

Case 4530586898

Court	Circuit type	Case No.	Judgment pronounced	Judgment issued
Madinah Court of Appeal	Civil	4530586898	–	July 3, 2024

Facts

A hearing was convened, attended by both parties. The attorney for the applicant submitted a statement of claim for annulment of the arbitral award in the dispute between the claimant (Company [...] Ltd.) and his client, the respondent (Company [...]).¹

The dispute had been submitted to an arbitral tribunal composed of [...], as presiding arbitrator; [...], as arbitrator appointed by the claimant; and [...], as arbitrator appointed by the respondent. The tribunal rendered its award on January 3, 2023 (10/6/1444H).

[The statement of claim reads as follows:]²

Pursuant to Article 51 of the Arbitration Law, my client has filed the present annulment action in respect of the award deposited under No. [...].

The arbitral award ruled as follows:

First: The respondent [Company ...], Commercial Registration No. [...], is ordered to pay the claimant [Company ... Ltd.], Commercial Registration No. [...], the following amounts:

- (1) SAR 100,000 as compensation for damages.
- (2) SAR 2,124,735.71 as rent due, plus value-added tax.
- (3) SAR 26,000 as the value of safety and firefighting equipment.

Second: All other claims of both parties are dismissed.

The conclusion of the award was read in the presence of both parties on January 3, 2023 (10/6/1444H) at 14:00 p.m. in Riyadh.

¹ Identifying information in this judgment has been redacted to protect personal and sensitive data.

² Editorial insertions in square brackets have been made by the SCCA team for clarity or completeness and do not appear in the original Arabic text.

Grounds for annulment:

Pursuant to Article 50 of the Arbitration Law, my client requests annulment of the arbitral award on multiple grounds:

First: The award rules on matters beyond the scope of the arbitration agreement

The tribunal addressed the issue of obligating my client to pay value-added tax at the increased rate of 15 percent, pursuant to Royal Decree No. A/638 dated June 6, 2020 (15/10/1441H). This constitutes an overreach of the tribunal's jurisdiction, as tax-related matters fall within the exclusive competence of the specialized tax committees of the Zakat, Tax, and Customs Authority, in accordance with the Income Tax Law, the Value-Added Tax Law, and the Real Estate Transactions Tax Law.

Moreover, the rent stipulated in the lease contract is inclusive of all obligations. Accordingly, it is impermissible to impose value-added tax [separately], increase its rate to 15 percent, or require the payment of additional amounts [beyond what was contractually agreed].

Second: One party was deprived of the opportunity to present its defense

The arbitral tribunal erred in ordering my client to pay rent without deducting the amounts it had previously paid to the claimant. This constitutes a material error resulting in manifest injustice.

My client, represented by one of its partners, paid the claimant on January 23, 2019, the rent for a six-month period from March 1 to September 1, 2019, in the amount of SAR 543,798.50. The tribunal failed to deduct this amount from the rent awarded.

Furthermore, my client was not afforded a proper opportunity to present its defense or clarify this payment before the tribunal, demonstrating a failure to consider all relevant factual circumstances between the parties.

Accordingly, the net amount due to the claimant—after deducting the payment already made—would be SAR 1,580,937.21.

The payments already made, as evidenced by the bank transfer, the rent receipt issued on the claimant's letterhead, and account statement submitted by the claimant, must be deducted from the awarded rent, should the award not be

annulled in its entirety. (See Exhibit No. 1: Copies of Bank Transfer, Rent Receipt, and Account Statement).

Third: Contradiction in the arbitral award

The arbitral tribunal contradicted itself by recognizing my client's right to terminate the lease while simultaneously obligating it to pay rent.

This contradiction is evident and must be taken into consideration, as it is inconsistent with established legal and Sharia principles. The tribunal rejected the claimant's request to enforce the penalty clause, stating in its reasoning that such entitlement was conditional upon the absence of breach by either party.

The tribunal further noted:

Upon review of the claims of both parties, we note that the claimant required the issuance of a Civil Defense Certificate for the entire building during the term of the contract—an obligation that had previously existed—due to changes in the regulatory requirements. This directly affected the respondent, as the required Civil Defense Certificate was not issued until June 17, 2021 (6/11/1442H), that is, after the date of termination and vacating of the premises. The effect remains, and the respondent's right to terminate the lease persisted for this reason.

Based on this reasoning, the tribunal confirmed the validity of my client's lease termination.

However, it proceeded to order my client to pay rent [for the same period during which it had recognized the respondent's right to terminate due to the absence of the necessary regulatory approvals]. Such reasoning is flawed. Having acknowledged that my client suffered harm and was unable to benefit from the leased premises due to the absence of the required permits, it is contradictory to impose rent for that same period. This inconsistency undermines the integrity of the award and warrants the Honorable Court to consider annulling the rent obligation for the relevant period.

Fourth: Failure to consider material evidence and witness statements

[We submit that the arbitral tribunal failed to verify or consider material evidence, including the statements and testimony of other tenants within the same complex.]

My client repeatedly informed the tribunal that other tenants within the same complex were aware of the circumstances giving rise to the dispute and of the harm suffered by my client, including deficiencies in the premises and the claimant's misrepresentations regarding renovations and their scope. Such deficiencies affected all tenants within the complex.

Moreover, the tribunal failed to address my client's requests concerning the absence of essential regulatory documentation, including the Civil Defense Certificate, municipal permits, and completion certificates, all of which are necessary for a proper assessment of the condition and usability of the premises.

The tribunal's failure to consider these elements reflects an incomplete examination of the facts and adversely affects the soundness of the arbitral award.

Fifth: Violation of established legal and Sharia principles governing lease contracts

[The arbitral tribunal contravened established judicial principles, including the fundamental requirement that a lease contract presupposes full possession and the ability to derive benefit from the leased property.]

We respectfully draw the attention of the Honorable Circuit to the fact that the tribunal disregarded my client's conclusive evidence demonstrating the absence of full possession and effective use of the premises. The claimant itself acknowledged that the Civil Defense Certificate for the property was issued only on June 17, 2021 (6/11/1442H), that is, after my client had vacated the premises. Moreover, the issuance of the municipal permit was contingent upon obtaining the Civil Defense Certificate for the entire complex, which had not been secured during the relevant period.

This constitutes a clear breach of established judicial principles, which oblige the lessor to provide the Civil Defense Certificate and enable the issuance of the municipal permit.

Authoritative scholarly and juristic opinion supports this position. It is reported from Sheikh al-Islam Ibn Taymiyyah in *Al-Fatawa* (258/30):

It has been agreed among scholars that if the benefit contracted for is diminished, the lessee has the right to terminate the lease.

Similarly, Judicial Principle No. 186, as set out in the Principles and Decisions Issued by the Supreme Judicial Council and the Permanent and General Committees of the Supreme Judiciary and the Supreme Court from 1391H [approx. February 1971 to February 1972] to 1437H [approx. October 2015 to October 2016], provides:

Rent is only due if the leased premises are suitable for the purpose for which they were leased. (p. 94)

We thus hold that, in accordance with Sharia, customary practice, and the law, the claimant is not entitled to rent once it has acknowledged that my client was unable to obtain full possession or derive benefit from the premises due to the absence of the required permits. The claimant's failure to comply with its contractual obligations caused substantial loss to my client, which must be duly taken into account.

Sixth: Failure to consider the expert report and payment of fees by the respondent

[The arbitral tribunal failed to properly consider the expert report submitted in the proceedings.] The tribunal had appointed an engineering expert [...] to inspect the premises and assess the factual circumstances presented by both parties.

The expert conducted an on-site inspection and issued a final report confirming, inter alia, that my client was affected by the renovation works to an extent of 75 percent; that it had not been informed of the scope of such works; and that the claimant had refused to provide the relevant renovation plans. The report further confirmed that my client was unable to obtain the municipal permit or Civil Defense Certificate until such documentation was issued for the entire complex by the claimant.

It was also established that my client remained in a state of uncertainty for a period of two years and two months pending the claimant's issuance of the Civil Defense Certificate and suffered additional damage caused by rainfall, as evidenced by photographic documentation.

[Notwithstanding the significance of these findings,] the arbitral tribunal failed to address or assess the expert report, nor did it provide any reasoning for disregarding its conclusions. The report was effectively ignored.

Such omission constitutes a material defect, undermining the integrity of the award and warranting the consideration of the Honorable Court. (See Exhibit No. 2: Copy of the Expert Report).

Seventh: Substantive and formal errors in the arbitral award

The arbitral tribunal committed a procedural error by exceeding the prescribed time limit for arbitration, which should have been calculated in accordance with Article 26 of the Arbitration Law. Furthermore, neither the hearing minutes nor the arbitral award includes the required particulars of the arbitrators—namely, their names, addresses, nationalities, and capacities—in violation of Article 42 (2) of the Arbitration Law.

Accordingly, this necessitates the annulment of the arbitral award pursuant to Article 50 (1) (g), which provides that:

If the arbitration tribunal fails to observe the conditions required for the award in a manner that affects its substance, or if the award is based on void arbitration proceedings that affect it.

Your Honors, my client has been subjected to an erroneous legal characterization of the contractual relationship, compounded by contradictions in such characterization and a failure to properly consider the factual circumstances in light of the expert report submitted in the case.

The claimant's fault was not duly considered; rather, my client was burdened with obligations exceeding its contractual commitments. Moreover, my client was ordered to pay rent that had already been paid in advance. My client has incurred substantial financial losses without deriving any benefit from the leased property during the relevant period.

Due consideration must be given to the significant harm suffered by my client as a result of the claimant's delay in obtaining the Civil Defense Certificate, the absence of a municipal license, and the ongoing renovation works affecting the restaurant [i.e., the leased premises in question]. The absence of possession and usable benefit is clearly established by the claimant's failure to secure the necessary permits.

Your Honors, the truth is manifest and evident from the pleadings and submissions reflected in the arbitral award. The clearest evidence of the absence of possession of the restaurant is the claimant's failure to obtain the

Civil Defense Certificate and the municipal license. Accordingly, we request the Honorable Circuit do justice to my client and examine the challenged award with due scrutiny, in discharge of responsibility and in support of the aggrieved party.

Requests:

Based on the foregoing, my client requests [that the Court]:

First: Accepts the annulment action in form, as it has been filed within the statutory time limit prescribed by the Arbitration Law.

Second: Issues a judgment declaring the arbitral award null and void for the reasons set out above.

Third: Alternatively, in the event that the arbitral award is not annulled in its entirety, annul the obligation imposed on my client to pay amounts already paid to the claimant, such that the net amount payable for the lease period up to the date of vacating shall be SAR 1,580,937.21.

Fourth: Order the suspension of enforcement of the arbitral award pending determination of the annulment action, pursuant to Article 54 of the Arbitration Law.

Upon presentation to the defendant's attorney, he responded as follows:

What has been submitted by the annulment applicant in support of the action constitutes, in substance, an attempt to reopen and reargue the facts of the case already examined by the arbitral tribunal, which rendered its award accordingly.

It is well established that an action for annulment is confined to the specific grounds exhaustively enumerated in Article 50 of the Arbitration Law, none of which are applicable to the arguments advanced by the plaintiff. The submissions presented relate to the facts and merits of the dispute and amount to an impermissible challenge thereto. It is further settled that arbitral awards are not subject to appeal by any means of recourse other than an annulment action, in accordance with Article 49 of the Arbitration Law.

Furthermore, the Court of Appeal lacks jurisdiction to reconsider the facts or the merits of the dispute, pursuant to Article 50 (4) of the Arbitration Law.

Requests:

Accordingly, I request [that the Court]:

First: Dismisses the annulment action and upholds the arbitral award.

Second: Orders the enforcement of the award by affixing the executory formula.

Upon presentation to the attorney of the annulment applicant, he replied as follows:

The contention that my client's petition fails to establish valid grounds for annulment is unfounded. The arbitral tribunal award clearly addresses matters beyond the scope of the arbitration agreement and outside the tribunal's jurisdiction, including tax-related matters imposed without a proper legal basis.

Additionally, there exist procedural violations that deprived my client of the opportunity to present a full defense, it was not questioned thereon, as well as formal defects in the award, most notably the presence of contradictory reasoning.

Requests:

Accordingly, we request that the Honorable Circuit grants relief to my client in light of the serious legal and procedural defects affecting the arbitral award.

Upon presentation to the defendant's attorney, he responded:

The jurisdiction of arbitration extends to all claims arising out of or connected with the subject matter of the contract, including ancillary financial obligations such as governmental fees and taxes. There is no provision in the Arbitration Law that precludes the arbitral tribunal from considering such matters, save for those expressly excluded (such as personal status matters and non-arbitrable disputes).

Furthermore, any alleged jurisdictional overlap between courts and tax committees does not negate the jurisdiction conferred upon the arbitral tribunal by virtue of the arbitration clause agreed between the parties.

Upon presentation to the attorney for the annulment applicant, he responded as follows:

The error committed by the arbitral tribunal lies in increasing the value-added tax from 5 percent to 15 percent without verifying whether the claimant was

registered for value-added tax, whether a Zakat and Income Certificate had been issued, or whether payment of the increased rate had actually been made. This constitutes unjust enrichment based on an unverified increase.

Additionally, there exist judicial precedents, issued by this Circuit, confirming both the invalidity of such tax increases and the lack of jurisdiction of arbitral tribunals to adjudicate such matters.

Upon presentation to the defendant's attorney, he responded as follows:

The amount of value-added tax awarded, as stated in the arbitral award on page 32, is SAR 61,328.

Upon review of the arbitral award, the Circuit noted that item (2) of the "First" order indicates that the adjudicated rent amount included value-added tax. Accordingly, the parties were directed to revert to the arbitral tribunal to clarify the breakdown between rent and value-added tax in detail. The parties acknowledged and complied with this direction, and the hearing was adjourned for that purpose.

Following review of the record, the hearing was reconvened with both parties represented by their respective counsel. Upon inquiry, the defendant's attorney stated:

The interpretation award issued by the arbitral tribunal has been attached to the case file in the Najiz electronic portal.

The Circuit adjourned the hearing for further deliberation.

At a subsequent hearing, both parties appeared. The interpretation award issued by the arbitral tribunal dated April 9, 2023 (18/9/1444H) was reviewed, and it provides as follows:

[The arbitral tribunal decided to reinterpret and redraft item (2) of the "First" order in the conclusion of the award. The amended conclusion reads as follows:]

First: The respondent [Company ...], Commercial Registration No. [...], is ordered to pay the claimant [Company ... Ltd.], Commercial Registration No. [...], the following amounts:

(1) SAR 100,000 as compensation for damages.

(2) SAR 2,124,735.71 as rent and service charges, plus value-added tax, detailed as follows:

(a) For the period from March 1, 2019, to June 30, 2020: SAR 1,351,867.90, plus value-added tax at 5 percent amounting to SAR 67,593.40.

(b) For the period from July 1, 2020, to January 24, 2021: SAR 613,282.10, plus value-added tax at 15 percent amounting to SAR 91,992.31.

(3) SAR 26,000 as the value of safety and firefighting equipment.

Second: All other claims of both parties are dismissed.

This amended conclusion was read in the presence of the parties on April 9, 2023 (18/9/1444H).

Upon asking the defendant's attorney to respond to the plaintiff's claim, he stated:

My client has no response beyond what has already been submitted in reply to the annulment action.

Accordingly, the hearing was adjourned for deliberation.

At a subsequent hearing, both parties appeared, and as the case was ready for adjudication, the judgment was pronounced.

Reasoning

Since the annulment action was filed within the statutory period stipulated in Article 51 (1) of the Arbitration Law, it is admissible in form.

As to the merits:

Since the plaintiff's attorney seeks, through the action, to annul the arbitral tribunal's award rendered in the dispute between his client, Company [...], and Company ... Ltd., dated January 3, 2023 (10/6/1444H), reference is made to Article 50 of the Arbitration Law issued by Royal Decree No. M/34 dated April 16, 2012 (24/5/1433H), which provides as follows:

(1) An action to nullify an arbitration award shall not be admitted except in the following cases:

(a) If no arbitration agreement exists, or if such agreement is void, voidable, or terminated due to expiry of its term.

(b) If either party, at the time of concluding the arbitration agreement, lacks legal capacity, pursuant to the law governing his capacity.

(c) If either arbitration party fails to present his defense due to lack of proper notification of the appointment of an arbitrator or of the arbitration proceedings, or for any other reason beyond his control.

(d) If the arbitration award excludes the application of any rules which the parties to arbitration agree to apply to the subject matter of the dispute.

(e) If the composition of the arbitral tribunal or the appointment of arbitrators is carried out in a manner that violates this Law or the agreement of the parties.

(f) If the arbitration award rules on matters not included in the arbitration agreement. Nevertheless, if the sections of the award relating to matters subject to arbitration can be separated from those not subject thereto, then nullification shall apply only to the sections not subject to arbitration.

(g) If the arbitral tribunal fails to observe the conditions required for the award in a manner that affects its substance, or if the award is based on void arbitration proceedings that affect it.

(2) The competent court considering the nullification action shall, on its own initiative, nullify the award if it violates the provisions of Sharia and public order in the Kingdom or the agreement of the arbitration parties, or if the subject matter of the dispute cannot be referred to arbitration under this Law.

(3) The arbitration agreement shall not terminate with the issuance of the competent court's decision nullifying the arbitration award unless the arbitration parties agree thereon or a decision nullifying the arbitration agreement is issued.

(4) The competent court shall consider the action for nullification in cases referred to in this Article without inspecting the facts and subject matter of the dispute.

Whereas the arbitral award included a ruling on value-added tax, and jurisdiction over such matters lies with the Tax Dispute and Violation Resolution Committee pursuant to Royal Decree No. M/113 dated July 25, 2017 (2/11/1438H), and whereas the portion of the award relating to value-added tax is severable in accordance with Article 55 (2) (b) of the Arbitration Law.

Whereas the remaining arguments raised by the plaintiff in the annulment action fall outside the exhaustively enumerated grounds under Article 50 and would require the Court to examine the facts and merits of the dispute, which it is not permitted to do.

And whereas the arbitral award otherwise addressed all aspects of the dispute arising from the arbitration agreement.

Accordingly, the Circuit concludes that the plaintiff's claims are unfounded, and the action must therefore be dismissed on the merits, the arbitral award upheld, and enforcement ordered in accordance with Article 51 (2) and Article 55 of the Arbitration Law.

Since no grounds have appeared before the Circuit that would preclude the affirmation of the arbitral award, the Circuit concludes with the conclusion of its judgment as set out below.

Ruling

The Court hereby rules as follows:

First: The annulment action is accepted in form and partially on the merits, and is otherwise dismissed.

Second: The arbitral award dated January 3, 2023 (10/6/1444H), issued in the dispute between Company [...] Ltd. and Company [...], is upheld and ordered to be enforced, [except as stated below]:

First: The respondent [Company ...], Commercial Registration No. [...], is ordered to pay the claimant [Company ... Ltd.], Commercial Registration No. [...], the following amounts:

- (1) SAR 100,000 as compensation for damages.
- (2) SAR 2,124,735.71 as rent and service charges, plus value-added tax, detailed as follows:
 - (a) For the period from March 1, 2019, to June 30, 2020: SAR 1,351,867.90, plus value-added tax at 5 percent amounting to SAR 67,593.40.
 - (b) For the period from July 1, 2020, to January 24, 2021: SAR 613,282.10.
- (3) SAR 26,000 as the value of safety and firefighting equipment.

Second: All other claims of both parties are dismissed.

Third: The arbitral award is annulled in part, solely with respect to the value-added tax imposed at the rate of 15 percent in paragraph 2 (b) of the “First” order, namely: “plus value-added tax at 15 percent amounting to SAR 91,992.31.”

This judgment is final and not subject to appeal, except the annulled portion relating to the 15 percent value-added tax, which may be challenged before a competent court within 30 days from the date of notification.