

MONTHLY NEWSLETTER

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Recent Legal Developments
in the
United Arab Emirates
and
Highlights from
Bahrain, Egypt, Iran, Kuwait,
Oman, Pakistan, Qatar and Saudi Arabia

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UNITED ARAB EMIRATES

1. Listing of Securities

The requirements for listing securities have been amended. Cabinet Resolution No. 12 of 2000 promulgated a set of rules governing the listing of securities on one of the licensed securities and commodities markets in the U.A.E. (see the July 2000 edition of this Newsletter). That Resolution established a number of criteria for the listing of securities issued by shareholding companies incorporated in the U.A.E. These included a requirement that the net assets of the company issuing the securities must be more than 20% of its paid up capital, or that the company must have realized net profits to be distributed to shareholders equal to an average of 5% of the paid up capital during the two previous years.

The amended criteria now instead require that the shareholders' equity in the company at the time of submission of the application for listing be no less than the paid up capital of the company. This ties share value more directly to the paid up capital of the company, as opposed to assets or past profits.

2. Penalty Clause

In a recent contract dispute, the Federal Supreme Court upheld a lower court's refusal to enforce a penalty clause. A contractual penalty clause stipulates payment of a specific, pre-agreed sum of money in the event of breach. In some countries, a distinction is made between a penalty clause, designed to punish the breaching party, and a liquidated damages clause, designed to quantify the damages payable to the non-breaching party when compensatory damages may be difficult to assess. In many countries where this distinction is drawn, courts are more hostile to penalty clauses than to liquidated damages clauses.

However, this distinction is not usually drawn in the U.A.E., where contracts containing penalty or liquidated damages clauses are frequently encountered. Moreover, the Federal tenders regulations and the Abu Dhabi tenders regulations both require that government contracts provide for the unilateral assessment of delay penalties against the contractor in the event of unexcused delays in performance. The Federal Supreme Court has affirmed that the project owner may assess such delay penalties and need not demonstrate harm to do so (see the December 1989 edition of

this Newsletter). However, as the current case illustrates, considerable discretion lies with the lower courts as to whether a particular clause should be applied in a particular circumstance.

The courts' discretion is exercised pursuant to the Civil Code. Article 390(1) of the Civil Code recognizes the concept of liquidated damages by providing that the parties to a contract "may fix the amount of compensation in advance by making a provision therefor in the contract or in a subsequent agreement." Article 390(2) of the Civil Code then gives the court the right to vary the parties' agreement as to the level of compensation "so as to make the compensation equal to the loss" upon the application of either of the parties to the contract, and further provides that any agreement to the contrary shall be void.

In the current case, a contract for the supply and installation of air conditioners was terminated by the buyer. The supplier brought suit, asserting that a penalty clause in the contract provided for payment of the sum of Dh 100,000 in the event of breach by the other party, and also claiming further damages for losses suffered.

Following investigation by a court appointed expert, the Court of First Instance awarded the supplier the penalty but dismissed the balance of the supplier's claims. The buyer appealed to the Court of Appeal, which reviewed the conclusions of both fact and law reached by the Court of First Instance and significantly reduced the award. The Federal Supreme Court, reviewing only issues of law, affirmed the judgement of the Court of Appeal as properly based on conclusions of fact not subject to review by the Federal Supreme Court.

The Federal Supreme Court also stated that the Court of Appeal was not bound by the penalty clause in any event, because the supply contract that contained the penalty clause had been terminated. This rationale, applied mechanically, would protect a wrongfully terminating party from the contractually agreed consequences of its wrongful act, at least as concerns a contract that did not provide for survival of the penalty clause following termination. However, the Federal Supreme Court stated that the Court of Appeal could still award compensatory damages, even though, strictly speaking, only the penalty clause had been placed before the Court of Appeal.

3. Bank Compliance with Instructions
of Account Holder

The Dubai Court of Cassation has recently held that a bank may refuse compliance with instructions of an account holder in only a limited number of circumstances, and that a bank may be exposed to civil liability for wrongful failure to comply with such instructions.

A customer maintained several accounts with a bank. In early 1999, the customer issued instructions to the bank that funds be moved to another bank in Dubai. The bank refused to comply with these instructions, stating that the customer's accounts had been frozen because the customer's business transactions led the bank to suspect that the accounts might contain funds belonging to a defaulter. The bank added that the accounts would stay frozen until the customer proved that the funds were unconnected to the defaulter. Two months later, the Central Bank ordered the freezing of the customer's accounts. The customer filed a criminal complaint against the bank, prompting the bank to file a cross complaint against the customer. This led the Public Prosecutor to order attachment of the accounts of the customer. This attachment was lifted by the Public Prosecutor in early 2000. The bank nevertheless continued to treat the accounts of the customer as frozen for several more months, releasing the accounts only after determining that the funds had no connection to the defaulter.

The customer brought a civil action against the bank for damages, which was dismissed by the Court of First Instance and the Court of Appeal, both of which held that the bank could not be held liable since it acted in good faith compliance with the instructions of the Central Bank.

Before the Court of Cassation, the customer asserted that compliance with instructions of the Central Bank could not by itself preclude liability on the part of the bank. The Dubai Court of Cassation agreed, holding that the issue of the bank's liability must be specifically considered by the lower courts.

The Court of Cassation stated that an account holder has the right to dispose of the funds in the account as he sees fit. The bank may be excused from liability for delay if it can prove that it did not cause the delay. However, the bank cannot otherwise refuse to perform the customer's instructions if there are funds in the account, unless it can be proved that the instructions are connected with criminal activity in which the account holder is involved, and that the funds have accordingly been attached by order of the competent judicial authorities.

In the present case, the instructions of the Central Bank, which is not a judicial authority, did not relieve the bank of liability to the customer. Instead, the courts below should have considered the elements of the plaintiff's complaint concerning the conduct of the bank prior to the attachment order issued by the Public Prosecutor, and after the Public Prosecutor's attachment order was released. The case was accordingly remanded to the Court of Appeal for further proceedings on these issues.

PAKISTAN

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1. Shariat Court Remands Riba Judgement;
Overturns Own Review

Pakistan's Shariat Appellate Bench of the Supreme Court ("SAB"), the appellate court in Pakistan's parallel Islamic legal system, surprised the nation this summer when, in a landmark decision, it set aside its own earlier judgement in which it had directed the Federal Government to eliminate riba, or interest, from the Pakistani economy. The SAB remanded the case to its trial level court, the Federal Shariat Court ("FSC"), for decision anew. This order has given new life to the modern banking system in the country, which had earlier been declared un-Islamic.

One of the more controversial judgements in Pakistan's history was rendered a decade ago when the FSC declared all forms of interest based banking un-Islamic in what has come to be called the riba judgement. The original case was brought before the FSC on the basis of Article 38(f) of the Constitution, which reads, "The State shall eliminate riba

as early as possible." In fear of massive change and due to a number of unanswered questions, the Government of Pakistan (the "GOP"), among others, subsequently appealed the judgement. On December 23, 1999, however, the SAB upheld the riba judgement and moreover directed the GOP to transform the economy into one following Islamic principles by eliminating in totality all forms of interest based banking (see the December 1999 edition of this Newsletter). Hopes raised by a fast expanding modern banking industry as well as increased foreign investment in the mid-1990s were drastically tempered.

A window of opportunity emerged last year when the SAB extended the period for implementation of its earlier judgement by one year, to June 30 of this year. However, it was only upon a recent review petition filed by United Bank Limited ("UBL"), which was subsequently supported by the GOP, that the SAB reversed the riba judgement and directed that the relevant Islamic jurisprudential issues be reconsidered.

In its judgement, the SAB showed appreciation for many of the arguments that support a reexamination of the topic in the lower courts. The SAB concluded its judgement by saying:

[T]he issues involved in these cases require to be re-determined after thorough and elaborate research and comparative study of the financial systems which are prevalent in the contemporary Muslim countries of the world. Since the Federal Shariat Court did not give a definite finding on all the issues involved the determination whereof was essential to the resolution of the controversy involved in these cases, it would be in the fitness of things if the matter is remanded to the Federal Shariat Court which under the Constitution is enjoined upon to give a definite finding on all the issues falling within.

The SAB specifically cited a number of earlier errors, including the fact that the prohibition against riba was incorrectly being applied to non-Muslims. However, these errors had not been identified less than three years before when the SAB affirmed the riba judgement. One possible explanation appears to be revised national priorities. This is suggested by one of the affidavits presented in evidence, in which the Secretary to the Ministry of Finance states:

That government of Pakistan has made best possible efforts under . . . the Constitution of the Islamic Republic of Pakistan . . . to find ways and means to implement the directives contained in . . . the Order . . . [of the SAB] but has found that implementation of the said directives is not practical or feasible and if attempted will pose high degree of risk to the economic stability and security of Pakistan.

The SAB identified a number of substantive issues that require further study. Definitions, for example, were an area which received much of the SAB's attention. UBL successfully adduced verses from the Holy Quran to contend that relevant quotes on the issue mainly refer to sadqaat, or spending in the cause of Allah, arguing that bank loans to large businesses cannot be made subject to the rules on sadqaat. The SAB appreciated UBL's contention that the Holy Quran does not prohibit that which is "reasonable and fair" and in fact only prohibits what is "doubled" and "multiplied." It was also argued that the SAB did not properly distinguish among the terms "usury," "riba" and "interest," and that the word "usury" is a kind of "riba" whereas the term "interest" refers to "profit." In addition, the failure to define "qarz" was faulted, and it was argued that the English word "loan" is not the exact counterpart of the word "qarz." Counsel for the GOP argued that the impugned judgement amalgamated legal and moral aspects of riba and the failure to distinguish between them was in violation of Islamic injunctions. It was argued that neither the FSC nor the SAB had the jurisdiction to declare riba to be illegal or impermissible. Under Article 38(f), it is the responsibility of the GOP to do so and on its own agenda, and that judicial intrusion on these subjects offended the constitutionally defined separation of powers.

In the final analysis, the pertinent fact is that the SAB ignored its own earlier opinion. What it did not do, however, was to make a ruling or conclusive finding. While it was restricted in scope in examining the issues at hand by the very nature of review jurisdiction, the SAB was meticulous in its choice of words and points raised.

In another affidavit filed by the Deputy Governor, State Bank of Pakistan, it was stated:

That having taken a series of steps to promote Islamic banking . . . and considering all other practical problems associated with the complete transformation of the financial system discussed herein, it is State Bank of Pakistan's considered judgement that a parallel approach will be in the best interest of the country. This means that Islamic banking is introduced as a parallel system of which a beginning has already been made, it is provided a level playing field vis-à-vis the existing conventional banks, and its further growth and development is supported by Government and State Bank of Pakistan through appropriate actions. This approach will eliminate the risk of any major costs/damage to the economy, give a fair chance to Islamic banks to develop alongside the conventional banks, and will provide a choice to the people of Pakistan, and the foreigners doing businesses in/with Pakistan, to use either of the two systems.

In forthcoming policy, Pakistan will most likely pursue a "parallel system" approach to an interest free economy. Given the fact that riba's eventual elimination is constitutionally enshrined, and given popular demand for choice in deciding whether to participate in an interest free environment, it is likely that the push for change will continue. At the same time, the SAB has made it clear that Pakistan must act first and foremost in accordance with that which is well reasoned and valid under its own laws. The SAB has affirmed that such a process can include transforming the economy to one which includes an interest free section of the economy, but only if the action being taken is grounded in principle. Pakistan's business community and foreign investors can take comfort from this recent decision by the SAB, although much remains to be decided on the consequences of the decision upon contractual obligations, the Constitution, the resuscitation of laws previously declared un-Islamic, recoveries of monies previously disallowed and other such issues of a practical nature.

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