

Bank guarantees in the UAE

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Guarantees and Article 1092 of the Civil Transactions Law

The time-limit for claiming a debt against a guarantor has been the subject of legal discussions and contradictory interpretation along with disagreements as to the form that a guarantee should take. This article only considers a guarantee given by a third party in connection with a borrower's obligations to a bank and not a unilateral guarantee given by a bank relating to an applicant's obligations to another party.

Article 1092 of the Federal Law No.5 of 1985 issuing Civil Transactions Law (the 'Civil Code') states that "If a debt is due, the creditor should claim the debt within six months from the date on which it fell due, otherwise the guarantor shall be deemed to have been discharged". Based on the provisions of Article 1092, a claim against an obligor (i.e. who has obligations similar to those of a guarantor) must be initiated within six months from the due date for payment.

There have, however, been different interpretations of Article 1092 and its application. The Supreme Court in Abu Dhabi has interpreted Article 1092 to apply to guarantees with respect to civil transactions only and that the time bar does not apply to guarantees in banking (i.e. commercial) transactions. In such cases, the Supreme Court has held that the applicable time bar is ten years. By contrast, in Dubai, the Court of Cassation has ruled that it applies to all guarantees meaning the 6-month period would be enforced.

In practice, UAE contracts of guarantee or a guarantee to which a UAE entity is party, will typically include a waiver of Article 1092. This practice arose to avoid any risk from the UAE Courts applying Article 1092 in order to determine whether or not the claim against a guarantor should be heard.

Landmark case on contracts of guarantee in financing transactions

The UAE Federal Supreme Court ('FSC') in a recent judgment (the 'Judgment') categorically clarified key principles relating to a guarantee contract in bank financing transactions. The Judgment held that:

1. Article 1092 of the Civil Code (concerning the guarantor's release from the guarantee if no claim has been brought against the guarantor within six months) does not apply to commercial guarantees (accordingly bank loans and facilities are not subject to Article 1092 of the Civil Code);
2. the secured debt need not be specified at the time when the contract was entered into, as it is the debt that is being guaranteed, not its amount;
3. a guarantee may take effect immediately or be deferred to a future time; and
4. a guarantee does not necessarily have to be set out in a separate contract.

Background of the case

The claimant bank (the 'Bank') commenced proceedings against the borrower (the 'Borrower') and its directors/partners, in their capacity as personal guarantors, in relation to the loan agreement made between the Bank and the Borrower. The personal guarantee was included within the terms of the loan agreement. The legal proceedings were initiated a few years after the debt had become due.

The guarantors based their defence on the arguments that: (i) the bank's claim is time-lapsed pursuant to Article 1092 of the Civil Code which (as per the defendants' defence) should have been applied in light of the absence of a special provision in the Commercial Transactions Law ('ComTL'); (ii) the guarantee undertaking is invalid as it was a paragraph included within the conditions of the loan agreement, whereas the guarantee should have been an independent legal agreement; and (iii) they have signed the loan agreement in their capacity as the company's shareholders and directors, and therefore, they triggered the corporate veil principles.

Article 1092 of the UAE Civil Code does not apply to a guarantee of a bank loan or facility

FSC held that "[b]ank loans and facilities are not subject to Article 1092 of the Civil Code which provides for the discharge of the suretyship if, after 6 months of the debt becoming due, no claim has been brought against the surety. Article 1092 is inapplicable in the case of a suretyship for commercial obligations".

In previous judgments FSC and UAE's other Supreme Courts tended to apply Article 1092 of the Civil Code in order to determine whether or not the guarantor's commercial obligation is not heard. The rationale of that revoked principle was based on Article 2 of the ComTL, which provides that Civil Code provisions shall apply where the ComTL and the customs are silent on the issue in question. Thus, pursuant to the retracted principle, FSC had ruled that guarantor's commercial obligation toward the creditor bank is not heard by the lapse of six months from the date on which such obligation falls due.

FSC appears to have changed its previous position, as it conclusively excluded the application of Article 1092 of the Civil Code in commercial loans. In addition, FSC decided that bank loans are deemed commercial transactions even if the other party is not a trader i.e. such a transaction does not fall within the ambit of the application of the ComTL.

FSC has not expressly specified the respective provisions which should apply in determining the guarantor's commercial obligations towards the creditor. However, it is inferred in the Judgment that such obligations shall be subject to the general principles in the ComTL and more specifically, Article 95 which provides that "Where there is a denial and non-existence of a legitimate excuse, the obligations of traders towards each other and concerning their commercial activities, shall not be heard on the lapse of ten years from the date on which the performance of the obligation falls due, unless the law stipulates a shorter period". This would align with the position taken by the Abu Dhabi Supreme Court.

In light of the above, a guarantor's obligation towards a bank can qualify as a commercial matter, governed by the ComTL. Therefore, it is likely, that in future cases, a time-limit of ten years starting from the date on which such obligation falls due, can be argued as applicable notwithstanding that a guarantor is not a trader.

No prescribed form of surety contract/guarantee is required

The FSC held that a guarantee is not required to be in a certain form but rather it shall be subject to the general principles of the Civil Code regarding the formation of an agreement and the interpretation of the contracting parties' intention. Hence, an offer of the guarantee and acceptance by the bank is sufficient. Furthermore, it held that the guaranteed amount may not be specified in the guarantee as long as it is clear in the contract what is being guaranteed. In the case, the FSC was happy that a general guarantee of "the satisfaction of all indebtedness of the client to the bank" is valid. Even though the actual secured obligation was unspecified at the time the contract of suretyship was entered into because the thing guaranteed is the debt, not its amount. Accordingly, the usual practice of referring to the facilities secured (but with no amount mentioned) accords with this approach. Moreover, guarantees of all debts due to a bank may be argued as determinable subject always to the facts and documentation applicable to the case.

The FSC dismissed the guarantors' argument in relation to the corporate veil principle, as it found that the obligations of the guarantors shall not be prejudiced by their capacity as the company's shareholders which was mentioned as the beginning of the guarantee clause, as long as the respective provision has been conclusively construed in favour of the guarantee agreement.

The FSC held that "[A] suretyship can exist with obligations of whatsoever nature and howsoever arising, as long as they are valid. In order for a suretyship to be formed, there must be mutual consent, expressed through the use of the word "suretyship", or language indicating suretyship. An offer of the surety, accepted by the creditor, is sufficient to form a suretyship. It is not necessary, for the document embodying the contract of suretyship to take a specific form, as long as it is expressly worded and can be proved by a conclusive evidence. A suretyship that is generally worded, without specifying the underlying obligations being guaranteed, but purporting, rather, to guarantee the satisfaction of all indebtedness of the client to the bank, is, at this level of generality, undoubtedly valid, for the secured obligation, while unspecified at the time when the contract of suretyship was entered into, is determinable, because the thing guaranteed is the debt, not its amount."

The court ruled also that "[A] suretyship may take effect immediately or unconditionally, depending on the debt's maturity structure, or may be deferred to a future time, as long as the debt is determinable".

The approach taken by the FSC now aligns with precedent from the Supreme Court in Abu Dhabi but not the Court of Cassation in Dubai. Consequently, while the FSC judgment is important and welcome, we would need to see it followed by Dubai Courts before any change in practice is made in bank documents across the UAE. This judgment will be an essential reference point in any case where Article 1092 is in question.

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