

Dubai : The Global Financial Crisis And The Principle Of Exceptional Circumstances

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In binding contracts, the general principal is that unilateral modification of contractual terms is not permitted. However, the UAE legislator, for requirements necessitated by justice, has made an exception in Article 249 of the UAE Civil Code, namely the principle of exceptional circumstances.

The principle allows for the reduction of the agreed upon obligations of a party to a contract if that party's performance was affected by an unforeseen public circumstances and justice warrants such a reduction by the judge. For this principle to be applicable, certain restrictions laid down by the legislator must be proven by the aggravated party whose contractual performance was rendered onerous by the unforeseen emergency. This principle is different than force majeure in that the latter renders the contractual performance impossible and thus the contractual obligations affected by it are cancelled.

In a recent case the Dubai Court of Cassation looked at the argument as to whether the Financial Crisis was sufficient cause to invoke the principle of exceptional circumstances as per Article 249 of the UAE Civil Code.

Facts:

A real estate developer entered into a sale agreement to sell a floor in one of its projects to an investment company. Later on, the parties agreed to terminate the agreement by virtue of a settlement agreement whereby the real estate developer took back the previously sold floor from the investment company for the amount of AED 25,300,176. However, the Claimant failed to pay the amount of AED 11,440,000 from the agreed upon settlement sum.

The investment company (the "Claimant") filed an action before Dubai Court of First Instance against the real estate developer (the "Respondent") requesting payment of the due amount plus 5% interest calculated from the date of each unsettled installment. The Respondent filed a counterclaim and requested the Court to abrogate the second agreement on grounds of Article 583 of the UAE Civil Code, and to reduce the due amount to a reasonable limit on grounds of exceptional circumstances as defined in Article 294 of the UAE Civil Code due to the occurrence of the global financial crisis.

Procedural History:

The First Instance Court appointed an expert to look at Respondent's performance of its contractual obligations. After submitting his report, the Court rendered its judgment as to the principal claim and ordered the Respondent to pay the amount of AED 11, 440,000 and 5% interest from the date of filing the claim until full payment and dismissed the counter claim.

Both the Claimant and the Respondent appealed the judgment to the Court of Appeals. The Court dismissed the Respondent's appeal and increased the interest to 9% in response to the Claimant's appeal and further upheld the lower court's judgment as to all other aspects. Consequently, the Respondent filed an appeal before the Court of Cassation requesting to overturn the lower court's

judgment.

The Court of Cassation:

The Respondent argued that the lower court erred in its application of the law when it relied in its judgment on the expert's report and disregarded the Respondent's argument as to its right for application of the principle of unforeseen circumstances stipulated under Article 249 of the UAE Federal Civil Transactions Law. While the Respondent would have performed its contractual obligations in usual circumstances, the occurrence of the Global Financial Crisis as an unforeseen public circumstance rendered performance of its obligations onerous and unreasonably excessive threatening it with vast losses due to the collapse of the real estate market. The collapse of the real estate market caused the deterioration of the Respondent's financial status. Furthermore, it placed the Respondent's business in daunting circumstances which led to financial distress and which requires reducing its contractual obligation to a reasonable level in accordance with the aforementioned article.

The Court of Cassation stated that it is well established that the basic rule in contracts is that it is not open to either of the two parties to a contract to unilaterally abrogate or vary from it nor is it permissible for the judge to do so. However, the legislator, in response to a pressing need necessitated by justice, laid down an exception, namely the exception of unforeseen circumstances as defined in Article 249 of the UAE Civil Code. The legislator has provided for material restrictions that must be present for the judge to be able to apply the aforementioned article, namely:

1. there must be an unforeseen event that rarely occurs and could not be predicated by the normal person;
2. the unforeseen event is public and not only affecting the debtor or a limited scale of people;
3. the event was not foreseen when the parties concluded their agreement and the criteria is the usual person measure;
4. the debtor was unable to avoid the consequences resulted from the unforeseen event by exercising a reasonable effort;
5. the unforeseen event occurred following concluding the agreement and prior to executing it;
6. the unforeseen event rendered the performance of the obligation onerous threatening with unreasonable loss for the aggravated party; and
7. in order to apply the principal of exceptional circumstances and to reduce the onerous obligation, the legislator used the term "if justice so required" which implies the necessitating of applying an objective judgment, and the judge has the discretion in characterizing the case facts and its evidence accordingly.

The Court further stated that the Global Financial Crisis and its consequential influences on the countries can not be deemed as an exceptional unforeseen disaster or emergency that calls for application of Article 249 of the UAE Civil Code. The Court reasoned that financial unfavorable events occur frequently and could be anticipated in general. Moreover, the Respondent did not dispute the amount owed; they simply wanted it to be reduced based on the Financial Crisis. Therefore, the Respondent's request to reduce its obligation set forth in the settlement agreement on grounds of Article 249 is groundless, and thus, the Court upheld the lower court's judgment and dismissed the case.

Practice Note:

It is important to distinguish between the principle of exceptional circumstances as defined in Article 249 and the principle of force majeure as defined in Article 273 of the Civil Code in that the former if applicable requires the judge to reduce the onerous performance while the latter ceases the performance and terminates the contractual obligation. Further as illustrated by this case, the Court's are reluctant to apply the principle of exceptional circumstances in events that occur

frequently or that can be generally predicted. While the recent impact of the Financial Crisis cannot be denied, due to the volatile nature of the financial markets the Court was unconvinced that it was truly unforeseen.