The Hospitality Industry in Latin America: The Emerging Market and the Challenges Ahead

The Hospitality Law Conference
February 9-11, 2009

Nelson F. Migdal, Esq.
Greenberg Traurig LLP
2101 L Street NW, Suite 1000
Washington DC 20037
202.331.3180
migdaln@gtlaw.com

Nelson F. Migdal

Shareholder
Real Estate; Hotels, Resorts & Clubs;
Real Estate Operations
migdaln@gtlaw.com

Greenberg Traurig

2101 L Street, N.W., Suite 1000
Washington, DC 20037
Phone: (202) 331-3180
Fax: (202) 331-3101

Nelson F. Migdal focuses his practice on hotel acquisitions, operations, development and finance, large mixed-use projects, condo hotels, hotel management agreements, general commercial real estate acquisitions, commercial leasing, lender representation, and the representation of property owners on telecommunications matters.

Areas of Experience

- Hospitality and resorts
- Real estate acquisition, development and leasing
- Telecommunications
- Condo hotel management and operations

Key Clients

- National Hotel Companies and Third Party Managers
- Local and Institutional Owners and Managers of real estate
- Institutional Hotel Owners

Articles

- Author, "In-Closing - There Can Still Be a Closing, Just No Closing Dinner," *Hotel Executive*, July 2008
- Co-Author, "The Battle Over Hotel Brand Standards and the Effect on the Bottom Line," *Hotel Executive*, July 2008

Awards & Recognition

- Smart Lawyer Choice Award, 2008
- Listed, *Chambers & Partners USA Guide*, an annual listing of the leading business lawyers and law firms in the world, 2007 and 2008 editions
- Listed, *Best Lawyers in America*, 2007 - 2009
- Listed, SmartCEO, Legal Elite, 2007 and 2008
- Listed, Waterparks Power 25, *Aquatics International*, 2007 and 2008

Education

- J.D., *cum laude*, Albany Law School, 1978
- B.A., *cum laude*, Hofstra University, 1975

Admitted to Practice

- District of Columbia and New York

TABLE OF CONTENTS

Page(s)

I. INTRODUCTION: THE CHALLENGES AND OPPORTUNITIES FOR THE HOSPITALITY INDUSTRY IN LATIN AMERICA. 1
- A. Brand vs. Boutique? 1
- B. "For-Sale" Hotel Units 1
- C. Land of Resorts 2
- D. Latin American Labor Laws and the Hospitality Industry 2

II. HOTEL FINANCING AND SUBORDINATION AND NON-DISTURBANCE AGREEMENTS. 2
- A. Government as "Landlord" 2
- B. SNDA - Always a Challenge 2
- C. Negotiating an SNDA 3
- D. Which SNDA Form Wins? 3
- E. The Economic Crisis and the SNDA 4
- F. Lender Stepping into the Shoes of Hotel Owner 4
- G. Nondisturbance- Not as Simple as it Appears 5
- H. Limitations on Liability 6
- I. Timing 6

III. EMPLOYMENT CONCERNS 6
- A. Belabor the Labor Laws 6
- B. Employees Misconceptions 7
- C. Additional Requirements for Concession Based Territories 7
- D. Hotel Developments Improve Existing Infrastructure 7
- E. To Employ or not to Employ? 8
- F. Employment Litigation Cuts into the Bottom Line 8
- G. Tips on Avoiding Employment Litigation 8

IV. WHAT SHOULD I DO WITH THE PROPERTY? 10
- A. Branding the Hotel Property 10
- B. Strength of the Brand = Strength of the Asset 11
- C. Positioning the Brand in Latin America 11
- D. International Considerations for Management Agreements 12
- E. Heightened Security 12
- F. So What's Next in Latin America 12

The Hospitality Industry in Latin America
The Emerging Market and the Challenges Ahead

By: Nelson F. Migdal, Esq. and Samantha Ahuja, Esq.

I. INTRODUCTION: THE CHALLENGES AND OPPORTUNITIES FOR THE HOSPITALITY INDUSTRY IN LATIN AMERICA.

Latin America is considered by many a popular tourist destination and has increasingly become considered one of the most visited regions in the world. The tourism industry in many parts of Latin America has spurred record growth in infrastructure and spending within the hospitality industry. Over the last ten years, Latin America has become more sophisticated in the ways of ground leases, concessions, labor requirements and other related construction and management issues pertaining to the hospitality industry. This paper will explore many of the areas that are of great focus to the owners and developers of the hotels, resorts, and other sectors of the hospitality industry.

A. Brand vs. Boutique?

A first consideration for many owners and developers of hotels is determining if a recognized brand or flag will assist in the marketing and increase in revenues for the property. Many of the well-known brands and flags within the United States have crossed over to Latin America seeking prime opportunities to continue their growth. While this makes for prime picking for branding opportunities for owners and developers it also creates a potential for smaller less recognized boutique hotels to thrive within Latin America. The continued growth of popularity of all-inclusive properties within the region should also be taken into consideration by the owner and developer. While there are basic business considerations in determining what type of property to build, including amount of land, rate of return expectations, and targeted customer base, the owner and developer will also need to consider if concessions from the government are required or desired for the proposed hotel project. Owners and developers should pursue the availability of available concessions as they can assist with territory exclusivity, tax provisions, wage and employment provisions and other similar considerations in a hotel development or project.

B. "For-Sale" Hotel Units

Over the past five to seven years, Latin America has seen an increased demand for hotel condominium and other similar for-sale hotel based units or properties. While the current global economic climate may not lend itself to the immediate building of additional for-sale units, an owner may want to consider the future availability of the such units within the immediate region of the hotel project. There may be great resistance to invest in such building over the next few years, as lenders most likely will be less likely to approve the increased development dollars in the building of for-sale units (whether such for-sale units constitute all or a portion of the project).

C. Land of Resorts

Latin America has proven to a be a "land of resorts." Many of the developments consist of large sized properties, including first-class golf courses, spas, villas, tennis courts, beach clubs and other amenities. The variety of amenities available at these resorts are often now expected by many consumers and developers are often competing for space and function when it comes to amenities. Property restrictions and/or environmental concerns may play a large part in the ultimate layout and elements of the developments. As in the United States, zoning and similar limitations are relevant and of greater concern to local governmental authorities as they continue to grow and reinforce their infrastructure.

D. Latin American Labor Laws and the Hospitality Industry

As in all international arenas, owners of hotel properties must be especially aware of local employment issues. Some regions have wage requirements, insurance requirements, local labor pool requirements, employment termination provisions to name a few. As owners seek permits and licenses for the hotel developments, they must educate themselves on the extent of the labor laws with respect to the hospitality industry. In addition to employment based issues, the recent events in Mumbai, India, have reinforced the importance of providing adequate and effective security for the guests and workers at hotel developments. While the area of security is in no way a new concern for hotel owners, the sophistication of the security and transparency in the levels of security which must be provided has recently become of greater importance to the hotel owner and hotel employees and guests.

II. HOTEL FINANCING AND SUBORDINATION AND NON-DISTURBANCE AGREEMENTS.

A. Government as "Landlord"

Financing hotel projects in Latin America often present lenders and developers alike with a host of new and difficult obstacles to overcome. In many cases within Latin America, a developer will find itself in a territory that requires government concessions in order to develop and construct the hotel development. In these cases, the government entity then acts as a ground lessor and because of its unfamiliarity with the development process and hotel business, it does not want to see itself as a landlord. The challenge for the developer then becomes assisting the government in obtaining comfort with acting as a landlord and achieving a balance between protecting all of the parties involved. The learning curve for the government can be quite significant, which makes the task for the developer cumbersome, frustrating and time consuming.

B. SNDA - Always a Challenge.

One of the most difficult documents to negotiate when financing a hotel project - regardless of the location of the hotel project - is the Subordination and Non-Disturbance Agreement or SNDA. The SNDA is a document among the developer, the hotel manager and the lender. The SNDA comes into play if the developer defaults on the loan and basically asks the hotel manager to recognize the lender and to subordinate its incentive fees to the lender and

the lender to keep the hotel manager in place. While Subordination and Non-Disturbance Agreements are a challenge to negotiate with respect to real estate deals taking place in the United States, they are even more difficult to negotiate and obtain in an international real estate arena. Many of the lenders, owners, ground lessors and lessees involved in deals within Latin America have much less actual experience with such matters and therefore are often hesitant to agree to what many may consider market terms in the United States. Further complications arise in these concession based territories where the granted concession requires the establishment and maintenance of a certain brand or flag as a condition of the term of the ground lease. This requirement then poses a further challenge in the negotiation of Subordination and Non-Disturbance Agreements because of a hotel manager's termination rights provided for in the hotel management agreement. Obviously the hotel manager does want to agree to convey and absolute right to the brand or flag in the event of a default by the developer or even the ground lessor or lessee. A potential solution to this problem is the separation of the subordination clauses and the non-disturbance clauses into two separate agreements. Another area of concern for the ground lessor is the actual flow of money in a situation of a default by the hotel manager or the developer/ground lessee. A novel resolution to this concern includes a provision for a conditional assignment of the operating revenues under the management agreement to flow directly to the ground lessor until such matter is cured. This provides some security for the ground lessor in the event of a default.

C. Negotiating an SNDA:

A Steep Learning Curve The SNDA is a common and familiar document in the financing arena in the United States, however, this concept is not as common place internationally. Even with some of the more interesting transaction structures in the REIT environment with operating leases and a careful segregation of the ownership of the real estate from the operation of the hotel, there will be an instrument intended to govern how the hotel owner, hotel manager and owner's lender will behave in the event of the hotel owner's default under its loan instruments with the lender. It is not just about foreclosure. The form of the SNDA is often the first battleground. In the negotiation of the hotel management agreement, the owner and manager will often pre-negotiate the form of the SNDA and attach it as an exhibit to the hotel management agreement. The recognized brands or "flags" within the United States will have well developed and tested SNDA forms that will be modified, if at all, only after considerable dialogue between the hotel owner and the hotel manager. Depending on the extent to which those brands manage properties outside of the United States, the hotel manager may or may not have SNDA forms acceptable in the international arena.

D. Which SNDA Form Wins?

Similarly, the lending community will have its battle tested forms of SNDA which may or may not be acceptable in the international arena. These may be exhibits to the loan application, and frequently overlooked at that stage of the relationship of the lender and the hotel owner, and later exhibits to the loan documents. It is not uncommon to expect a great deal of time and money to be expended when negotiating the SNDA when in Latin America. Woe unto the less than careful hotel owner that finds itself with one required form of SNDA as an exhibit to the hotel management agreement and a second required form of SNDA as an exhibit to the loan documents. The various forms of SNDA seen in the market place provide insight into the

objectives and philosophy of some lenders. For example, it was commonplace for some SNDA forms recite that they are to provide for the continued management of the hotel pursuant to the hotel management agreement. Compare that to the forms that recite that the lender has required the execution and delivery of the SNDA to govern should the lender foreclose the lien of the security instrument or otherwise succeed to the rights of the hotel owner. It is unclear how the current economic crisis will modify the expectations of the rights of the lender. As recently as the last quarter of 2008, some lenders were requiring the ability to terminate the hotel manager outright without regard to whether the hotel manager or the borrower was in default. Whether this will become commonplace is unclear and yet to be determined. Despite any changes that may take place within an SNDA form, the objective always remains to have a clear and concise expression of the respective rights and obligations of the parties that will spring into action in the event of an owner loan default and the exercise by the lender of its rights and remedies under the loan documents.

E. The Economic Crisis and the SNDA

Most SNDA forms in the United States include language that permits the hotel owner and hotel manager to behave under the hotel management agreement without regard to the SNDA so long as there is no event of default under the loan documents. As true as that may be, the SNDA is usually accompanied by a collateral assignment to the lender of the hotel owner's rights under the hotel management agreement and both the collateral assignment of the hotel management agreement and the SNDA are immediately effective upon the loan closing. This is even more prevalent given the current economic climate. The result is that the hotel management agreement is immediately subordinate to the rights of the lender, and this may give the lender certain rights immediately upon default, which is long before the foreclosure. Because the SNDA and collateral assignment are immediately effective, it is important to understand what has been subordinated and what has not been subordinated to the lender. The strongest position for the lender is to have all of the right, title and interest of the manager under the hotel management agreement, and all rights of the hotel manager relating to the use of funds in the various hotel accounts subject to the SNDA. This particular issue is of great concern to lenders on properties in Latin America. Because the foreclosure process is not as developed in Latin America and property may be owned by a government entity (with simply a ground lease in place), the rights of the lender and the ability of the lender to effectuate the collateral assignment of the hotel management agreement may be ultimately be stifled.

F. Lender Stepping into the Shoes of Hotel Owner

In this configuration, as soon as the lender begins to exercise its rights and remedies under the loan documents, it can insert itself into the hotel manager's operations of the hotel as to such matters as the disbursement of funds from FF&E reserve accounts and even operating accounts. Admittedly, a reasonable and experienced lender with an understanding of the hospitality industry is not likely to undermine hotel operations that are in accordance with the hotel management agreement and the approved annual budget, and intended to preserve the value of the asset as a going concern, including its position in the market place and overall value. Given the value of the on-going operations of the hotel, it is quite surprising that the lenders are now not even willing to grant the manager the right to continue in such a situation. If the objective of the lender is to regain possession and control of the hotel in order to sell it at

foreclosure, any action which would diminish the value of the hotel would be counter-intuitive and illogical. Nevertheless, it has been known to occur and may occur more frequently. When lenders insert themselves into hotel operations post-default but pre-foreclosure, it tends to make the job of the hotel manager that much more difficult. Compare this to other situations where the SNDA either does not cover the hotel accounts or provides a series of carve-outs to permit the hotel manager to continue to operate the hotel in accordance with the terms and conditions of the hotel management agreement. The lender is still present and interested, but the level of scrutiny of the hotel manager is directed primarily to assessing conduct against the standards set forth in the hotel management agreement, which most lenders now underwrite and approve prior to closing in any event, instead of undertaking a *de novo* examination into the conduct of the hotel manager. In the best of circumstances for the hotel manager, there is a recognition by the lender that there can be a time gap of many months, even years, between the acceleration of the indebtedness under the note and the foreclosure sale, and during that period of time, the hotel manager must continue to operate the hotel in accordance with the hotel management agreement, with the lender acting as hotel owner.

G. Nondisturbance- Not as Simple as it Appears

The companion to the discussion as to subordination is the discussion about nondisturbance. It is important for the hotel manager to gain commitments from the lender that essentially say to the hotel manager, no matter what our borrower, the hotel owner, may do or fail to do under the loan documents, so long as you, hotel manager, are behaving as required under the hotel management agreement, not only will we, the lender, leave you alone, but anyone who steps into the shoes of the hotel owner through us will also leave you alone, and you, hotel manager, will be able to get the benefit of the bargain you thought you made with the hotel owner.

Some of the more common elements of nondisturbance are:

- the hotel manager will not be made a party to the lender's actions against the hotel owner;
- the hotel management agreement will not be terminated by the lender or a subsequent owner acquiring the hotel through the foreclosure; and
- the hotel manager will be permitted to continue to operate the hotel under the hotel management agreement.

Another aspect of non-disturbance benefiting the hotel manager is the so called spring back provisions. If the hotel management agreement was wrongfully terminated by the hotel owner, or if the hotel manager was precluded from operating the hotel in a manner not contemplated by the hotel management agreement, then the hotel manager's right to manage the hotel under the hotel management agreement will "spring back" when a subsequent owner acquires the hotel through foreclosure. One way to think of it is the prevention of mischief by an owner or lender to gain an unencumbered hotel, free from the encumbrance of the hotel management agreement, by wrongfully terminating the hotel management agreement prior to foreclosure. The subsequent owner still acquires the hotel encumbered by the wrongfully terminated hotel management agreement, through the obligation to enter into a new hotel management agreement on the same

terms as the prior hotel management agreement for the remainder of the term of the prior hotel management agreement.

H. Limitations on Liability

Most SNDA forms are generally fair in that the subsequent owner will avoid liability for most of the failures of its predecessor. These include the prior owner's defaults under the hotel management agreement, with the understanding that there are certain omissions or failures by a prior owner that will continue and need to be remedied by the subsequent owner as a matter of continuing hotel operations and good business. For example, if the prior owner failed in its obligations to provide cash to cover a shortfall, the subsequent owner will not be directly liable to the hotel manager if the hotel manager advanced funds, but the subsequent owner would inherit the responsibility to insure that all reserves are fully funded and that all operating accounts are at proper levels.

I. **Timing** - Do Not Save the SNDA for Last

A word about timing. Properly dealing with the SNDA can be very complex and time consuming. The relationship and interplay between the loan documents and the hotel management agreement requires a solid understanding of both in order to assess and address the wide variety of potential concerns. In addition, the SNDA can be, and often is, used as the vehicle for the modification of the hotel management agreement either temporarily, for the term of the loan as affecting the current lender only, or permanently, for the term of the hotel management agreement, as a 'back hand' amendment. With so much to negotiate in the SNDA it remains one of the great mysteries of life in the law that the SNDA is relegated to the end of the deal and rises up like a great wave on an endless sea after the loan documents are fully negotiated and as the parties believe they are on the last road to the closing table. The final word on the SNDA is about developing best practices. One important element of best practices it to place the development, structuring, form fights and negotiation of the SNDA more at the core of the entire transaction rather than at the tail end. The likelihood is that the process will be timelier and that the product will be better.

III. EMPLOYMENT CONCERNS

A. Belabor the Labor Laws

As in the United States, hotel managers and owners in Latin America must be fully aware of the ever-changing employment regulations and laws. Unlike the United States, the laws and case law in Latin America are not fully developed and are often in flux as the legislative and judicial bodies seek to protect the local populations. Over the last ten years, Latin America has taken many steps towards better protecting the local populations' job pool while promoting long-term employment options. Like in the United States, the legislative bodies must balance the need of the local labor force with the interests of the hotel managers and owners. Any hotel owner or hotel manager must engage local legal counsel to ensure that the local rules and regulations are being followed in accordance with the then current interpretations. Because the regulations and laws are ever-changing, it is essential for both the hotel owners and hotel managers to stay current as to avoid potential litigation in the employment arena.

B. Employees Misconceptions

Many of the employees and workers may be under a misconception that the hotels are flush with cash and that they are entitled to certain rights or compensation levels as found in the United States. Compensation and money are constantly of concern. This concern may be amplified by ideas formed from information from other line employees, family members, television and the Internet. This can lead to the belief that employers are "deep pockets" and easy targets for lawsuits. There is a massive amount of information available that discusses protected categories under federal or state law and workplace discrimination. Most employers are capable of knowing how to comply with the law, and are motivated to do so for solid business reasons that go right to the employer's bottom line. On the other hand, it is easy to see how some employees might interpret what they hear and see to mean that they have a case against their employer. Employees often do not understand that merely being in a protected class is not sufficient to prove a case, or that treatment they consider unfair is neither discriminatory or unlawful.

C. Additional Requirements for Concession Based Territories

For the concession based territories, there may be additional requirements or exemptions granted by the governing authority. For example, the concession may provide that a certain percentage of the construction or permanent hotel management workforce consist of the local population or nationals or even that the suppliers for materials consist of local and regional suppliers. The hotel owner often has the opportunity to negotiate some of these terms based on the availability of the labor pool and other similar factors. For many in Latin America, the hospitality industry is considered a prime job given the level of compensation and the opportunity to advance one's career. Because many jobs within the hospitality industry are considered such a 'snag', the availability of local and regional workers is often abundant. Placement of high level management positions (i.e. general managers, directors of marketing and public relations and controllers) is where the owner and hotel manager may struggle as the pool of qualified candidates for such positions may be smaller and such positions are in great demand.

D. Hotel Developments Improve Existing Infrastructure

As the hotel developments continue to grow within Latin America, many of the government authorities see this as a way to build and improve on existing infrastructure. Such requirements and/or exemptions may be found in concessions (if applicable). However, a more common practice is upon approval or granting of permits and licenses by the relevant governing authorities, is for the license and/or permit to be conditioned upon the building of certain roads or other similar structures. Because many of the hotel developments and resorts are not developed in populated cities but rather more secluded areas, the development of roads, housing, basic retail areas, and schools are necessary in order to house the workforce employed at the hotel. It is not uncommon to have many of the workers travel a great distance in order to seek and gain employment at a hotel development, therefore it is important to provide the workforce with a community in which to reside. This type of a situation is a win-win for all parties involved. The hotel manager is able to lure top talent and provide them with current and up-to-date living facilities on site, the employees and their families benefit from newly built

communities and educational based opportunities, and the region benefits from the building of infrastructure and the infusion of additional jobs and money into the communities.

E. To Employ or not to Employ?

A continuing area concern is in the employment arena is which party is going to take on the role as "employer". It is critical that the management agreement sets forth the roles and responsibilities of each party when it comes to the hotel staff. Typically, the owner is responsible for the costs of employment as an operating expense of the hotel regardless of which party is the employer. Similarly, the issues of imputation of liability for the conduct of certain employees are often the same regardless of which party is the employer. It is not unusual for the manager to be the party best equipped to deal with the legal aspects of employment issues, including collective bargaining agreements. That being said, the owner can still be the "employer" yet transfer the majority of the employment related duties to the manager through the provisions of the management agreement. The management agreement is the primary document governing the relationship between the owner and the manager and which party is the employer of the hotel employees. Because the management agreement is the vehicle for so much of what governs the parties, the agreement itself becomes important in considering the legal issues governing the allocation of responsibilities for the hotel employees. This distinction is especially important if the hotel manager or owner is an entity formed and governed by the laws of another country.

F. Employment Litigation Cuts into the Bottom Line

As in the United States, being an employer in the hospitality industry is filled with exciting opportunities and wonderful challenges to not only run a profitable enterprise, but also provide employment and advancement opportunities for a broad range of employees. However, those opportunities also provide the basis for potential legal risks. Unfortunately, as we hear from many employers, employees can either find a lawyer to represent them against the employer, or they simply proceed without a lawyer. Even when employees lose their lawsuits, defending against these cases can be costly to any employer and can consume hundreds of hours of employee time that would be much better spent focused on the job rather than on litigation. Although considering every employee a lawsuit waiting to happen would overburden the hospitality industry beyond belief, certain precautions can help prevent future lawsuits and make it much easier to get the lawsuits that are filed dismissed before trial or settled for less than the cost of defense. Hotel managers and owners should engage well qualified human resource professionals, managers and supervisors and encourage then to consistently follow procedures, however, or these precautions will not be worth the paper they are printed on.

G. Tips on Avoiding Employment Litigation

There are many ways to avoid employee trouble. Below are some simple examples that apply in any locality.

1. Anti-discrimination and Anti-harassment Policy. Be sure to have a strong and clear written anti-discrimination and anti-harassment policy. Distribute the policy statement to every employee, and have each employee sign it, with a signed copy placed in each

employee's personnel file. That anti-harassment policy should cover, in addition to sexual harassment, harassment because of race, national origin, religion, age, disability and every other status protected under federal and state law. The policy should be worded simply enough for all employees to understand. Consider using versions in other languages tailored to the employee population.

2. Training on Anti-discrimination and Anti-harassment. Train every management employee on enforcement of the employer's anti-discrimination and anti-harassment policies. Keep written records of who attends training sessions. Train non-management employees on how to report discrimination and harassment. Train everyone on the policy against retaliation. Training is generally required by the courts for the employer to mount a successful defense of a claim of discrimination or harassment, and it is worth repeating all training on a regular basis. All new employee orientations should include training about the employer's anti-discrimination and anti-harassment policies.

3. Keep Job Descriptions Current. Be sure all job descriptions are current and that performance is evaluated regularly against those job descriptions. That is, be sure to assess performance based on job-related requirements. Such generalities as "attitude" should be more specifically defined and are irrelevant. For example, a more objective way to address "attitude" is the way an employee treats co-workers and guests.

4. Honest Performance Reviews. Honest performance evaluations are essential. Evaluation inflation does not help anyone, least of all the employee who needs to know where he or she stands. The work place is not Lake Woebegone, and all employees are not "above average." Not everyone is an outstanding employee. Most are average, and some are definitely below average. A unjustified glowing appraisal is singularly unhelpful and may be used to establish discrimination against the employer in the event an employee is terminated based on poor performance. An employee who is not performing up to standard should be told what is needed to achieve standard, how to correct the problem, and how much time he or she has to correct the problem.

5. Document, Document, Document! The critical need for keeping excellent documentation is the hardest lesson for employers to learn. However, the lack of clear and thorough documentation can leave an employer defenseless in an employment matter. Managers and supervisors should be trained to document all employment problems properly. The problem should be described in concrete language so that anyone can understand what has happened. The employee should receive a copy of the write-up and be asked to sign a copy for the file, indicating receipt and the opportunity to discuss the contents. The employee should be told that signing the write-up is not an indication of agreement and the employee should be given the opportunity to write a rebuttal to be included in the file. Then there is no possibility of an employee successfully claiming not to have received the write-up.

6. Act on Early Detection. If a new employee appears to be a problem very early in his or her employment, terminate the employment before the end of the usual probationary or introductory period. There is no need to wait until the 90th day when it is obvious from the 30th day that the employee is not working out. Hoping for real improvement and extending the probationary period is usually asking for trouble.

7. Write it Down Prior to Implementation of Discipline. When there is a recommendation for discipline, be sure to articulate the reason in writing before that discipline is imposed. If this can not be done, perhaps there is inadequate justification for the recommendation. Also be sure the discipline has been consistently applied without regard to race, gender, age, national origin, religion, disability or any other protected class.

8. Consult an Expert. Before imposing any serious discipline, especially suspension or termination, consult human resources professionals and/or legal counsel. They can help facilitate the process and make sure there is consistency. It is also useful to have someone from human resources participate in imposing the discipline.

9. Choose Words Carefully. Never say "I'm sorry" when terminating employment. The employee will interpret that phrase as an admission of unfair treatment. Help the employee retain dignity by wishing him or her well and saying that, although this situation did not work out, he or she can perhaps find a situation more fitting.

10. Be Consistent. Be totally consistent in the reason for terminating an employee. Tell the employee the precise truth, put the same reason on the separation notice form used in the local jurisdiction, and tell the local employment regulatory body the same thing if a charge is filed. Inconsistency almost always leads to trouble if there is litigation, as it can be used to show that the reason for termination is merely a pretext for discrimination or wrongful termination. Not telling the employee the reason for the termination is an open invitation for that employee to visit a lawyer, a visit which almost always leads to litigation or threats of litigation.

11. Fair Treatment. Treat every employee fairly and with respect at all times. A happy employee is far less likely to sue than one who is chronically disgruntled. The employee who blames all of his or her problems on someone else is the employee who will not take responsibility for his or her own actions. An hour spent interviewing an employee before hiring can save countless problems later on.

12. Pay Attention. Don't ignore a problem and hope it will just go away. It won't. It will almost certainly come back to haunt the employer at some point. And don't try to goad an employee into quitting. That practice is unfair, is perceived to be unfair, and will ultimately boomerang on the employer. If a case gets to a jury, that jury will be far more concerned with the perception of fairness than with what the judge instructs it as to the law. If the employer's version of the facts do not pass the "red face" test, the jury will find liability most of the time.

IV. WHAT SHOULD I DO WITH THE PROPERTY?

A. Branding the Hotel Property

As the owner/developer defines the extent of the hotel and/or residence project and the governance regime (i.e. condominium or other for-sale units), the determination of whether to court a brand or particular flag for the project becomes more critical. There are many very familiar "brand" names of hotels and U.S. based hotel operating companies expanding their reach into Latin America. The name carries value that investors and underwriters recognize in hotel valuation. Whether or not a hotel carries a "flag" "franchise" or "brand" is an important

factor for prospective sellers and purchasers to consider in the universe of transactions representing components of what we consider the hotel sale and purchase. The flag impacts everything. The financial health of the hotel today and in the future as a result of the management of day-to-day operations of the hotel, the inventory of personal property that is sold along with the physical structure of hotel, unfunded pension liability, and intellectual property rights are all relevant.

B. Strength of the Brand = Strength of the Asset

Like in the United States, the flag of the hotel is critical to the revenue generated and the value of the hotel in Latin America. For example, if a hotel changes its franchise affiliation and goes from a strong franchise to no franchise or to a weak franchise, the hotel may lose a portion of the revenue stream that might have come through a strong central reservation system and an array of amenities provided by the brand through what is commonly referred to as "centralized services". A hotel that is sold "encumbered" (in the language of hotel owners) or "enhanced" (in the language of hotel operators) by a strong flag may be valued much higher than an independent hotel or a hotel that is sold with a weak flag. Purchasers must consider that along with the physical structure of the hotel, comprised of the land and the building, they may also be purchasing the right to use the name of the hotel, and all the benefits and obligations that entails. Sellers must ponder the same consideration, along with one other. The potential that the hotel management agreement includes a right of first offer, right of first refusal or some other purchase right or option for the benefit of the hotel manager. Hotel sellers should not assume that the sale of the hotel can occur without the involvement of the hotel manager as a matter of right. If the seller does not have an asset manager that may be intimately familiar with the management agreement, the seller needs to check for purchase options as part of the initial selling strategy.

C. Positioning the Brand in Latin America

Many of the hotel flags that are well recognized in the United States have staked their claim (or at the very least interest) in Latin America. Because hotel managers are eager to be present in many of the Latin American regions, an owner/developer may have its pick of flag based on the planned level of the property. A flag can provide many benefits to an owner/developer, including very defined brand and operating standards. On the flip side, because Latin America is growing at an enormous rate, an owner/developer can position himself with a less known name or brand or even a boutique. With the rise and return of boutique hotels, many consumers are loyal to their boutique and search them out over well known and publicized brands. The revenue per available room (RevPAR) may vary between a branded and well known hotel and a no-name or boutique hotel. Another consideration of whether to brand is whether the project is located in a convention or meeting destination. As Latin America grows as a popular convention destination, this consideration becomes more important. Some Latin American countries have waived sales tax entirely on convention expenses attended by non-residents in order to lure the convention business to their country. As always, it is important to consider the long-term intention of the asset and the value that the flag may or may-not bring to the asset.

D. International Considerations for Management Agreements

Many of the brands that have properties within the United States or even abroad use the same or very similar management agreement for all of their properties, regardless of location. Some of the brands maintain some separation between properties located within the United States and outside of the United States by using On-Shore Management Agreements and Off-Shore Management Agreements. No matter the form of the management agreements, the substance of the agreements are similar. The issues of centralized services, purchasing, licenses, permits, employment related issues, restricted territories and so forth are addressed. The well established brands bring a well-oiled machine to the table and will most-likely be able to provide the owner/developer with many of the same level of services it is able to provide in the United States.

E. Heightened Security

An additional consideration in the branding decision is the type of property being developed. All-inclusive resorts are growing in popularity and most likely will continue to grow as families look to limit their budget on family vacations. In addition, all-inclusive properties now include multiple fine dining options and other recreational options which are a great temptation for families. All-inclusive resorts provide in essence "one-stop shopping" for consumers and further, for those located in what may be considered unstable territories, a safe and protected environment. Given the recent events in India, security is now a greater concern to those traveling abroad. The need for the for hotels to provide detailed and transparent security for both workers and guests is critical. All-inclusive resorts provide a more limited access and therefore a potential for a greater level of security.

F. So What's Next in Latin America?

Like most places in the world, the global economic downturn has had a great impact on revPAR and pipeline projects in Latin America. Between the difficulty in obtaining financing for the construction and building of a new hotel development and the hesitancy to purchase and invest in land or a new hotel development, the pipeline for new projects has seen a huge decline. The numbers vary from a decline in occupancy between 12% to 35% over the past year. While Latin America is a large region, it will most likely rebound before other more far away and less obtainable regions. Given that most owners seek a fairly high return on invest on hospitality based undertakings, many are likely to delay acquisitions and building until there is at the very least a slight rebound in the economy, The pipeline for new projects in Latin America as of the end of the third quarter for 2008 was projected to be approximately 640 new projects with 113,000 additional rooms. It is hard to know which of these projects actually were able to proceed given the rapid deterioration on the credit markets at the end of 2008. While some of projects must have already started construction, many be on hold through the end of 2009. These numbers show a major decline in the projects starts and pipeline projects by more than a 35% decline. This decline will most likely grow over the next 12 months. However, for those able to obtain financing and construct their project, they will be poised to dominate the market upon rebound. While the trend may be downward, all those involved in Latin America believe that to be temporary and the once quickly growing economies of Latin America will emerge as leaders again within the hospitality industry.

Nelson F. Migdal is a shareholder in the law firm of Greenberg Traurig. He focuses his international practice on hotel acquisitions, operations, development and finance, condo hotels, hotel management agreements, general commercial real estate acquisitions, commercial leasing, lender representation, and the representation of property owners on telecommunications matters. He can be contacted at 202-331-3100 or migdaln@gtlaw.com

Samantha Ahuja is an attorney in the law firm of Greenberg Traurig. She focuses her international practice on hotel acquisitions, operations, development and finance, condo hotels, hotel management agreements, general commercial real estate acquisitions, commercial leasing, lender representation, and the representation of property owners on telecommunications matters. She can be contacted at 202-331-3100 or ahujas@gtlaw.com.

The 2009 Hospitality Law Conference

February 9-11, 2009

Approaches and Considerations for Launching Hotels in the Middle East

John M. Vernon
The Vernon Law Group, PLLC, Dallas, Texas
The Hospitality Law Conference
February 9-11, 2009

John M. Vernon, Esq.
The Vernon Law Group, PLLC
4242 Renaissance Tower, 1201 Elm St.
Dallas, TX 75270
(214) 751-2000 (main)
(214) 751-2002 (fax)
jvernon@vernonlawgroup.com
www.vernonlawgroup.com

Mr. Vernon advises and counsels clients on cross-border international and domestic transactions, including a full range of acquisition, joint venture, privatization, project financing, foreign investment, trade resolution dispute resolution, dealer/supplier franchising, licensing product distribution transactions, export compliance, customs and international trade, FCPA, FTZs, ITAR, NAFTA, FTAs, economic sanctions, OFA, BIS, EAR, CTPAs, CFTA and "deemed export issues." He has guided the development of U.S.-based companies' expansion into Mexico, Latin American, the Middle East, Europe, and the Far East. Conversely, he has guided the development of foreign-based companies' expansion into the United States and Mexico. He is also an adjunct professor at SMU Law School teaching courses in franchising and distribution law.

COURT ADMISSIONS

U.S. District Courts, Texas
Court of International Trade
U. S. District Court for the Central District of Utah
Utah State Courts

BAR ADMISSIONS

Bar of Texas
Bar of Utah

SELECTED PRESENTATIONS AND ACTIVITIES

- Interim Chair, International Bar Association Leisure Industries Section, 2008-Present.
- Hot for Hotels, presented at the International Bar Association Conference in Buenos Aires, Argentina. October 12-17, 2008.
- Doing Business in Europe: Procedural, Contract & Liability Issues, presented at the 6th Annual Hospitality Law Conference in Houston, Texas. February 12-13, 2008.
- International Condo Conversions, presented at the 5th Annual Hospitality Law Conference in Houston, Texas. February 8, 2007.
- Hotel-Condo Conversions in the New Europe, presented at the 2006 International Bar Association conference in Chicago, Illinois. September 17-22, 2006.
- Franchising Hotel Real Estate Purchases: Legal and Commercial Terms presented at the Legal Strategies and Opportunities for doing Business in Mexico Conference in Los Cabos, Mexico. April 4-6, 2006.
- The International Perspective on Hospitality Legal Issues at the 4th Annual Hospitality law Conference in Houston, Texas. February 2, 2006

Table of Contents

I. Scope of the Article 1

II. Survey of the Legal Landscape in the Middle East: Bahrain, Saudi Arabia, and the United Arab Emirates 1

A. Bahrain: Financial Center, Tourist Destination, and Naval Base 1

1. Bahrain Duties and Taxes 2

2. Foreign Investment in Bahrain 3

3. Bahrain Customs Regulations 4

4. Intellectual Property Protection in Bahrain 4

B. Saudi Arabia 4

C. United Arab Emirates (UAE) 6

1. Attractiveness of Dubai 6

2. New Real Estate Regulations in Dubai 7

3. Landlord and Tenant Legislation Needed in Dubai 8

4. Impact of Global Financial Crisis on the UAE 8

5. Franchise Opportunities in Dubai 9

D. Patent Protection in the Gulf 9

E. Trademark Protection in the Gulf 9

III. Shari'a law **10**

A. Overview **10**

1. Classes of Companies under Shari'a Law **11**

2. Governing Structure of the UAE and Application of Shari'a Law **12**

B. Shari'a Law and Dispute Resolution **13**

1. Litigation and Arbitration Considerations **13**

2. Application of Shari'a Law in U.S. Courts **14**

IV. Shari'a Financing **16**

A. Overview **16**

B. Sukuk **17**

C. Bahrain's Commanding Presence in Islamic Finance **17**

D. Challenges in Islamic Banking **18**

E. Islamic Banking and the Global Financial Crisis **18**

V. Conclusion **18**

I. Scope of the Article

Historically, real estate investors have not considered investment in the Middle East due to political instability, lack of adherence to international standards, and inability of foreign investors to own land. While these concerns have not been completely erased, Arab countries are making concentrated efforts to attract investors by reducing bureaucratic obstacles and by making greater use of Internet technologies. In addition, a rapidly growing population, demand for Western services, increases in tourism, and abundant wealth are driving real estate investment, particularly in the Arabian Gulf. Furthermore, increased foreign investment in the region is leading to adoption of international standards. Investment gurus in the region believe that adoption of these international standards will lead to needed harmonization of rules and laws across Middle Eastern jurisdictions. However, investors are advised to work in concert with legal counsel to draft agreements that regulation in other parts of the world would provide. An overview of Shari'a law is presented accompanied by a discussion of the application of Shari'a law in U.S. courts. Finally, this paper sets forth principles of Shari'a financing and to what extent those principles may have insulated Islamic banks from the current global financial crisis.

II. Survey of the Legal Landscape in the Middle East: Bahrain, Saudi Arabia, and the United Arab Emirates

The Arabian Gulf is a powerhouse economy at the core of the Middle East and North Africa (MENA) region. Western countries refer to it as the Persian Gulf. Countries bordering the Gulf are Iran, Iraq, Kuwait, Saudi Arabia, Bahrain, Qatar, United Arab Emirates and Oman. These countries have a combined population of 1.4 billion people and an astounding combined gross domestic product (GDP) of $1.9 trillion.[1] The region benefited from the oil-boom of the 1970s which provided its citizens not only with increased wealth but also with increased educational and travel opportunities. After venturing abroad, Gulf citizens returned home to demand Western goods and services. This paper will explore the legal landscape of Bahrain, Saudi Arabia, and the United Arab Emirates (UAE) in the context of real estate investment.

A. Bahrain: Financial Center, Tourist Destination, and Naval Base

Bahrain has a reputation for ease of doing business and, as a result, has become the regional center of international finance and commerce. The downtown business center in Manama, is home to Salomon Smith Barney, HSBC, Coca-Cola, IBM, UPS, Ericsson, Citicorp, American Express, Nomura Investment Banking, Arab Banking Corporation, Gulf International Bank, DHL and Investcorp.

Due to its accessibility with GCC states, Bahrain attracts many tourists from the Gulf region. In 2000, an estimated 4.8 million people visited, 70% of those

[1] Franchising in the Middle East – An Overview, Franchise International, *available at*: http://www.franchise-international.net/franchise/Franchising-in-the-Middle-East-An-Overview/1789 (last visited Jan. 12, 2009).

visitors were from neighboring Gulf Cooperation Council (GCC) States.[2] That year, 3.9 million of those who visited Bahrain entered via the King Fahd Causeway that connects Bahrain to Saudi Arabia.[3] In January 2009, construction is slated to begin on another causeway. The second causeway, called the Qatar-Bahrain Friendship Bridge-Causeway, will connect Bahrain and Qatar.[4] The new causeway will link with the King Fahd Causeway thus connecting the entire Arabian Gulf region. Completion of the new causeway is expected at the end of 2012. Moreover, Bahrain features ancient historical sites, recreation, and luxury accommodations including seven five-star hotels and fourteen four-star hotels in Manama alone. In addition to the financial sector and tourism industry, Bahrain is also the site of a major U.S. navy base.[5]

Bahrain's financial structure and monetary policy is maintained by its Central Bank, the Bahrain Monetary Agency (BMA). In 1998, in an effort to encourage investment, the BMA applied a higher minimum capital ratio (of 12%) than required by the Basle Convention (8%).[6] Although tensions remain over political liberalization and economic inequality, the political landscape is considered stable under the rule of King Hamad bin Isa al-Khalifa. Due to the global financial crisis, the Economist Magazine predicts real GDP growth to slow significantly in 2009 to 3.4%, as regional and international demand weakens for Bahrain's exports of goods and services.[7] Businesses should consult the Bahrain Commercial Companies Law of 2001 to ensure that they have selected an appropriate form of organization. Furthermore, hotels must obtain commercial licenses to operate in Bahrain.[8]

1. Bahrain Duties and Taxes

Import duties are assessed at 5% for food products and non-luxuries and 7.5% for consumer goods.[9] Duties on automobiles, boats, alcohol, and tobacco are much higher. For example, duties on alcohol are a whopping 125%.[10] However, duty-free treatment is given to imports from other GCC states.

---

[2] About Bahrain, Embassy of the Kingdom of Bahrain, *available at:* http://www.bahrainembassy.org/index.cfm?fuseaction=section.home&id=33 (last visited Jan. 12, 2009).
[3] *Id*.
[4] Work Begins on Qatar-Bahrain Causeway, AME Info, Dec. 29, 20008, *available at*: http://www.ameinfo.com/179812.html (last visited Jan. 12, 2009).
[5] The Country and People of Bahrain, *available at*: http://www.hejleh.com/countries/bahrain.html (last visited Jan. 12, 2009).
[6] Central Bank of Bahrain, *available at*: http://www.cbb.gov.bh/cmsrule/default.jsp (last visited Jan. 12, 2009).
[7] Bahrain: the EUI View, ViewsWire, *available at*: http://viewswire.eiu.com/index.asp?layout=VWCountryVW3®ion_id=&country_id=1860000186&rf=0 (last visited Jan. 12, 2009).
[8] Commercial Companies Law 2001, Central Bank of Bahrain, *available at*: http://cbb.complinet.com/cbb/display/rulebook.html?rbid=1625 (last visited Jan. 12, 2009).
[9] Country Specific Tariff and Tax Information: Bahrain, *available at:* http://www.export.gov/logistics/country_tariff_info.asp#P54_2461 (last visited Jan. 12, 2009).
[10] *Id*.

The Bahraini currency "dinar" is freely convertible, and there are no restrictions on the payment of capital or profits. Bahrain does not tax either individual or corporate earnings, although there is a 1% Social Insurance Tax on the salaries of Bahraini nationals and residents.[11] In addition, the country does not have any value-added tax, property tax, production tax or withholding tax.[12] Bahrain has few indirect and excise taxes, including a tax on gasoline, rental taxes which vary depending on the type of property, and firms with 10 or more employees must also pay up to 10% of the employee's gross income to social welfare taxes.[13] The municipal tax varies from 7.5% to 10%.[14]

As a member of the six-nation GCC, Bahrain participates in GCC efforts to reach harmonization of economic regulations among its member states (Kuwait, Oman, Qatar, Saudi Arabia, the United Arab Emirates, and Bahrain). In January 2006, the U.S. signed a Free Trade Agreement with Bahrain.[15] The Agreement was considered an important step by the Bush White House in achieving a Middle East Free Trade Area (MEFTA) by 2013. Following the announcement of MEFTA in May 2003, the U.S. has completed free trade agreements with Bahrain, Morocco, and Oman as well as initiated steps toward a free trade agreement with the U.A.E. and assisted Saudi Arabia's acceptance to the World Trade Organization.

2. Foreign Investment in Bahrain

Foreign investors can achieve 100 percent ownership of new industrial enterprises and the establishment of representative offices or branches of foreign companies without local sponsors.[16] Bahrain allows 100% foreign ownership of land in designated areas, while other areas may be leased from the government.[17] Certain sectors are guaranteed 100% ownership in enterprises, including hotels and other parts of the tourism sector.[18]

[11] *Bahraini Tax Facts*, Association of International Life Offices, *available at:* http://www.ailo.org/downloads/Bahrain.pdf (last visited Jan. 12, 2009).
[12] Global Indirect Tax Rates – Bahamas to Burundi, *available at:* http://www.deloitte.com/dtt/article/0,1002,cid%253D5034,00.html (last visited Jan. 12, 2009).
[13] *Id*.
[14] *Living in Bahrain.* Bahrain Exhibition & Convention Authority, *available at:* http://www.bahrainexhibitions.com/travel_living_bh.asp (last visited Jan. 12, 2009).
[15] President Signs H.R. 4340, U.S.-Bahrain Free Trade Agreement, January 12, 2006, *available at*: http://www.whitehouse.gov/news/releases/2006/01/20060111-1.html (last visited Jan. 12, 2009.
[16] Kingdom of Bahrain – Economy, *available at:* http://www.bahrainconsulate.org.hk/AboutBahrain/economy.htm (last visited Jan 12, 2009).
[17] Bahrain Advantage, *available at:* http://www.bahraingateway.org/index.cfm?fuseaction=section.home&id=21(last visited Jan. 12, 2009).
[18] *Id.*

3. Bahrain Customs Regulations

Despite the theoretical end to the boycott of Israel, calls have been made for an official renewal.[19] Other than the potential boycott issues, Bahraini Customs is generally accessible and easily understood by those used to import procedures in western nations, in part evidenced by their robust web presence.[20] The web presence also shows that the Customs officials are accessible, especially via their website.

4. Intellectual Property Protection in Bahrain

Bahrain is a participant in the General Agreement on Tariffs and Trade (GATT), Uruguay Round, and WTO agreements, including the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs).[21] In February 1995, Bahrain joined the World Intellectual Property Organization (WIPO).[22] Bahrain is also a signatory of the Berne Convention for the Protection of Literary and Artistic Works as well as the Paris Convention for the Protection of Industrial Property. Bahrain remains one of the few Middle Eastern countries not on the Special 301 Report Watch List.[23] In recent years, Bahrain has made great strides in the enforcement of intellectual property laws as well as legislating protection of copyrighted and trademarked goods.

B. Saudi Arabia

Saudi Arabia is the largest market in the Gulf region. But, despite being a large and capital rich market, it is an underserved market.[24] Although it has more than 27 million residents, small and medium-size businesses contribute only 28% of GDP.[25] In 2006, King Abdullah established a target of making Saudi Arabia one of the top 10 countries in the world to do business with by 2010.[26] This goal led

---

[19] Michael Freund, "Bahraini parliament calls to boycott Israel and parley,"*available at:* http://www.jpost.com/servlet/Satellite?pagename=JPost%2FJPArticle%2FShowFull&cid=1195546714819 (last visited Jan. 12, 2009).
[20] See Bahrain Customs (English), *available at:* http://www.bahraincustoms.gov.bh/customs/en/home.htm (last visited Jan. 12, 2009).
[21] *Id*.
[22] WIPO Profile – Bahrain, *available at:* http://www.wipo.int/about-ip/en/ipworldwide/pdf/bh.pdf (last visited Jan. 12, 2009).
[23] 2008 USTR Special 301 Report, *available at:* http://www.ustr.gov/assets/Document_Library/Reports_Publications/2008/2008_Special_301_Report/asset_upload_file553_14869.pdf (last visited Jan. 12, 2009).
[24] Middle East Real Estate Debate: Middle East Holds Its Own in Unsteady Global Markets, EuroMoney, Sept. 2008, *available at*: http://www.euromoney.com/Article/2018636/Debates/763/ChannelPage/8949/Middle-East-real-estate-debate-Middle-East-real-estate-holds-its.html?p=1 (last visited Jan. 12, 2009).
[25] Doing Business in the Arab World 2009, a co-publication of the World Bank and the International Finance Corporation, ©2008 The International Bank for Reconstruction and Development/The World Bank, p. 46, *available at*: http://www.doingbusiness.org/features/ArabWorld2009.aspx (last visited Jan. 12, 2009).
[26] *Id*. at 44.

to the establishment of the Saudi Arabia Government Investment Authority (SAGIA). SAGIA has successfully targeted reforms throughout departments and ministries in Saudi Arabia. And, on a quarterly basis, it reported its progress directly to the king. As a result of SAGIA initiatives, in July 2007, Article 164 eliminated the minimum capital requirement. This requirement was previously one of the world's highest, e.g. $125,000 for limited liability companies.[27]

In addition, Saudi Arabia's public registry cut the minimum loan size and doubled the number of borrowers in 2004.[28] Saudi Arabia also maintains its own private credit bureau. Launched in 2007, the bureau reports on companies' credit risk while also providing their financial statements and ownership information. Recently, Saudi Arabia introduced stringent requirements for bankruptcy proceedings. Consequently, creditors can now expect to obtain at least partial recovery within one month of judgment.

In 2008, Saudi Arabia reduced business start-up time by two days and cut commercial registration fees with its Ministry of Commerce by 80%.[29] The country also instituted new protections for minority shareholders. And, as of 2008, business and property registrations can be completed online. For example, Saudi Arabia introduced electronic registration of title deeds with the First Notary Public Department in Riyadh. This electronic registration of title allows parties to transfer property in one day. Correspondingly, Saudi Arabia now boasts the number one spot globally, according to the World Bank, in ease of registering property. Furthermore, in 2007, Saudi Arabia began allowing electronic transfer of trade documents and abolished its requirement for a consular certificate. Finally, port capacity has been increased resulting in more containers processed daily through Saudi Arabia's Jeddah port.

Despite these successes, Saudi Arabia presents the most challenges from a legal title perspective. Lawyers in Saudi Arabia advise that foreigners can own 100% under the law but in reality it hasn't been done.[30] Because foreign investors can't directly invest in Saudi property, experts advise participation in joint ventures or investment in real estate funds.

[27] *Id*. at 46.
[28] *Id*. at 25.
[29] *Id*. At 11-12.
[30] Middle East Real Estate Debate.

C. United Arab Emirates (UAE)

The United Arab Emirates ("UAE") is a Federation of seven emirates established in 1971. The seven emirates are: Abu Dhabi, Dubai, Sharjah, Ras Al Khaimah, Umm Al Quwain, Ajman and Fujairah**.** Dubai and the UAE in totality are considered the most politically stable areas in the Arabian Gulf. The UAE's total population broke 5 million in 2009.[31]

1. Attractiveness of Dubai

Dubai is a rapidly growing city ripe with opportunities for investment in real estate and hospitality. It is forecasted that Dubai's population will reach at least 1.8 million by 2010.[32] In addition to a rapidly expanding population, Dubai is focused on attracting tourism which currently accounts for 35 percent of retail sales and is expected to reach 50 percent by 2010. The government aims to increase visitors from seven million each year in 2006, to 40 million by 2015.[33]

Dubai is committing to building a strong economy independent of oil and leads the way regionally in attracting foreign investment. It was the first GCC state to extend full ownership of businesses to foreign investors. Moreover, Dubai is quickly gaining status as a hot-spot for commerce as a result of its burgeoning port, Free-Zones and growing airport. In addition, large multi-national companies are choosing Dubai as the site of their regional headquarters. Furthermore, immigration in Dubai has been at 7% consistently for the last 15 years.[34]

In 2008, Abu Dhabi was identified as having the most favorable prospects of any emerging city in the World Winning Cities Programme by Jones Lang LaSalle. In 2002, Dubai was given a similar status making UAE a strong candidate for investment.[35] The Middle East is considered a suitable market for investment as only 11% of capital expenditures are from foreign investment. However, one European property fund management company predicts that the market will mature in five years.[36]

Because the region is capital flush from oil, the most valued contribution of a Western co-investor may be experience and best practices. Experts opine that there is opportunity, particularly in Abu Dhabi, for asset swaps

---

[31] Expat growth widens UAE demographic gap, *available at:* http://www.uaeinteract.com/docs/Expat_growth_widens_UAE_demographic_gap__/32128.htm (last visited Jan. 12, 2009).
[32] Peter J. Cooper, DCCI population figures highlight demand shortfall, *available at:* http://www.ameinfo.com/115452.html (last visited Jan. 12, 2009).
[33] *Id*.
[34] Middle East Real Estate Debate.
[35] *Id*.
[36] *Id*.

with European investors as local trading families want to diversify beyond the Middle Eastern region.[37] Based on faith in the economy and the government, local investors are willing to inject large sums into a project with little hesitation. Larger institutional investors like AIG and Pramerica are also doing deals in the region thus instilling Western investors a sense of confidence in the investing environment.[38]

Experts indicate that the Dubai International Financial Centre is utilizing standards from London, Singapore, Australia, and the U.S. Moreover, large commercial investors Aldar and Nakeel have created investment grade stock for the first time in the region.[39] Their participation in the region further signals a transition to international legal standards. In addition, Jones Lang LaSalle's Global Transparency Study ranked the MENA region as making the most improvements in real estate transparency on a global basis over the last two years.[40] Dubai is considered the most transparent MENA country. Abu Dhabi, Bahrain, the Kingdom of Saudi Arabia, and Egypt are also making strides in increasing transparency of real estate transactions. However, greater transparency goes hand-in-hand with regulations that may lead to lower returns than are present in higher risk environments.

2. New Real Estate Regulations in Dubai

In 2009, new regulations in Dubai, known as Law 26, will require licensing for real estate brokers and online registration of rental contracts.[41] The new regulations are intended to reduce ambiguity in real estate transactions and to promote investment. Precipitating the changes is an agreement signed by the Department of Economic Development (DED) and Dubai's Real Estate Regulatory Authority (RERA). Prior to the agreement, any national of the UAE or GCC could serve as a real estate agent. Following the agreement, any approved real estate agent must apply for a license. The chief executive of RERA, Marwan Bin Galita, has said applicants should be over 18 years of age, possess a good conduct certificate, and complete RERA training. Furthermore, starting January 2009, all tenancy agreements in Dubai must be registered on RERA's new online registration website called Ejari.[42] RERA will use the data to compile a rental index by 2010. The rental index will map out rent structures in Dubai. Approximately 100 companies have already complied with the registration requirements.

---

[37] *Id*.
[38] *Id*.
[39] *Id*.
[40] *Id*.
[41] No more freelancers will operate in Dubai's property sector, posted by Exclusive Dubai, Jan. 1, 2009, Estates Dubai, *available at*: http://www.estatesdubai.com/ (Jan. 12, 2009).
[42] *Id*.

3. Landlord and Tenant Legislation Needed in Dubai

In Dubai, typical leases are for one-year and are executed on one-page documents. Education and effort may be necessary to negotiate a lengthier legal document and to extend the lease term to three to five years.[43] In Abu Dhabi, the solution is the 99-year peppercorn lease for foreign nationals. In Dubai, there is freehold title easily transferable between foreigners if purchased in a designated area. However, there are some leases in the region where an investor owns the estate but may not own the land on which the estate is located. Nakheel has conducted many real estate transactions recently in the region. It requires investors to build on the land within a prescribed timeframe. This requirement is intended to limit speculation. Similarly, Aldar requires that property be developed in a particular timeframe according to its master plan, its building lines, and to a design it has approved.

4. Impact of Global Financial Crisis on the UAE

The global financial crisis has led to a decrease in real estate transactions and loans in the UAE as financial institutions tighten their lending criteria.[44] Moody's Investors Service announced that it made downward revisions on the ratings of four UAE banks: 1) Dubai Islamic Bank PJSC, 2) Dubai Bank, 3) Abu Dhabi Commercial Bank PJSC, and 4) First Gulf Bank PJSC. Moody's modified the banks' ratings to negative from stable. Moreover, all senior unsecured debt issued by these banks has also been similarly downgraded. According to International Monetary Fund (IMF) estimates, the Dubai economy grew 7 percent in 2008 but is expected to slowdown in 2009.[45] In contrast, the Minister of State for Financial Affairs said that the outlook for economic growth in 2009 is positive. He added that the Ministry of Finance had imposed conditions on the release of payments to banks to end the liquidity crisis. Furthermore, Central Bank Governor Sultan Nasser Al Suwaidi has stated that the Dubai national economy remains robust.

Due to the global financial crisis, real estate investors may need to obtain financing through foreign partners with access to the local banks. Due to an immature legal framework in the region, international banks are largely unwilling to lend based on the value of the asset.[46] Exposure to these banks is further amplified by the burgeoning size of the deals being done in the region.

---

[43] Middle East Real Estate Debate.
[44] Banks under pressure on the prospect of increasing loan defaults, posted by Exclusive Dubai, Dec. 31, 2008, Estates Dubai, *available at*: http://www.estatesdubai.com/ (Jan. 12, 2009).
[45] *Id*.
[46] Middle East Real Estate Debate.

5. Franchise Opportunities in Dubai

In the Arabian Gulf, revenues generated by franchising are estimated at $30 billion and the franchise industry is growing at approximately 27 percent annually.[47] Dubai, with over 120 nationalities and an enviable location as a regional commercial hub, is considered a prime test location for international franchisors. This year, Franchising Middle East Exhibition 2009 will showcase franchise investment opportunities March 2-4 in Dubai.[48] The exhibition is supported by the International Franchise Association (IFA) and is touted as the largest international franchise show in the MENA region.

D. Patent Protection in the Gulf

As of April 2007, the Patent Cooperation Treaty (PCT) consists of 137 member states including Bahrain and the UAE as well as other Arab nations.[49] Under this treaty, inventors may file international applications for the protection of their inventions. Applicants are required to file through the national office of a contracting state. The treaty requires that an applicant be either a resident or national of the contracting state. In addition, the GCC established the Patent Regulation and Statute of the GCC Patent Office in December 1992. The GCC Patent Office is located in Riyadh, Saudi Arabia and began receiving applications in October 1998. Patents granted by the GCC secure protection in GCC member states.

E. Trademark Protection in the Gulf

There are 57 member nations to the Madrid Agreement Concerning the International Registration of Marks. Egypt, Cyprus and Iran are Arab signatories to the agreement as of July 2007.[50] To protect trade and/or service marks, applicants must be nationals of a contracting country. Registration occurs at the International Bureau through the intermediary of the national office of the country of origin. In addition, Bahrain, Saudi Arabia and the UAE are members of the Paris Convention for the Protection of Industrial Property. These three countries also adhere to the International Classification of Goods and Services for the Purposes of the Registration of Marks under the Nice Agreement. However, in Saudi Arabia, trademarks covering alcoholic goods cannot be registered as well as retail and wholesale services.

---

[47] Franchising in the Middle East.

[48] Franchising Middle East Exhibition, *available at*: http://www.franchisingme.com/files/index.php (last visited Jan. 12, 2009).

[49] Abu-Ghazaleh Intellectual Property Handbook ©2007 Abu-Ghazaleh Intellectual Property, *available at*: http://www.agip.com/AGIP_Handbook.pdf?lang=en (last visited Jan. 12, 2009).

[50] *Id*.

III. Shari'a law

A. Overview

Shari'a law derives from the text of the Holy Qur'an as well as from religious teachings by the Prophet Mohammed (the Sunna).[51] In addition, interpretations by religious scholars of the Qur'an are treated as a secondary source of Shari'a Law. In areas where the population is predominantly Muslim, Shari'a law is widely applied.

Shari'a legal principles were confirmed in Majalat Al-Ahkam Al-Adlia ("Al Majala"), the Civil Code of the Ottoman State which was based on Islamic Law.[52] Al Majala was derived mainly from the Hanfi Sect. It was compiled by legal scholars and disseminated in Istanbul in 1836. It was applied in most Arab countries that were under the Ottoman rule until the First World War. After achieving independence from the Ottoman Empire, Islamic countries continued to apply Al Majala until they developed their own civil codes. In modern times, Al Majala remains a highly influential source of Islamic Law.

Early Islamic law scholars were categorized by guilds or schools. Today, only four of those guilds are still in existence: the Hanbali, the Hanafi, the Shafi'i and the Maliki.[53] In Saudi Arabia, judges must rule exclusively in accordance with the instruction of the Hanbali guild. It is important to note that generally court decisions in Saudi Arabia are not published. In ruling on cases, Saudi judges consult scholarly treatises to identify a range of solutions to any issue. Well-known scholarly treatises are two works by Mansur al-Bahuti, a 17th century scholar, as well as the works of Ibn Qudama and Al Maqdisi. Successful legal analysis of an issue under Shari'a law depends upon the study and analysis, or ijtihad, that a judge applies to a case. "The critical inquiry is whether the proper analytical procedures are followed in reaching the results."[54]

Other Islamic countries have adapted religious tenets to meet modern demands.[55] But, in Saudi Arabia, Shari'a is adhered to conservatively in resolving commercial and contract law questions.[56] When the general practices of international commerce conflict with the standards of the Hanbali guild, it is the Shari'a principles that guide Saudi courts in resolving disputes.[57]

---

[51] Islamic Law (Shariah), Gulf-Law.com, *available at*: http://gulf-law.com/islamic_law.html (last visited Jan. 12, 2009).
[52] *Id*.
[53] Saudi Basic Industries Corp. v. Mobil Yanbu Petrochemical Co., Inc., 866 A.2d 1 (Del.Supr. 2005).
[54] *Id*.
[55] National Group for Communications and Computers, Ltd. v. Lucent Technologies Intern., Inc. 331 F.Supp.2d 290 (D.N.J. 2004).
[56] *Id*. citing (Vogel Tr. 166:14-25).
[57] *Id*. citing Vogel, Islamic Law and Legal System, 305.

A fundamental tenant within Shari'a is the prohibition on gharar (risk or uncertainty).[58] Gharar is abhorred in Islamic law. A dire outcome of this prohibition is that Saudi courts will not enforce the sale of anything uncertain or unknown. "The object of a contract must be certain and defined and in existence."[59]

It is often challenging to engage in complex business transactions and remain compliant with Shari'a. Consequently, other Islamic countries have endeavored to create sources of law to replace or complement Shari'a. It is advisable when conducting business in Islamic countries to include either choice of law clauses or provisions for commercial arbitration to exclude application of Shari'a law.[60]

1. Classes of Companies under Shari'a Law

The term "company" in Arabic is shirkah which translates into "join together or intermix".[61] Shirkah is considered a contract between partners in capital and profits. Shirkah was recognized from the beginning of Islam. Under Shari'a, companies are divided into two categories: property companies and contractual companies. This classification was adopted by the Al Majala. Moreover, UAE Federal Courts recognized this classification prior to the adoption of its Company Law.

Property companies are subdivided into voluntary and mandatory companies. Voluntary companies are defined by the agreement of two or more persons to jointly own property. In contrast, mandatory companies are formed when two or more persons are thrust into joint ownership, for example by inheritance or through endowment. Inherently, contractual companies are established by contract. Contractual companies are also further divided into two categories: mufawadha and aanan. Mufawadha means "negotiation" or "delegation." It is formed when partners have equal shares in the enterprise as well as equal rights to share profits and management. On the other hand, aanan is translated as "reins". It is established when partners have differing shares and when profits are not distributed equally between the members.

Contractual companies are also further categorized based on the type of contribution each partner brings to the enterprise. First, capital companies are established when each partner provides a specific share in the capital of the company. Second, work companies are formed when two or more partners provide labor as capital. Third, personal companies are identified

[58] National Group for Communications and Computers, Ltd. v. Lucent Technologies Intern., Inc. 331 F.Supp.2d 290, D.N.J.,2004.
[59] *Id*. citing Ballantyne, Essays and Addresses on Arab Laws, 267.
[60] *Id*. citing Vogel, F. and Hayes, S. Islamic Law and Finance, 50-51 (1998).
[61] Companies in Islamic (Shariah) Law, Gulf-Law.com, *available at*: http://gulf-law.com/uaecolaw_shariah.html (last visited Jan. 12, 2009).

as two or more partners who endeavor jointly based on the trust and goodwill they possess in the business community. The personal company does not require investment of capital.

2. Governing Structure of the UAE and Application of Shari'a Law

The UAE Provisional Constitution provides the legal framework for the Federation of Emirates. The Constitution provides that Shari'a is the main source for legislation in the UAE.[62] The federal government is tasked with legislating to direct the federal judicial system, federal finance and loans, postal and communication services, electricity services, and other programs. Federal laws also regulate labor, real estate, civil legislation, company laws, laws of procedure, and protection of intellectual property. The Constitution also provides that local governments of the seven Emirates may legislate on local matters not confined to the Federal Government. Although all the local governments have expanded appreciably over the last 30 years, each Emirate differs in size and complexity. Distinguishing features are the population, geography, and extent of development.[63]

Modern evolution of Islamic legal systems began in the early twentieth century leading to the establishment of civil courts.[64] These courts can consider civil, commercial and other types of disputes. Separate criminal courts were also established. However, personal matters such as marriage, divorce, custody and inheritance traditionally remained with the Shari'a courts. Some Islamic countries such as Saudi Arabia resisted modern change and maintained legal systems based on Islamic Law. Later in the some Emirates, particularly Abu Dhabi, the capacity of the Shari'a courts was enlarged to include all civil and commercial disputes as well as serious criminal offenses. Therefore, in addition to the civil courts, each of the seven Emirates maintains a parallel system of local Shari'a courts.

In the relatively short timeframe since its inception, the UAE has made important strides in regulating its burgeoning economy. Among its legislative efforts are: The Labour Law No. (8) of 1980, the Agency Law No. (18) of 1981, the Maritime Law No. (26) of 1981, Commercial Companies Law No. (8) of 1984, Insurance Law No. (9) of 1984, Civil Transactions Law No. (5) of 1985, and the Penal Code Law No. (3) of 1987.[65] Furthermore, other essential legislation was disseminated in recent years including: the Law of Evidence in Civil and Commercial

---

[62] Background on the United Arab Emirates (UAE) Legal System, Gulf-Law.com, *available at*: http://gulf-law.com/uaecolaw_legalsystem.html (last visited on Jan. 12, 2009).
[63] UAE Law and Legislation, Zayed University, *available at*: http://www.zu.ac.ae/library/html/UAEInfo/UAELaw.htm (last visited Jan. 12, 2009).
[64] Background on the United Arab Emirates (UAE) Legal System.
[65] *Id*.

Transactions No. (10) of 1992, the Civil Procedure at the Federal Courts Law No. (11) of 1992, the Trade Marks Law No. (37) of 1992, the Law for the Protection of Intellectual Property and Author's Rights No. (40) of 1992, the Regulation and Protection of Industrial Property of Patents, Drawings and Industrial Designs Law No. (44) of 1992, and the Commercial Transactions Law No. (18) of 1993.[66]

It is important to note that the civil law system employed by Islamic countries is fundamentally different than the common law system we are familiar with in the U.S. Under common law, deference is given to judicial precedents. In contrast, under Islamic civil law systems, discretionary interpretation is not allowed in legislated matters. And, in the absence of a specific law, courts must apply Shari'a principles. Furthermore, when deliberating, a Shari'a judge is not bound by precedent, even his own prior rulings. However, decisions of the Federal Supreme Court and other Appeals Courts can serve as a guide to legal interpretations in this jurisdiction.[67] The Federal Ministry of Justice publishes a quarterly law journal with legal articles and noteworthy decisions of the courts.

B. Shari'a Law and Dispute Resolution

1. Litigation and Arbitration Considerations

Litigation in Shari'a jurisdictions should be considered as a last resort due to the uncertainty of scholarly interpretation of Shari'a principles.[68] It is advisable to research the judicial process in the particular jurisdiction to obtain a clear understanding of the implications of success or failure in litigation. Costs of litigation vary significantly among jurisdictions. In some jurisdictions, litigation is rather costly. There are also practical considerations of embarking on a litigious path which might jeopardize one's commercial success in a relatively narrow business community.

As a result of the twisted and uncertain path that litigation presents, most multi-national companies that conduct business in Arab countries will provide for arbitration as a means to resolve disputes. Most Arab countries have begun to accept local arbitration supervised by local chambers of commerce but are still wary of international arbitration such as that offered by the International Chamber of Commerce.[69]

---

[66] *Id*.
[67] *Id*.
[68] Resolution of Disputes, Gulf-Law.com, *available at*: http://gulf-law.com/resolution.html (last visited Jan. 12, 2009).
[69] *Id*.

2. Application of Shari'a Law in U.S. Courts

Many U.S. federal courts have interpreted Saudi law.[70] In 2008, a Texas court found that while having to consider the impact of interpreting foreign law in the forum non conveniens analysis, this factor did not require the Texas court to dismiss the case.[71] Courts must not be "relucta[nt] to undertake the task of deciding foreign law, a chore federal courts must often perform."[72] Understandably, the impact of foreign law on the issues will be briefed and argued by counsel. When tasked with determining the elements of a Shari'a law and the related damages, the judge must weigh the credibility of the Shari'a expert and undertake its own ijtihad (analysis) to reach the proper solution.[73] What makes the judge's work even more difficult is that testifying Shari'a law experts themselves are likely to disagree.

When should a U.S. court apply Shari'a law? In 1995, a Texas appellate court answered this question with reference to the Restatement (2nd) of Conflicts of Laws.[74] In CPS Intern., Inc. v. Dresser Industries, Inc., the court found that the applicable law will usually be the local law of the state where the injury occurred**.**[75] The court detailed a four-factor analysis under Restatement § 145. The first factor requires that the court identify the location where the injury occurred. In the Dresser case, the court found that the injury occurred in Saudi Arabia because the dispute revolved around anti-competitive efforts to secure business there.[76] The court rejected appellants' contention that because they were harmed financially in Texas that Texas was the site of the injury. The court opined that "financial harm is a mere measurement of and was produced by Appellants' inability to operate in Saudi Arabia."[77] The court found the record was void of any evidence of anti-competitive activities outside of Saudi Arabia or that appellants' competitiveness in the U.S. was negatively affected. Therefore, the judge found that Section 145's first element favored application of Saudi Arabia law.

The second element considered by the court under Section 145 is the location of the conduct producing the injury. Appellants argued

---

[70] UNC Lear Services, Inc. v. Kingdom of Saudi Arabia, Slip Copy, 2008 WL 2946059 (W.D.Tex. 2008) citing *Arabian Teading & Chem. Indus. Co. Ltd. v. The B.F. Goodrich Co.,* 823 F.2d 60, 62-63 (4th Cir.1987); *Nat'l Group for Commc'ns and Computers Ltd. v. Lucent Techs. Int'l Inc.,* 331 F.Supp.2d 293-301 (D.N.J.2004); *Chadwick v. Arabian Am. Oil Co.,* 656 F.Supp. 857, 860-62 (D.Del.1987); *see also Levine v. Arabian Am. Oil Co.,* 1985 U.S. Dist. LEXIS 13386, at *15-17 (S.D.N .Y. Nov. 27, 1985) (citing federal cases applying Saudi law).
[71] *Id*.
[72] *Id*. citing Manu Int'l., 641 F.2d at 63.
[73] *Id*.
[74] CPS Intern., Inc. v. Dresser Industries, Inc., 911 S.W.2d 18 (Tex.App.-El Paso 1995).
[75] *Id*. citing Restatement (2nd) of Conflicts of Laws § 145 and 156.
[76] *Id*.
[77] *Id*.

unsuccessfully that the tortious activity was directed from Texas. The judge decided that although the "tortious conduct may have been directed from Texas does not alter the reality that the conduct was directed to and carried out in Saudi Arabia, and it was the carrying out of the conduct that was the source of its harmful nature."[78] As a result, the second element also indicated application of Saudi Arabia law.

The third Section 145 element considered by the court was the parties' domiciles and residences. In the Dresser case, there were nine litigants with domiciles in four countries. None of the litigants was a Texas corporation and only two had offices in Texas. Significantly, although both appellant and appellee were headquartered in Texas, neither was a direct signatory to any of the documents. Yet again, the third element favored Saudi law.

> The judge admonished, "[Y]ou had this offshore business for a particular reason to achieve the benefits of having an offshore corporation and also carry out some liability that comes along with this kind of way of doing business. You have to accept the risk of those liabilities along with accepting the benefits that you get from that kind of business."[79]

The fourth and final Section 145 element considered by the Dresser court was the relationships among the parties. Two primary relationships were found: a competitive relationship and a relationship based on contacts. The court found that the parties competed in the Saudi market to provide energy equipment maintenance and repair services. Secondly, the court found the parties' contacts were directed to Saudi Arabia. Thus, all four Section 145 elements favored application of Saudi Arabian law.

The Dresser court also found unpersuasive appellants' contention that their claims should not be governed by Saudi law because vindication of their rights implicated the public policy of Texas. The court held that "the fact that the law of another state is materially different from the law of this state does not itself establish that application of the other state's law would offend the fundamental policy of Texas."[80] Further, the court found that the "Texas Supreme Court's adherence to the Restatement leads us to further conclude that the Restatement's most significant relationship test itself is woven into the fabric of Texas policy. Thus, even if Texas had a significant policy interest in giving extraterritorial effect to its own laws, it would be countered by Texas' interest in having the tort claims in this

[78] *Id.*
[79] *Id.*
[80] *Id.*

litigation governed by the state with the most significant relationship to the claims and parties."[81]

IV. Shari'a Financing

A. Overview

Islamic banking has grown an astounding 400% in the last few years. In 2000, total assets were $1.9 billion and by July 2006 they had reached $10.3 billion.[82] Correspondingly, the market share of Islamic banks rose from 1.8% of total banking assets in 2000 to 6.2% in 2006.

In addition to the avoidance of gharar (excessive speculative risk), there are other unique prohibitions found in Shari'a financing.[83] These are usury, maysir (gambling), riba (surcharge, rent, or fee), julah (fixed payment), and haraam (illegal sectors). Allowed activities are called halal. Investors are required to have an underlying asset to match the transaction in accord with the mandate that borrowers do not over-extend themselves. Shari'a law also prohibits investment in alcohol and drugs. Because of these prohibitions, Islamic banks may invest heavier in other asset classes like real estate.

Islamic banks provide a variety of products. Murabaha is a contract of sale between the bank and its client for the sale of goods at a price plus an agreed profit margin for the bank.[84] Ijara is a contract with a bank to purchase an item and lease back to the customer.[85] Mudaraba is an investment by an Islamic bank on the client's behalf where the bank charges for its expertise to make the transaction Shari'a compliant.[86] Musharaka is a profit sharing agreement with a requirement that any losses be proportionate to the amount invested.[87] Istitsna'a is a contract for delayed delivery of custom made items.[88] Other Islamic financial products include restricted and unrestricted investment accounts, syndications and other structures used in conventional finance modified to comply with Shari'a principles.

---

[81] *Id.*
[82] Islamic Finance, Central Bank of Bahrain, *available at*: http://www.cbb.gov.bh/cmsrule/index.jsp?action=article&ID=19 (last visited Jan. 12, 2009).
[83] Islamic Finance Debate: Prospects and problems of Shariah-compliant finance, Euromoney, Dec. 2008 *available at*: http://www.euromoney.com/Article/2060693/Category/763/ChannelPage/8949/Islamic-finance-debate-Prospects-and-problems-of-Shariah-compliant-finance.html (last visited Jan. 12, 2009).
[84] Institute of Islamic Banking and Insurance, *available at*: http://www.islamic-banking.com/Shariah/sr_murabaha.php (last visited Jan. 12, 2009).
[85] Glossary of Islamic Terms, Islamic Bank of Britain, *available at*: http://www.islamic-bank.com/islamicbanklive/IslamicTerms/1/Home/1/Home.jsp (last visited Jan. 12, 2009).
[86] *Id.*
[87] *Id.*
[88] Islamic-Finance.com by Kreatoc Limited, *available at*: http://www.islamic-finance.com/item_istisna_f.htm (last visited Jan. 12, 2009).

B. Sukuk

Sukuk is a financial security that complies with Shari'a law. It is an Islamic equivalent of a bond.[89] Islamic banks trade large amounts of capital via commodity murabaha. Sukuk insurance is a recent development in Islamic financing. The market for sukuk accounts for nearly 15% of the Islamic financial industry.[90] Currently sukuk is not traded on a market because there are not many instruments. Sukuk is largely purchased by either Islamic institutions or market participants that want the security. Islamic banks utilize the returns of the sukuk's longer asset life to balance against the shorter-term returns they distribute. Although sukuk does not offend Shari'a principles relating to securitization or packaging, a legal problem exists in achieving an effective sale. There is a conflict between legal ownership of an asset and equitable ownership of an asset. Experts urge that regulatory standards as well as real-time information on sukuk prices are needed to increase trading of sukuk across borders.[91]

C. Bahrain's Commanding Presence in Islamic Finance

Bahrain is recognized as a global leader in Islamic finance. Many Islamic financial institutions are situated in Bahrain including 24 Islamic banks and 11 Islamic insurance companies (takaful).[92] Bahrain is also active in the sukuk market both short-term government sukuk as well as leasing securities.

The Central Bank of Bahrain (CBB) has led the way in developing a comprehensive guide to Islamic banking and insurance. The CBB rulebook for Islamic banks is a source for licensing requirements, capital adequacy, risk management, business conduct, financial crime and disclosure/reporting requirements.[93] Its insurance rulebook delineates the features of takaful and re-takaful firms. Both rulebooks were the first comprehensive regulatory frameworks that dealt with the Islamic finance industry.

Bahrain is also home to indispensable organizations responsible for Islamic finance, including: 1) the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), 2) Liquidity Management Centre (LMC), 3) the International Islamic Financial Market (IIFM), 4) and the Islamic International Rating Agency (IIRA).[94] The AAOIFI has been acknowledged as the principal authority in Shari'a for Islamic finance.[95] Additionally, the Central Bank of Bahrain (CBB) recently established a fund to further research, education and

---

[89] Islamic Economics and Finance, *available at*: http://islamicbanking.worldmuslimmedia.com/what-is-sukuk/ (last visited Jan. 12, 2009).
[90] Islamic Finance Debate: Prospects and problems of Shariah-compliant finance.
[91] *Id*.
[92] Islamic Finance, Central Bank of Bahrain.
[93] *Id*.
[94] *Id*.
[95] Islamic Finance Debate: Prospects and problems of Shariah-compliant finance.

training in Islamic finance, known as the Waqf Fund.[96] Finally, the CBB is an active participant in the development of Islamic banking standards.

D. Challenges in Islamic Banking

Challenges arise under Shari'a in determining interest charged. Some Shari'a scholars regard all types of interest as usury which is prohibited in Shari'a, others deem simple interest acceptable and only compounded interest to be prohibited.[97] Another difficulty is that accounting standards differ among jurisdictions. Furthermore, contractual terms acceptable to one Shari'a scholar may be rejected by another. Experts urge for standardization in three areas: accounting, regulation, and contracts documentation. "A Shari'a board [needs] to create the parameters of functioning in an Islamic bank."[98]

E. Islamic Banking and the Global Financial Crisis

Some have suggested that due to structural differences of Islamic banking that it has less vulnerability to the current financial crisis. Since Islamic banks may not trade debts, some believe this has insulated Islamic banks from the devastating affects of sub-prime mortgages. Commentators suggest that the Islamic banking system is protected from interest rate risks as well as overvaluation or speculation. But the system is still subject to economic risks driven by consumer confidence.[99]

V. Conclusion

It is an exciting time to explore investment in the Middle East real estate market. The participation of large commercial investors in the region as well as government commitment to fostering economies independent of oil indicate that foreign investors can anticipate an increasingly standardized environment. However, investors are cautioned to understand the unique legal challenges presented by Shari'a law. In summary, although the Shari'a financial industry is still in its infancy, it holds principles that have application in the current global financial crisis.

---

[96] Islamic Finance, Central Bank of Bahrain.
[97] Islamic Law (Shariah), Gulf-Law.com.
[98] Islamic Finance Debate: Prospects and problems of Shariah-compliant finance.
[99] *Id*.