Repo Transactions under the Qatari law

Kamal Hafez
k.hafez@tamimi.com

March 2011

Since the onset of the world financial crisis, financiers have been developing various methods to better secure finance. Popular in Islamic finance is the use of a Repo arrangement instead of a more traditional security arrangement (e.g. borrowing on the security of a particular asset). In a Repo transaction the financier purchases an asset from the borrower (seller) and grants an option to the borrower to repurchase the asset for a higher price at a future time.

The buyback option provides strong security because the title to the assets is with the financier. This means that, if the borrower does not re-acquire the asset, then the financier has freedom to sell the assets without the need for costly enforcement through the courts. A pledge will give priority rights over a particular asset, however, the complicated procedures to recover the amount of the loan makes this a much less attractive process of having the financier's attain outright ownership, with all the advantages of ownership.

But are buybacks valid under Qatari Law?
A simple repurchase transaction is most likely void under the Qatari law.

Article 474 of the Qatari Civil Code provides that:

"If at the time of sale the seller retains the right to recover the sold asset, the contract shall be void".

Pursuant to jurisprudence, specifically the Egyptian scholar Al Sanhouri, the principle set out in Article 474 of the Civil Code is intended to protect the seller from unfair contractual terms, as in practice, Repo transactions may be an indirect arrangement of security and not merely a sale agreement. Security is regulated under mortgage and pledge provisions in the Civil Code, and creditors secured by a mortgage are not entitled to receive more than the amount of their secured rights from the proceeds of selling the mortgaged or pledged security after enforcement.

Accordingly, the legislators in Egypt and various Arab legal systems decided to prohibit Repo transactions with the result that they are void. The purpose is to compel the parties to resort to mortgages which are regulated by the law to protect the interest of the parties.

Despite this, financiers have developed new models to try and avoid the possibility of the entire transaction being void. For example, the seller could sell an asset to the financier using a Sale and Purchase Agreement and then the financier could enter into a separate agreement with the seller, to sell him back the sold asset within a fixed period, conditional upon recovering back the price plus fees and certain costs (equivalent to lending interest). Also, the seller could sell an asset to the financier, and then the financier could sell the asset to a third party under a separate agreement with the seller. The third party could then sell the asset back to the seller under a third agreement conditional upon recovering back the price plus fees and costs within a fixed period.

Courts in Qatar have not had the opportunity to properly consider these models and so it is still open to argument as to whether they can circumvent the operation of Article 474. However, Egyptian jurisprudence points the way to shedding some light on how Qatari courts may handle such cases. Qatari courts may recognise the principles of the Egyptian scholar Abdulrazik Alsanhori as a persuasive authority

in absence of local resources.

According to Abdulrazik Alsanhori these models may still be void, as a judge has the discretionary power to trace the transaction or the series of transactions to find out whether the buyback sale is intended to cover a financing transaction and in which case a judge would declare the sale and all the transactions based on this sale, null and void.

Technically, when a seller sells an asset to a financier, and on a later date they enter into a separate agreement granting the seller the right to repurchase the asset, would not fall within the scope of Article 474 of the Qatari Civil Law. However, the court might look at the intention of the parties at the time of conclusion of the first agreement to determine whether the series of transactions was to cover a financing transaction. There is a risk that a court could construe this arrangement as void if they find it as being an arrangement that falls within Article 474 of the Qatari Civil Law.

Situation under the Various Jurisdictions

Article 1333 of the Iraqi Civil Code stipulates that “sale with a right to recover the sold, is considered a pledge” and, therefore, the transaction contemplated by Repo arrangement will not be void, however, the Iraqi courts will not look at the sale provisions under the Iraqi Civil Law to determine on a dispute arising from a Repo arrangement, instead, it will apply pledge provisions set out the Iraqi Civil Law to determine on the transaction.

The attitude in the Libyan and the Syrian Civil Code is the same as in the Egyptian Law, as Article 454 of the Libyan Civil Code and Article 433 of the Syrian Civil Code prohibit buyback sale.

However, the attitude in Lebanon is different as buyback sale is allowed under the Lebanese Obligations and Contracts Law, as Articles 473-486 described the buyback sale in details.

Conclusion

The Arab legal position on the validity of the Repo arrangements varies from one Arab jurisdiction to another. The majority of the legal systems consider these arrangements invalid (Egypt, Libya and Syria), and some other Countries consider them as a pledge (Iraq), while Lebanon validates them. Although there are no precedents available in Qatar, the Repo arrangement is at risk of being voided by Qatari courts, if the Qatari courts adopt, as persuasive authority, the principles laid down by Egyptian precedents.

We suggest that considerable care be given to structuring arrangements of this kind to ensure they are not later subject to the argument that can make them void.