



The New Civil Transactions Law in Saudi Arabia - Profit Sharing Contract {Mudarabah}

Civil Transactions Law of Saudi Arabia (Law) which has codified the principles and rules covering civil transactions will come into force on 21 December, 2023. This note highlights major provisions related to Profit Sharing Contracts.

Introduction

One of the popular forms of investments in the region is Mudarabah or Profit-Sharing Contract wherein a capital owner provides capital to an entrepreneur and the profit generated is shared between the parties. Many people prefer this arrangement primarily for two reasons, namely; (1) it enables them to participate in trade and business activities through people who have the knowledge and expertise; (2) the profit generated or income earned on capital invested is not treated or considered as interest.

Mudarabah Principles:

The Saudi real estate market is a dynamic tapestry comprising residential, commercial, retail, and warehouse properties. Each category plays a unique role in shaping the nation's thriving property landscape. Residential properties, influenced by GDP, per capita and population trends, coexist with a burgeoning commercial sector, particularly in cities like Riyadh, which are experiencing robust growth. Retail properties and warehouses contribute their own dynamics, reflecting distinct pricing patterns driven by consumer spending and logistics requirements.¹

One of the conditions of Mudarabah contract is that the capital is to be handed over to the Mudareb who will have full right to utilize and dispose of the capital subject to condition that he shall exercise the same care as he would exercise for the sake of his own property. In case, he receives a remuneration or a share in profit for his work, he is required not to fall below the standard expected of a reasonable person. Besides, he would not retain any of the assets derived from the capital for himself nor use it for himself.²

Obligations of Mudareb:

The Mudareb is required to provide all information related to the activities of Mudarabah contract and statement of account upon expiration of the term and in case of an indefinite term contract, he should provide such statements at the end of every year. He is also bound to follow restrictions of time, place and type of business activities agreed with the capital owner. In case, the Mudarabah contract is of unrestricted nature, the Mudareb could conduct activities that are in accordance with the customary practice.³

While the Law restricts the managing partner from combining the property of Mudarabah with his own property or providing the property of Mudarabah to any third party with the aim of engaging in Mudarabah activities unless the customary practice so permits or where the capital owner has explicitly authorized him to do so; yet, in cases where there are no such restrictions, the profit of every property is to be calculated pro rata its ratio to the combined property.

Profit and Losses:

The Law specifically restricts parties from entering into any Mudarabah arrangements wherein the parties agree that the capital owner shall not be held liable for any capital loss. It furthers this argument and protects the Mudareb against any liability for any decrease in the value of

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¹Article 551

²Articles 553, 539, 541

³Articles 554, 555 and 556



capital without any wrong doing or negligence on his part. However, in case of any wrong-doing or negligence on part of the Mudareb, he shall be fully liable to compensate the capital owner for any capital loss and damages resulting therefrom.⁴

The parties may agree on profit share of each contracting party under the Mudarabah arrangement. However, if there is no agreement, it will be determined on the basis of customary practice. It is important to note that like restrictions against insulating or guaranteeing the capital owner that there will no loss or decrease in the capital, the Law restricts any arrangement wherein any contracting party is guaranteed a fixed sum as profit. However, the parties may agree for equal sharing of profit or agree that profit in excess of certain limit shall exclusively accrue to one party. They may also agree on variation in profit share with the change in the amount of profit generated. The Law also allows parties to agree on fixed remuneration in consideration of a particular job by any of the parties. Although the parties shall be entitled to a profit share upon termination of the Mudarabah unless there is an agreement on valuation of the Mudarabah profit and determination of each party's share on certain fixed dates or periods with the continuation of Mudarabah, however, the profits distributed in the course of such a Mudarabah contract would be considered as part of the profit share.⁵

Termination:

Mudarabah contract shall terminate upon expiration of the agreed term or upon completion of the work for which Mudarabah contract was executed. The parties are not entitled to withdraw from a fixed term Mudarabah contract prior to the expiry of the term. However, a party may petition to the court to permit an early withdrawal if acceptable grounds are furnished and provided the other party would be compensated for any damage sustained because of such withdrawal. In case of an indefinite term Mudarabah contract, either party may withdraw by notifying the other party sufficiently prior to the withdrawal date and provided that the withdrawal is not requested at an inappropriate time.⁶

The Mudareb is obliged to refund to the capital owner his share in the Mudarabah capital upon expiration of the Mudarabah contract. In case, he fails to refund the capital upon expiration of the contract without an acceptable justification and the capital decreases for any reason, the Mudareb shall be held liable for the decrease. However, if the capital so withheld generates profits, the capital owner shall be entitled to all profits generated until the capital is refunded.⁷

The Mudarabah contract shall be considered terminated upon the death of the managing partner, interdiction or insolvency or upon institution of bankruptcy proceedings against either of the contracting parties.⁸

Conclusion:

The Law restates the norms and principles governing Mudarabah contracts that clarifies the entire working of Mudarabah contracts and removes ambiguities surrounding such arrangements.

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⁴Article 557

⁵Article 557, 558 and 559

⁶Article 561 and 562

⁷Article 564

⁸Article 565