Legal issues relating to construction contracts in the United Arab Emirates

Celine Abi Habib Kanakri and Habib Al Mulla
Baker & McKenzie

INTRODUCTION

The construction industry in the United Arab Emirates (UAE) adopts and follows international best practices for construction contracts governed by UAE law or implemented in the UAE. These contracts are heavily modelled after International Federation of Consulting Engineer (Fédération Internationale Des Ingénieurs-Conseils)(FIDIC) forms of contracts.

However, domestic law considerations should not be ignored. It is true that in principle, UAE courts recognise FIDIC contracts. However, there are several UAE law principles that have a direct impact on the parties’ contractual terms and prevail over such terms in some cases.

As UAE is a civil law jurisdiction, UAE law principles are mainly codified in the Civil Transaction Law No. 5 of 1985, as amended by virtue of the Federal Law No. 1 of 1987 (Civil Code). More specifically, Articles 872 to 896 of the Civil Code contain several requirements applicable to construction contracts. Some of these provisions are imperative. This means that these provisions are default provisions and that parties must explicitly contract out of them. Other provisions are rules of public order. This means that parties cannot contract out of these rules when they seek enforcement in the UAE, even where a foreign law is applicable to their contract and/or a foreign court or arbitration tribunal is competent to rule on a dispute arising from such contract.

Therefore, opting for the application of a foreign law to a construction contract or for the submission of disputes to a foreign court or to an arbitration tribunal does not make the construction contract immune from being subject to certain rules of UAE law.

Understanding the legal framework applicable to construction contracts in the UAE requires shedding light on what the parties can and cannot agree in their contract. To this end, this article outlines:

- The extent to which a foreign law governs a construction contract performed in the UAE.
- The choice of dispute resolution mechanisms in construction contracts.
- The possibility of enforcing foreign judgments and arbitral awards relating to construction contracts.
- Key concepts of UAE construction laws that can assist employers, engineers, contractors and subcontractors in setting out their respective rights and obligations, at the stages of negotiation, implementation or dispute resolution.
- Practical steps parties should take before entering into a construction contract.

CHOICE OF FOREIGN LAW

The UAE, and in particular Dubai, has emerged as one of the leading regional commercial hubs, attracting foreign investors from all over the world. Therefore, it is understandable that parties to a contract based in the UAE commonly elect a foreign law as the law applicable to their contractual relationship, even where contracts are executed or performed in the UAE. However, it is crucial to understand the consequences of choosing a foreign law.

In principle, electing a foreign governing law is permissible in construction contracts (Article 19 (I), Civil Code), except for:

- Contracts relating to right in rem (that is, pertaining to property located in the UAE).
- Contracts entered into with a governmental or semi-governmental body of the UAE.

UAE law applies to procurement contracts with governmental and quasi-governmental entities, and parties cannot agree to a different choice of law. At the federal level, Ministerial Decision No. 20 of 2000 concerning the system of administrative contracts (Federal Procurement Law) and Cabinet Resolution No. 32 of 2014 set out requirements for contracts concluded with the UAE federal government, ministries and federal agencies.

At the local level, Abu Dhabi, Dubai and Sharjah have enacted stand-alone procurement laws applicable to tenders issued by local public authorities. Generally, local procurement laws are substantially similar to the Federal Procurement Law, although some matters may be addressed differently in each jurisdiction.

In addition, certain specific laws apply to the procurement and tendering activities of certain public authorities. For example, Dubai Procurement Law does not recognise FIDIC contracts, and imposes its own laws and regulations. Most public authorities have a set of standard procurement contracts and documentation for the provision of contracting work, services and supplies, among others.

Before opting for a foreign governing law, parties must avoid some legal pitfalls and consider certain matters.

If the party that invokes a contractual choice of foreign law before a UAE court fails to prove it and to determine its effects, UAE law will apply regardless of the parties’ agreement. In practice, UAE courts have held in several instances that UAE law will apply instead of a choice of foreign law clause where the parties either fail to present satisfactory and tangible evidence as to the existence of the contractually agreed foreign law, or fail to determine its effects.

This issue does not arise if the dispute is referred to international arbitration, as local courts looking at enforcing the international award in the UAE will most likely apply the Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (New York Convention), which only provides for very limited grounds for refusing the enforcement of an international arbitral award (for example, where the foreign award violates a rule of public order in the country in which enforcement is sought).

In addition, a contractual choice of foreign law only applies to the extent that it does not contravene Islamic Sharia, or the public
order or morals of the UAE (Article 27, Civil Code) (this provision must be interpreted in accordance with the definitive provisions and fundamental principles of Islamic Sharia under Article 3 of the Civil Code).

In this context, domestic public order, as interpreted in the UAE, includes, among other things, matters of personal status, freedom of trade, circulation of wealth and rules of individual ownership to the extent that these matters do not contravene the imperative provisions and the essential principles of Islamic Sharia from which UAE laws are inspired.

The concept of domestic public order is very broad and creates a certain degree of uncertainty and risks as to what may be deemed of a public order nature in the UAE.

This issue is not only raised where a matter is entertained by a UAE court, but may also come into play where foreign judgments or arbitral awards are being enforced in the UAE (see below, Enforcement of foreign judgments and arbitral awards).

**CHOICE OF DISPUTE RESOLUTION MECHANISMS**

In principle, parties to a construction contract performed in the UAE can agree to refer their disputes to UAE courts, to a foreign court or to arbitration (either domestic or international).

Interestingly, and regardless of the parties’ express agreement to refer a dispute to international arbitration or to a foreign court, UAE courts will accept jurisdiction to hear the dispute if the dispute falls within the UAE courts’ jurisdiction and there is a legal nexus with the UAE, on the basis that rules relating to the jurisdiction of UAE courts are of a public order nature (Articles 31 to 41, Civil Procedure Code). Where the parties have agreed to refer a dispute to arbitration in the UAE, a UAE court will equally override the parties’ agreement and will accept jurisdiction over the matter if the defendant fails to object to the competence of the UAE court and fails to raise the existence of the arbitration agreement in the first court hearing in which the defendant is duly represented.

Disputes arising from procurement contracts with governmental and/or quasi-governmental entities are generally referred to the UAE courts. Such entities can agree to resort to domestic arbitration in their respective Emirates.

**ENFORCEMENT OF FOREIGN JUDGMENTS AND ARBITRAL AWARDS**

**Enforcement of Judgments**

A final and binding judgment issued by a domestic court in the UAE is not subject to any further judicial consideration or supervision. Execution proceedings can be initiated by the judgment creditor as soon as the judgment becomes final and binding. In practice, Court of Appeal judgments are generally subject to execution regardless of whether a further appeal is pending before the Court of Cassation.

The enforcement of foreign court judgments is governed by Article 235 of the Civil Procedure Code, which applies de facto in the absence of a bilateral or multilateral treaty/convention.

Judgments issued by a foreign court can be executed in the UAE pursuant to the same conditions provided in the law of the foreign state (Article 235(1), Civil Procedure Code). This general provision applies subject to certain qualifications, including that a petition for an execution order must be filed before the competent court of first instance in the UAE, and provided that the following conditions are met:

- **UAE courts have no jurisdiction over the dispute and the foreign courts have jurisdiction.** The rules on the competence of UAE courts are set out in Articles 31 to 41 of the Civil Procedure Code.
- **The judgment or order was passed by the competent court according to the law of the respective foreign country.**
- **Parties to the dispute on which the foreign judgment was issued were summoned and duly represented.**
- **The judgment or order is final and binding under the law of the issuing foreign country.**
- **The judgment or order does not conflict with or contradict a judgment or order previously passed by another court in the UAE.**
- **The judgment does not violate the concepts of public morals or UAE public order.**

UAE law is only a party to few international conventions/treaties for the enforcement of foreign judgments. The UAE is a party to reciprocal enforcement agreements with other members of the Gulf Cooperation Council, as well as bilateral treaties with Saudi Arabia and France.

**Enforcement of arbitral awards**

The enforcement of arbitral awards differs depending on whether the award is a domestic or an international award.

**Domestic arbitral awards.** The enforcement of domestic arbitral awards (that is, awards that are issued in the UAE) will in practice be subject to judicial scrutiny in the UAE. This judicial scrutiny is limited to form and there is no review of the substance of the award. Domestic arbitral awards cannot be enforced unless ratified by the competent UAE court (Article 215, Civil Procedure Code). In addition, domestic courts are entitled to refer to the arbitrator(s) any issues that, in the opinion of the court, have been omitted (Article 214, Civil Procedure Code).

To ratify a domestic arbitral award, the court must review the award and ensure that the following requirements are met:

- **The award does not contravene public order as defined above (see above, Choice of foreign law).**
- **There is a written and signed arbitration agreement.**
- **The signatories of the arbitration agreement have the capacity to enter into such agreement.**
- **The terms of reference or any other document setting out the powers of the arbitrator have been signed by parties entitled to do so.**
- **The award was issued within the six-month timeframe prescribed in the Civil Procedures Code (in the absence of any valid extension agreement).**
- **Each page of the award, and in particular the pages containing the decision of the arbitral tribunal, has been properly initialled by all the arbitrators.**
- **The arbitrator has not ruled extra petita (that is, beyond the scope of the matters put before the arbitrator) or infra petita (that is, failing to consider some or all of the matters put to arbitration).**

Domestic arbitral awards are final and binding and not subject to appeal; the court does not review the merits of the case. However, in the event the court deems that the award is null and void for violation of any of the reasons stated above, the court will deal with the dispute/merits of the case on the basis that the arbitration agreement has been exhausted.

The requirements for ratification of domestic arbitral award set out in the Civil Procedure Code are mostly formal requirements but are rather cumbersome. In some cases, the application of these requirements has proven to delay and complicate the ratification and enforcement of domestic arbitral awards, especially when counsels representing the parties in arbitration are not familiar with these requirements. However, in a number of recent judgments, the courts have adopted a relatively liberal approach in the application and interpretation of those requirements.
For example, in the context of construction contracts, and in particular FIDIC contracts, UAE courts have recently considered that the intention of the parties to refer the dispute to arbitration can be implied when there is a clear reference to apply the General Conditions of FIDIC in any correspondence between the parties to the dispute.

Along similar lines, the Dubai Court of Cassation has adopted the view that an arbitration agreement was valid despite the fact that the agreement was not signed by one of the contracting parties, on the basis that the tender documents, which included an arbitration clause, had been accepted by the defendant and the defendant had effectively performed the contract, and therefore should be bound by the arbitration agreement. It must be pointed out that a new draft arbitration law is in circulation and is expected to enter into force.

**Foreign arbitral awards.** The UAE is a party to the New York Convention and applies its rules, regardless of the conditions listed in the Civil Procedure Code. The requirements of the New York Convention are less stringent than those in the Civil Procedure Code. Therefore, the enforcement of foreign arbitral awards has proven more effective to a certain extent. However, the enforcement of foreign arbitral awards under the New York Convention remains subject to rules of public order (see above, Choice of foreign law).

Enforcement of awards and judgments can equally be sought before the courts of the Dubai International Financial Centre (DIFC) regardless of whether there is a nexus with the DIFC (Article 43, DIFC Arbitration Law; Article 24, DIFC Court Law). DIFC adopts a much less formalistic approach to enforcement. The grounds for refusing recognition or enforcement of an arbitration award are set out in Article 44 of the DIFC Arbitration Law. Once an award or a judgment is enforced by the DIFC courts, it can easily be enforced in Dubai through the application of the Protocol of Enforcement between the Dubai Courts and the DIFC Courts. It remains to be seen whether a DIFC judgment ratifying an award that has no nexus to the DIFC will enjoy similar deference before the courts in other Emirates.

**KEY CONCEPTS OF CONSTRUCTION CONTRACTS**

In light of the uncertainties relating to the notion of public order, the following key concepts of UAE construction law must be addressed to point out the imperative rules and rules of public order (or those that may be deemed as such by a UAE court) that must be respected by the parties.

**Variation in price**

Similar to English law, extra costs cannot be recovered for the execution of a design that has been agreed upon. In principle, under a lump sum contract, any request for additional costs or remuneration for the execution of the originally agreed design is prohibited (Article 887, Civil Code).

In a re-measurement contract, the contractor must immediately notify the employer of any significant increase in the price for the implementation of the agreed design, failing which the contractor loses its right to claim extra costs for the implementation of the design (Article 886, Civil Code).

There are exceptions to the “no extra costs” rule in cases of unforeseen circumstances (Article 249, Civil Code) or events of force majeure, including circumstances arising out of the acts of a third party or the employer in connection with the construction contract. However, UAE courts have been conservative in applying these provisions.

Additional costs or remuneration can be demanded as a result of variations or additional works to the initial works or design. The reasoning is that a variation to the agreed design may be deemed to have created a new agreement between the parties. The contractor may therefore be entitled to a fair remuneration, in addition to the value of the materials provided. Contractors mistakenly plead unjust enrichment to claim additional costs and/or remuneration in performing variations or additional works. Unjust enrichment can only be claimed outside the context of a contractual liability, and it is not possible to combine tort claims and contractual claims.

Most construction contracts contain express provisions for the ordering and valuation of variations, which must be followed. Where the construction contract is silent as to remuneration, the contractor will be entitled to a fair remuneration in addition to the value of the materials provided (Articles 887(2), 888 and 889, Civil Code).

The principles above apply when the contract is governed by UAE law, but do not constitute public order rules (that is, parties can contract out of those provisions). Therefore, if the parties’ agreement is not in line with the provisions of the UAE Civil Code outlined above, the terms must be clearly phrased in order to avoid the application of the general principles.

**Liquidated damages clauses**

In principle, liquidated damages clauses are valid and enforceable (Article 390(1), Civil Code). However, the courts have the power to reassess such clauses, provided an application in that respect is made by a party, and regardless of any agreement to the contrary (Article 390(2), Civil Code). The burden of proof is on the party requesting reassessment. As it is considered a matter of public order, any agreement or limitation clause that purports to exclude or limit a party’s right to request the court to reassess the damages will be deemed null. Therefore, a party can request a judge or an arbitrator to reassess contractually-agreed damages regardless of any agreement to the contrary. The explanatory note of the Civil Code expressly provides that the judge will have the discretion to increase or decrease the contractually-agreed compensation to make it equal to the damages incurred. UAE law recognises compensation for actual damages, and these can be recovered provided that such damages are:

- The direct and only result of the acts of the other party.
- Certain and foreseeable at the time of contracting.
- Quantifiable.

Compensation for future damages can also be recovered, provided that the above criteria are met, in addition to the criterion of certainty to occur in the future. However, compensation for indirect and hypothetical damages are very unlikely to be recovered under UAE law (Articles 292 and 293, Civil Code).

A contractual penalty for delay in handing over the works can be triggered and ordered by the court if the contractor has performed all its contractual obligations, save for the timely delivery of the works/project.

**Warranties**

Under the Civil Code, the contractor and the designer/engineer who prepared the design and supervised the contractor’s works are automatically, jointly and severally liable towards the employer for both:

- Any total or partial collapse of the building or other fixed structures occurring within ten years from the handover date.
- Any defect that threatens the safety and stability of the building occurring within ten years from the handover date.

This applies even when the defect or the collapse arises out of a defect in the land on which the building is erected, and even when the employer consents to the construction of the defective building.
This liability is a matter of public order (Articles 880 and 882, Civil Code). The presumption of liability can only be rebutted by proving either:

- An event of force majeure (Article 878, Civil Code).
- An event that was not foreseeable by an ordinary man at the time of contracting and could not have been prevented (Article 878, Civil Code).

Any agreement or limitation clause that purports to exclude or limit the liability of the contractor or designer must be considered null (Article 882, Civil Code). The limitation period for any claims arising under a warranty for defects is three years from the collapse or the discovery of the defect (Article 883, Civil Code).

In a relatively recent case, the UAE courts established that this type of liability does not extend to the subcontractor that delivered the works to the contractor, who was in a position to examine such works.

Regarding other types of defect, where a structure/building in which there is an apparent defect is handed over without any reservation, and acceptance amounts to a waiver of the right to claim compensation under the warranty. For latent defects, a statutory warranty period of at least six months applies from the handover date (although this can be extended by agreement between the parties) (Article 117, Commercial Transactions Law of the United Arab Emirates No. 18 for year 1993 (Commercial Transactions Code)).

**Termination**

The UAE Civil Code recognises (Articles 268 to 271, Civil Code):

- Automatic termination.
- Termination by agreement of the parties.
- Unilateral termination (that is, termination for convenience).

UAE courts will recognise termination for convenience if the contractual provisions governing termination mechanisms are clear, express and detailed. More specifically, the agreement must expressly provide that any party has the right to unilaterally terminate the agreement for convenience and without the need for a court order. Parties must give notice of termination, unless they expressly contract out of this requirement (Article 27, Civil Code).

The effect of termination is relatively unique to the UAE. The contract is deemed non-existent, meaning that UAE law will govern all aspects of the dispute. Any contractual terms providing that certain specific provisions of the contract will survive termination (for example, an exclusion of liability for consequential loss) are unlikely to survive the termination of the contract and to be enforceable before UAE courts.

Restitution will be awarded, and if this is impossible, compensation claims will be allowed. This is unusual both from a common law perspective and by reference to other civil law systems. However, this rule is clearly provided under Article 274 of the UAE Civil Code and the Explanatory Note of the UAE Civil Code on the articles of termination of contracts (Articles 267 to 273). Additionally, the UAE jurisprudence is constant in this respect.

Where one party disputes the other party's right to terminate, the contract remains in force until the court decides whether termination was lawful or not. Therefore, contractual provisions remain applicable between the parties.

**Subcontracting**

Subcontracting is permitted under UAE law, unless the contract between the employer and the contractor expressly prohibits subcontracting (Article 890, Civil Code). The contractual relationship between contractor and subcontractor is limited to these two parties and does not extend to the employer. The contractor remains responsible to the employer for the works performed by the subcontractor. "Pay when paid" or "back-to-back" clauses are valid under UAE law and can be used in favour of the contractor, when the contractor has not been paid by the employer. If a main contractor fails to exercise its rights against the employer to seek payment of money due under the main contract, UAE law gives the subcontractor the power to initiate court proceedings against the employer in the name of the main contractor (indirect claim) (Articles 392 and 393, Civil Code). The subcontractor can request payment from the employer directly if the contractor has assigned its right to do so (Article 891, Civil Code).

Subcontractors can lawfully claim damages for actual losses and loss of profits against the contractor if the main contract between the employer and contractor is terminated unilaterally.

**OTHER RELEVANT GENERAL CONCEPTS OF UAE LAW**

**Agency**

An agent-principal relationship is established by law between the engineer and the employer. The employer is bound by the acts/decisions of the engineer, unless it is proven that the engineer exceeded its mandate or committed a fraud. The concept of apparent agency is favourable to the contractor.

**Good faith**

UAE law attributes great importance to the concept of good faith and the obligation of the parties to perform their contractual obligations in good faith (Article 246, Civil Code).

**Silence**

UAE law provides that silence must not generally be deemed to constitute acceptance, although silence in a situation where a statement is clearly called for must be regarded as acceptance (Article 135, Civil Code).

**Right to withhold performance**

UAE law recognises the legal right of a party to refrain from performing its contractual obligations if the mutual obligations of the contracting party should have been performed, but were not (Article 247, Civil Code).

A person who seeks performance prematurely must be penalised by being deprived of such performance (Article 69, Civil Code).

Any request made by a person to set aside or revoke what has conclusively been performed by him must be rejected (Article 70, Civil Code). This reflects the principle of estoppel that is known in English law.

**Agreements must be kept (pacta sunt servanda)**

In commercial transactions, the contract is the primary source of obligation, provided that it does not contravene UAE imperative laws. In addition, UAE law applies where an agreement is silent. If the law is silent, then local custom will apply. If these are silent, international customs must be considered, provided that they do not contravene public order and public morals (Article 2, Commercial Transactions Code). A party to a commercial transaction can prove its case by all means of evidence (Article 94, Commercial Transactions Code).

**PRACTICAL STEPS**

It is crucial to seek legal advice before entering into a construction contract. It is particularly recommended to seek advice from local counsel on UAE imperative laws and laws of public order applicable to construction contracts, even where the contract is governed by a foreign law.
In addition, it is recommended that parties:

- Investigate the place and means for achieving successful enforcement of the contract when agreeing on applicable law and dispute resolution clauses.
- Conduct commercial and technical due diligence before pricing and committing to a delivery date.
- Keep a complete record of the facts that can have an impact on their legal and contractual rights.

It may be possible to secure the appointment of experts via the courts in certain circumstances, in order to issue reports in support of a claim, even where no proceedings (whether domestic or foreign) have been commenced. Parties should consider with local counsel other local interim measures in support of their case, even if proceedings are conducted abroad. These can include:

- Provisional attachment orders.
- Expert appointments.
- Hearing of witnesses.
- Production of documents orders.
- Provision of official classified data.

It is also often worth investigating the possibility of stopping the calling of a performance bond.
Practical Law Contributor profiles

Celine Abi Habib Kanakri, Counsel
Baker & McKenzie Habib Al Mulla
T +971 4 423 0025
F +971 4 447 9777
E celine.kanakri@bakermckenzie.com
W www.bakermckenzie.com

Professional qualifications. Lebanon, Lawyer, 2005
Areas of practice. Arbitration; construction; real estate.
Non-professional qualifications. BA in Lebanese and Comparative Law, Saint Joseph University, Lebanon, 2004
Recent transactions
- Acted as Counsel in a multimillion AED construction dispute (DIAC Rules) between a Fortune 100 contractor and an employer concerning work on an eminent project in Dubai.
- Acted as Counsel in a multimillion AED construction dispute (DIAC Rules) between a contractor and a semi-governmental entity responsible for the development of land in Dubai.
- Acted as Counsel in a multimillion AED construction dispute (ICC Rules) between a contractor and a subcontractor over the execution of construction works in a renowned Dubai project.
- Acted as Counsel in a multimillion AED commercial real estate dispute (DIAC Rules) between the owner of a hotel and the hotel operator.
Languages. English, Arabic, French
Professional associations/memberships.
- Member of the International Bar Association.
- Member of the Lebanese Bar Association.
- Member of the UAE International Chamber of Commerce.
Publications

Habib Al Mulla, Chairman
Baker & McKenzie Habib Al Mulla
T +971 4 423 0000
F +971 4 447 9777
E habib.almulla@bakermckenzie.com
W www.bakermckenzie.com

Professional qualifications. United Arab Emirates, 1984
Areas of practice. Commercial litigation; international arbitration; public law/regulatory disputes; real estate; construction.
Non-professional qualifications. PhD in Law, University of Cambridge (1993); Master of Law, Harvard Law School, 1987; LLB Sharia and Law, UAE University, 1984
Recent transactions
- Acted as sole arbitrator in a Qatar-based ICC arbitration involving a major construction project in Qatar between two Middle Eastern companies.
- Acted as co-arbitrator in a Qatar-based ICC arbitration involving a major construction project between an Indian and a UAE company.
- Acted as sole arbitrator in a DCCI arbitration involving a dispute over a construction contract between two UAE companies.
- Counseled the respondent in a DIAC arbitration concerning a dispute relating to a major Dubai-based development project worth AED500 million.
- Counseled the claimant in an ad hoc arbitration involving a major construction project in Dubai.
Languages. English, Arabic
Professional associations/memberships.
- Chairman of the Board of Trustees of Dubai International Arbitration Centre (DIAC).
- Vice-Chairman of Dubai Board of Trustees of the American University.
- Member of the International Chamber of Commerce Institute.
- Member of the UAE International Chamber of Commerce National Committee.
- Fellow member of the Chartered Institute of Arbitrators.
Publications

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