

Guarantees as security in the UAE

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July – August 2013

Lenders often rely on guarantees provided by corporations and individuals for third party debts as a form of security. While both corporate and personal guarantees justifiably provide lenders with some comfort, they do not in themselves create a security interest and there are various aspects a cautious lender must be aware of in respect of such guarantees in the UAE.

UAE Civil Code

Guarantees generally fall under the purview of Federal Law No. 5 of 1985 as amended ('Civil Code'). Article 1057 of the Civil Code defines guarantees as a suretyship with 'the joining of the liability of a person called the surety (the guarantor) with the liability of the obligor (the principal debtor) in the performance of his obligations.'

Most importantly for lenders, the Civil Code in relation to guarantees provides that:

1. the obligation of a guarantor is incidental to the obligation of the principal debtor. Any discharge of the principal debtor's obligations may, therefore, result in the guarantee no longer being valid;
2. if the principal debtor becomes bankrupt, the creditor must prove its debt in the bankruptcy, failing which it will lose its right to claim against the guarantor to the extent of any sums which the creditor might have received had it proved such debt in the bankruptcy; and
3. upon discharge of the relevant debt, the creditor must deliver to the guarantor all necessary papers to enable the guarantor to exercise its right of recourse against the principal debtor.

It is important to note that unless a guarantee is backed by security, a lender's claim on the guarantor will be unsecured. This could subordinate the lender's claim to other lenders who have obtained security from the guarantor in the form of a mortgage or a pledge over the assets of the guarantor.

Limitation Period Applicable to Guarantees

Lenders must be aware of the different limitation periods in respect of guarantees. Article 1092 of the Civil Code provides that 'If a debt is due, the creditor should claim the debt within six months from the date on which it fell due, and otherwise the guarantor shall be deemed to have been discharged.' There have been different interpretations of Article 1092 of the Civil Code and its application. The Supreme Court in Abu Dhabi has interpreted Article 1092 to apply to guarantees with respect to civil transactions only and has found that the time bar does not apply to guarantees in commercial transactions, particularly where the beneficiaries are banks and financial institutions. In such cases, the Supreme Court has held that the applicable time bar is ten years. By contrast, in Dubai, the Court of Cassation considers a guarantee a civil obligation and has ruled that Article 1092 applies to all guarantees and a claim against a guarantor must be initiated within six months from the due date of payment.

All Monies Guarantee

The distinction between specific guarantees and all monies guarantees is an important one. Under an all monies guarantee, a guarantor guarantees any and all obligations from the principal debtor to

the lender, whether existing at the time of the guarantee or arising in the future. Lenders should be aware that guarantees for 'all monies' may face issues upon enforcement in the UAE, with Article 1061 of the Civil Code requiring that guarantees must be issued with respect to a specified debt or a thing certain in amount. While there have been judgments in the recent past where the UAE Courts have recognised and enforced all monies guarantees, the application of such judgments is limited.

Due Diligence of Guarantor's Assets

All lenders must undertake the necessary due diligence prior to the execution of a guarantee in respect of the nature of the guarantor's assets. In terms of enforcement, it is important to note that UAE law does not recognize the concept of 'self help remedies'. As such, guarantees in the UAE must be enforced through a process led by the UAE courts. The lender will require an attachment order, either prior to commencing substantive legal proceedings or once a final judgment has been obtained, in order to recover the monies due under the guarantee. In order to increase the expediency of the attachment process, lenders should conduct the necessary due diligence and obtain all details of the unencumbered assets of the guarantors, including but not limited to funds in bank accounts, real estate properties, immovable properties, vehicles, shares/stocks etc. The advantage of identifying the assets is that it would assist the court in an expedient issuance of the attachment order and such order will prevent the sale of such assets pending the final judgment (noting public searches are difficult in the UAE).

If a lender is unable to acquire the relevant details in respect of the guarantor's assets, the attachment process can be drawn out until the court can ascertain the extent of the guarantor's assets. While the final result is the same, ie the ring-fencing of the guarantor's assets in favour of the lender, the process is more cumbersome and time-consuming when the guarantor's assets are not identifiable.

Furthermore, the location and value of the guarantor's assets should play a key role in choice of governing law of the guarantee. It would be of little value to obtain a UAE law guarantee from an individual or legal entity whose assets are located in a foreign jurisdiction where UAE law may not be recognized or there is no reciprocity on enforcement of judgment with that jurisdiction.

Additionally, lenders must be prepared to undertake periodic monitoring of the guarantor's assets as the provision of a guarantee does not prevent a guarantor from transferring ownership of their assets or disposing of their assets in entirety.

Personal Guarantors

Lenders should be aware that claims against a personal guarantor will need to be brought against the personal guarantor's estate in the event that the personal guarantor passes away. The general legal position relating to probate and inheritance is covered by the UAE Federal Law No. 28 of 2005 concerning personal affairs ('Personal Affairs Law') which governs how the estate of a UAE resident or national will be managed upon the death of the individual.

Under the Personal Affairs Law, the Shariah Court in the relevant Emirate would have jurisdiction to review any application for a declaration declaring the death of and naming the survivors of the deceased ('Death Declaration') in respect of the guarantor and to conduct any proceedings relating to succession. Once the Death Declaration is obtained, any of the potential heirs may apply to the Shariah Court to institute succession proceedings, which will only be necessary if the deceased has assets in the UAE.

Under Article 275 of the Personal Affairs Law the creditors of the deceased would have priority over any other distribution except for any burial expenses. Once the lender is aware of the Death Declaration and the distribution of assets it must immediately file proceedings against the estate

and the heirs as the case may be to exercise its rights under Article 275 in its capacity as creditor.

Enforcement of Guarantees

Lenders must be aware of the overall enforcement process with respect to guarantees and the time required for a final judgment. A lender seeking to enforce a guarantee is required to have first notified the guarantor of the default of the primary obligor by serving a legal notice in accordance with the terms and conditions of the guarantee. A lender can either file for attachment first and later commence substantive legal proceedings or commence substantive legal proceedings immediately.

The next step is for the lender to file substantive legal proceedings at the Court of First Instance against the guarantor claiming the outstanding amount under the guarantee (within eight days from the date on which the assets of the guarantor are attached, if applicable). Substantive legal proceedings usually last between 8 to 10 months if no defences are raised by the guarantor. If the guarantor raises any defences, the Court may appoint a financial expert (usually a chartered accountant) to determine the financial issues arising out of such substantive proceedings. In such cases, proceedings may last for as long as two years.

Once the final judgment is obtained by the lender the case will be transferred to the Execution Court for the liquidation of the guarantor's assets and any funds realized from such liquidation of assets will be paid to the lender to the extent of the liability under the guarantee. Any surplus would revert back to the guarantor.

Conclusion

While there are various factors for lenders to consider before relying on a guarantee as a form of security, guarantees should not be dismissed altogether. A prudent lender should consult with legal counsel on the efficacy and suitability of any security package to avoid unpleasant surprises.