

Unified Center for Lien Registration - do Saudi pledges now have to be registered?

The long-awaited Unified Center for Lien Registration is now operational for the registration of Saudi pledges. What is the impact for banks taking security in the Kingdom?

The traditional view

Banks in the Saudi Arabian market might be forgiven for thinking, other than for particular asset classes such as aircraft¹ ships² real estate³ and listed shares⁴, that a pledge (*rahn*) in Saudi Arabia has no perfection requirements as such.

According to this view, a pledge is a form of possessory security which is effected by delivery of the pledged asset to the pledgee and, provided the pledgee can demonstrate it has the necessary degree of control over the pledged asset and certain other criteria are met, the pledge will be effective. The concept is recognised in Shari'ah and rules regarding establishment and enforcement are provided for in the Commercial Pledge Law⁵. From experience, banks might conclude Saudi Arabian law and regulation impose no further general perfection requirements.

Is that view still correct?

The purpose of this briefing note is to consider the recently established Unified Center for Lien Registration (the "UCLR") which became operational last year under the aegis of the Saudi Arabian General Investment Authority ("SAGIA") (originally contemplated to be under the Saudi Arabian Ministry of Commerce and Industry ("MOCI")) and where, according to the implementing regulations pursuant to which it was established, pledges must be registered.

The Unified Center for Lien Registration

The Minister of Commerce and Industry mandated the establishment of a unified center to register pledges in 2004 by way of a ministerial decision amending the implementing regulations⁶ (the "Implementing Regulations") to the Saudi Arabian Commercial Pledge Law.

Key issues

- Saudi Arabian security
- Perfection requirements

Article 8 of the Implementing Regulations (as amended) states as follows:

"The Debtor/Pledgor and the Creditor must register the pledge at the Unified Center for Lien Registration if there is not, for the pledged asset, a competent authority responsible for issuing the pledge deed."

The "competent authority" reference relates to instances where there is already an authority responsible for registering pledges of the asset class in question, such as aircraft or ships. Article 7 of the Implementing Regulations provides in such cases that the certificate of registration of the pledge from the asset specific registry in Saudi Arabia must be filed by the pledgee or an agent appointed by the parties (*adil*) with the UCLR.

These provisions were academic for some time as the UCLR did not actually exist. However, pursuant to an agreement between the Minister of Commerce and Industry and the Governor of SAGIA, SAGIA took

responsibility for the establishment of the UCLR. The UCLR consequently became operational last year, and has already registered some sixty or so pledges (largely, we understand, equipment pledges taken ancillary to financings in which the Saudi government has participated).

Does this mean if we have taken a pledge which is not registered it is unenforceable? Does registration guarantee priority for our pledge?

Not necessarily. For one thing the Implementing Regulations are entirely silent on the consequences of non-registration.

The regulations are also subordinate legislation and cannot override the primary requirements of the Commercial Pledge Law, which provides at Article 6 that a pledge shall not be effective against third parties until possession of the pledged asset is transferred to the pledgee or *adil*, and at Article 7 that the pledgee or agent shall be considered to possess the pledged asset if it is placed under his disposition in a manner that induces third parties to believe it is in his possession or where he receives documents of title entitling him to receive the asset as its holder.

If possession is not duly transferred as set out above, registration with the UCLR cannot “cure” this and make an invalid pledge valid. It follows that if

possession is clearly transferred to (and retained by⁷) an original pledgee or *adil*, a second purported pledgee who comes later in time should not be able to assert a better claim than the original pledgee simply by registration of their own supposed pledge document.

As for challenges to enforcement of an unregistered pledge by the pledgor (as opposed to third parties), the pledgee can look in the first instance to its contractual rights under the pledge document (complete, in a well-drafted example, with a further assurance clause to do all acts necessary to protect or perfect the relevant security interest).

Furthermore it is hard to see how it would lie in the mouth of the pledgee to oppose enforcement of the pledge by reason of non-registration, as it is the responsibility of the pledgor as well as the pledgee to effect such registration under Article 8 of the Implementing Regulations.

There is also no time limit specified for registration, and no implementation date or point in time following which pledges which are created (or pledges which already exist) must be registered.

So why register?

At the very least it must be evidentially helpful. It is reasonably easy to imagine cases, for example, where notionally pledged assets were subject to claims by rival parties each claiming that they had possession or were entitled to treat the assets as being in their possession. In such circumstances registration could make all the difference.

Though the uncertainties discussed in the foregoing section may mean that non-registration is not fatal in enforcement proceedings before the

Board of Grievances, this outcome cannot be guaranteed and there is always the possibility of obstruction, additional processes or merely time-wasting defences founded on non-registration.

It is also very hard to assess the impact that non-registration would have in an insolvency were a liquidator to challenge the pledge.

Furthermore, we do not yet know how the relevant law will develop and it is conceivable that registration with the UCLR may become more of a clear legal necessity than it is today.

What assets can be registered?

The Commercial Pledge Law and the Implementing Regulations provide for pledges over moveable assets (construed broadly) granted to a creditor with respect to commercial debts. The pledged assets must be in existence (not future assets), owned by the pledgor and capable of being disposed of by the pledgor, tradable (sellable/acquirable) and be specifically identified without ambiguity. Interestingly, the bilingual Arabic/English application form for pledge registration contemplated registration of both “individual items that can be uniquely identified, e.g., cars, boats, airplanes, serial-numbered equipment” and instances where “collateral is general, e.g., inventory, accounts receivable..”, in effect apparently contemplating both the pledging of debts owed to the pledgor and inventory pledges (though, for the avoidance of doubt, a general “floating charge” style concept of security over a business’s fluctuating stock of assets is not in our view currently possible in Saudi law and there are specific requirements for the quantity, weight and other

characteristics of pledged assets to be described under Article 11 of the Commercial Pledge Law).

How does the pledgee register a pledge?

Once the relevant pledge agreement has been entered into, such document or, where there is an asset specific registry in Saudi Arabia able to issue a certificate of registration of the pledge, such certificate of registration will need to be lodged at the UCLR together with a completed registration application form signed by the pledgor and the pledgee and a copy of the pledgor's identification documents.

The UCLR aims to be usually able to process a registration within 24 hours from submission of all required documents. Currently no charges are levied to process a registration.

As the UCLR is a new registry the registration process is still evolving and the practicalities of registration may in certain respects be

challenging (for example, there is still ambiguity over whether English language documents can be registered without first being translated into Arabic and there is a requirement for the signatures of the pledgor and the pledgee (on the pledge agreement and on the registration application forms to be completed in support of the registration) to be verified by the Saudi Arabian Chamber of Commerce in order to be acceptable to the UCLR)⁸.

Is the register searchable?

The register can be searched against the name of the debtor in order to identify whether any pledges have been registered with the UCLR over any of its moveable assets.

At the time of writing, a search can only be conducted by request in person at the UCLR itself (free of charge), though we understand that an online search facility may become available in future⁹.

Conclusion

In conclusion, the development of the UCLR, as an institution –its policies and practices, the significance ascribed to registration in Saudi court proceedings, and the market reaction to its existence –are something to be watched in 2012 and beyond. Prudence would seem to dictate that it would be wise for banks to register new pledges in circumstances where it is practicable to do so. We have yet to see any market movement to protectively register existing pledges. The market may well however have to digest new qualifications in law firms' legal opinions on the subject of pledge enforceability in the year to come.

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Footnotes:

¹ Registration with the Saudi National Aircraft Register required pursuant to the Saudi Arabian Civil Aviation Law.

² Ship mortgages to be registered at the relevant department at the Saudi Arabian Ministry of Transportation in accordance with the Vessel Mortgage Law.

³ Currently proposed new mortgage law. Under the existing regime, notarisation would be required of a real estate pledge but this is problematic in practice.

⁴ Trading block applied through the Tadwul.

⁵ Issued by Royal Decree No. M/75 dated 21/11/1424 *Hijri* (corresponding to 14 Jan. 2004).

⁶ Issued by the Ministerial Resolution No. 6320 dated 18/6/1425 *Hijri* (corresponding to 5 August 2004) as amended by Ministerial Resolution No. 267/8/1/1812 dated 19/2/1431H.

⁷ Required under Article 6 of the Commercial Pledge Law

⁸ This section reflects our informal understanding from UCLR as at late last year.

⁹ As per footnote 8 above.

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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