



Landmark ruling of Dubai Court of Cassation on Shari'a compliant contracts

A recent judgment by the Dubai Court of Cassation has concluded that for a contract to be Shari'a compliant, an Islamic bank or financial institution is required to do more than just to name that contract as a *Murabaha* contract (Cassation Appeals Nos. 898-927/2019).

The Court of Cassation ruled that a *Murabaha* contract has to meet certain objective criteria to be considered as Shari'a compliant. These criteria are subject to review by the court and, if these are not satisfied (in part or in whole), the contract may be deemed null and void by the court.

The Court explained that a *Murabaha* contract has no legislative founding. As such, to better understand the validity criteria for a *Murabaha* contract, one should look to the *Maliki* school of jurisprudence.

According to the Court, for a *Murabaha* contract to be valid, the Shari'a compliant bank or financial institution should have ownership of the goods prior to selling them on to the customer.

In this case, the customer (the defendant) argued that the *Murabaha* contract in question was essentially a loan agreement with interest as the goods under the *Murabaha* contract were never delivered to or received by him. The customer further claimed that that he only received funds (and not any goods or commodities) and he simply had an obligation to return the funds to the bank together with interest in due course.

Another submission by the customer was that a *Murabaha* in nature is a sale contract where the financier buys the goods or commodities in question, owns them and then resells them on to the customer on a principal plus profit basis. If the role of the financier is merely to finance the deal (without the proper purchase of goods), then this would constitute usury (which is prohibited by Shari'a).

The Court ruled that this defense is a valid one and that the Court has an obligation to look into the nature of the *Murabaha* contract to ensure that the criteria has been satisfied.



Whilst the conditions for the validity of a *Murabaha* contract as stipulated by the Court are not new, the fact that the Court has accepted the customer's argument that the *Murabaha* contract in this case was simply a veiled conventional bank financing (including an interest component) is a significant development in such claims.

We expect this ruling to have a significant impact on similar claims going forward and the above defense may be used by other defendants on future claims, particularly as this is a Court of Cassation judgment. Shari'a compliant financial institutions can no longer assume that their *Murabaha* contracts will be upheld by a court as being Shari'a compliant simply by virtue of being labelled as such (even if the document has been blessed by their Shari'a boards).

Going forward, it will be essential for financial institutions to ensure they have considered the structure of the underlying *Murabaha* transactions and that the above criteria has been satisfied. This will be critical in mitigating the risk that a court may review these transactions during subsequent litigation with the power to set them aside on the basis that such criteria has not been fully considered.

For further information, please feel free to contact one of the lawyers below or your usual Baker McKenzie contact.

Contacts



Dr. Habib Al Mulla
Executive Chairman &
Head of Dispute Resolution
Dubai
Habib.Almulla@
bakermckenzie.com



Sandeep Puri
Head of Banking &
Finance
Dubai
Sandeep.Puri@
bakermckenzie.com



Mazen Boustany
Head of Financial
Regulatory
Dubai
Mazen.Boustany@
bakermckenzie.com



Amir Alkhaja
Head of Banking
Litigation
Dubai
Amir.Alkhaja@
bakermckenzie.com