

DUBAI COURT OF CASSATION DECISION ON VALIDITY OF MURABAHA CONTRACTS

This briefing considers the decision of the Dubai Court of Cassation in Appeal Numbers 898 and 927 of 2019, and the impact of this decision on the validity of murabaha financing contracts in the UAE.

Background

A financial institution (the "**Financial Institution**") made available to its customer (the "**Company**") murabaha facilities (the "**Facility**"), which the Company subsequently failed to repay. The Financial Institution filed a claim in the Dubai courts for the Company to pay the outstanding amounts owed to it under the Facility. The Company argued that the murabaha contract should be deemed null and void for violation of Islamic Shari'a principles, on the basis that it was a murabaha facility in name only.

The Dubai Court of First Instance and the Court of Appeal found, having appointed a banking expert, that the Company must pay to the Financial Institution an amount which was less than the amount claimed by the Financial Institution. Both parties appealed the decision on the basis that: (i) in respect of the Financial Institution, they had not received a judgment for all amounts specified under the terms of the Facility; and (ii) in respect of the Company, the Courts had not followed the law and had not considered its arguments correctly.

The two appeals were joined and heard before the Dubai Court of Cassation in January 2020 (but only reported at a later date).

Arguments of the Company to the Dubai Court of Cassation

The Company's arguments to the Dubai Court of Cassation included setting out the fundamental requirements that must be present in a murabaha contract for it to be considered valid. It claimed that, on the face of the terms contained in its agreement with the Financial Institution, the Facility was simply a conventional interest-bearing loan and the Company was obliged to repay amounts on the basis of interest (*riba*), which was not valid under Shari'a principles. Further, the Company argued that the commodity specified in the murabaha contract was introduced only for the purpose of disguising a conventional interest-bearing loan as a Shari'a compliant murabaha facility. The Company supported its several claims as to non-Shari'a compliance by requesting a referral to the Department of Islamic Affairs in Dubai to make a determination as to Shari'a compliance in respect of the Facility.

Key issues

- Dubai Court of Cassation Case involved payment under a murabaha financing.
- A question arose as to whether the financing was a true Islamic compliant murabaha facility.
- The case highlights the importance of ensuring that a murabaha financing contains certain fundamental terms to ensure that it is Shari'a compliant.

Decision of Dubai Court of Cassation

The Dubai Court of Cassation held that a murabaha financing arrangement in name only is insufficient to be legally considered a true Islamic compliant, murabaha financing. The Court found that certain objective criteria must be satisfied for a murabaha financing to be compliant with Shari'a principles and UAE law. The Court stated that there are no rules or guidelines under UAE law which specify the relevant criteria for Shari'a compliance (although note our comments below on the Civil Transactions Law) and instead the Court must look to Shari'a principles as defined in the Maliki school of jurisprudence.

The Court found that a commodity murabaha arrangement involves the sale of a commodity for its purchase value plus profit at an identified percentage, and that murabaha contracts must, among others, satisfy the following requirements:

- (a) the commodity must be owned by a seller prior to being sold to the purchaser;
- (b) if the commodity is purchased by the seller immediately prior to being sold to the purchaser, the cost price of the commodities must be known at the time of sale from the seller to the purchaser;
- (c) the deferred sale price of the commodities may comprise a single calculation or distinguish between the cost price and profit components of the deferred sale price; and
- (d) the deferred sale price payable for the commodities must not be payable in the same kind of commodities.

The Court also found that, in relation to murabaha contracts entered into by specialist finance providers or Islamic banks, there are several conditions to be met:

- (a) there must not be a commitment to sell the commodities until such time as the commodities are in the ownership and possession of the seller;
- (b) there must not be any guarantee provided by either party in respect of any loss or damage to the commodities; and
- (c) the contract is not valid until the seller has ownership of the commodity and it is noted that, in respect of such an arrangement, there are two contracts; the first between the commodity seller and the bank and a further contract between the bank and the purchaser (or there may be a tripartite agreement between the three of them).

The Court of Cassation did not, in this case, make a decision as to whether the particular contract entered into between the Financial Institution and the Company was, on its facts, Shari'a compliant, and therefore whether the contract should be upheld as enforceable between the parties. The key finding of the Court of Cassation was that there was insufficient consideration by the Court of First Instance and the Court of Appeal as to the arguments put forward by the Company, and, in making their rulings, the Courts should have taken due consideration of the arguments and the facts put forward by each party. As such, the decision of the lower courts was found to be defective on procedural grounds and therefore the case is to be referred back to the Court of Appeal to be considered again.

"The Dubai Court of Cassation held that a murabaha financing arrangement in name only is insufficient to be legally considered a true Islamic compliant, murabaha financing"

The decision in this case does, however, underline the importance of murabaha finance documents in the UAE being drafted in a Shari'a compliant manner, to ensure the documents accurately reflect the murabaha structure and fundamental terms. Whilst the Court of Cassation's finding in this respect is not comprehensive and will be subject to further determination by the Dubai Courts, it is important for Shari'a advisers and Internal Shari'a Supervision Committees to thoroughly review murabaha structures to ensure Shari'a compliance.

Whilst the final outcome of this case remains to be seen, one potential mitigant is for financial institutions to ensure they include a representation by the customer to confirm that it has concluded and made its own assessment as to Shari'a compliance and that it will not subsequently argue against the validity of a contract based on non-compliance with Shari'a principles. Whilst, as far as we are aware, such a provision has not been tested before the UAE courts, this may mitigate the risk of similar claims being brought by customers in the future. We note that such provisions are common in most Islamic finance transactions, and companies readily agree to include these.

It should also be noted that commodity murabaha transactions are a form of sales contract under UAE law, and sales contracts are governed by the Civil Transactions Law (Federal Law No. 5 of 1985). Whilst also ensuring Shari'a compliance, it is important that murabaha contracts continue to comply with the applicable provisions of UAE law and, in particular, the Civil Transactions Law.

As a reminder, it should also be noted that UAE law is not, in our opinion, capable of conclusive interpretation, as there exists no general system of judicial precedent. This means that the decisions of a court (including the Dubai Court of Appeal and Court of Cassation) in one case will have no binding authority in respect of another case.

It should also be noted that any banks licensed by the Central Bank are subject to the provisions of the UAE Banking Law (Federal Law No. 14 of 2018 on the Central Bank and Organisation of Financial Institutions and Activities) and, as such, they are also regulated by the Higher Shari'a Authority, which operates under the umbrella of the UAE Central Bank. There seems to be a strong trend in the UAE in ensuring Islamic finance transactions are Shari'a compliant, and the Higher Shari'a Authority has issued resolutions to regulated Islamic Financial Institutions instructing them that they must conduct their business in accordance with the Shari'a Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI). Please see our previous article on the scope of the UAE Banking Law and its impact on Islamic Financial Institutions [here](#).

Conclusion

Given that the current case is to be considered further by the Court of Appeal, which will have to consider the facts of the case and the argument raised by each party again, there is no immediate cause for concern for market participants structuring and executing murabaha transactions in the UAE. We will continue to monitor this case further and to the extent the judgment is reported (which is not always the case), we will report back to the market on any changes required to current market practices. In the meantime, market participants should continue to include Shari'a representations in their financing documents, ensure compliance with the Civil Transactions Law, and ensure their commodity murabaha documentation continues to be approved by Shari'a advisers and Internal Shari'a Supervision Committees.

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