

The 2009 Hospitality Law Conference

February 9-11, 2009

Approaches and Considerations for Launching Hotels in the Middle East

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The Hospitality Law Conference
February 9-11, 2009

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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

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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, 2008, *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 EU 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 ijthihad (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.*