

Legal aspects of documenting shipping finance transactions in the United Arab Emirates

By Paul Jarvis and Tien Tai, Denton Wilde Sapte & Co

The United Arab Emirates (UAE) is strategically placed between Europe and the Far East. The UAE has been ranked among the top 15 maritime nations by the United Nations Conference on Trade and Development and the UAE Government is working on plans to transform the shipping industry into one of the country's major economic sectors.

Local and international banks active in the shipping market have taken a keen interest in supporting the expansionist plans of local and state backed ship owners and oil companies. Islamic finance, in line with conventional financing, has made substantial inroads in shipping in the Middle East. With increasingly sophisticated asset backed deals being undertaken against the background of laws that have not been fully tested, the legal landscape for lenders is not plain sailing.



UAE Maritime Code

The UAE Federal Law No 26 of 1981 (as amended in 1988) (the UAE Maritime Code) governs and regulates all shipping practices in the UAE. As well as the UAE Maritime Code, there are several decrees or local laws regulating the registration of vessels and restrictions on foreign flag vessels.

The National Transport Authority (NTA) is a federal government entity and, since 2009, has been working on new maritime legislation which, it is hoped, will revamp the current rules on foreign ownership and mortgage registration in an effort to modernise the ship registry. The aim of the legislation will be to create the foundation on which the maritime economy of the UAE will grow. We understand from the NTA that possible changes will end the rule that only UAE-owned ships can fly the UAE flag, and allow ships that are 100% foreign owned to fly the UAE flag provided they are operated outside the country. However, at the time this paper went to press, the time frame for the new flag to be up and running was in the first quarter of 2011.

Ship registration

It is not permissible for a ship to fly the flag of the UAE unless that ship has been registered pursuant to the UAE Maritime Code. However, there are certain categories of ships that are exempt from registration (such as certain fishing and pleasure boats). Additionally, and unlike certain flags of convenience, registration of tankers more than 10 years old is prohibited. The UAE Maritime Code sets out detailed procedures for the registration of ships. However, it is always worth checking the

exact requirements with the Marine Affairs Department at the Ministry of Communications in the emirate where registration is sought to determine the exact documents and procedures required as such matters are liable to change.

Applications for registering ships must be made within 30 days following the construction of the ship or following the purchase of the ship by the owner who seeks registration. Following this application, the Marine Affairs Department will advertise the prospective registration and only continue to registration if no objections are received within a certain period.

The UAE Maritime Code also contains provisions dealing with the deletion of the ships. There is an unusual provision giving UAE authorities a right of pre-emption where any registered ship is proposed to be sold to a foreigner.

Finally, it is also worth noting that the UAE Maritime Code specifically deals with shipbuilding contracts. The UAE position matches up with the generally accepted international position in that contracts for the building of ships should be subject to private agreements and that the contracts should be in writing. Unless agreement is made to the contrary, title to the ship will pass from the builder to the buyer only on delivery and acceptance of the ship by the buyer after sea trials.

UAE ship mortgages

The UAE Maritime Code specifies a limited number of formal requirements, for example the mortgage must be in writing and signed by the parties. The mortgage deed will need to be in English and Arabic and should be signed in front of a notary public.

Other than this, the parties are free to insert whatever provisions they wish. Since the UAE Maritime Code does not specify the rights and obligations of the mortgagor and mortgagee, the mortgage itself must deal with these areas in some detail. It is not uncommon to see a UAE ship mortgage based on a Panamanian or Liberian ship mortgage. This means that loan and guarantee obligations of some complexity can be secured by a UAE ship mortgage.

It is important to note that acceptance by the Marine Affairs Department of the mortgage in a particular form will not necessarily mean that the mortgage is enforceable before the local courts. For example, terms contrary to public policy or the Shari'ah may not be enforced. In our experience, simplicity is the best policy.

The UAE Maritime Code provides that any ship which is registered and above 10 DWT may be mortgaged. A ship is defined to mean any structure normally operated or made for the purposes of operating in navigation. Ships under construction are also capable of being mortgaged.

In theory, the registration procedure is relatively straightforward. A standard application form needs to be completed which sets out the parties involved and the obligations to be secured. The appropriate fee and the mortgage deed (in English and Arabic and notarised) needs to be lodged with the Marine Affairs Department. On receiving the application form, the fee and the mortgage deed, the Marine Affairs Department endorses details of the mortgage on the ship's provisional registration certificate and keeps a copy of the mortgage deed in the ship's file.

Enforcement of mortgages

Whether a ship mortgage registered in the UAE will be recognised and enforced by a court outside the UAE depends on the laws of the country where enforcement is sought. There are no provisions in the UAE Maritime Code on this point. However, we would expect that most countries with a reasonably developed conflict of laws regime will recognise UAE ship mortgages.

Documentation issues in shipping finance transactions

The Civil Code and the Commercial Code form the pillar of UAE law under which asset finance transactions are conducted, and set out the laws relating to loans, guarantees, pledges and assignments. However, as transactions have increased in complexity, there have been instances where the application of the current law remains unclear.

Denton Wilde Sapte

Denton Wilde Sapte (DWS) has an established shipping finance practice based in London, Abu Dhabi and Dubai. DWS has extensive experience in large-value, complex, cross-border transactions and are known for their client focused and innovative approach. DWS acts for many UAE based and international banks and other financial institutions (including Islamic institutions), owners/operators, equity investors and government agencies.

The market leading Shipping Finance team at DWS has advised financiers and owners of all types of vessels. Their experience includes transactions involving LNG tankers, crude and product carriers, container vessels, dry bulk carriers as well as drilling rigs and offshore support vessels.

DWS has had a particular focus on shipping transactions involving the use of sophisticated Islamic Finance shipping structures. These range from structures utilising conventional debt combined with Islamic equity to structures that are funded entirely via Shari'ah compliant investments. The team is recognised as a leader in creating new structures and documentation that not only accommodates the requirements of the Islamic scholars, but also provides the equivalent protections and flexibility found in conventional debt finance structures. The team have built up an enviable reputation in a wide range of Islamic Finance shipping products and have been recognised by industry bodies and awards.

Security over bank accounts

Banks operating in the UAE commonly take security over earnings, debt service and retention accounts. Given that there are no statutory provisions dealing with a pledge over a bank account, the general provisions relating to commercial pledges are applied. To have a commercial pledge, an identifiable asset is needed. A fixed deposit is an identifiable asset. However, there are arguments as to whether an account that has a fluctuating balance is an identifiable asset and therefore there is a question mark over the effectiveness of a pledge over it.

Guarantees

The Civil Code requires a lender to claim against a guarantor within six months of the date the guaranteed debt became due. It is not certain

whether the parties can validly contract out of this rule.

Assignments

Many ship financing arrangements in the UAE require an assignment of the charter income, insurances or the rights under contracts as security. Neither the Civil Code nor the Commercial Code contains rules governing the assignment of a right. However, UAE courts have suggested that in commercial matters a counterparty's consent to the assignment of a right is not necessary, although evidence is needed to demonstrate that the counterparty has been put on notice of the assignment. Delivery by courier of a notice to the counterparty should be acceptable evidence of delivery.

Governing law and jurisdiction

Syndicated international shipping deals often require the documentation to be governed by English or New York law and for borrowers to submit to the jurisdiction of foreign courts. The Civil Code permits parties to choose the governing law of an

agreement. If the UAE courts need to consider foreign law, the Civil Code provides that any provisions that are contrary to Shari'ah or public order in the UAE will not be enforceable. Further, the UAE courts have jurisdiction to hear cases brought against UAE nationals or against foreigners who have residence in the UAE. Accordingly, there is no guarantee that an exclusive jurisdiction clause in favour of a lender will exclude the jurisdiction of the UAE courts.

Security agency provisions

In the London market, syndicated loan facilities are often structured so a security trustee holds legal title to the security on trust for the syndicate banks.

As is the case in most civil law jurisdictions, the concept of a trust is not recognised by UAE law. As a result, there is doubt as to how a UAE court would view a security trustee holding UAE security under an English trust. The danger is that, in the event of a transfer by a syndicate bank, a UAE court might decide that the incoming bank is unsecured as it was not a lender at the time the security was created (and it does not recognise that the security

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Denton Wilde Sapte “has in-depth knowledge of ship financings and sharia-compliant structures”

(Legal 500 EMEA guide, 2010)

Denton Wilde Sapte is the largest international law firm in the Middle East and has advised on award winning shipping transactions across the region.

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trustee holds the security for the beneficiaries of the trust from time to time). Or worse, a UAE court might decide the security is invalid because it does not recognise the basis on which the security was originally created in the first place. However, the concept of commercial agency is well understood, so ideally transactions should be structured using a security agent.

Foreign judgements

Absent a treaty between the UAE and the jurisdiction where the judgement is obtained means that certain conditions need to be satisfied before a foreign judgement is enforced in the UAE. The UAE courts must have no jurisdiction over the claim or the subject matter of the judgement. If a judgement involves a UAE party, the UAE courts are likely to assert jurisdiction. Therefore, there is no certainty that a foreign judgement would be enforced without re-examination of the case in the UAE.

It is worth noting that the UAE acceded to the New York Convention on recognition and enforcement of foreign arbitral awards. This means that foreign arbitral awards should be enforceable in the UAE.

Summary

Despite the increasing sophistication of conventional

and Islamic banking deals in the region, the UAE is a jurisdiction where the legal market is still evolving. For the time being, international banks need to work with their advisers to understand the legal framework and what can be done to mitigate the risks.

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