

When can a seller's mortgage be considered a reason to cancel a sale and purchase agreement?

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Introduction

The UAE Courts have a wide range of discretionary powers to resolve disputes between sellers and purchasers if sufficient reasons exist to cancel the sale and purchase agreement concluded by the parties. The court will evaluate whether the parties fulfilled their obligations, and the reasons for and extent of the shortcoming of the alleged defaulting party.

In a recent judgment issued by the Dubai Court of Cassation (Appeal number 8/2019 hearing dated 6 March 2019), the Court held that a developer was in breach of its obligations towards the purchaser of a unit, as the developer had mortgaged the unit as security for a loan. The court arrived at this conclusion even though the purchaser was in default of its payment obligations because it had not made its payments due to the developer under the payment schedule annexed to the sale and purchase agreement.

Background

The developer ('Developer') concluded a sale and purchase agreement ('SPA') with the purchaser ('Purchaser') for the off-plan purchase of a unit in Dubai. The Purchaser made an advance payment of 40 per cent to the Developer at the time of signing the SPA. The provisions of the SPA did not specify the time for completion of the project. As the project was progressing at a slow pace, the Purchaser failed to make due payments and the Developer cancelled the SPA through the Dubai Land Department ('DLD'). Consequently, the Developer mortgaged the unit for a loan.

The Purchaser filed a lawsuit before the Dubai Court of First Instance seeking the cancellation of the SPA requiring the Developer to return the purchase price. The Purchaser argued that the project was moving at such a slow pace that it had the right to withhold the payment of the purchase price. The Developer

responded that it had the right to cancel the SPA as the Purchaser defaulted to make the payment, and further pleaded that the unit remained available for use and occupancy as it had not been sold to a third party; the Purchaser could take possession of the unit after paying the remaining balance of the purchase price.

Judgment

The Dubai Court of First Instance decided to cancel the SPA and obliged the Developer to return the purchase price paid by the Purchaser.

The Developer filed an appeal before the Dubai Court of Appeal challenging the First Instance Court judgment, but the Appeal Court rejected the appeal.

The Developer brought an appeal before the Court of Cassation on the following grounds:

1. the Court of Appeal had erred in rejecting the appeal because, although the unit was mortgaged, that did not preclude the Developer from transferring the title of the unit to a third party;
2. the Developer had lawfully exercised its right to cancel the SPA through the DLD and registered the unit in the Developer's name as the Purchaser defaulted in paying the purchase price; and
3. since the unit was still registered under the Developer's name, that did not make the contract impossible to perform as the mortgage on the unit could be released.

The Court of Cassation confirmed the Appeal Court's judgment which dismissed the Developer's appeal and stated that the Purchaser had the right to withhold the contractual obligation to make the purchase price, taking into account that the project was progressing at a slow pace.

The Court relied on the Mortgage Law (Dubai Law No. 14 of 2008) and observed that when a debt was secured by a mortgage over the unit, it provided an undivided interest therein, right in rem, or personal right over the property to the mortgagee until the mortgage debt was repaid. It also provided the mortgagee the right to follow the mortgaged property into the hands of any person in possession of the property thereof, to obtain payment of the mortgaged sum.

The Court stated that, in a binding contract, if one of the contracting parties did not do what he or she was obliged to do under the contract, the other party may require that the contract be rescinded. The existence of sufficient grounds for cancellation of a binding contract and the determination of whether or not either party is in default of performance of his or her contractual obligations was a question of fact for the trial court to decide as fact finder.

A registered mortgage contract which the developer entered into with the mortgagee, be it a licensed bank or a finance company or institution, with the proposed real estate or real estate unit as collateral, would legally bar the developer from disposing of the real estate or real estate units which had been mortgaged to secure its legal obligations against the purchaser who purchased the units as long as the mortgage contract remained in effect.

Conclusion

The Cassation Court's judgment indicates that, in an action for the cancellation of the contract, the court examines the contractual obligations of the parties and assesses the extent of the breach committed to determine if the breach committed by one of the parties is sufficiently gross to justify the cancellation of the contract.

In this decision of the Cassation Court, even though the Purchaser was in default because of a failure to pay, the court observed that the Developer's action to mortgage the real estate unit as collateral legally barred the Developer from disposing of the real estate. The breach committed by the Developer was more serious than the breach by the Purchaser and this justified the Purchaser's request to cancel the SPA.

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