

Dubai Court of Cassation clarifies the legal principles governing long-term lease agreements

Eman Ahmed - Senior Counsel - Litigation

e.ahmed@tamimi.com - Dubai International Financial Centre

Mohamed Abou Sakr - Senior Counsel - Litigation

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

A leasehold interest consists of usufruct, that is, the right to enjoy the use and advantages of demised premises, short of destroying or damaging it. That property right is delivered by the landlord to the tenant in consideration of payment of specified rent. The landlord retains ownership of the demised premises and the tenant must surrender the demised premises to the landlord at the end of the lease term. The landlord also has the right to recover the demised premises for non-payment of rent. Providing the property is returned in a fit state, granting the right of leasehold should represent a secure investment for the landlord rather than a risk. At the same time, a leasehold right is beneficial to the tenant because it guarantees him the usufruct of property which it would be beyond his financial means to acquire.

In view of the benefits which leasehold provides to the landlord and the tenant, it is commonly used as a means of legally structuring the financing and acquisition of property, as it can be adapted and modified to give the tenant ownership of the demised premises during or at the end of the lease term. Therefore, leasehold, in addition to acquiring usufruct rights over premises during the lease, can become a means of acquiring title to the premises. This provides security to the landlord while enabling the tenant to easily acquire title to the demised premises. This is known as a 'leasehold ending with ownership' and is used in certain financial transactions carried out by Islamic banks and financial institutions.

Long-term leases ending with ownership have led to issues and ambiguities concerning their legal essence, particularly in regard to the consequences of termination. Should this type of contract be regarded as a lease, where the landlord keeps the money paid for the enjoyment of the premises, on the basis that a lease is a time-based contract and the parties are not returned to the positions they occupied prior to the contract? Or should it be regarded as a contract of sale which, if terminated, would restore the parties to their original positions and under which the tenant would recover the money paid?

Claim

The Dubai Court of Cassation in a recent Judgment (Cassation number 178-182/2015 Property) addressed the legal essence of a long-term lease ending with ownership.

The background of the case was that the parties to the dispute had entered into a long term lease (deferred usufruct) for a plot of land against the payment of specific consideration. The lease was registered in the Interim Real Estate Register at the Dubai Land Department. The claimant landlord (the 'Landlord') alleged that the defendant tenant (the 'Tenant') was in full breach of the contract, having failed to execute the construction works agreed upon. Those works became impossible to complete by the contractual deadline. The Landlord further alleged that the Tenant had failed to make agreed payments and failed to pay the fee for registration of the contract with the Interim Real Estate Register. The Tenant filed a counterclaim seeking to restore the position that existed before the contract was made and recover the money paid to the Landlord.

The Court of First Instance

The Court of First Instance ordered the contract to be terminated due to a breach by the Tenant and that the original position be restored by having the Landlord return all the sums of money paid by the Tenant.

The Court of Appeal

The Landlord appealed and the Court of Appeal dismissed his appeal and upheld the primary Judgment.

The Court of Cassation

The Landlord appealed to the Court of Cassation arguing that the Court of Appeal erred in treating the long term lease as a contract of sale when it was explicitly clear from all its terms that the parties were in a landlord-tenant relationship and that the rental amount and the lease terms were specified at various places in the contract. The Court of Appeal should not have departed from plain meaning of the contract and should not have characterised it as sale and purchase contract, contrary to the facts. The Landlord asked the Court to enforce the contract's breach and termination clauses.

The Landlord stressed that a lease is a continuing contract which meant that the Landlord would keep the rent for the period that lapsed before the contract was invalidated or terminated, in consideration of the Tenant's obligation to return the usufruct he enjoyed in the demised premises during that period.

In other words, the effects produced by the contract prior to invalidation or termination survived because that invalidation or termination only had a prospective effect, or consequences for the future. This was because a lease is a time-based, fixed-term contract in which time is of the essence without retroactive effect. The payments the Tenant had made in performance of his obligation could not be recalled and the effects produced prior to termination remained.

The Court of Cassation held that the trial court had the discretion to characterise contracts and determine the intent of the parties. Characterisation of a contract is done by reference to the facts, evidence and the terms of the agreement underlying the claim. According to the terms of the agreement, the parties intended to enter into a sale-purchase contract whereby the Tenant purchased a plot of land for a price which he was bound to pay in monthly installments. The contract stated that the plot should be delivered to the Tenant only upon payment of the full price. The Court of Cassation found that this was clearly inconsistent with the nature of leasehold where rent is only payable in consideration of a tenant being provided periodic enjoyment of the demised premises. The Court of Cassation noted, however, that the Tenant breached the contract by not paying the installments due despite the Landlord having registered the contract in the tenant's name.

Conclusion

The Dubai Court of Cassation therefore regarded the agreement of a lease ending with ownership as a contract of sale, rather than a strict lease. The Court consequently applied the legal effects of a contract of sale, including the effects of termination such that the parties were restored to the positions they occupied prior to the contract and any sums paid were returned.