat Al-Ahkam Al-Shar'iyah*. In many instances, no corresponding provision can be found in the *Majalat Al-Ahkam Al-Shar'iyah*. In many instances, the cited principle is interpreted or applied differently, or with modifications, by Saudi Arabian jurists applying principles of the Hanbali school of Islamic jurisprudence. Many such differences or modifications were made known to the author orally in discussions, and no specific reference is made in this paper to the variations from the *Majalat Al-Ahkam Al-Adliyah*. Although not all such differences are discussed in this paper, the various documents for the Saudi Chevron financing included adaptations to give effect to those differences.

Each of the *Majalat Al-Ahkam Al-Shar'iyah* and the *Majalat Al-Ahkam Al-Adliyah* use a single Arabic word ("*al-rahn*") for security interests in both real and personal property, without distinction, and that convention is followed in this paper. However, in certain instances, an English-language term is used. In partial conformity with the *Majalat Al-Ahkam Al-Shar'iyah* and the *Majalat Al-Ahkam Al-Adliyah*, only the English terms "mortgage" and "pledge" are used. The term "mortgage" refers to security interests in real property and other immovable property (essentially "fixtures" under New York and English law), while the term "pledge" refers to all security interests in personal property, including contract rights, cash, accounts, movable assets, permits, and intellectual property.

[ii] Although not discussed in this paper, Islamic alternatives to the debt portion of the financing have been developed and implemented. One such alternative was developed by the author in conjunction with three Saudi Arabian banks and was implemented in the financing of an electricity-generating project (including transmission equipment) in Saudi Arabia. That project involved the use of an undisclosed *mushāraka* comprised of the project sponsor and the financing banks. The *mushāraka* shares and project assets were sold over time, pursuant to a *murābaḥa*, from the financing banks to the project sponsor. The obligation under the *murābaḥa* could be secured in essentially the same manner as discussed in this paper.

Because the Saudi Chevron project financing involved debt financing, this paper makes reference to a debt portion of the financing.

[iii] The definition cited is of a "pure" project financing; recourse is limited to only such cash flows and other assets. Such a structure is sometimes referred to as "non-recourse project financing," although most practitioners refer to such a structure as a "limited recourse project financing" because there is recourse to project company assets. In many project financings, there is additional limited recourse to assets outside those of the relevant economic unit—such as where a parent company provides a limited completion guarantee during the construction period.

[iv] As is customary in project financings, the Project Company is a single-purpose entity and has few assets other than such cash flows and the assets comprising the project itself.

[v] Very difficult issues arose in connection with the intercreditor arrangements between the Banks and SIDF. These issues were successfully resolved, in some cases with unique arrangements and provisions. Those issues and the means of their resolution are not discussed in this paper.

[vi] A unique exception in Saudi Arabia is in the area of ship mortgages, which is governed by the Commercial Court Regulations (Royal Decree No. M27 of 1931), the Ship Mortgage Regulations (which came into force on June 17, 1955), and the Regulations for Ports and Harbors (Royal Decree No. M27 of July 14, 1974), and the Regulations for Ports, Harbors and Lighthouses dated 19/6/1394 (Resolution No. 934 of the Council of Ministers).

[vii] Under the *sharīᶜa* it is unlikely that a mortgage or pledge would constitute a nominate contract of assignment (*hawala*). The Islamic contract of *hawala*, which means literally to "turn over," contemplates a situation where a creditor, A, assigns to his own creditor, C, a debt that is owed to A by B. In order for this contract to be effective as a contract of *hawala*, the amount owed to A by B must exactly equal the amount owed by A to C. Furthermore, A must be indebted to C and B must be indebted to A at the time the contract of *hawala* is concluded. The contract of *hawala* may not relate to future indebtedness, a particularly thorny issue in an ongoing funding regime for a project financing.

It is unclear under the *sharīᶜa* whether other rights ancillary to the right to receive payment (for example, the right to accelerate payment upon the occurrence of a specified default, or the right to claim under a tax indemnification provision) are in fact "turned over" to the assignee. With respect to ancillary rights, it can be argued that A may only grant to C the power to act as A's agent in enforcing them, again subject to the various conditions applicable to contracts of agency.

A contract of assignment that does not meet the narrow conditions of the nominate contract of *hawala* will, generally speaking, be considered a contract of *wakala*, or agency. In other words, in the present case, under the various Security Documents, the Project Company would be considered to have granted the Security Agents what is effectively a power of attorney empowering the Security Agents to exercise all or certain of the borrower's (i.e., the Project Company's) rights under the various Project Documents being assigned.

The characterization of a mortgage or pledge (*rahn*) as a contract of *wakala* has several implications. *First,* under the *sharīᶜa* as applied in Saudi Arabia, contracts of agency are generally considered cancelable at will by either the principal or the agent. (An exception is noted in the text of this paper.) *Second,* where a principal grants to an agent the power to exercise certain of the principal's rights, the principal retains the power to exercise such rights in its own name independently of the power in the agent, and the actions of the principal would be superior to those of the agent (which would be unacceptable to the Banks in any financing). *Third,* a Saudi Arabian court or other adjudicatory authority might construe the grant of the power of agency pursuant to a mortgage or pledge narrowly, finding that the Security Agent has only such powers as are expressly granted thereunder.

[viii] Notably, where a power of attorney or agency relationship is revoked contrary to the terms of the documents granting such power and one of the parties is thereby harmed, an appeal can be made to the Saudi Arabian courts for relief, as an equitable matter, to make the harmed person whole.

[ix] Interpretation issues are discussed in Sections VII.E and, especially, VII.F of this paper. The SAMA Committee (officially, the Banking Disputes Settlement Committee of the Saudi Arabian Monetary Agency) is the enforcement entity in Saudi Arabia that is most likely to have jurisdiction in a dispute pertaining to a financing such as the Saudi Chevron project financing. However, as discussed in Sections VII.E and VII.F of this paper, it is not the only entity that may have jurisdiction.

[x] See, for example, Articles 940-944 and 1008-1017 of the *Majalat al-Ahkam Al-Shar'iyah* and Articles 701-761 of the *Majalat Al-Ahkam Al-Adliyah*.

[xi] The *marhūn* may also be held by the mortgagee or pledgee, and the *ᶜadl* many be one of the mortgagees or pledgees.

[xii] The *rahn* structure has found considerable use in financings of residential property, for example.

[xiii] If the parties so agree, only the consent of the mortgagee/pledgee will be required.

[xiv] There are various instances in which consents must or may be obtained in connection with the application of *sharīᶜa* precepts relating to the *rahn*. In many of those instances, the consent may be obtained at the time of entering into the *rahn*.

[xv] The rights of banks to use and operate property that is mortgaged or pledged as collateral, and to apply the proceeds derived from such use and operation to indebtedness secured thereby, is unclear under Saudi Arabian law. The practice in Saudi Arabia is for Banks to sell the property granted as collateral rather than to operate such property and apply such proceeds. However, the *sharīᶜa*, the *Majalat Al-Ahkam Al-Adliyah*, the *Majalat Al-Ahkam Al-Shar'iyah*, and the Saudi Arabian Banking Control Law do contemplate such use and operation and the application of such proceeds. For example, a camel provided as security must be fed and cared for and may be milked. The milk may be sold and the proceeds of such sale may be applied to the reduction of the secured debt. Similarly with regard to the fruit of trees on land with respect to which a *rahn* has been granted.

[xvi] Because the term "*rahn*" encompasses both mortgages and pledges, and because mortgages of real property and pledges of personal property are treated identically for most purposes under the *sharīᶜa*, and a *rahn* encompasses both mortgages and pledges, the outline of legal principles in this section makes reference to principles applicable to both types of property, except where otherwise noted by use of the term "mortgage" or "pledge."

[xvii] Consider, for example, the examples cited in Articles 711, 723, and 724 of the *Majalat Al-Ahkam Al-Adliyah*. SIDF takes a mortgage on leasehold interests. Similarly, in practice, other real property interests may be subjected to a mortgage.

[xviii] Consider, for example, the examples cited in Articles 711 and 714 of the *Majalat Al-Ahkam Al-Adliyah*. As noted in this paper, certain types of personal property rights may not be pledged: they must be assigned. Assignment agreements (often incorporated into the Pledge (*Rahn*) Agreement) were used for granting rights in such property in the Saudi Chevron financing. In Saudi Arabia, intellectual property is subject to a special set of rules, which are not discussed in this paper.

[xix] Consider, for example, Article 711 of the *Majalat Al-Ahkam Al-Adliyah* with respect to the *rahn* of a piece of land as including all trees growing thereon and the fruits of such trees, and Article 715 of the *Majalat Al-Ahkam Al-Adliyah* as to increases arising out of the pledge or mortgage.

[xx] Consider, for example, the examples of pledges that are cited in Articles 711, 712, 723, and 724 of the *Majalat Al-Ahkam Al-Adliyah*.

[xxi] Article 731 of the *Majalat Al-Ahkam Al-Adliyah*.

[xxii] Article 709 of the *Majalat Al-Ahkam Al-Adliyah.* Also consider Article 710 of the *Majalat Al-Ahkam Al-Adliyah*.

[xxiii] Article 713 of the *Majalat Al-Ahkam Al-Adliyah*. This precept, as applied in Saudi Arabia, is critical to many aspects of a project financing structure. In the usual case, the Financing Agreements are executed before there is any real collateral (other than Project Documents). Thus, essentially all of the *Marhūn* is "after-acquired" or "after-constructed." In the Saudi Chevron financing, various structural modifications were made to continually update the *Marhūn* and include all Project Company assets therein. Some of those modifications are discussed in this paper.

[xxiv] This element of Saudi Arabian law presented interesting issues at the time that SIDF entered the financing structure (which was some time after the Banks had undertaken their financing obligations). SIDF, for example, was interested in taking a mortgage in the property but in leaving the revenue from operations to the Banks as collateral security.

[xxv] Consider, for example, Article 709 of the *Majalat Al-Ahkam Al-Adliyah*.

[xxvi] But, consider Article 714 of the *Majalat Al-Ahkam Al-Adliyah*.

[xxvii] But, consider Articles 726-728, 735, and 736 of the *Majalat Al-Ahkam Al-Adliyah*.

[xxviii] Article 723 of the *Majalat Al-Ahkam Al-Adliyah*.

[xxix] Article 724 of the *Majalat Al-Ahkam Al-Adliyah*.

[xxx] Article 725 of the *Majalat Al-Ahkam Al-Adliyah*.

[xxxi] It is to be noted that "constructive possession" is a concept that is not incorporated in the *sharī*^{c}*a*. The term is used here solely as an analogy that is familiar to United States and English lawyers and financiers, and further discussion of the principle is provided in this paper.

Recordation of real property in Saudi Arabia is effected by the Public Notaries according to the system of personal recording (in the name of the owners of the real property) since there is no separate record and number for each parcel of real property. In recording a *rahn* of real property, the Public Notaries inscribe the full text of the *rahn* agreement on the title deed for the particular property and deliver such deed to the mortgagee. Because of the present lack of recordation in Saudi Arabia, an owner of mortgaged real property (the debtor/mortgagor) is not precluded from obtaining a replacement deed (in lieu of the one claimed lost). Thus, such debtor/mortgagor is capable of disposing of such property, by sale or by other property-transferring dispositions, without the consent or knowledge of the mortgagee if the mortgagee is not in possession of such property. Even where there is recordation, Public Notaries require that an annotation be inscribed indicating that the mortgagee has possession of the mortgaged property, and are often very strict in this respect. It is not clear that Public Notaries would be amenable to undertaking not to issue replacement deeds for a particular parcel of land.

[xxxii] See, Supreme Judiciary Council Decision No. 291, dated 25/10/1401 A.H. (August 25, 1981).

[xxxiii] There is some difference of opinion as to whether recordation of a mortgage is merely evidence of the existence of the mortgage or goes to the validity of the mortgage itself. The weight of authority in Saudi Arabia, particularly given the present practice in which recordation is not available, is that recordation speaks only as evidence of the existence of the mortgage.

[xxxiv] Local banks in Saudi Arabia have utilized a number of techniques to obtain recordation in the face of the unwillingness of Public Notaries to record. For example, banks have used nominee individuals or companies as mortgagees. More recently, Saudi Public Notaries have refused to record mortgages in favor of any individual or company other than government-owned lending agencies, on the grounds that such individuals or companies are likely to be acting only as nominees for local banks engaged in lending transactions inconsistent with the *sharī*^{c}*a*.

Prior to the absolute prohibition on recordation (other than for SIDF and similar entities), another alternative device to obtain adequate collateralization was the transfer of title to the mortgaged real property to a nominee individual (such as a bank officer) or company (such as a company formed by certain shareholders of the bank). The borrower would sell the real property to the nominee individual or company at a nominal price and transfer the title deed to such nominee. The bank would then provide contractually (usually through a trusteeship agreement), and through control over the relevant individual or company, that the property so held is held for the benefit of the bank and for the proceeds of any sale to be paid to the bank, while the borrower would sign a letter granting the nominee-trustee the right to arrange the sale of the security on first demand.

This solution was not wholly satisfactory to most local banks, as disputes have arisen upon the death of a nominee or disagreements have arisen among shareholders of the nominee company. There have been, however,

several examples where banks have successfully used this mechanism to realize value on their real property collateral by arranging for the sale of such property.

[xxxv] Article 744 of the *Majalat Al-Ahkam Al-Adliyah*. This precept and its application gave rise to delicate structural and drafting issues where both the Banks and SIDF took security interests in the same property. In other transactions, SIDF has permitted second mortgages without regard to the extinguishment possibility. The author is unaware of any actions in Saudi Arabia in which the cited principle has been tested.

[xxxvi] Article 756 of the *Majalat Al-Ahkam Al-Shar'iyah.*

[xxxvii] Obtaining title would be an option available to the Banks in a New York or English financing. Frequently, however, banks are reluctant to take title to a project for reasons pertaining to such matters as lenders' liability or environmental law issues.

[xxxviii] Consider Articles 756-761 of the *Majalat Al-Ahkam Al-Adliyah.*

[xxxix] See also *Majalat Al-Ahkam Al-Adliyah* and *Majalat Al-Ahkam Al-Shar'iyah*.

[xl] For example, Article 10, paragraph (2), of the Banking Control Law of Saudi Arabia permits a bank to have a direct interest, as shareholder, partner, proprietor, or in another capacity, in a commercial, industrial, agricultural, or other enterprise only if such interest accrues to the bank in settlement of a debt from a third party. The bank must liquidate such interest within two years or such longer period as may be determined by SAMA.

[xli] Immovable property under the *sharīᶜa* is defined as "any property that is stable and fixed so that it may not be moved or transported without damage." It includes land, buildings, and trees. Also regarded as immovable property is movable property placed, by its owner, on immovable property also owned by such owner for the purpose of serving or exploiting such immovable property. Examples include doors and windows in a building which, even though they are originally movable property, become part of the immovable property in actual use. This is equivalent to the concept of fixtures. It is unclear, however, how fixtures would be treated in the context of the Saudi Chevron project since the Project Company would be erecting facilities on land leased, but not owned, by it.

[xlii] Precision as to the amounts of interest or costs and expenses is very difficult, if not impossible in many instances. The Security Documents do contain requirements that the Security Documents be "amended" from time to time as such amounts become precisely determinable.

[xliii] Set-off rights in respect of bank accounts are one type of right applicable to only a given type of collateral. Two sets of set-off rights applied in the Saudi Chevron financing, one set under Saudi Arabian law and one set under English law. The Security Documents were tailored to give effect to the relevant rights in each jurisdiction.

Although there are no specific statutory provisions in Saudi Arabia relating to the set-off of debts, the rights of banks in Saudi Arabia to effect a set-off are broad. A set-off is either compulsory by force of law, as in the case of state debts owed by individuals and debts of individuals owed by the state, or by mutual agreement (*hawala wa idhin bil isteefa*) that is irrevocable. The lender may not exercise the right of set-off unilaterally, absent prior irrevocable consent in an agreement (which consent may be given at the time of execution of the relevant Financing Agreement or Security Document). Absent such an agreement, before setting-off any amounts, the bank has to hold the funds and bring an action in court to allow it to exercise such right of set-off.

[xliv] The author is not aware of a transaction in which this type of recordation on the deed has been made.

[xlv] If enforcement is had before the SAMA Committee, for example, these provisions are likely to be respected.

[xlvi] The NIO operates in practice like a court, with hearings being held in a number of different circuit locations in Saudi Arabia. For ease of reference, references to the NIO will be in the singular.

[xlvii] SAMA Committee decisions are final and unappealable.

[xlviii] NIO judgments may be appealed to the Legal Committee of the Ministry of Commerce.

[xlix] Determinations of the Board of Grievances may be appealed to the Board of Grievances Scrutinization Committee.

[l] The author has been informed that the Minister of the Interior has instructed the Civil Rights Department, the department of the Ministry of the Interior responsible for enforcing judgments of the SAMA Committee, that decisions of the SAMA Committee are to be enforced in the same manner as a decision of a court.

[li] Many transactions are thus structured to provide separate notes for principal, interest, and other costs and expenses. These transactions frequently have a requirement of ongoing provision of such notes.

[lii] A judgment issued by the NIO may be enforced through a presentation of the judgment to the Civil Rights Department of the Ministry of the Interior. Saudi Arabian legal practitioners have indicated that, unfortunately, the Civil Rights Department is often somewhat less than diligent in enforcing judgments.

[liii] It is likely that, on the basis of Council of Ministers Resolution No. 729/8 (which establishes the jurisdiction of the Board of Grievances to enforce foreign awards) and the animosity with which many Board of Grievances judges view non-Islamic banks, the Board of Grievances will refuse to exercise jurisdiction over the enforcement application submitted by a non-Islamic commercial bank. On the other hand, the Board of Grievances might decide that it is inappropriate for a decision of a foreign arbitral body or court to be referred to a non-judicial

body such as the SAMA Committee for enforcement, particularly where jurisdiction over enforcement actions is specifically given to the Board of Grievances.

[liv] For a comprehensive analysis of issues arising in respect of enforcement actions, see Kritzalis, A., *Saudi Arabia*, in International Execution against Judgment Debtors (D. Campbell, 1993).

[lv] The author is unaware whether this is a foreign court judgment or a foreign arbitral award.

[lvi] The author has been unable to determine at this time whether the party seeking enforcement of the foreign award has sought enforcement by the SAMA Committee in the referenced case.

[lvii] Rules of Civil Procedure before the Board of Grievances, Council of Ministers Resolution No. 190 dated 16/11/1409 A.H. (June 20, 1989), Article 6. Additional requirements for the enforcement of foreign judicial awards are set forth in Circular Number 7 of the President of the Board of Grievances, 15/8/1409 A.H. (May 5, 1985).

[lviii] In these companion cases, the Board of Grievances initially issued a decision recognizing the three English High Court decisions. On appeal, however, the Board of Grievances found that there was no treaty between Saudi Arabia and the United Kingdom allowing for the reciprocal enforcement of judgments and that, on the evidence submitted, no law of the United Kingdom would provide for automatic recognition of a Saudi Arabian judgment. Rather, the Board of Grievances concluded that a judgment creditor seeking to enforce a Saudi Arabian court judgment in England would have to commence a common law action against the English judgment debtor in the English High Court to recover the debt evidenced by the Saudi Arabian judgment; in such new action, the English High Court could accept the Saudi Arabian judgment as proof of the debt. The Board of Grievances therefore held that the enforcement of the three High Court judgments should be denied.

[lix] The structure for the Saudi Chevron transaction was designed to allow the banks, through the Onshore Security Agent, to attempt to enforce the foreign award through the SAMA Committee, rather than through the Board of Grievances. This should result in (i) substantially quicker resolution and enforcement, and (ii) avoidance of a *de novo* review of the underlying documentation by the Board of Grievances in the enforcement action.

The respective jurisdictional ambits of the SAMA Committee and the Board of Grievances in this situation are unclear and, to the author's knowledge, except as noted in the text, no actions have been brought by a bank in either forum for enforcement of a foreign arbitral or judicial award to date.

[lx] Perhaps the clearest example of an element of an award that would be contrary to the *sharī'a* would be where it contains an element of interest. Interest is considered a form of unearned gain, or *ribā*, which is prohibited under the *sharī'a* as construed in Saudi Arabia. The Board of Grievances will decline to enforce that part of any foreign award that constitutes an award of interest or amounts in the nature of interest. No pre-judgment interest on damages suffered is therefore recoverable.