

UAE: Liability of banks and Financial Institutions for fund transfers when financial sanctions are involved

Mohammad Al Muhtaseb - Partner - Litigation

m.almuhtaseb@tamimi.com - Dubai International Financial Centre

Marwa El Mahdy

m.elmahdy@tamimi.com

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In a fund transfer, an originator instructs his/her financial institution to transfer a specified amount of money to a beneficiary either domestically or internationally. Typically, the most commonly used currency to transfer funds internationally is US dollars or Euros. In order to execute the remittance of the transfer, the originator's financial institution transfers the funds through an intermediary (correspondence) if not the beneficiary bank. A transfer of funds in US dollars is executed through US financial institutions. The question that such transactions raise is that to what extent sanctions affect the liability of the originator's domestic bank or financial institution? The below judgment involves a scenario and the approach adopted by Dubai Courts.

Facts of the case

The Claimant (Originator), a UAE based company, instructed a UAE financial institution (the Respondent) to transfer the amount of USD 80,000 to the Beneficiary, an overseas company. This amount was the purchase price of goods the Claimant purchased from the Beneficiary Company. The Respondent initiated the fund transfer, however, the intermediary bank (Correspondent) appropriated the funds due to financial sanctions levied by the Office of Foreign Assets Control (OFAC).

Due to the appropriation, the funds transferred were not delivered to the Beneficiary and in return the Beneficiary Company refrained from delivering the purchased goods. Consequently the Claimant filed for legal action before the Dubai Court of First Instance seeking a court order against the Respondent to reimburse the amount transferred. During the hearings before Dubai courts, the Respondent submitted an application to the court requesting the joining of the Correspondent "located in New York" to the case on the grounds that the funds transferred were attached by the Correspondent due to OFAC sanctions.

Procedural History

The Court of First Instance issued a decision dismissing the case. The Claimant appealed before the Dubai Court of Appeal which was dismissed, because the losses suffered by the Claimant were not caused by the actions of the Respondent. The case was then appealed to the Dubai Court of Cassation.

Court of Cassation

Before the Court of Cassation, the Claimant argued that the Appeal Court erred in rejecting the appeal due to the lack of the liability of the Respondent on the grounds that the loss suffered by the Claimant resulted by a third party.

The Claimant further argued that the Respondent was under a contractual obligation to ensure the receipt

of the fund transfer and that the Respondent's contractual obligation was to deliver the funds transferred from the Claimant to the Beneficiary.

The Claimant further noted that due to the appropriation of the funds by the Correspondent the Beneficiary did not deliver the goods purchased by the Claimant. Furthermore, the Correspondent was appointed by the Respondent as its agent to undertake its contractual obligations to complete the fund transfer. Therefore, the Respondent is liable for the actions of its agent (the Correspondent in such instance) especially since the Claimant paid the commission and costs of the fund transfer to the Respondent.

The Court

There are several key and important points noted by the Dubai Court of Cassation. The first is that three elements were identified to ascertain the liability of a financial institution when completing a fund transfer. The second is the grounds upon which a financial institution may refute such liability. The third is the standard of care expected by financial institutions when completing a fund transfer.

The first key point noted by the Dubai Court of Cassation is that three elements must be present in order for the Financial Institution to be liable: (i) error, (ii) damages/losses and (iii) a causal link between the error and the damages suffered. Such liability is governed by clauses of the terms and conditions for transferring funds executed between the financial institution and their customers whether such liability is stated explicitly, implicitly or as per the custom adopted by financial institutions.

Furthermore, financial institutions are liable for damages or losses caused to their customers even if such damages resulted from errors of agents, legal representatives, employees or an entity performing the obligations on behalf of the financial institution provided the presence of the aforementioned three elements.

The second important point noted by the Dubai Court of Cassation is that financial institutions may refute liability. The court further held that, financial institutions may refute their liability by proving the fulfillment of its commitments or the lack of the causal link between the financial institution and the damage or loss sustained by its customer.

Lastly, the Dubai Court of Cassation noted that financial institutions are responsible to exercise extraordinary care in initiating and completing a fund transfer. The consideration of whether a financial institution exercised such extraordinary care is subject to the discretion of the court without supervisory review from the Court of Cassation.

In this instance, The Court of Appeals held that the Respondent had performed its obligation by transferring the funds, however, due to the fact that the transfer order issued by the Claimant included the name of a financial entity upon which financial sanctions were imposed, the funds were therefore attached by the Correspondent in accordance with the rules of OFAC. In light of this, the Court of Cassation concluded that the Respondent did fulfill its obligations set forth in the funds transfer and exercised the required level of extraordinary care. The funds transferred were attached by the Correspondent due to the mention of an entity upon which OFAC financial sanctions are imposed hence the error and consequently the liability are not attributed to the Respondent. Therefore, the Court of Cassation upheld the appealed judgment and rejected the Claimant's petition.

Practice note

Reading of the Articles of the UAE Commercial Code pertaining to fund transfers provides that banks and financial institutions are under the obligation to deliver the funds transferred to the Beneficiary and therefore liable if the end result was not achieved. However, in the judgment above, UAE Courts have reduced the liability of a financial institution in the event that a correspondent acts independently of the financial institution and appropriates funds in accordance with international sanctions.

For any queries in relation with economic sanctions, please contact Ibtissam Lassoued, Special Projects Department, at i.lassoued@tamimi.com