

Issues relating to bank guarantees in the UAE

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A bank guarantee (“Bank Guarantee”) is defined in Article 411 of the Commercial Transaction Law No. 18 of 1993 (“CTL”) as “An undertaking issued by a bank to settle the customer’s debt to a third party in accordance with conditions agreed and included in the guarantee, which may be for a limited or unlimited period of time”.

Introduction

Under UAE Law, Bank Guarantees are considered a commercial activity regardless of the capacity of the person to whom the Bank Guarantee is issued or the purpose for which it is issued, hence they are governed under the CTL. But on some points reference may also be made to the Civil Transactions Law No. 5 of 1985.

In a Bank Guarantee, the obligation of the issuing bank (the “Guarantor”) is separate from that of the principal debtor (“Principal Debtor”). It is an independent obligation by the Guarantor to the creditor of the Principal Debtor (“Beneficiary”). A Bank Guarantee is independent from the underlying contract or transaction between the Principal Debtor and the Beneficiary. The Guarantor is bound by the Bank Guarantee irrespective of the position of the Beneficiary or the nature of the contracts between the Guarantor and the Principal Debtor, or between the Principal Debtor and the Beneficiary. In issuing the Bank Guarantee, the Guarantor is not acting as a representative, agent or surety of the Principal Debtor but as a principal debtor itself. Both the Guarantor and the Principal Debtor owe an independent obligation to the Beneficiary since a Bank Guarantee gives rise to joint and several obligations. In this way a Bank Guarantee can be distinguished from other guarantees under UAE Law which create incidental obligations dependent on the enforceability of the underlying obligations of the debtor.

Amount and Time Limit of Bank Guarantee

A Bank Guarantee under UAE law cannot be for an undefined amount and should contain the fixed amount for which the Bank Guarantee is being provided.

There is no requirement under UAE Law to provide a time limit in the Bank Guarantee. However, if included a Bank Guarantee will expire automatically upon the expiration of such limit. As per Article 418 of the CTL, unless it had been expressly agreed to renew the said term of the Bank Guarantee prior to its expiry and provided no request for payment has been received from Beneficiary during the validity period of the Bank Guarantee, the Guarantor shall be discharged from liability vis-à-vis the Beneficiary upon the expiry of the validity period of the Bank Guarantee.

However, in the event there is no time limit specified in the Bank Guarantee, then the general limitation periods (time bars) provided under UAE Law will be applicable. UAE Law does not provide for a limitation period specifically for Bank Guarantees, therefore the general limitation period of ten (10) years shall be applicable for Bank Guarantees.

Assignment of Bank Guarantee

Under Article 416 of the CTL it has been prescribed that the Beneficiary shall not assign its rights under a Bank Guarantee to any third party without the consent of the Guarantor. Therefore all assignments by the Beneficiary shall be with the prior consent of the Guarantor which should be in writing. A right to assignment can however be provided to the Beneficiary at the time of signing of

the Bank Guarantee by making the right a part of the Bank Guarantee and the Guarantor agreeing to it at the outset.

Once the Beneficiary has assigned its rights under the Guarantee the assignee steps into the shoes of the Beneficiary and all rights of the Beneficiary vest in the assignee. The Guarantor shall be liable only to the assignee, and shall be duly discharged from its obligations under the Bank Guarantee once it has made the payment under the Bank Guarantee to the assignee upon invocation by the assignee. The Beneficiary will have no right to make any further claims on the Guarantor under such assigned Bank Guarantee.

Invocation of Bank Guarantee

Even though the issuance of a Bank Guarantee results in joint and several obligations of the Guarantor and the Principal Debtor, the Guarantor is only liable to pay to the Beneficiary upon an invocation of the Bank Guarantee by the Beneficiary and not upon a default or act or omission by the Principal Debtor. Principally, a Bank Guarantee should be unconditional, however if it is subject to conditions or submission of any documents by the Beneficiary and such conditions are provided within the text of the Bank Guarantee. The Beneficiary shall not be able to invoke the Bank Guarantee unless such conditions are met or the required documents are submitted. It is the responsibility of the Guarantor to prove that the Bank Guarantee is subject to such conditions.

Upon the successful invocation of the Bank Guarantee, the Guarantor is required to make all payments due under the Bank Guarantee and can not decline to make such payment except if it is pursuant to a court order.

There has been no time limit prescribed under the laws of UAE for the Guarantor to make payment post invocation of the Bank Guarantee. This is governed by the terms of the Bank Guarantee and the Guarantor will have to comply with the time limit provided in the Bank Guarantee for making payment. Therefore it is between the Guarantor, Beneficiary and the Principal Debtor to decide at the time of signing of the Bank Guarantee, the time limit to be provided to the Guarantor for making payments under the Bank Guarantee upon its invocation.

In exceptional cases, the court may levy a seizure on the Bank Guarantee amount with the Guarantor. Article 417 of the CTL lays down that an interim injunction over the Bank Guarantee amount is only possible when the Principal Debtor requests for an injunction on serious and exceptional grounds, in the opinion of the courts. The Dubai Commercial Court of Cassation held in Appeal No. 247/2007 that a court will not stop the bank from paying the money under the Bank Guarantee to the Beneficiary unless there are exceptional and compelling reasons to do so, the claim is fully ascertained and provided that there are no previous judgments in favour of the Principal Debtor against the Beneficiary based on the same documentation.

In the event the Guarantor fails to make payments under the Bank Guarantee in absence of a court order, it shall amount to a breach of the Bank Guarantee, permitting the Beneficiary to file proceedings against the Guarantor claiming the value of the Bank Guarantee and any other damages arising from such a breach. Since this is an independent obligation of the Guarantor, the Beneficiary is not required to file a claim against the Principal Debtor prior to filing a case against the Guarantor for breach of a Bank Guarantee.