

Part I

General Concepts and Legal Issues

COPYRIGHTED MATERIAL
<http://www.pbookshop.com>

<http://www.pbookshop.com>

Rahn Concepts in Saudi Arabia: Formalization and a Registration and Prioritization System

Michael J.T. McMillen*

1.1 INTRODUCTION

The first limited recourse project financing in the Kingdom of Saudi Arabia, the Saudi Chevron petrochemical project, commenced in 1996.¹ Conventional interest-based financing was provided by a group of international, regional, and local lenders to a special purpose entity established to construct, own, and operate the project. As recourse was limited to the assets comprising the project and cash flows generated by the project, the collateral security structure provided to those lenders was critical.² A primary difficulty in creating an effective collateral security structure in 1996, and at all times up to and including the present, is the fact that mortgages, pledges, and other security interests may not be registered in Saudi Arabia.³ Which is not to say that mortgages and pledges are unavailable as part of a collateral security package in Saudi Arabia. They are available pursuant to the principles and precepts of Islamic Shariah (the “Shariah”) as enforced in Saudi Arabia, most particularly those applicable to *rahn* (mortgage and pledge) arrangements.⁴ The Shariah is the paramount law of the land in the Kingdom of Saudi Arabia and is enforced in the courts of Saudi Arabia.⁵

The absence of recordation capability, and the uncertainties resulting from the absence of *stare decisis* principles and reliance on *de novo* case-by-case enforcement in the Saudi Arabian courts,⁶ have hindered certain aspects of development in Saudi Arabia. Those factors have also increased the need for involvement by the Saudi Arabian government in terms of additional government support undertakings, as would be the case in any jurisdiction subject to such factors. A couple of examples may give a flavour of those hindrances. Each example seems independent of the factors that have emerged in the post-2007 economic crisis. Development of infrastructure, real estate, industrial, and other projects in Saudi Arabia has remained robust throughout this economic crisis. However, the participation of international banks and financial institutions in the provision of financing may be characterized as modest, at best, due in large part to these systemic infirmities. Financing is provided primarily through local banks and financial institutions, a pattern that is apparent in many sectors of the Saudi Arabian economy. From a risk diversification perspective, this is not the ideal situation for the Saudi Arabian financial sector. Another example is the limited availability of home purchase financing in Saudi Arabia due to the reluctance of banks and financial institutions to provide financing because

of the aforementioned factors. Home financing structures have been developed, and there has been some expansion of available credit for these purposes. However, given the uncertainties with respect to collateral security, current levels of credit availability seem insufficient and pricing may be suboptimal for home purchasers.

The dramatic growth of Islamic banking and finance, internationally and within Saudi Arabia, the lack of participation of international banks and financial institutions in financings, and the pressing needs for home purchase financing, among other factors, have resulted in intensive consideration of formalization of collateral security concepts within Saudi Arabia. Specifically, drafts of different bills pertaining to *rahn* (mortgage and pledge) principles, including recordation systems and enforcement processes, have been prepared and were approved by the Shura Council of Saudi Arabia in mid-February 2010. These long-discussed pieces of “legislation” have taken concrete form, although their ultimate form is as yet uncertain and there is no defined timetable for formal adoption. The primary substantive *rahn* bill is the “Bill of Registered Real Estate Mortgage Law” (the “Mortgage Law”). There are four other related bills, although it is uncertain whether all will be adopted together with the Mortgage Law: (a) the Real Estate Funding Project (the “RE Funding Project”); (b) the Bill of Financial Leasing Definition; (c) a Bill of Finance Companies Control Law; and (d) a Bill of Execution Law (the “Execution Law”). For convenience, the five laws are collectively referred to as the “Financing Laws”.⁷

This chapter considers the Mortgage Law and limited aspects of the other Financing Laws. The focus is on the correlations and divergences between the Mortgage Law and substantive principles of classical *rahn* formulations, as embodied in the “*Majelle*”⁸ and discussed in “Al-Zuhaylī”⁹ and “Ibn Rushd”.¹⁰ The Finance Laws, as finally effective, are likely to vary from the current drafts. However, given that the current drafts of the Finance Laws have been discussed and reworked for a considerable period, and received Shura Council approval, it seems appropriate, even prior to finalization, to consider the principles adopted by the new collateral security structure that appears likely to emerge.

1.2 THE MORTGAGE LAW

1.2.1 General Observations

As a general statement, the substantive Mortgage Law, and to some extent the Execution Law, embodies classical Shariah principles of *rahn* but does not appear to be wholly consistent with the classical formulations of those principles. Embodiment of those principles is consistent with the paramount position of the Shariah in Saudi Arabian law and is important given that the Mortgage Law will likely be enforced by the Board of Grievances (*Qiwān Al-Mazālī'im*) or a similar court or body, each of which applies Shariah principles.¹¹ The Mortgage Law and the Execution Law contemplate local jurisdictional enforcement, rather than enforcement by the Banking Disputes Settlement Committee of the Saudi Arabian Monetary Agency (the “SAMA Committee”) (which has jurisdiction over disputes between a bank and its customers) or the Office for the Settlement of Negotiable Instruments Disputes (the “NIO”). Thus, it can be surmised that, even if the SAMA Committee or the NIO has jurisdiction over the financing agreements for a transaction, enforcement of the mortgage will be within the jurisdiction of a separate Shariah court. That said, the jurisdictional ambits are not clearly delineated in the Mortgage Law, the Execution Law, or the other Financing Laws.

That raises a critical question of whether a local Shariah court will enforce a mortgage or pledge if the obligation secured by the mortgage is interest-based or otherwise violative of the Shariah. That issue, of course, is what has precluded registration of mortgages and pledges up to the present. And that issue is not specifically addressed in the Financing Laws.

The Mortgage Law applies to real estate and certain other movable assets that have a “regular record” (other than “securities”). It does not specifically address other property, such as movable property that does not have a regular record. Specifically, the Mortgage Law and the other Financing Laws do not preclude, by their express terms, *rahn* arrangements under the Shariah in respect of such other property. The RE Funding Project is clearly directed, in part, at residential housing initiatives. The Mortgage Law is not so addressed and seems to have a broader application, although popular press discussions of the Mortgage Law have focused primarily on its application to residential housing matters. It is conceivable that the RE Funding Project also has a broader application to commercial properties and to securitizations, but that is not discussed in this chapter.

The Mortgage Law contemplates registration of security interests and addresses the rights of registered and unregistered holders of security interests, including the priorities of interests. A registered mortgage becomes effective as against third parties upon registration, subject to certain third party proprietary rights predating registration.¹² The mortgagee’s priority is determined by the entry number and registration date of the mortgage, a “race to the counter” system that is shared with numerous other jurisdictions within the Gulf Cooperation Council.¹³ The concept of priority is accepted under classical *rahn* principles, including in the bankruptcy of the debtor mortgagor.¹⁴ Registration seems to be an extension of traditional “possession by the mortgagee” concepts to something more akin to “constructive possession” concepts. The Mortgage Law applies classical Shariah principles in the context of a modern registration system. This is a welcome development, but is certain to give rise to the need for further clarification and refinement, quite possibly in the litigation and dispute resolution context. As noted above, the *de novo* case-by-case process, unrestricted by *stare decisis* doctrines, in the Saudi Arabian system makes it difficult to predict the nature of the clarifications and refinements.

It is helpful to consider ten primary consequences of a valid contractual arrangement under classical *rahn* principles as an analytical framework for assessing the extent to which the Mortgage Law gives effect to *rahn* principles:¹⁵

1. Association of the underlying debt with the mortgaged property.
2. The right of the mortgagee to hold and keep the mortgaged property.
3. The obligation to safeguard and maintain the mortgaged property.
4. The obligation to pay the expenses associated with the mortgaged property.
5. Forbidding the mortgagor debtor or the mortgagee creditor from dealing with (selling, lending, leasing, mortgaging, pledging, gifting, or placing in trust) the mortgaged property during the term of the mortgage.
6. Forbidding the mortgagee creditor from using the mortgaged property.
7. Guarantee of the mortgaged property, which pertains to the relationship between the value of the mortgaged property and the underlying debt.
8. Selling the mortgaged property, or demanding that the creditor sell the mortgaged property, to pay the secured debt.
9. Giving the mortgagee creditor in possession of the mortgaged property priority in payment over other creditors.
10. The obligation to return the mortgaged property if the debt is repaid.

1.2.2 Specific Provisions

1.2.2.1 Asset Application

As suggested by its full title, the Mortgage Law pertains to real estate.¹⁶ However, by its terms, it also applies to certain other movable assets that have a regular record, such as automobiles and other vehicles, airplanes, and the like, but expressly excluding securities.¹⁷ The implication is that the Mortgage Law will not apply to movable assets where there is no “regular record”. Classical *rahn* concepts cover both mortgages and pledges, and pertain to any mortgaged property, movable or fixed, that meets the sale and other applicable requirements of the Shariah. Given the paramount status of the Shariah in Saudi Arabia, the Mortgage Law will presumably not preclude the practice of obtaining a valid *rahn* on other assets, including movable assets not subject to registration, and enforcement of that *rahn* in the relevant Saudi Arabian courts and adjudicative bodies. Thus, a *rahn*, enforceable outside the Mortgage Law under the Shariah, should be available with respect to assets that are not the subject of the Mortgage Law.

It appears that certain assets, such as proceeds from the operation of mortgaged property (*marhūn*) that are subject to the Mortgage Law, are within the ambit of the Mortgage Law, which is consistent with the majority position of the four orthodox Sunni *madhahib* (schools of Islamic jurisprudence) regarding classical *rahn* principles.¹⁸ The mortgage gives the creditor mortgagee a proprietary right in the registered property and an established priority over other creditors with respect to the proceeds of the sale of the mortgaged property, which is also consistent with classical *rahn* principles.¹⁹ Successive mortgagees of the same mortgaged property are contemplated.²⁰ The customary statement of the classical *rahn* principle is that the provision of a *rahn* over the *marhūn* by the mortgagor to a third party, with the consent of the mortgagee, renders the first *rahn* void and the second *rahn* to be the sole valid *rahn*.²¹ The granting by the mortgagor of such a third party *rahn* without the consent of the mortgagee would be void under classical principles.²² Thus, the Mortgage Law effects a position that is somewhat divergent from classical principles.

1.2.2.2 Registration and Possession

The Mortgage Law focuses on “registration” concepts, and specifically links the validity of the mortgage and the determination of relative priority to the registration process (and, under the Mortgage Law, a mortgage is not effective vis-à-vis third parties unless it is registered).²³ This is an extension of the relevant Shariah principles that speak of the necessity of “receipt and possession” of the *marhūn* by the mortgagee.²⁴ Specifically, it is an adoption of “constructive possession” concepts (in modern parlance), at least in the context of the mortgage registration process.²⁵ There is a basis in classical *rahn* formulations for acceptance of constructive possession formulations.²⁶ Specifically, various *madhahib* have long defined “receipt” of the *marhūn* as either actual receipt or the removal of impediments to such receipt (for example, provision of access). Other classical *rahn* principles are also supportive of the concept of continuing possession, for *rahn* purposes, by the creditor mortgagee in situations where physical possession and use are retained by the debtor mortgagor. These include the provisions hereinafter discussed with respect to use of the *marhūn* by the debtor and certain termination principles.

Two types of registration are addressed in the Mortgage Law: (a) registration pursuant to the provisions of the system of real estate registration, with registration being effected in accordance with such law; and (b) registrations that are not made pursuant to the provisions of that system, which must be made by way of countersignature on the record of the property at

the relevant court or notary public.²⁷ Given that there is currently no central registry of property that coordinates registrations with courts and notaries public, careful attention must be paid to the relevant requirements of applicable law, and due diligence efforts must be extensive with respect to many types of movable property, in particular. If mortgaged property is not registered pursuant to that system, the mortgagor may not dispose of the property during the term of the mortgage, unless the mortgagor and the mortgagee shall have otherwise agreed.²⁸ Registration and renewal expenses are for the account of the mortgagor and are considered to be part of the mortgage debt secured by the mortgage, absent agreement to the contrary.²⁹

1.2.2.3 *The Mortgaged Property*

Pursuant to the Mortgage Law, a mortgagor must be the owner of the mortgaged property, with full power, authority, and entitlement to dispose of that property.³⁰ If the mortgagor is not the owner of the mortgaged property, the relevant mortgage becomes effective only from the date upon which the mortgagor obtains a deed of ownership with respect to the mortgaged property.³¹ This implies that a mortgage may be granted with respect to property to be acquired in the future. This implication is supported by other provisions of the Mortgage Law, such as the provision that makes the mortgage effective against all annexures to the mortgaged property (such as buildings, plants, services, constructions, and modifications), expressly including those coming into being subsequent to the mortgage deed, unless the mortgagor and the mortgagee otherwise agree.³² This is largely consistent with classical *rahn* principles, which usually include in the *marhūn* both annexures and contiguous increases and separate growths of the *marhūn*.³³ Under the Mortgage Law, the mortgagor may, but need not, be the debtor on the debt secured by the mortgage: the mortgagor may be a guarantor, including a guarantor that provides a mortgage without the consent of the debtor.³⁴ Another implication of the ownership requirement is that mortgages of borrowed or previously mortgaged property are impermissible. Interpreted literally, this is somewhat contrary to the classical formulation which allows a *rahn* of borrowed property with the consent of the ultimate owner.³⁵ The classical rules pertaining to mortgages of previously mortgaged property involve issues pertaining to the comprehensiveness or restricted nature of the initial mortgage, consents and permissions with respect to subsequent mortgages, and the extent to which the two mortgages contradict one another, among others. However, the classical formulation under the *Majelle* indicates that the original mortgage pertaining to the mortgaged property that is subsequently mortgaged again is rendered void by the second mortgage.³⁶

The mortgaged property must be of a tangible or contingent nature and capable of being sold, which is consistent with classical Shariah principles.³⁷ Thus, the mortgaged property must (a) be in existence at the time of the grant of the *rahn*, (b) have a quantifiable value, and (c) be saleable and deliverable.³⁸ The mortgaged property must be accurately described in the mortgage deed itself or in a supplemental contract.³⁹ While the supplemental contract concept in the Mortgage Law allows for some privacy as among the contracting parties, it also introduces an element of uncertainty and ambiguity that will have to be further clarified as the system is effectuated. Given the lack of centralization of the registration system, this provision may result in difficulties in effective due diligence and related opaqueness. As noted above, the mortgaged property will include annexures constituting “after acquired” or future property unless otherwise agreed by the mortgagor and the mortgagee.

Under the Mortgage Law, each part of the mortgaged property is security for the entirety of the debt secured by the mortgage, and each part of the debt is guaranteed by the mortgaged

property, unless otherwise agreed by the mortgagor and the mortgagee.⁴⁰ These principles are congruent with classical *rahn* principles relating to “association of the underlying debt” which provide that the underlying secured debt is associated with the entirety of the mortgaged property and the mortgaged property is associated with the entirety of the debt.⁴¹ Thus, repayment or forgiveness of part of the debt leaves the remaining outstanding unpaid debt associated with the entirety of the mortgaged property and no portion of the mortgaged property is released until payment in full of the debt even if there are multiple debts or multiple items of mortgaged property.

If the property is registered pursuant to a system of real estate registration, leases issued by the mortgagor to third parties may not be enforced in favour of the mortgagee, provided that the property was registered prior to the registration of the mortgage deed, unless the period of the lease is less than five years.⁴² If the property is not registered pursuant to that law, the mortgagor must disclose, in the mortgage deed, all in-kind original and accessory rights relating to the mortgaged property, and the mortgagor is liable to the mortgagee for any failure to disclose if any such rights affect the right of the mortgagee.⁴³ If a failure to disclose is in bad faith, the mortgagor is subject to criminal actions pursuant to the laws pertaining to forgery.

1.2.2.4 *The Secured Debt*

Pursuant to the Mortgage Law, the debt secured by the mortgage must be (a) of a financial nature, (b) a specific amount to be acquired in the future, (c) a secured asset, or (d) a debt to be repaid, such as a conditioned debt or a debt to be established in the future or a potential debt. It is difficult to determine the distinctions between and among the foregoing categories, which are listed as summary statements, without further explication, in the Mortgage Law. Further elucidation will likely be forthcoming only in the litigation context and interpretive sources may then include classical *rahn* principles.⁴⁴ In each case, however, the mortgage secures only debt that is specified in the mortgage deed, including as to its amount and the maximum period for repayment.⁴⁵ Although not addressed in the Mortgage Law, caution dictates careful specification of the nature of the debt, including contemplated future advances and other similar matters. Conventional *rahn* principles allow increases in debt subsequent to the grant of the *rahn*.⁴⁶ Thus, it seems that conventional *rahn* principles will support most of the categories of permissible debt that are listed in the Mortgage Law. However, some *madhahib* have not permitted a *rahn* in respect of debt that has not yet arisen.⁴⁷ It is difficult to predict whether courts and adjudicative bodies in Saudi Arabia, when considering the Mortgage Law categories in the litigation context, will define those categories in a manner that is consistent with classical Shariah principles or adopt a more expansive interpretation of the Mortgage Law categories.

Under the Mortgage Law, the debt obligation, and the related mortgage, may be transferred by the mortgagee to a third party, unless the relevant documentation otherwise limits this right.⁴⁸ The Mortgage Law here strives for flexibility and responsiveness to modern financing arrangements and is permissively broad in its conception of debt that may be secured by a registered mortgage. It seems that the Mortgage Law, on its face, will easily apply to multiple draw, revolving and term credit facilities, so long as the amounts and tenors are specifically determinable and stated. It would also seem to be applicable to more creative financing arrangements, including those pertaining to some uncertain future events. This will likely be warmly received by banks and other providers of financing. The absence of outside constraints

and limits, however, will require that debtors carefully consider and negotiate the designated terms, including amounts and tenors. And questions remain as to whether the courts will give effect to the intention that seems to be embodied in the Mortgage Law.

The Mortgage Law provides that the mortgage is subordinate to the debt, and thus terminates upon payment of the debt.⁴⁹ This provision is consistent with classical *rahn* formulations, including the consequence of the “right of the mortgagee to hold and keep the mortgaged object” until payment in full of the debt.⁵⁰ Corollaries of this principle, and of the consequences, under classical *rahn* principles, of “dealing in and sales of the mortgaged property”, are that (a) the debtor mortgagor may not deal in (sell, lend, lease, mortgage, pledge, gift, or place in trust) the mortgaged property without the consent of the creditor mortgagee, and (b) the creditor mortgagee may not deal in the mortgaged property without the consent of the debtor mortgagor.⁵¹ Pursuant to the Mortgage Law, the debt may be prepaid prior to its maturity date in accordance with the agreement of the parties to the debt and mortgage documents.⁵² This is consistent with the Shariah principle that allows a debtor to prepay his, her, or its debt at any time, even if the financing arrangement expressly precludes early payment.

1.2.2.5 Operation, Safety, and Expenses of the Mortgaged Property

Under the Mortgage Law, the mortgagor is entitled to manage the mortgaged property during the term of the mortgage so long as such management does not prejudice the mortgagee’s rights, and the mortgagor is entitled to receive the proceeds from operation of the mortgaged property and pay expenses relating to the operation of such property.⁵³ This is consistent with the classical *rahn* principles of some of the orthodox Sunni *madhahib*, most notably the Shāfi’ī *madhhab*, which allow debtor use so long as the use does not harm the mortgaged property,⁵⁴ and of the general classical principles of the Hanbalī, Shāfi’ī, and Mālikī *madhahib* to the effect that the creditor mortgagee is not permitted to use the mortgaged property in any way.⁵⁵ The Hanafī and Hanbalī *madhahib* allow the debtor mortgagor to use the mortgaged property only with the consent of the creditor mortgagee, which forms the basis for covenant restrictions on use in transactional documentation.⁵⁶ The Mālikī *madhhab* does not permit any use of the mortgaged property by the debtor mortgagor, and any such use is said to invalidate the *rahn*.⁵⁷ The classical formulation of the Hanbalī principle regarding creditor mortgagee use of the mortgaged property is that creditor mortgagee use is impermissible absent debtor mortgagor consent.⁵⁸ This position is based upon a number of different rationales: that the mortgaged property, and its usufruct, is the property of the debtor mortgagor and may not be taken without consent; that the debtor’s property may not be taken without the payment of compensation, even with debtor consent; and that any benefit to the creditor may constitute *ribā* on the underlying secured debt obligation. Thus, the Mortgage Law seems to adopt and give effect to the classical Hanbalī doctrines in the area of debtor and creditor use of the mortgaged property.

The general classical Hanafī *rahn* principle is that the debtor mortgagor is responsible for the expenses relating to the benefit and upkeep of the mortgaged property without credit for such expenses against the outstanding debt, while the creditor mortgagee is responsible for safeguarding the mortgaged property with the limit of the creditor’s liability being the amount of the underlying secured debt.⁵⁹ The other three orthodox Sunni *madhahib* took a somewhat different view, which seems to underlie the view of the Mortgage Law: the debtor mortgagor is responsible for all expenses relating to the benefit and upkeep of the mortgaged property

and also for the expenses relating to safeguarding the mortgaged property.⁶⁰ The basis for this position is that the debtor mortgagor is the owner of the mortgaged property and is entitled to its output and is correspondingly responsible for its expenses.

The Mortgage Law provides that the mortgagee may be authorized to collect and receive the proceeds from operation of the mortgaged property prior to foreclosure, but is not allowed to retain those proceeds.⁶¹ Any provision authorizing the retention of those proceeds by the mortgagee is null and void as a matter of law, although the mortgage deed itself will remain valid and binding.⁶² These provisions should permit the use of lockbox collateral security structures, especially if considered together with Shariah principles pertaining to *adl* structures.⁶³ This should also permit the use and enforceability of reserve account provisions so long as the funds in those accounts are not applied to the debt except in accordance with the enforcement provisions set forth in the Mortgage Law and the Execution Law. These arrangements are consistent with classical *rahn* formulations.⁶⁴ Under those formulations, the mortgagee cannot take any benefit from the mortgaged property during the term of the mortgage absent the consent of the mortgagor. However, if the mortgagor's consent is obtained, the benefits of the mortgaged property, to the extent of the consent, are retained by the mortgagee and do not constitute a reduction in the secured debt. The Mortgage Law appears to prohibit this mortgagor consent arrangement (note the Mortgage Law provision that makes any such arrangement, even with consent, is null and void),⁶⁵ although it does allow for consent to collection, without mortgagee retention, by the mortgagee.

Under the Mortgage Law, the mortgagor remains obligated to guarantee the safety and value of the mortgaged property until repayment of the secured debt obligation.⁶⁶ This obligation extends to all matters that might result in a decrease in the value of the mortgaged property or prevent the mortgagee from recovering due to destruction or defect of the mortgaged property.⁶⁷ The mortgagee may object to all matters that would result in such a decrease in value or make the mortgaged property subject to loss or defect and may take necessary measures to ensure the safety of the mortgaged property, with the mortgagees' costs being for the account of the mortgagor.⁶⁸ The extent of this right in the mortgagee, and how far it extends into the "self-help" domain, remain unclear, but the bare language of the Mortgage Law is favourable to a strong position in favour of the mortgagee. That language also supports the use of strong preservation and use covenants in the related financing agreements. In any event, the mortgagee is permitted to seek a court injunction against actions that might have the effect of exposing the mortgaged property to destruction or damage or that might render it insufficient as collateral for the debt.⁶⁹

Under the Mortgage Law, if a decrease in value or a loss or defect occurs with respect to the mortgaged property or the rights or interests of the mortgagee in such property, there are three situations that must be considered, each of which bears defined consequences.⁷⁰ With respect to the first situation, if the decrease, loss, or defect is the result of the mortgagor's negligence or wilful misconduct, the mortgagee may require immediate payment of the debt or demand security that is adequate to that provided by the mortgage. This should be compared with the classical *rahn* principle that requires the mortgagor to pay an amount of compensation equal to the amount of the loss or defect.⁷¹ A second situation addressed under the Mortgage Law provides that, if the decrease, loss, or defect is not the result of the mortgagor's negligence or wilful misconduct, the mortgagor is obligated to either provide a sufficient guarantee of the debt or pay the debt. The third situation addressed under the Mortgage Law is particularly confusing, including in the original Arabic text, and provides that the mortgagee may accept a new or substitute mortgage that is equal in value to the decreased, lost, or defective mortgage,

unless the mortgagee has an interest in the decreased, lost, or defective mortgage, in which case a mortgagee may request immediate payment of the debt.⁷² And upon any damage to or decrease in the value of the mortgaged property, the mortgagee's rights attach to any money that is substituted for the mortgaged property without the consent of the mortgagee and the mortgagee shall have rights, and the mortgage's priority, against such money, which is consistent with classical *rahn* concepts.⁷³

Under classical *rahn* principles, decrease, loss, or defect resulting from third party acts that are not attributable to the mortgagor must be compensated by the third party and that compensation then becomes subject to the mortgage.⁷⁴ If the decrease, loss, or defect results from acts or omissions of the mortgagee, the amount of the decrease, loss, or defect is struck from the secured debt as it is compensable by the mortgagee.⁷⁵ The different orthodox Sunni *madhahib* treat the guarantee or assurance with respect to the mortgaged property somewhat differently.⁷⁶ The Hanafī position, which characterizes the creditor mortgagee's possession as a possession of trust, allows for a reduction in the amount of the underlying secured debt if the mortgaged property perishes, with the mortgaged property being protected in an amount equal to the lesser of its value and the amount of the underlying secured debt. Various conditions attach in order to make a diminution, loss, or defect compensable while in the possession of the creditor mortgagee: (a) existence of the underlying secured debt at the time of the relevant event; (b) possession by the creditor mortgagee (and not the debtor mortgagor) at the time of the event; and (c) that the affected mortgaged property is part of the original underlying mortgaged property, and not an increase to or output of that property.⁷⁷ The other orthodox Sunni *madhahib* view the creditor mortgagee's possession as one of guarantee, such that perishing of the mortgaged collateral gives rise to a reduction in the underlying debt unless the creditor mortgagee is responsible by way of transgression or negligence. The Mortgage Law conception extends somewhat further than the classical *rahn* conception.

The second and third situations addressed by the Mortgage Law are not entirely inconsistent with classical *rahn* principles, although they do place the burden on the debtor to pursue the compensation from the non-debtor offender, which is an element of the classical Hanbalī position based upon the position that the debtor mortgagor is the owner of the mortgaged property.⁷⁸ Thus, under classical principles, the debtor would provide adequate security, equal to the value of the decrease, loss, or defect, and thus to the full amount of the debt, for the benefit of the mortgagee and separately pursue an action against the third party or mortgagee, as relevant, for the amount of such value.

1.2.2.6 Defaults and Remedies

Under the Mortgage Law, provisions in a mortgage deed or related documents that allow the mortgagee to take ownership of the mortgaged property upon non-payment of the secured debt are null and void, although the mortgage itself will remain valid.⁷⁹ This is entirely consistent with classical *rahn* principles and an oft-quoted *hadith*, although some Hanbalī jurists have sometimes allowed the transfer of ownership of the mortgaged property upon non-payment.⁸⁰

The mortgage is cancelled upon payment of the secured debt under the Mortgage Law. Defaults other than payment defaults, such as covenant defaults, allow the mortgagee to foreclose upon the mortgaged property.⁸¹ A default entitles the mortgagee to request sale of the mortgaged property pursuant upon adequate notice and compliance with the provisions of the Execution Law,⁸² with the mortgagee having the designated priority with respect to the proceeds of such a sale.⁸³ If those proceeds are insufficient to pay the secured debt in full, the

mortgagee becomes an unsecured *pari passu* creditor with respect to the unpaid balance of the secured debt.⁸⁴

These provisions of the Mortgage Law are largely consistent with classical *rahn* principles. For example, classical principles favour sale of the mortgaged property in default scenarios, including pursuant to judicially ordered sale.⁸⁵ However, the classical formulations permit the debtor mortgagor to sell the mortgaged property in some situations (this rule is often stated as the preferred rule in light of the debtor mortgagor's retention of ownership)⁸⁶ and permit the mortgagor to appoint the mortgagee or another person as attorney for the sale of the mortgaged property.⁸⁷ The Mortgage Law and the Execution Law do not make provision for sales by the mortgagor or by the mortgagee as attorney for the mortgagor.

The mortgage lien, and rights of the mortgagee, survive any transfer of ownership or possession of the mortgaged property.⁸⁸ A holder of the mortgaged property or certain rights in the mortgaged property is deemed to be in possession of the mortgaged property for purposes of the Mortgage Law if that holder came into possession after the mortgage or acquired a mortgaged proprietary right without personal liability for the debt secured by the mortgage.⁸⁹ At any time prior to the sale of the mortgaged property in accordance with the Execution Law (and as otherwise provided by law), possessors of the mortgaged property have a right to make payment of the secured debt upon receipt of notice of default and foreclosure, and, upon any such payment, such possessors succeed to the position of the mortgagee and are entitled to reimbursement of expenses from the mortgagor.⁹⁰ This effects a "right of redemption" in possessors "until the gavel falls" upon foreclosure sale. Possessors of the mortgaged property, which presumably include the owner mortgagor if a possessor, may participate in the auction sale of a mortgaged property in foreclosure, and may purchase the mortgaged property at any such sale, free of the lien of the mortgage.⁹¹ The purchaser in foreclosure will acquire the mortgaged property free of the mortgage lien.

Upon a foreclosure sale, a portion of the sale proceeds, equal to instalments due and unpaid at the time of the foreclosure sale, is paid to the creditor and the remainder of the proceeds are placed in a bank account (and can be released upon the agreement of the creditor if a bank guarantee is obtained with respect to the payment of future debt payments).⁹² These provisions of the Mortgage Law give effect to classical *rahn* principles that are based upon the theory that the proceeds obtained by sale of the mortgaged property substitute for the original mortgaged property, with continuation of the original transaction arrangements in respect of the underlying debt until maturity of the debt.⁹³ Of course, an arrangement such as this introduces issues pertaining to a previously unconsidered credit, that of the bank holding the funds until maturity. The identity of the owner of the bank account is not clear in the Mortgage Law, whatever the strictures of the release provisions pertaining to that account. Under most classical *rahn* formulations, the debtor mortgagor continues to own the proceeds as mortgaged property as it is substituted for the original collateral. That arrangement, of course, would expose the amounts in the bank account to the subsequent bankruptcy of the debtor mortgagor (although it is likely that the creditor mortgagee's priority in those amounts would continue during the bankruptcy).

Foreclosure sale terminates the mortgage upon the mortgaged property, as does (a) repayment of the debt (previously discussed), (b) expiration of the stated term of the mortgage, (c) a unification of the mortgage and ownership in a single person, (d) a waiver by the mortgagee creditor during the term of the debt,⁹⁴ and (e) pursuant to mortgagor request, expiration of the statute of limitations on the underlying secured debt.⁹⁵ Presumably, the mortgaged property must then be returned to the debtor mortgagor if it is held by the creditor

mortgagee at the time of mortgage termination. The registration concept, with possession for use being retained by the debtor mortgagor during the term of the mortgage, should minimize the issues that arise under classical principles with respect to retention of possession by the creditor mortgagee.⁹⁶ The terminations upon foreclosure and in the cases in clauses (a) and (d) find explicit support in compilations of the classical *rahn* principles, and the terminations provided in clauses (b) and (c) find implicit support from classical principles.⁹⁷ Statute of limitations provisions are an example of more modern conceptions of the orderly conduct of business.

1.3 CONCLUSION

Saudi Arabia is in the process of taking the critical first step to the establishment of a collateral security regime based upon a registration system and prioritization principles. This is to be lauded. The regime will enhance the confidence of current and potential market participants. It will expand the range and number of market participants, particularly financiers. The regime will encourage broader and more penetrating participation in Saudi Arabian financings by local, regional, and international financiers. It will do much to encourage greater creativity and product range in the Saudi Arabian markets.

The proposed regime embodies existing *rahn* principles in the statutory framework. As indicated in this chapter, much remains to be done and much remains to be clarified. The basic principles set forth in the Mortgage Law will need to be elucidated in greater detail, hopefully to the end that the entire regime is internally consistent. At present, it is difficult to discern doctrinal consistency in the choice of principles, and the current draft of the Mortgage Law is selective and quite summary in nature in terms of the principles that have been chosen for inclusion. The elucidation and development process will be challenging in any case. If that process is left to the courts and other adjudicatory authorities, the process may not result in coherency and consistency for many years due to the lack of reporting of decisions and the absence of a *stare decisis* framework. And the implementation of that process may become intertwined with the reorganization of the judiciary and quasi-judiciary system, adding yet further complexity.

The review presented in this chapter is intended as one of optimism; it is intended to focus discussion, constructive analysis and criticism so that the collateral security regime that emerges in Saudi Arabia best serves the markets and the needs of the full range of market participants.

NOTES

- * Member of the bar of the state of New York and lecturer in Islamic finance at the University of Pennsylvania Law School and the Wharton School of Business. Dr McMillen's primary areas of practice are Islamic finance and project finance. Dr McMillen has practised law in the Kingdom of Saudi Arabia, the United Arab Emirates, and other Middle Eastern jurisdictions since 1996 and lived in Saudi Arabia from 1996 to 2000 and in the United Arab Emirates from 2009 to the present. Copyright © 2010, Michael J.T. McMillen; all intellectual property rights reserved to Michael J.T. McMillen.
- 1. The development and implementation of the project, including the then unique collateral security structure developed for and implemented in the Saudi Chevron financing, is described in Michael J.T. McMillen (2001) "Islamic Shari'ah-Compliant Project Finance:

- Collateral Security and Financing Structure Case Studies”, *Fordham International Law Journal* 24, 1184 (“McMillen: 2001”), at pp. 1184–232.
2. The transaction also involved limited technology and completion recourse. For a discussion of the definition and historical development of project financing, see Michael J.T. McMillen (2009) *Islamic Project Finance: An Introduction to Principles and Structures, III Global Infrastructure*, Fulbright & Jaworski LLP, entire issue (“McMillen: 2009”), and sources cited therein, particularly, with respect to historical considerations; Stuart E. Rauner, “Project Finance: A Risk Spreading Approach to Commercial Financing of Economic Development” (1983) *Harvard International Law Journal* 24(145), at 146–156. Michael J.T. McMillen, “Shari’ah-Compliant Project Finance” and Michael J.T. McMillen, “Islamic project finance” in M. Kabir Hassan and Mervyn K. Lewis (eds) (2007) *Handbook of Islamic Banking*, also discuss Shariah-compliant structures that are used in infrastructure, real estate, electricity, petrochemical, mining, industrial, and other project financings, virtually all of which have evolved since 1996.
 3. See McMillen: 2001, above n. 1, at pp. 1184–232. In orthodox jurisprudence of the Shariah, no distinction is made between a mortgage and a pledge as those concepts are known to contemporary Western legal practitioners: the term “*rahn*” encompasses both of those concepts. Many government officials, lawyers, and financiers in Saudi Arabia believe, and have long believed, that the unwillingness to register mortgages and pledges derives from the assumption that they secured, and continue to secure, interest-bearing obligations that are contrary to the Shariah. That set of beliefs was frequently asserted to the author during the period in which the author lived and practised law in Saudi Arabia (1996–2000 and 2008–2010). At that time, Shariah-compliant financing transactions were uncommon in Saudi Arabia. As an aside, those beliefs, and the unwillingness to register *rahn* interests, also influenced the formation and powers of the SAMA Committee (see, for example, the discussion at McMillen: 2001, above n. 1, at pp. 1193–203). Recent discussions with Saudi Arabian government officials, lawyers, and financiers support the assertion that the growth of Islamic banking and finance throughout the world, and particularly in Saudi Arabia, has had a marked impact on thinking with respect to the appropriateness of registering *rahn* interests and may be one impetus to consideration of the legislation discussed in this chapter. Shariah-compliant financings are now commonplace in Saudi Arabia, as are interest-based financings. *Rahn* arrangements supporting Shariah-compliant financings are entirely consistent with ancient Shariah-compliant practices in the fields of commerce and finance.
 4. See McMillen: 2001, above n. 1, at pp. 1184–232, with *rahn* principles being discussed at pp. 1219–26. As discussed in McMillen: 2001, a collateral security structure that is compliant with the Shariah as enforced in Saudi Arabia was developed for the Saudi Chevron petrochemical project. That structure has been, and continues to be, widely used in Saudi Arabia. For definitions of *rahn* as adopted by each of the four orthodox Sunni *madhahib*, see Al-Zuhayli, below note 9, at pp. 79–80.
 5. Article 48 of the Constitution of the Kingdom of Saudi Arabia.
 6. See McMillen: 2001, above n. 1, at 1193–203, Michael J.T. McMillen (2008) Asset Securitization Sukuk and Islamic Capital Markets: Structural Issues in the Formative Years, *Wisconsin International Law Journal* 25, p. 703, and Michael J.T. McMillen (2007) Contractual Enforceability Issues: Sukuk and Capital Markets Development, *Chicago Journal of International Law* 7, p. 427, for discussions of some of the enforceability, enforcement, and other uncertainties, and their genesis, under Saudi Arabian law.

7. The translation of the Mortgage Law used for this chapter was prepared by Fulbright & Jaworski LLP. The author expresses particular gratitude to his former partners, Hassan El-Sayed and David Silver, and to other Arabic language scholars whom we have consulted, for their thoughts and observations on the original Arabic text of the Mortgage Law, some of which is particularly unclear in the original Arabic text. A single set of the translations of the other Financing Laws (and a separate translation of the Mortgage Law) have been provided to the author from various different sources (the same translations came from each source); the original source is unknown. Only select sections of those translations were checked by Fulbright & Jaworski LLP and it is to be noted that the Fulbright & Jaworski translations are materially different from the other set of translations. It is also to be noted that the Arabic version of the Mortgage Law is itself difficult, confusing, and somewhat internally inconsistent, even to skilled legal professionals whose native language is Arabic and who work in the Arabic language.
8. Two versions of the “*Majelle*” have been used for the preparation of this chapter: *Majalat Al-Ahkam Al-Adliyah* (an English language translation prepared by Judge C.A. Hooper as *The Civil Law of Palestine and Trans-Jordan*, Vols I and II (1935), and reprinted in various issues of *4 Arab Law Quarterly*, 1968) (“Hooper 1933”), and C.R. Tyser, D.G. Demetriades, and Ismail Haqqi Effendi (2001) *The Majelle: Being an English Translation of Majallah El-Ahkaml-Adliya and a Complete Code on Islamic Civil Law*. These versions are essentially identical; the minor differences between them are irrelevant for purposes of this chapter. Thus, “*Majelle*” refers to both translations or either translation. The *Majelle* is an unfinished digest of principles and rules of the Shariah under the Hanafī *madhhab* as applied in civil law transactions (*muāmalāt*). It was prepared by a committee of Ottoman Hanafī scholars during the period from 1865 to 1888, was published between 1870 and 1877, and was codified as law in the Ottoman Empire as applicable to matters outside the commercial code. See S.S. Onar (1955) “The Majalla” in Majid Khadduri and Herbert J. Liebesny (eds), *Law in the Middle East*. Although the *Majelle* reflects the position of the Hanafī School (*madhhab*) of Islamic jurisprudence, the differences between the Hanafī *madhhab* and the Hanbalī *madhhab*, which is predominant in Saudi Arabia, are relatively minor as to most matters referred to in this chapter.
9. Wahbah Al-Zuhaylī (Mahmoud El-Gamal, translator, and Muhammad S. Eisaa, revisor), *Al-Fiqh Al-Islamī wa-Adillatuh (Islamic Jurisprudence and its Proofs)*, Wahbah al-Zuhaylī, *Financial Transactions in Islamic Jurisprudence*, which is a translation of Volume 5 of *Al-Fiqh Al-Islamī wa-Adillatuh*, fourth edition (1997) and appears in two volumes (“Al-Zuhaylī”). *Al-rahṅ* concepts are discussed in part X, chapters 69–74, vol. II, at pp. 79–194. All references in the chapter are to vol. II, unless otherwise specifically indicated. A short summary of a few *rahṅ* principles is contained in Wael B. Hallaq, *Shari’a: Theory, Practice, Transformations* (2010), at pp. 267–68, a book constituting an excellent introduction to Shariah concepts and the development of the Shariah.

Al-Zuhaylī provides the following introduction to *rahṅ* concepts, at p. 79.

The Arabic term “*rahṅ*” may refer either to constancy, or to holding and bindingness. In this regard, the verse “every soul will be held (*rahīmah*) in pledge for its deeds” [74:38] refers to the binding aspect of the term. Of the two opinions, the holding aspect is the more physical one, and hence we deem it to be the primary linguistic meaning, while the permanency meaning is derived from that primary one. The juristic meaning of the term is closely associated with its linguistic meaning. Oftentimes, one uses the term *rahṅ* to refer to the object that was pawned to ensure a debt.

10. Ibn Rushd, *The Distinguished Jurists' Primer, Volume II, Bidāyat Al-Mujtahid Wa Nihāyat Al-Muqtasid* (Imran Ahsan Khan Nyazee, translator, and Mohammad Abdul Rauf, revisor) ("Ibn Rushd").
11. For a discussion of the Board of Grievances and other adjudicative bodies in Saudi Arabia, see McMillen: 2001, above n. 1, at pp. 1195–203. Saudi Arabia is currently contemplating a reorganization and rationalization of its judicial and quasi-judicial organization. It is not possible, at this stage, to surmise on the nature of that reorganization and the effect it might have on enforcement of collateral security interests.
12. Article (22), Mortgage Law.
13. Article (23), Mortgage Law.
14. Al-Zuhaylī, above n. 9, at p. 175. With respect to Shariah principles in the bankruptcy context, see Michael J.T. McMillen, "Shari'ah Considerations in the Bankruptcy Context and the First Bankruptcy (East Cameron)" (2010) ("McMillan: 2010"), forthcoming article being published by the Islamic Financial Services Board.
15. Al-Zuhaylī, above n. 9, at pp. 143–82, discusses each of these consequences and the positions and rulings of each of the four orthodox *madhahib* with respect to each consequence.
16. Article (1)(a), Mortgage Law, and full title of the Mortgage Law: "Bill of Registered Real Estate Mortgage Law".
17. Article (48), Mortgage Law. To the extent of inconsistencies, the Mortgage Law supersedes the Commercial Mortgage Law.
18. Consider, for example, Articles (12) and (20)(a), Mortgage Law, Ibn Rushd, above n. 10, at pp. 330–1. See, also, McMillen: 2001, above n. 1, at p. 1220, discussing the prohibition on the pledging of rent and other proceeds of operation of the mortgaged property without a mortgage or pledge of the underlying asset generating the rent or other proceeds.
19. Articles (1)(a) and (27), Mortgage Law. And see the discussion of priority at nn. 12–14 and 48, below, and accompanying text.
20. Article (27), Mortgage Law, providing for collection by successive mortgagees of their respective debts in the order of their respective priorities.
21. Article 744, *Majelle*.
22. Article 743, *Majelle*.
23. Article (1)(d), Mortgage Law.
24. See e.g. Articles 718, 722, and 751, *Majelle*, and Al-Zuhaylī, above n. 9, at pp. 106–22.
25. See McMillen: 2001, above n. 1, at 1203–32, Al-Zuhaylī, above n. 9, at p. 80 (which notes that the *rahn* is a voluntary charitable contract (*tabarru'*) because the mortgaged property is given without financial consideration and involves non-fungibles, and, as such, is not considered totally binding until the object of the contract is delivered and received by the mortgagee) and p. 82 (with respect to Hanafī delivery requirements), and Ibn Rushd, above n. 10, at pp. 328–9. Proofs of the legality of the *rahn* from the Qur'an and the Sunna are summarized at Al-Zuhaylī, at pp. 80–1, and Ibn Rushd, at p. 325.
26. Al-Zuhaylī, above n. 9, at pp. 106–22, discusses a wide range of receipt-related issues under the four primary orthodox Sunni *madhahib*. It is also common, under the classical formulations, for the debtor to be permitted to hold and operate the mortgaged property during the term of the mortgage (with an obligation to produce the mortgaged property for confirmation upon demand by the mortgagee in certain circumstances, such as at the time of repayment; see, Al-Zuhaylī, at pp. 148–9). See, also, Al-Zuhaylī, at pp. 187–8.
27. Articles (1)(c) and (1)(d), Mortgage Law, respectively.
28. Article (11), Mortgage Law.

29. Article (1)(d), Mortgage Law.
30. Separate rules apply to grants of mortgages by multiple owners of mortgaged property. See Article (7), Mortgage Law. The Mortgage Law does not explicitly address the possibility of grants of a mortgage by an individual or entity that is not the owner of the mortgaged property, and it is unclear whether such grants are prohibited by the Mortgage Law, at least in the context of mortgages that can be registered. The *Majelle* specifically addresses mortgages by entities or persons that are not the owner of the mortgaged property. See e.g. Articles 710, 726–728, and 732, *Majelle*. Al-Zuhaylī, above n. 9, at pp. 104–5 and 128–38, and Ibn Rushd, above n. 10, at p. 326, discuss the granting of a *rahn* in respect of borrowed property (which is said to be permitted by all *madhahib*), the granting a *rahn* on the property of others, including mortgaged property, and various permission requirements pertaining to mortgaging non-owned property.
31. Articles (2)(a) and (3), Mortgage Law.
32. Article (5), Mortgage Law. Notably, in the case of subsequent annexures, the rights of third parties in and to such annexures are protected. The application of third party rights provisions is straightforward in some circumstances; it will undoubtedly give rise to disputes in other cases.
33. Article 711, *Majelle*. See Al-Zuhaylī, above n. 9, at pp. 183–5. As noted in Al-Zuhaylī, different *madhahib* have somewhat different interpretations of these principles, with the Mālikī being the most restrictive and the Hanbalī being quite comprehensive and general as to which annexures, increases, and growths constitute part of the mortgaged property.
34. Article (2), Mortgage Law. If the mortgagor is a guarantor or the mortgaged property is without a debtor [is mortgaged by another person who is not the debtor], enforcement may only be made against the assets constituting the mortgaged property who is not the debtor [i.e., and not against the non-debtor mortgagor]. Bracketed language indicates the presumed intention of the Article.
35. See e.g. Articles 726 (*rahn musta'ar*), pp. 735, 736, 737, 765 and 823, *Majelle*.
36. See e.g. Al-Zuhaylī, above n. 9, at pp. 134–6. Article 745, *Majelle*, provides that a mortgage by the creditor mortgagee of previously mortgaged property with the consent of the mortgagor debtor renders the first mortgage (by the mortgagor debtor to the mortgagee creditor) void, with the second mortgage being treated as valid and akin to the mortgage of lent property. Article 743, *Majelle*, provides that if either the mortgagor debtor or the mortgagee creditor mortgage the previously mortgaged property to a third party without the consent of the other, the second mortgage to the third party is void. This provision does not address effects on *bona fide* third parties without knowledge of the original mortgage. Article 744, *Majelle*, provides that a mortgage of the previously mortgaged property to a third party by the original mortgagor with the consent of the mortgagee renders the initial mortgage void and the second mortgage as the sole valid mortgage. Rather precise rules have been developed for some specific types of mortgage arrangements and specific types of mortgaged property. See e.g. Al-Zuhaylī, at pp. 136–9, which addresses mortgages of indebted estates, perishables, fruit juices, and religious books.
37. Articles 709 and 715, *Majelle*. See, also, Al-Zuhaylī, above n. 9, at pp. 101–6, and Ibn Rushd, above n. 10, at p. 326. The ability of the *marhūn* to be sold is said to be necessary both at the time of the grant of the *rahn* and upon termination of the *rahn*.
38. Article 709, *Majelle*. See, also, Al-Zuhaylī, above n. 9, at pp. 101–6, and Ibn Rushd, above n. 10, at p. 326. Mortgages of claims for a debt are not permitted. The issue of “after acquired” property, or property added to the *rahn* after the execution of the

- mortgage deed, is discussed in McMillen: 2001, above n. 1, at pp. 1220. With respect to the “existence” requirement and the requirement of Article (4), Mortgage Law, regarding accurate description of the mortgaged property, it is important to note that Article 713, *Majelle*, specifically permits the post-execution addition of collateral to the mortgage and pledge. The safest course, particularly in light of the description requirements set forth in Article (4), Mortgage Law, even in the face of invocation of Article (10), Mortgage Law, and Article 711, *Majelle*, is supplementation of the mortgage deed to additionally list critical after-acquired property. With regard to the nature and many conditions and requirements pertaining to saleability and deliverability and sales transactions, see Al-Zuhaylī, above n. 9, vol. I, at pp. 1–366, and Articles 197–299, *Majelle*.
39. Article (4), Mortgage Law. See the next preceding note with respect to post-execution additions of collateral to the coverage of the mortgage deed. Consider, Al-Zuhaylī, above n. 9, at pp. 123–5, with respect to grants of *rahn* with respect to unidentified property shares, at pp. 125–7, with respect to connected and occupied properties and fungible liabilities, and at pp. 127–8i, with respect to leased or lent non-fungibles.
 40. Article (10), Mortgage Law.
 41. Al-Zuhaylī, above n. 9, at pp. 144–6, with discussion of the Hanbalī principles being at p. 145, and Ibn Rushd, above n. 10, at pp. 329–30. As summarized by Al-Zuhaylī and Ibn Rushd, there are circumstances in which the orthodox Sunnī *madhahib* modify the unitary *rahn* contract principles, such as where there are multiple debtors and multiple creditors and, in some cases, where the underlying debt is multiple. See, also, Articles 713, 714, and 729–732, *Majelle*.
 42. Article (21)(a), Mortgage Law. The original Arabic version of this Article of the Mortgage Law is particularly unclear and confusing. Different native Arabic speaking lawyers and academicians have been unable to agree on the meaning of the original Arabic version, and different readings are feasible. The statement in the text must thus be further investigated and treated with caution.
 43. Article (21)(b), Mortgage Law.
 44. Al-Zuhaylī, above n. 9, at p. 83, observes that there are three forms of mortgages: (a) a mortgage required pursuant to the debt-generating contract, such as a condition in a sale agreement that a mortgage be provided to secure payment of the sale price; (b) a mortgage originating after the establishment of the relevant secured debt; and (c) a mortgage prior to the establishment of the relevant secured debt, such as a mortgage of property prior to incurring of any indebtedness. With respect to the last category, Al-Zuhaylī notes that the Shāfi‘īs and most Hanbalīs (whose doctrines predominate in Saudi Arabia) ruled that such a mortgage is not valid. The Shāfi‘īs and the Hanbalīs established a number of conditions relating to the liability underlying the mortgage, including the requirement that liability must be an established and matured fungible debt. See, Al-Zuhaylī, at pp. 99–100. The Hanafīs also set forth a number of conditions for the underlying secured debt, including that the underlying right in respect of which an object is mortgaged must be binding and matured. See, Al-Zuhaylī, at pp. 93–9. The Mālikī conditions are discussed at Al-Zuhaylī, pp. 100–1.
 45. Articles (23) and (9), Mortgage Law.
 46. Article 714, *Majelle*. See, also, Al-Zuhaylī, above n. 9, at pp. 185 and 93–8.
 47. Al-Zuhaylī, above n. 9, at p. 83, notes that the Shāfi‘ī and Hanbalī *madhahib* have disapproved on the grounds that insurance of a legal right may not precede the establishment of the legal right, characterizing a *rahn* as a derivative of a legal right. See n. 44, above.

See, also, Al-Zuhaylī, at pp. 93–8, in respect of the positions of different *madhahib* with respect to the maturity of the secured debt, including distinctions as to “finally established” loans and those that are not “finally established”, and pp. 98–101, with respect to other underlying debt conditions.

48. Articles (18), (24) and (26), Mortgage Law, with Article (18) subjecting such transfers to the Disposition of Debt Provisions and Article (24) requiring registration of the transfer. The Arabic language of Article (24) is particularly unclear as to what rights of third parties are being discussed and the circumstances in which that Article will be applicable. Considerable care should be taken in investigating and interpreting the implications of Article (24). Article (26) allows certain waivers of priority by a mortgagee in favour of another mortgagee. Article (26) does not provide any indication of the consequences of any permitted waiver: consider, for example, the consequences of a waiver by a first priority mortgagee creditor of an SAR 500 million mortgagee position in favour of a second mortgagee in a situation where there are three priority creditors. Does the waiving first priority mortgagee then become second, or third, priority in respect of the waived priority? What if the waiver is for less than all of the total secured mortgage claim of the waiving mortgagee (e.g., the total mortgage in favour of the waiving first priority mortgagee is SAR 1 billion, but the waiver pertains to only SAR 500 million)?
49. Article (40), Mortgage Law, and Al-Zuhaylī, above n. 9, at p. 187 (among many other references). The mortgage is automatically reinstated, subject to intervening rights of *bona fide* third parties, if the debt is lifted and subsequently re-effected. It is unclear how this provision will operate in the case of revolving credit concepts, but it can be surmised that they will be unaffected and that this provision operates to a complete termination and reinstatement of the debt rather than a period in which no debt is actually outstanding (see, for example, Articles (23) and (9), Mortgage Law). See, also, Al-Zuhaylī, at pp. 111–12, as it pertains to payment of the debt and reinstatement of the *rahn*.
50. Articles 729, 739, 740 and, in the case of placement of the mortgaged property with an *adl*, 751, *Majelle*. See, also, Articles 730 and 731, *Majelle*. See, also, Al-Zuhaylī, above n. 9, at pp. 146–8, which explains the association of the “right of the mortgagee to hold the mortgaged object” with the consequence of the “association of the underlying debt with the mortgaged property” and also discusses the rationales adopted by the four orthodox Sunni *madhahib*.
51. Al-Zuhaylī, above n. 9, at pp. 159–65. Note that the Hanbalī position is that (i) any such dealing in the mortgaged property by the debtor mortgagor without the consent of the creditor mortgagee is invalid *ab initio*, but is permissible with the consent of the creditor mortgagee, and (ii) any such dealing in the mortgaged property by the creditor mortgagee without the consent of the debtor mortgagor is invalid *ab initio*, but is permissible with the consent of the debtor mortgagor. See, also, Al-Zuhaylī, at p. 189, pertaining to the termination of a mortgage or pledge upon permitted leasing, gifting, or sale of the mortgaged property by the debtor or the creditor and noting that the mortgaged property may thereafter be held pursuant to different principles (such as those pertaining to a lease, a gift, or a sale).
52. Article (41), Mortgage Law. This Article is particularly unclear, including in the original Arabic language text. Caution should be exercised in the interpretation and application of this Article.
53. Article (12), Mortgage Law.

54. See the discussion of the Shāfi'ī position at Al-Zuhaylī, above n. 9, at pp. 147, 152, and 154, which most clearly states the principle. Most formulations of the classical *rahn* principles require the creditor mortgagee to safeguard the mortgaged property, and to assume responsibility for at least some of the expenses relating to such activities. See, also, Al-Zuhaylī, at pp. 149–50, and Ibn Rushd, above n. 10, at pp. 330–1.
55. Al-Zuhaylī, above n. 9, at pp. 154–8.
56. *Ibid.*, at pp. 152–3.
57. *Ibid.*, at pp. 153–4.
58. *Ibid.*, at pp. 158–9. There are limited exceptions, such as for animals that require feeding.
59. *Ibid.*, at pp. 150–2.
60. *Ibid.*, at p. 151.
61. Articles (12) and (20)(a), Mortgage Law, Al-Zuhaylī, above n. 9, at p. 151, and Ibn Rushd, above n. 10, at pp. 330–1.
62. Article (20)(a), Mortgage Law. See, also, the discussion of conditions included in a mortgage or pledge transaction under classical *rahn* principles at Al-Zuhaylī, above n. 9, at pp. 90–101, and Ibn Rushd, above n. 10, at p. 329.
63. McMillen: 2001, above n. 1, at pp. 1213–16 and 1219–26.
64. Article 750, *Majelle*.
65. Article (20)(b), Mortgage Law.
66. Articles (13) and (14), Mortgage Law, and Al-Zuhaylī, above n. 9, at pp. 165–71.
67. Article (14), Mortgage Law.
68. Article (13), Mortgage Law.
69. Article (16), Mortgage Law.
70. Article (14), Mortgage Law.
71. Article 741, *Majelle*.
72. Virtually every lawyer and academician that has examined Article (14), particularly Article (14)(c), of the Mortgage Law has discerned a different meaning and expressed concern with both the original Arabic language drafting and the inconsistency with other provisions of the Mortgage Law (including Article (14)(b)).
73. Article (17), Mortgage Law.
74. Article 742, *Majelle*.
75. Article 741, *Majelle*.
76. Al-Zuhaylī, above n. 9, at pp. 166–71, and Ibn Rushd, above n. 10, at pp. 331–2. As noted in the Al-Zuhaylī discussion, there are separate rules pertaining to consumption of the mortgaged property.
77. Al-Zuhaylī, above n. 9, at pp. 167–9, and Ibn Rushd, above n. 10, at p. 333. Note also that the time of valuation of the mortgaged property is an important consideration, and rulings vary as to whether the relevant value is the value at inception of the mortgage or at the time of the diminution or loss event. Insurance proceeds are not addressed in the Mortgage Law, although they would presumably substitute for the lost or destroyed mortgaged property.
78. Al-Zuhaylī, above n. 9, at pp. 170–1. The Mortgage Law position varies slightly from the classical Hanbalī principle in that the Mortgage Law seems to allow the debtor mortgagor to retain proceeds obtained from the party that is liable, a position that is internally consistent given the requirements that the debtor mortgagor provide increased assurances directly to the creditor mortgagee, including during the pendency of the action against the liable party.

79. Article (20)(b), Mortgage Law. See, also, n. 62, above, with respect to conditions included in a mortgage or pledge transaction under classical *rahn* principles.
80. Al-Zuhaylī, above n. 9, at pp. 175–6; the *hadith* is referenced at 175, footnote 62 and accompanying text.
81. Articles (30) and (41)(c), Mortgage Law.
82. Article (30), Mortgage Law.
83. Article (19), Mortgage Law.
84. Article (19), Mortgage Law.
85. Article 757, *Majelle*. See, also, Al-Zuhaylī, above n. 9, at pp. 171–80, and Ibn Rushd, above n. 10, at p. 329. A similar sale preference is evident in Shariah principles applicable in the bankruptcy context, where marshaling of assets and asset sale is preferred; see McMillen: 2010, above n. 14.
86. Articles 757 and 758, *Majelle*; Al-Zuhaylī, above n. 9, at pp. 173–4. The “normal” rule of debtor sale quickly gives way to judicially mandated sale if the debtor refuses to sell or is recalcitrant in effecting a sale of the mortgaged property.
87. Articles 760 and 761, *Majelle*. See, also, Article 759, *Majelle*, pertaining to sales of assets that can spoil or otherwise lose value.
88. Article (28), Mortgage Law.
89. Article (29), Mortgage Law.
90. Articles (31) and (32), Mortgage Law.
91. Articles (34) and (35), Mortgage Law. The original Arabic text of certain related articles, such as Articles (36) to (39), is somewhat confusing as to whose rights and obligations are being addressed with respect to related matters.
92. Article (41)(c), Mortgage Law.
93. Al-Zuhaylī, above n. 9, at pp. 175 and 187–8.
94. Al-Zuhaylī, above n. 9, at p. 188, discusses this principle as adopted by all four orthodox Sunni *madhahib*.
95. Articles (44), (45), and (46), Mortgage Law.
96. See e.g. Al-Zuhaylī, above n. 9, at 178–80.
97. It is noteworthy that classical *rahn* principles indicate a termination of the *rahn* arrangement if either the debtor or the creditor leases, gifts, or sells the mortgaged property with the permission of the other. See, for example, Al-Zuhaylī, above n. 9, at p. 189.

<http://www.pbookshop.com>