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## Secured Creditors Under the Saudi Bankruptcy Law

### INTRODUCTION

Creditors filing claims under Saudi bankruptcy proceedings aspire to be classified as “secured creditors”. This is because the Bankruptcy Law<sup>1</sup> provides certain priorities and protections that are exclusive to such creditors. For example, in liquidation proceedings, secured creditors are the first class of creditors to be paid following the discharge of the liquidation costs (the fees and expenses of the officeholders and trustees, and the expenses relating to the sale of the bankruptcy assets). Furthermore, while secured creditors may be prevented from enforcing their interests against collateral during the application of claims moratoria, their interests in the collateral are afforded various protections by the Bankruptcy Law. Given the importance of being considered a secured creditor, a key question for consideration is who is in fact considered a secured creditor for purposes of the law.

### DEFINITION OF SECURED CREDITOR

Unfortunately the Bankruptcy Law and the Bankruptcy Law Implementing Regulations<sup>2</sup> (together, the **Bankruptcy Regulations**) do not provide an actual definition for “secured creditor”. In various instances, the regulations refer to “secured creditors”, without elaborating on the precise meaning of this term.<sup>3</sup> The Bankruptcy Law does, however, include certain articles that may be helpful in providing perspective on the meaning of this term.

### ARTICLE 184 OF THE BANKRUPTCY LAW

For example, in the context of addressing secured debtor-in-possession financing,<sup>4</sup> the Bankruptcy Law considers the following “secured financing”: (a) financing that has priority over non-secured debts; (b) financing that is secured by an asset of the debtor that is not subject to another pledge or mortgage (*rahn*); (c) financing that is secured by an asset of the debtor that is subject to a pledge or mortgage (*rahn*) that ranks higher in priority to the proposed new security to be granted; and (d) in certain limited instances involving a judgement of the court or the consent of the existing secured creditor that may be impacted by the same, financing that is secured by an asset of the debtor that is subject to a pledge or mortgage (*rahn*) that ranks *pari passu* or lower in priority to the proposed new security to be granted.

As is apparent, the common thread running through the definition of secured financings under Article 184 is: (i) security in the form of a pledge or mortgage (*rahn*) over an asset, and (ii) priority over other security or creditors.

#### ARTICLE 196 OF THE BANKRUPTCY LAW

More to the point, Article 196 of the Bankruptcy Law expressly recognises debts that are secured by collateral as the first debts to be paid from the proceeds of sale of the bankruptcy assets in the context of liquidation proceedings (following the fees and expenses of the officeholders and trustees, and the expenses relating to the sale of the bankruptcy assets). The specific term for the security used in this article is “ضمان عيني” (*dhaman ayni*), a term of art that does not have an exact corresponding term in the English language.<sup>5</sup> In essence, the term comprises the following elements: (a) security that relates to a thing (“عين”), as opposed to a personal obligation, such as a guarantee; (b) the secured party has priority over other creditors (“حق التمتع”); and (c) the secured party’s security interest in the collateral remains, and may be “traced”, notwithstanding any transfer of the collateral to a third party (“حق التتبع”). In considering whether the elements mentioned in limbs (b) and (c) above are present, and in the absence of a civil code in Saudi Arabia that provides a definition or other guidance, reference should be made to relevant legislation relating to security in Saudi Arabia.

#### REGISTERED REAL ESTATE MORTGAGE LAW

Under the Registered Real Estate Mortgage Law,<sup>6</sup> for example, the law provides that the beneficiary of a registered real estate mortgage is granted “حق عيني” (*haq ayni*), an interest in the relevant property, pursuant to which the mortgagee/creditor has priority over all creditors in having the underlying secured debt discharged from the value of the property, irrespective of who may own the property at the time of enforcement.<sup>7</sup> The law also expressly provides that, subject to a limited exception, a real estate mortgage is enforceable against third parties from the date of registration.<sup>8</sup>

#### LAW ON SECURING RIGHTS WITH MOVEABLE ASSETS

Turning to moveable (i.e., non-real estate) assets, the Law on Securing Rights with Moveable Assets,<sup>9</sup> which generally<sup>10</sup> applies to agreements and transactions involving the creation of security over tangible, intangible, present and future rights and moveable assets, including security assignments or transfers of rights:

- a. defines a security interest under the law as “حق عيني” (*haq ayni*), an interest in the relevant collateral;<sup>11</sup>
- b. provides that the security interests that satisfy certain conditions<sup>12</sup> and are perfected (either via registration with the registry established under the law for this purpose, the Unified Registry of Rights Over Moveable Assets (the **Unified Registry**), or in more limited cases, transfer of the possession of the collateral to the secured party) are enforceable against third parties;<sup>13</sup>
- c. provides that a secured party has priority over all creditors in having the secured obligation discharged by the collateral;<sup>14</sup> and
- d. dovetails with Article 196 of the Bankruptcy Law by expressly providing that security interests that are enforceable against third parties have priority over the payment of other debts, including amounts owed to employees and governmental entities.

#### ISSUES IN PRACTICE

In practice, the classification of secured creditors by officeholders and courts, particularly during the first year of the application of the Bankruptcy Law, has been inconsistent. For example, we understand there have been instances where:

- only mortgagees (i.e., secured parties under real estate mortgages), to the exclusion of other secured creditors, were considered “secured creditors” for purposes of the Bankruptcy Law. We expect this is an errant application of the law

premised on the faulty assumption that only security over real estate would entitle the beneficiary thereof to be considered a secured creditor for purposes of the Bankruptcy Law; and

- assignments of receivables, which commonly feature in security packages in Saudi Arabia, have not been recognised as security entitling the beneficiaries thereof to be considered secured creditors. Assuming an assignment of receivables, which is expressly recognised by the Law on Securing Rights with Moveable Assets as an arrangement covered by the law, satisfies the conditions relating to (a) validity,<sup>15</sup> and (b) enforceability against third parties (i.e., providing notice of the assignment to the third party-obligor in relation to the receivables, so that the assignment would be valid as against that third party, and registration of the security interest with the Unified Registry), the beneficiary thereof should, in our view, be considered a secured creditor for purposes of the Bankruptcy Law.

## CONCLUSION

While there have been inconsistencies to date in the classification of secured creditors for purposes of the Bankruptcy Law, this is perhaps not unexpected given that the law is only in its third year of application, and during this period, the framework for the grant, perfection and enforcement of security interests over movable assets in the Kingdom of Saudi Arabia was substantially transformed twice. As the dust settles on this framework and the Bankruptcy Regulations, more consistency and predictability in relation to the classification of secured creditors by officeholders and courts will follow. From a secured creditor's perspective, it should be a priority to ensure that all the conditions required to perfect its security interest are satisfied so that this interest is enforceable against third parties, and the creditor is classified as a secured creditor under the Bankruptcy Law.



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<sup>1</sup> Issued pursuant to Royal Decree no. M/50 dated 28/5/1439H (corresponding to 14 February 2018G), as amended.

<sup>2</sup> Issued pursuant to Council of Ministers Resolution no. 622 dated 24/12/1439H (corresponding to 4 September 2018G).

<sup>3</sup> See for example Articles 21.1(b), 72, 75.4, 75.5, 82, 97.3, 133.3, 152.4 and 152.5 of the Bankruptcy Law, and Article 16(j)(2) of the Bankruptcy Law Implementing Regulations.

<sup>4</sup> Article 184 of the Bankruptcy Law.

<sup>5</sup> "Security *in rem*" would partially capture the meaning of the term. We note here that the English translation of Article 196(a) of the Bankruptcy Law refers to debts that are secured by "real" security interests, which is not accurate, if not misleading.

<sup>6</sup> Issued pursuant to Royal Decree no. 49 dated 13/8/1433H (corresponding to 3 July 2012G).

<sup>7</sup> Article 1 of the Registered Real Estate Mortgage Law.

<sup>8</sup> Article 21 of the Registered Real Estate Mortgage Law.

<sup>9</sup> Issued by Royal Decree No. M/94 dated 15/8/1441H (corresponding to 8 April 2020G).

<sup>10</sup> The law does not apply to security interests over ships and aircraft, securities listed in the capital market, trademarks, investment accounts and assets for which an ownership register where the security interest may be recorded exists.

<sup>11</sup> Article 1 of the Law on Securing Rights with Moveable Assets.

<sup>12</sup> For example, the grant of the security interest should be in writing, should describe the secured obligation, and should also describe the collateral so that the same may be identified.

<sup>13</sup> Article 8.1 of the Law on Securing Rights with Moveable Assets.

<sup>14</sup> Article 19.2 of the Law on Securing Rights with Moveable Assets.

<sup>15</sup> The Law on Securing Rights with Moveable Assets sets out various conditions in order for a security interest to be valid and effective as between the grantor of the security interest and the secured party in the first instance. In this regard, it should also be noted that the law expressly provides that it does not apply to security assignments or transfers of rights "for purposes of debt collection".