BUSINESS ORGANIZATION AND

CONTRACT LAW IN KUWAIT

by

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Until the recent Iraqi invasion and subsequent successful outcome of Operation Desert Storm, it would probably have been necessary to start this article with a geographical, economic, and political outline of Kuwait. The extensive media coverage, however, means that (for good or bad) most people now have at least a basic knowledge of the country, albeit in a war-ravaged state. Nevertheless, the following brief points should be noted.

Kuwait is a modern civil law jurisdiction which combines Islamic concepts with those of the Continental systems (such as France's), as well as trade custom and practice. Thus, the Kuwait legal system is similar to that in a number of the other Middle East countries, such as Egypt.

Martial law was imposed by Amiri decree on 27 February 1991 with the cessation of hostilities, and it is expected to remain in place for at least three months. The Kuwaiti government has established a Reconstruction Committee (KRC) to deal with the country's emergency needs during the martial law period.

It is estimated that today Kuwait has over $89 billion in foreign assets (which alone produce a substantial revenue) and has oil reserves for over 200 years.

POST-WAR NEEDS

At a conference in London on 18 March 1991, the Kuwaiti Ambassador to London, Mr. Gasi M.A. Al-Rayes, explained that with the cessation of hostilities Kuwait needs "everything", but that tenderers and suppliers will have to compete on price, quality and time in order to secure work. Mr. Al-Rayes forecast that the rebuilding process will take between five and ten years.

The actual scope and cost of Kuwait's needs are far from clear. Fortunately, the Kuwaitis' fears of a "zero-option" have not been realized, and so the cost of rebuilding is not likely to reach the US$500 billion figure that had been mooted. In any event, it will nevertheless be substantial.

As can be expected in the aftermath of war, the present political situation in Kuwait is uncertain. On 20 March 1991, the entire Kuwaiti Cabinet resigned, and at the time of writing it is not possible to assess what impact this will have on commercial laws and the conduct of business. So far, most of the institutions, authorities and procedures that previously applied to doing business in Kuwait have not been re-established; when and if they are still remains to be seen. For the purposes of this article, we have assumed they will be.

As at the time of writing, the Kuwaiti borders are closed for general purposes, even to Kuwaitis who have been living overseas. As a result, anyone wishing to enter Kuwait must seek prior permission from the Kuwaiti government. We believe that employees of entities with contracts to carry out work in Kuwait will have no problem in getting permission to enter, but anyone seeking to enter without a contract or other existing business interests may find it more difficult.

Under current emergency circumstances, the Kuwaiti government may be more flexible as regards constraints on Saudi Arabian and other Gulf Co-Operation Council (GCC) nationals entering Kuwait, because of regulations granting certain reciprocal rights to such nationals.

Any foreigner must obtain a visa and entry permit before entering Kuwait. (This usually requires a Kuwaiti "sponsor".) After arrival in Kuwait, an employee must also obtain a residence permit through its employer, and the application must be accompanied by a certificate of good conduct.

FORMS OF BUSINESS ORGANIZATION

1. Branch Offices

The Kuwaiti Commercial Code provides that a foreign company may only establish a branch or carry on trading activities in Kuwait through a Kuwaiti agent. The Kuwaiti agent may be an individual or a company, but must be properly qualified and registered to act in such capacity, for example, in the Commercial Register. In theory, a foreign company must establish its Kuwaiti branch by registering the Agency Agreement together with other necessary documents with the Ministry of Commerce.

However, in practice, these formalities are not always followed, and it is not unusual for the branch's business transactions conducted in Kuwait to be in the name of the Kuwaiti agent and the agent to be responsible for all branch employees. The agent takes actions on behalf of the foreign company, and the agent and foreign company are obligated to each other under agency law concepts.

Although it is expected that a foreign company might continue to need a Kuwait agent in order to bid on government tenders, it is not clear whether the Kuwaiti government might allow foreign companies to establish their own branch offices to perform contracts in Kuwait without a sponsor, at least during the initial emergency reconstruction work.

2. **Contractual Joint Venture**

The Kuwaiti Commercial Companies Law recognizes the concept of a contractual joint venture, which is considered to be a partnership between two or more parties, which has no independent legal personality, and which binds only the parties concerned. A contractual joint venture does not need to be approved by the Ministry of Commerce and Industry, and is not registrable in the Commercial Register. The law allows the joint venture partners to agree on the capital, management, distribution of profit and loss, accounting procedures, and liquidation of assets.

The Joint Venture Agreement must specify the authorized partners who are to represent the joint venture before third parties. If a non-Kuwaiti party in a joint venture undertakes business transactions with a third party, the non-Kuwaiti party is required to have a Kuwaiti sponsor (like the agent mentioned above) for those transactions. The Kuwaiti government customer must be informed that only the specified partner or partners are authorized to speak for and make binding commitments for the contractual joint venture. This is of particular importance, because a third party may invoke the Joint Venture Agreement, and hold all joint venturers as jointly and severally liable, if the latter have dealt as a joint venture with that third party.

3. **Companies**

In general, there are only two vehicles available for a foreign party contemplating the establishment of a company in Kuwait. These are a limited liability company and a closed joint stock company (which is similar to the continental *société anonyme*).

Kuwaiti law requires that Kuwaiti equity must be not less than 51% of the total share capital in either type of company. We understand that a closed joint stock company has been considered in the past to be a slightly cumbersome vehicle for closely held business involving foreign participation. Unfortunately, the limited liability company causes potentially greater difficulties.

All partners in a limited liability company must be natural persons - i.e., can include no corporate entities as partners. To avoid the restrictions of this rule, an arrangement was developed whereby foreign corporate partners hold their interest in the company through an individual trustee. The Kuwaiti government appears to recognize the practical need for this device, at least until the government eventually amends the Commercial Companies Law to allow corporate entities as partners in such companies. However, the timing of such amendment will depend on the speed with which the Kuwaiti government resolves other legal issues of greater priority.

4. **Commercial Agents**

Kuwait has special legislation governing the qualification, registration, operation and termination of commercial agents and distributors.

TENDER RULES AND CONTRACTS

Kuwaiti government tender procedures are defined in a number of laws and regulations. Before the Gulf Crisis, the Central Tender Committee was responsible for adjudicating most significant Kuwaiti government tenders, and detailed rules existed for, *inter alia*, pre-qualification registration bidding procedures, bond requirements, and rules for the award of tenders.

Many of the recent contracts for Kuwaiti reconstruction have apparently not followed Kuwaiti government tender rules. Although this would not be considered unusual for contracts awarded by the US Army Corps of Engineers under the initial emergency reconstruction program, it is more significant in contracts negotiated by the KRC. At this stage, it is not possible to assess whether special tender rules will develop. This is an area which will be monitored closely in the coming months.

There are other tender requirements which may be re-evaluated by the Kuwaiti authorities in the present circumstances. These could include the requirement that a foreign company have a Kuwaiti agent in order to submit tenders, and the requirement on occasion that foreign tenderers be aligned in a joint venture with a Kuwaiti party.

While it appears that some of the initial contracting work has been let on a "cost plus" basis, prior to the hostilities the usual practice was to have fixed price contracts. We suspect that the

Kuwaiti government will reimpose fixed price contracts just as soon as it can.

We understand that a 1979 decision applied the Tender Regulations to the Kuwait Oil Company, the Kuwait Petroleum Company, and the petrochemical industry. However, the Minister of Petroleum has power to grant exemptions in case of emergency or necessity; and this power could be used in the present circumstances.

Although Kuwaiti law has generally required a foreign company to have a local agent (or partner) for bidding on government contracts, local agents have been prohibited in Kuwaiti Ministry of Defense (MOD) procurement of military equipment. In MOD procurement, foreign companies have been able to bid, negotiate and contract directly with the MOD itself. With the forecast increase in military sales, these special MOD procurement rules will be important.

As far as contracts are concerned, the Kuwaiti Civil Code (1980) contains very comprehensive decennial liability provisions which impose responsibility on architects, engineers, contractors and the like for total or partial collapses of buildings. Some consultants and contractors have had difficulty insuring this obligation in the past.

The decennial liability provisions of the Kuwaiti Civil Code are contained in a detailed section on "contracting", which also discusses warranties, defects, deadlines for performance, subcontracting, *force majeure,* and termination of contracts.

Kuwait has two sets of "standard" general conditions, one for local tenders and another for international. The international set is based on FIDIC 2nd Edition, with substantial amendments to give the Kuwaitis extra protection - i.e., bid bonds (2%), performance bonds (5-10%), penalties and the like. All bonds, letters of credit and the like normally must be issued through a local Kuwaiti bank, now likely to be the National Bank of Kuwait, the least financially damaged of the local banks.

There is hope that less onerous forms of contract might be acceptable to the Kuwaitis, and that it might be possible to introduce other structures and concepts. No final settlement may be made with any contractors, sub-contractors or others until a Tax Clearance Certificate from the Ministry of Finance is presented to prove that all tax liabilities have been settled. This process can take a considerable amount of time.

TAXES AND DUTIES

Decree Number 3 of 1955 (the Tax Law) created an income tax in Kuwait which, until 1977, was not actively enforced. Since 1977, however, the Kuwaiti income tax department has been applying the Tax Law in respect of non-Kuwaiti companies. Income tax is levied on corporate entities only and not on individuals. Likewise, a Kuwaiti partnership is subject to income tax, as is regarded as a separate legal entity under the Kuwaiti Commercial Companies Law.

Article 1 of the Tax Law imposes tax on "every body corporate wheresoever incorporated carrying on trade or business in Kuwait..." Although Kuwaiti companies fall within this definition, in practice the government does not tax them under this law. Kuwaiti companies are instead subject to *Zakat*, a religious tax.

Kuwaiti income tax is levied on the profits or capital gains of corporate entities only (whether they are incorporated in Kuwait or abroad), provided that they carry on a trade or business in Kuwait either directly or through agents, or carry on a trade or business in Kuwait as an agent of others. In each case, it is the foreign corporate entity that bears the tax. Foreign individuals are exempt.

By Ministerial Resolution 44 of 1985, entities doing business in Kuwait must submit, to the Ministry's Tax Department, a list of the names and addresses of all contractors, sub-contractors or others with whom the entities deal, together with a copy of the contract.

Kuwait has signed Double Taxation Treaties with France, Germany and Italy, as well as Canada and Cyprus. Kuwait has a Double Tax Treaty with the UK but this only relates to income derived from the operation of international aircraft.

The local currency is the Kuwaiti Dinar (KD), which is divided into units of 1000 *fils*. The KD was freely convertible and there were no general exchange control restrictions or regulations; however, it is still unclear as to what the post-war position of the KD will be. It has been reported that a new currency might be issued to replace it.

Customs regulations (Customs Law Number 13 of 1980), and Implementing Regulations of the Ministry of Communication No. 152 of 1980, require that the importer of goods into Kuwait must be a Kuwaiti national, or a Kuwaiti company at least 51% Kuwaiti owned. A flat *ad valorem* duty of 4% on a CIF basis is assessed on most imported goods.

With respect to products similar to those produced by Kuwaiti national industries, however, the duty may be increased, and some products may be banned from import. A "Certificate of Origin" is required in addition to the customary shipping documents.

EMPLOYMENT REGULATIONS

The employment laws for the private sector apply to all workers with a few exceptions (primarily in government employment).

Employment must first be offered to Kuwaitis, then to GCC nationals, and last to other nationals. The law itself, however, does not require a quota for Kuwaiti employees.

The law does not require written employment contracts but, if a written contract is concluded, it must be in Arabic and show the date of employment, salary, term, and nature of work. Contracts can be for a definite or indefinite period of time but, if for a definite period, shall not be greater than five years.

There is no minimum wage requirement under the law. There is an eight hour working day, six days a week, with an unpaid rest day on Friday. The working day is reduced in the holy month of Ramadan. There is a maximum of two hours overtime per day, and employees are entitled to an overtime supplement. There are certain specified paid public holidays each year.

Sick leave, sick pay, and annual leave apply to all workers. A Kuwaiti social insurance plan was developed pursuant to Law No. 61 of 1976.

There are provisions to pay employee severance pay upon expiration of the term of the employee's employment (or upon termination), computed by reference to whether the employee is paid weekly or monthly, and to years of service.

In certain cases, an employee's service may be terminated without severance pay or damages, for example, absence without leave, fraud, or disclosure of trade secrets. There is a one year statutory limit on all actions brought by an employee against an employer.

PATENTS AND TRADEMARKS

In the intellectual property field, patents and trademarks may be registered in Kuwait but licenses are not registrable.

ARAB BOYCOTT

Kuwait enacted a Boycott of Israel Law (Law No. 21 of 1964), and has not always shown the same flexibility as some other Middle Eastern Countries (such as Saudi Arabia) towards the constraints imposed on companies subject to US anti-boycott regulations.

DISPUTES

Under Kuwaiti law, contractual parties are generally 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.

Nonetheless, the Kuwaiti Council of Ministers issued a decision (in its session No. 14/88, dated 13 March 1988) generally prohibiting government ministries, public corporations, and wholly government-owned companies from agreeing to Kuwaiti or international arbitration. The same decision also required that such government contracts provide for resolution of disputes by Kuwaiti courts and under Kuwaiti governing law. This Council of Ministers' decision provides one narrow exception which allows foreign arbitration upon the review and approval of the Council of Ministers only.

It may be that the Kuwaiti government will be more flexible in the aftermath of the Gulf War in its attitude toward foreign arbitration or court proceedings, particularly while the Kuwaiti court system is rebuilt. However, we expect the Kuwaiti government will generally continue to insist on the application of Kuwaiti law in virtually all of its contracts.

CONCLUSION

By its general nature, this article summarizes a very broad and complex area of Kuwaiti law. Furthermore, the situation in Kuwait is presently uncertain and fluid. However, efforts are underway to identify practical procedures by which companies may tender for contracts effectively in this small but important country.

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April 1991