

The effect of using Real Estate as security in Kuwait

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Local entities are in continuous need to expand their business and engage in new projects in order to keep pace with an ever growing competitive market. Naturally, these expansions and considerable growth are accompanied with a number of legal issues that may turn into legal disputes.

One of the main reasons for disputes is a default of payment and the subsequent rescheduling of the debt. Lending banks regularly come across an important question when entering into a rescheduling agreement with their borrowers – does a promise to give security over real estate assets give rise to any property rights over those assets in favor of the secured party?

Under Kuwaiti law a promise to give security over assets is considered a ‘promise to enter into a contract’. Under the Kuwait Civil Law, “a promise to enter into a contract” is an agreement between two or more parties according to which one party promises to execute a specific contract in favor of the other party (‘a Promise Agreement’).

The Kuwait Civil Law provides for specific formal requirements for the conclusion of a Promise Agreement:

1. There must be consent (consent of both parties to enter into the underlying contract);
2. The obligation created by the underlying contract must be valid, applicable and possible; and
3. The cause must be legal.

As long as the formal requirements mentioned above have been met and satisfied with respect to the Promise Agreement, the promise will be considered as a contractual obligation. As such, any failure by the promising party with respect to the execution of the agreed upon contract is considered as a breach of a contractual obligation, entitling the counter party to claim for compensation for any damages and losses sustained as a result of the breach.

In this respect, a lender may be in a position to claim for damages arising out of the borrower’s failure to execute a pledge or mortgage on the asset. Nevertheless, a claimant must effectively prove the losses and damages sustained in order to be entitled for compensation.

In such cases, a lender may be in a position to file either of the following lawsuits before Kuwaiti Courts:

1. A claim requesting the court to execute a mortgage on specific assets of the borrower (if the Promise Agreement specified the properties to be mortgaged in favor of lender);
2. A claim requesting the court to execute a mortgage on any of the borrower’s assets (if the Promise Agreement did not specify which of the properties was to be mortgaged in favor of the lender); and
3. A claim requesting the court to oblige the borrower to pay an amount equivalent to the asset’s value plus compensation (if an asset was specifically determined).

Generally it can be said that in the event the court establishes that specific performance (i.e. the execution or perfection of a mortgage) by the defendant is practically impossible for any reason, the court will likely consider an equivalent payment plus compensation. The compensation under Kuwait Law is calculated

according to the damages suffered and loss of profits.

Finally, the statute of limitations to file a lawsuit for any breach of contract, under Kuwait Law and with respect to a Promise Agreement, is 15 years.

In the future, we will discuss how a Promise Agreement may vary on a case by case basis.