

Guaranteeing Future Obligations Under Kuwait Law

Islam Abaza

i.abaza@tamimi.com

In loan transactions, lenders normally require the borrower to provide collateral or other forms of security to secure the debt obligation of the borrower. One such form of security, which is widely recognized and used across various jurisdictions, is third party guarantees. A guarantee is a promise by one party (the "Guarantor") to assume the financial responsibility for the debt obligation of a borrower in the event the borrower defaults on its debt obligation under the loan transaction by the borrower. Where the borrower is a corporate entity, the parent company or the shareholder of the borrower, often assumes the role of a Guarantor for the debt obligations of such borrower.

In Kuwait, the relevant provisions governing guarantees are set out in Law No. 67 of 1980 (the "Civil Code"). Under the Civil Code, a guarantee is a contract or agreement where the Guarantor joins his liability with the borrower to fulfill the latter's obligation by undertaking to the lender to discharge the same, should the borrower fail to do so. The obligation of the Guarantor is to guarantee the underlying obligation of the borrower. Once the Guarantor agrees to guarantee certain obligations, the Guarantor's obligations will continue until the fulfillment of the original debt.

One point of confusion under the Civil Code is whether the concept of a time limited guarantee exists. Such confusion arises in view of the provisions of Article 749 of the Civil Code whereby such article allows a Guarantor to give notice to terminate a guarantee that does not otherwise specify a termination date. This article is often interpreted as implying that a guarantee that does have a termination date must be also allowed.

The provisions of Article 749 also raises the issue of whether under the guarantee, if the debt obligation of the borrower is not discharged by the maturity date, the lenders can automatically extend a guarantee without obtaining the prior consent from the Guarantor. This relates to Article 746 of the Civil Code where it states that guarantee is not presumed but must be expressly obtained from the Guarantor to guarantee the debt obligation of the borrower. In other words, the said Article 746 refers to the evidentiary requirement of a guarantee, where the consent of the Guarantor must be expressly stated (i.e. it must be in writing or clear verbal statement) and not implied (e.g. by omission or inaction).

Article 749 of the Civil Code states the following:

1. An obligation in the future may be guaranteed provided that the extent of the Guarantor's obligation has been determined in advance.
2. A guarantee without a fixed time limit may be rescinded by the Guarantor any time so long as the secured obligation has not arisen and provided that the Guarantor serves a notice of his rescission on the lender at a reasonable time."

Based on the above Article:

(a) It is clear that the above Article regulates guarantee on future obligations and not obligations which already arisen.

(b) The above Article allows a Guarantor to grant a guarantee on a future obligation which does not exist at the time of the guarantee, as well potentially guarantee, such as guaranteeing the obligations under current accounts (Al Sanhoury, Al Waseet Vol 10 para 22, page 42, Arabic and Beaudry et Vale para 950

page 510, French).

(c) The guarantee of existing debt obligations of an unspecified amount will not be considered as a guarantee of future obligation (Beaudry et Vale para 950 page 511, French) and therefore does not fall within the purview of the above Article. Consequently, if the amount being guaranteed is known and clearly specified in the guarantee agreement, then Article 749 will not apply.

(d) The reference to Article 749(2) on the rescission of a guarantee without a fixed time limit meant that the Guarantor may rescind at any time as long as the debt obligation has not arisen. However, in cases where there is a time limit for the future obligation to arise and when such guaranteed obligation arises, the Guarantor cannot rescind his guarantee in such event (Al Sanhoury, Al Waseet Vol 10 para 22, page 46, Arabic and Egyptian Cession Court Judgement No. 31 of the Judicial Year 1942, Session 14 June 1976). The Explanatory Memorandum of the Civil Code also supports this view.

(e) Furthermore, Article 753 of the Civil Code states that the liability of the Guarantor is discharged by the discharge of the borrower's debt obligations. Therefore, whenever the borrower fulfills its obligations under the loan documents, the guarantee will be automatically terminated by law.

In view of the above, the lenders may automatically extend a guarantee without the prior consent from the Guarantor so long as the debt obligations of the borrower still exist. As stated above, once the Guarantor agrees to guarantee certain obligations, the Guarantor's obligations will continue until the fulfillment of the original debt and the Guarantor may not rescind or terminate his guarantee prior to the full settlement of the debt by the borrower. If the borrower has paid off its debts to the lender, the guarantee is automatically terminated by law. Therefore, under Kuwaiti law, the concept of time limited guarantee is only applicable to future obligations which do not exist at the time of the guarantee.

In addition, from a commercial point of view, a guarantee will not be useful and clearly defeats the purpose of a lender obtaining a guarantee if the Guarantor is allowed to cancel the guarantee prior to the date when all the obligations of the borrower are fully discharged, as the lender initially grants the facility on reliance of the guarantee and its continuity until the full payment of the whole debt.