

## **RECONSTRUCTION OF KUWAIT:**

### **EMERGING LEGAL ISSUES**

**by**

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**and**

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Multinational companies have begun asking about proposed or actual changes in Kuwaiti laws to facilitate doing business there.

The most difficult problem in providing advice on Kuwaiti commercial law in the aftermath of the Gulf War is that the political situation has not fully stabilized (in Kuwait, the Gulf or the Middle East), and significant and sudden changes are possible. On March 20, for example, the entire Kuwaiti cabinet resigned. As this article is written, it is not possible to assess what specific impact this change will have on commercial laws and doing business in Kuwait.

Our preliminary thoughts on developing legal issues, discussed below, are based on an analysis of Kuwaiti legal issues emerging before, as well as after, the war. The areas involved are:

- tender rules,
- decennial liability,
- contracting,
- contractual joint ventures,
- commercial companies,
- the U.S.-Kuwaiti Agreement on Investment Guaranties,
- military sales,
- commercial agency and distributorship,
- the Arab boycott, and
- dispute resolution.

The issues in these areas will continue to develop as reconstruction proceeds, and changes in law and practice may be expected. A recent National Bank of Kuwait brochure on post-liberation recovery and reconstruction commented that "we expect that [the Kuwait legal and regulatory rules] will remain broadly unchanged after liberation." We make the same assumption in our discussion below. However, martial law was imposed on Kuwait by Amiri decree on February 27, 1991, and it is expected to remain in force for at least three months. Recent newspaper reports suggest that it may be extended for many more months. Therefore, under the current emergency conditions, the Kuwaiti government may be expected to show flexibility on at least some otherwise applicable

regulations.

Kuwait is a modern civil law jurisdiction in which Islamic concepts are combined with those of continental legal systems (such as in France), as well as with trade custom and practice.<sup>1</sup> Thus, the Kuwaiti legal system is similar to the systems in a number of other Middle East countries (such as Egypt).

### **Tender Rules**

Kuwaiti government tender and bidding procedures are defined in a number of laws and regulations.<sup>2</sup> Before the Gulf crisis, the Central Tender Committee (CTC) was responsible for evaluating and awarding most significant Kuwaiti government tenders, and detailed rules exist for, among other things, prequalification registration, bidding procedures, bond requirements, and award of tenders.

In many of the recent contracts for Kuwaiti reconstruction, Kuwaiti government tender rules have not been strictly followed. This failure to follow the rules cannot be considered significant for contracts awarded by the U.S. Army Corps of Engineers under the initial emergency reconstruction program, but it is more noteworthy for contracts negotiated by the Kuwaiti government.

Foreign companies interested in reconstruction business opportunities should closely follow the tender procedures adopted by the Kuwaiti government in the coming months and assess whether special tender customs or practices will develop.<sup>3</sup>

For example, we understand that some of the initial contracting work for Kuwaiti reconstruction has been awarded on a cost-plus basis. Although cost-plus contracts are not unprecedented in Kuwait, fixed-price contracts were the general rule before the invasion. In the coming months, given the difficult working environment in Kuwait, the government may be more inclined toward cost-plus contracts.

Other tender rules may be reevaluated, including the requirement that a foreign company have a Kuwaiti agent in order to submit bids,<sup>4</sup> and the requirement, on occasion, that the foreign tenderer be aligned with a Kuwaiti party in a joint venture.

### **Decennial Liability**

Articles 689-697 of the Kuwaiti Civil Code (1980) contain comprehensive decennial liability provisions.<sup>5</sup> Under decennial

liability, contractors and architects<sup>6</sup> are responsible for total or partial collapse of buildings and other such construction works for 10 years after completion. Decennial liability applies not only to all types of office and residential buildings, but also to bridges, storage facilities, highways and other types of permanent works.<sup>7</sup> Obviously, the contracting for reconstruction and repair in Kuwait will involve many such buildings and construction works.

The decennial liability provisions in the Kuwaiti Civil Code are designed to give maximum protection to the owner/employer (for purposes of this summary, usually the Kuwaiti government). The Kuwaiti Civil Code also provides that any provision excluding or limiting the otherwise applicable decennial liability will be null and void. However, under Article 696 of the Civil Code, no action can be brought in Kuwait against the contractor or the architect after three years from the date of the collapse or the discovery of the defect.

Based on prior experience with similar provisions in the Egyptian Civil Code,<sup>8</sup> we know that U.S. and British contractors had great difficulty, and faced great expense, in obtaining decennial liability insurance. As a result, certain large construction projects in Egypt funded by U.S. and British government financial aid were eventually exempted from the decennial liability provisions of the Egyptian Civil Code. This exemption was made possible only by a tripartite agreement between Egypt, the U.S. and Britain.<sup>9</sup>

### **Contracting**

The decennial liability provisions of the Kuwaiti Civil Code are contained in a general section regarding "contracting" (aqd al-muqaawala). This general section of the Code is similar to sections in other Middle East civil codes (such as the Egyptian and Iraqi codes), but it appears more elaborate and detailed.<sup>10</sup>

We expect this Kuwaiti Civil Code section on contracting will become increasingly important for reconstruction work in the coming months. Among its provisions, the section discusses the supply of work materials, warranties, defects, deadlines for performance, subcontracting, payment, force majeure<sup>11</sup> and termination of the contract.

### **Contractual Joint Ventures**

We have noticed that a number of companies are approaching Kuwaiti reconstruction projects through contractual joint ventures

or consortia. The Kuwaiti Commercial Companies Law (Articles 56-62) recognizes the concept of a contractual joint venture: it is considered as a partnership between two or more parties, which has no independent legal personality, and which binds only the parties concerned. (Incidentally, somewhat similar provisions regarding joint ventures are found in Articles 40-47 of the Saudi Arabian Companies Law and Articles 59-64 of the Egyptian Commercial Code.)

Unlike Kuwaiti companies with independent legal personality, a contractual joint venture does not have to be approved by the Ministry of Commerce and Industry and is not registrable in the Commercial Register.

Under Articles 57 and 59 of the Commercial Companies Law, the joint venture partners can agree on, among other things, the capital, management, distribution of profit and loss, accounting procedures and liquidation of assets. Kuwaiti law does not explicitly require any minimum percentage of local ownership for unincorporated joint ventures. In practice, we have encountered joint ventures with majority Kuwaiti ownership and others with majority foreign ownership.<sup>12</sup>

The joint venture agreement should also specify the partner(s) authorized to represent the joint venture before third parties. For example, the agreement might specifically nominate the "lead" venturer and state that in dealings with third parties, the joint venture expresses itself only through the lead venturer. (If a non-Kuwaiti party in a joint venture undertakes business transactions with a third party, however, the non-Kuwaiti is required to have a Kuwaiti "sponsor" in those transactions.)<sup>13</sup>

The Kuwaiti government customer should be informed that only the lead venturer is authorized to speak for the contractual joint venture and to make binding commitments for it. This latter aspect is particularly important because a third party may invoke the joint venture agreement and hold all joint venturers jointly and severally liable if they have dealt as a joint venture with that third party. We believe that many Kuwaiti government customers will insist that all joint venturers (or at least the lead venturer) remain fully liable to perform the main contract, despite the joint venturers' assignment of responsibilities among themselves.

### **Companies**

In general, only two vehicles are available to a foreign party planning to establish a company in Kuwait:

- a limited liability company, which is referred to in Kuwait as a company "with limited liability" (WLL company) and is similar to the limited liability company in Egypt and Saudi Arabia (and the French société anonyme à responsabilité limitée); and
- a "closed" joint stock company (similar to the continental société anonyme).

Under Kuwaiti law (for example, Article 23 of the Commercial Code), Kuwaiti equity cannot be less than 51 percent of the total share capital in either type of company.<sup>14</sup>

Before the Gulf War, aspects of the Kuwaiti Commercial Companies Law came under criticism by some business people and lawyers. Some considered the closed joint stock company a slightly cumbersome vehicle for closely-held business involving foreign participation.

The WLL company, unfortunately, posed even potentially greater difficulties. All partners in a WLL company must be natural persons; that is, corporate entities may not be partners in a WLL company. (We understand that a similar situation existed in Egypt until the Egyptian company law was amended in 1977).

To avoid this restriction, an arrangement was developed whereby foreign corporate partners held their interest in the WLL company through individual "trustees," either Kuwaitis or non-Kuwaitis. The government appeared to recognize that there was a practical need for this device until the Commercial Companies Law could be amended. (This amendment apparently was still in draft form when Iraq invaded last August.) However, the trustee arrangement has come under attack by government authorities when it is used to evade Kuwaiti income taxes (only companies, and not individuals, are subject to Kuwaiti income tax.) We believe it could also be attacked if it is used to evade the requirement that WLL companies be majority owned by Kuwaitis (for example, if a foreign company uses a Kuwaiti trustee to hold a majority interest).

We expect the Commercial Companies Law will eventually be amended to allow corporate entities to be partners in WLL companies. The timing of the amendment, however, will probably depend on how speedily the government resolves other higher-priority legal issues.

### **U.S.-Kuwait Protection of Investment Treaty**

The United States and Kuwait signed an Agreement on Investment Guaranties on April 24, 1989. Under the agreement, insurance coverage provided by the U.S. Overseas Private Investment Corporation (OPIC) is available for certain commercial activities by U.S. parties. For example, OPIC offers a program designed to assist small business contractors who have difficulty getting financial institutions to issue performance or advance payment guaranties (letters of credit) for projects in Kuwait.

Recently, OPIC reemphasized that its contractors and exporters political risk program is available for Kuwait. Under the program:

OPIC insures against wrongful callings of bid, performance or advance payment guaranties and other guaranties, usually issued in the form of bank standby letters of credit. OPIC also provides suppliers of goods and services with political risk protection against loss of or damage to physical assets, as well as protection against unresolved contractual disputes with the foreign buyer.

We understand that OPIC's coverage was rarely used for Kuwait work in the past two years (apparently only one U.S. investor, involved in a construction management project, used it). The OPIC treaty will probably become increasingly significant, however, given the anticipated amount of U.S. goods and services needed for Kuwait's reconstruction.

### **Military Sales**

Although Kuwaiti law generally requires foreign companies to have a local agent (or partner) in order to bid on government contracts, such agents have been prohibited in Ministry of Defense (MOD) procurements of military equipment.<sup>15</sup> In these procurements, foreign companies have been able to bid, negotiate and contract directly with the MOD. The MOD has acted as the foreign company's "sponsor" for the local government liaison needed, for example, for entry visas and import licenses. If the foreign company was required to formalize its local operations by setting up a branch office, the MOD would stand in place of the agent usually required for establishing a branch, or it would permit the foreign company to operate locally under the MOD umbrella.

Recent comments by high-level U.S. government officials suggest that large military sales to many of the Arab coalition countries, including Kuwait, can be expected in the near future.<sup>16</sup>

However, we would be surprised if the MOD changes its rules regarding agents. We do not expect that the Kuwaiti government will encourage greater local private-sector involvement in military transactions, either through an agency requirement or preferences for "mixed," Kuwaiti-foreign joint ventures. This view is based on the policies underlying the MOD rules, which were an attempt to avoid undue influence or intermediation and the added cost of middleman fees, but were also motivated by considerations of confidentiality for defense requirements and purchases.

### **Commercial Agency/Distributorship**

Kuwait is one of the Middle East countries that have enacted special legislation governing the qualifications, registration and operation of commercial agents and distributors.<sup>17</sup> For example:

- Commercial agency and distributorship activities are reserved to Kuwaiti nationals (or local companies majority-owned by nationals).
- Kuwaiti law requires commercial agency and distributorship agreements to be registered with the Ministry of Commerce.
- Finally, Kuwaiti law also includes special protection for the local commercial agent/distributor in the event the foreign principal decides to terminate or not to renew the relationship.<sup>18</sup>

We do not expect the Kuwaiti laws applicable to commercial agencies and distributorship to change significantly in the aftermath of the Gulf War. If any changes are made, it would probably be to increase the protections for commercial agents/distributors.

Currently, it is possible for a foreign principal to appoint a nonexclusive distributor for Kuwait. The termination or nonrenewal of nonexclusive distributors is governed by the agreement of the parties and general Kuwaiti contract law, rather than by the special protective legislation. The government may decide that all new distributor agreements must be exclusive.<sup>19</sup>

The Ministry of Commerce may also decide to give closer scrutiny to the commercial agency and distributorship agreements submitted for registration and refuse to register those containing provisions deemed contrary to Kuwaiti law or unfair to the Kuwaiti party.

## Arab Boycott

Kuwait enacted a law on the Arab Boycott of Israel in 1964 (Law No. 21 of 1964), and it has not always been as flexible as some other Middle East countries in dealing with constraints imposed upon companies subject to U.S. antiboycott legislation.<sup>20</sup> Nonetheless, although Kuwait has been considered one of the most "hard-line" of the Gulf states in prosecuting the boycott, the government has been sensitive to the potential and actual difficulties the boycott poses for U.S. persons, and it has sometimes been willing to make compromises.<sup>21</sup>

In the aftermath of the Gulf War, high-level U.S. government officials have been pressing the Gulf states to take "confidence-building measures" as a beginning toward settling the Arab-Israeli conflict. These measures include steps to end, or at least soften, the Arab Boycott of Israel.<sup>22</sup>

Unrelated to these U.S. initiatives, the Kuwaiti government may be reexamining its approach to the boycott. In an interview published approximately a year ago, the director general of the Kuwaiti Boycott Office suggested a significant overhaul of boycott rules and procedures.<sup>23</sup> While the proposed overhaul would be designed to make the boycott more efficient (and therefore perhaps stricter), the director general also suggested that fewer boycott-related questions be asked of foreign companies. (Submitting boycott-related questions to a U.S. company often puts it squarely between the conflicting requirements of Arab boycott and U.S. antiboycott law, starting a process that eventually leads to blacklisting of the U.S. company.)

Last summer, U.S. embassy officials in Kuwait reported an easing of boycott language in letters of credit, which made related documents more compatible with U.S. antiboycott regulations<sup>24</sup> -- another indication that Kuwaiti practice may have been becoming more flexible before the war.

## Disputes

Under Kuwaiti law, contractual parties generally are permitted to agree to foreign governing law and foreign arbitration to resolve disputes. In addition, Kuwait is a party to the New York Convention on Recognition and Enforcement of Foreign Arbitral Awards.

Yet a Kuwaiti Council of Ministers decision dated March 13, 1988 (issued in its session No. 14/88) generally prohibits government ministries, public corporations and wholly government-

owned companies from agreeing to Kuwaiti or international arbitration and requires that their contracts provide for resolution of disputes by Kuwaiti courts and under Kuwaiti governing law. The decision provides for a narrow exception, allowing foreign arbitration upon review and approval by the Council of Ministers.

We would assume that the Kuwaiti government may be more flexible in its attitude toward foreign arbitration in the aftermath of the war, particularly while the Kuwaiti court system is being rebuilt. But we expect the Kuwaiti government generally to continue to insist on the application of Kuwaiti law in virtually all its contracts.

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April 1991

**FOOTNOTES**

1. See Civil Code, Art. 1:
  - (1) Legislative provisions govern those matters to which such provisions either explicitly or implicitly apply.
  - (2) In the absence of a legislative provision, the judge shall decide according to custom. In the absence of custom, the judge shall formulate his opinion guided by the rules of Islamic jurisprudence most in accord with the situation and interests of the country.
2. The primary Kuwaiti law governing public tenders is Law No. 37 of 1964, as amended.
3. Fawzi al-Sultan, former coordinator of the Kuwait Emergency and Recovery Program, seemed to confirm this when he referred to  

procurement guidelines and procedures outside the scope of the prevailing procurement regulating procedures, but in accordance with a new emiri decree or order establishing special procurement regulations to be followed in respect of the Emergency Relief Program. . . .

Testimony to the Committee on Small Business, U.S. House of Representatives, March 11, 1991.
4. Article 5 of Law No. 37 of 1964.
5. The provision for decennial liability is found not only in the Kuwaiti Civil Code, but in many other Middle East civil codes: for example, Articles 651-653 of the Egyptian Civil Code and Articles 870-872 of the Iraqi Civil Code. Decennial liability apparently originates in French law (for example, Articles 1792 and 2270 of the Napoleonic Civil Code of 1804).
6. The Kuwaiti Civil Code refers to al-muhandis, which literally would mean "the engineer." The Egyptian and Iraqi civil codes are somewhat less ambiguous (or more narrowly

drafted), using the term al-muhandis al-mímaari as "the architect." Compare Jalili, "Decennial Liability In Some Arab States," Middle East Executive Reports (MEER) (October 1982), at p. 17: "[A]ll 'engineers' are responsible within the limits of their duties. The [Kuwaiti Civil] Code covers not only architectural engineers but also structural, civil, mechanical and electrical engineers."

7. Id. See also Edge, "The Development of Decennial Liability in Egypt," at p. 165, in Heer (ed.), Islamic Law and Jurisprudence (1960).
8. A number of English language sources discuss Egyptian decennial liability. For example, Davies, Business Law in Egypt (Kluwer, 1984), pp. 213-221; Attia, "Decennial Liability Under Egyptian Law," Arab Law Quarterly November 1986), pp. 504-524.
9. See MEER (January 1980), Texts Section B, for the text of the tripartite agreement.
10. For a brief description of these provisions, see Kassim, "The New Civil Code of Kuwait: The Contracting Dimension," MEER (February 1982), p.2.
11. Another important emerging Kuwaiti issue may be the force majeure and unexpected circumstances claims postponed since the invasion of Kuwait last August, Stovall, "Force Majeure and Companies Caught Mid-Stream in Contracts in Kuwait," MEER September 1990), p. 8. Compare Xefos and Sayen, "Force Majeure and the War," MEER (March 1991), p. 9.
12. Informal opinions from local lawyers differ as to the permissibility of a contractual joint venture with majority foreign ownership. As a matter of custom and practice, such joint ventures are not unusual, and Kuwaiti law does not explicitly prohibit them. However, majority Kuwaiti ownership is required in the formation of any Kuwaiti company. "The same rule of 51-49 percent equity should apply to de facto companies [contractual joint ventures], even though in one authoritative opinion, this ratio could be ignored." Kassim, "A Guide to [Kuwaiti] Joint Venture Law," MEER (March 1985), p. 16.

13. We use the term "sponsor" for the Arabic al-kafil. Local sponsorship is required in a number of different contexts in the Middle East, including for a foreign individual's entry visa and a foreign company's branch office. In regard to the latter, it was recently held in a Bahraini court case and a Dubai court case that a local sponsor was not financially liable for the actions of the sponsored person. See, respectively, International Business Lawyer (March 1989), p. 97; and MEER (July 1989), pp. 6-7.
  
14. In case no. 4-116/1987 (Commercial), by an appellate decision issued on March 14, 1988, the Second Circuit of the Kuwaiti Commercial Cassation Court decided that this requirement was a matter of "public order." Accordingly, any agreement to set aside or circumvent such requirement, and any activity, transaction or operation breaching the requirement, will be deemed null and void. (Although not relevant for our present discussion, Law Decree No. 45 (1989) amended certain provisions of the Commercial Code in response to this decision.)
  
15. "Military equipment" is defined in an amiri decree dated October 11, 1964, and includes all kinds of armaments, ammunition, boats, aircraft, telecommunications equipment, radar equipment, mobile hospital units, and other military articles.  
  
Ministry Circular No. 4A/88, dated June 8, 1972, provides that contracts for arms, ammunition and spare parts should be concluded between the MOD and its suppliers directly, without the intervention of any agent or intermediary. Although the Circular is expressly addressed only to arms, ammunition and spare parts, in practice the prohibition on agents and intermediaries in connection with MOD procurement has been extended to procurement of other equipment by the MOD (and the Security Forces), unless a specific directive provided otherwise. Normally the MOD requires assurances from the supplier either in the relevant government contract or by contractual supplement and/or affidavit.
  
16. See e.g., "Mideast Arms Outlays Seem Unlikely to Face Any Tough New Curbs," Wall Street Journal (March 4, 1991), p. 1; "Good-Will Goals Stressed," New York Times (March 8, 1992), p. 1.

17. Kuwaiti Law No. 36 of 1964, "Regulating Commercial Agencies"; and Chapter Five of the Commercial Code (1980), Articles 260-305, concerning "Commercial Agency and Commercial Representatives."
18. See, e.g., Stovall, "Distributor Termination: Guide for Preliminary Risk Analysis," MEER (January 1988), p. 9.
19. Of course, the Kuwaiti government might decide that nonexclusive distributorships encourage wider private sector participation, and that "monopoly" distributors do not serve the best interests of reconstruction. Compare Article 15 of Lebanese Law Decree 73 of September 1983, which sought to open the import market during difficult economic times by allowing enforcement of distributor exclusivity only for "luxury" goods.

Under Article 286 of the Kuwaiti Commercial Code, only exclusive distributorships benefit from the protections granted commercial agents under Articles 281 and 282 of the Code relating to termination and nonrenewal.

20. The United States has established two separate programs of antiboycott regulation relevant to the Arab boycott of Israel. Section 999 of the Internal Revenue Code provides for the imposition of income tax penalties on United States taxpayers that agree, as a condition of doing business with or in an Arab country, or with a national of an Arab country, to participate in or cooperate with that boycott. Export Administration Act regulations prohibit United States persons and firms from taking or agreeing to take certain specified boycott-related actions in connection with any transaction in U.S. commerce, with intent to comply with or support that boycott.
21. We have reviewed a prepublication copy of a Boycott Law Bulletin article, analyzing the long-overdue Department of Treasury report on boycott participation by U.S. taxpayers in 1986: "[W]hile Kuwait and Saudi Arabia generated the largest number of boycott participation requests in 1986, both countries were accommodating when it comes to insisting on U.S. corporate compliance with those requests."
22. "Good-Will Goals Stressed," New York Times (March 8, 1991), p. 1. (An op-ed column on p. A13 of that issue of the New

York Times was to the same effect.)

23. The interview, in the Kuwaiti press, was reported in "Kuwait's boycott boss calls for Sweeping changes in boycott," Boycott Law Bulletin (February 1990), p. 7.
24. "Boycott Language Softened," MEER (June 1990), pp. 4-5.