

UAE court judgment: A subcontractor's limited entitlement to payment from an employer

Euan Lloyd - Partner - Construction and Infrastructure

e.lloyd@tamimi.com - Abu Dhabi

Leith Al-Ali - Senior Counsel - Construction and Infrastructure

l.alali@tamimi.com - Abu Dhabi

Introduction

Traditionally, under UAE law, a subcontractor has very limited grounds upon which to pursue an employer for unpaid amounts due from a main contractor under a subcontract.

In this article, we review a recent judgment of the UAE Federal Supreme Court (Judgment 851 of 2021) concerning claims made by a subcontractor against an employer and highlight some of the key practical considerations subcontractors should consider when negotiating the terms of a subcontract.

The Facts

The employer engaged a main contractor under a muqawala (or building) contract, dated 20 June 2013, for the construction of a new private school on a plot of land belonging to the employer

The main contractor subsequently subcontracted out a portion of the works for execution by the subcontractor.

The subcontractor alleged that, despite satisfactorily completing the subcontracted works, the main contractor (and the project consultant) had not performed their obligations regarding the subcontractor's legitimate entitlement to payment, despite various requests for them to do so.

The subcontractor therefore initiated legal action to recover AED 10,493,252 plus interest, jointly and severally, against the employer, the main contractor and the project consultant.

The Court Judgments

Court of First Instance

On 31 August 2020, the Court of First Instance ordered the main contractor to pay to the subcontractor the sum of AED 5,352,291 plus interest. No order was made against the employer or the project consultant.

Court of Appeal

Both the subcontractor and the main contractor appealed the Court of First Instance's decision.

On 6 July 2021, the Court of Appeal held that:

- "In response to the subcontractor's appeal, the employer must pay to the subcontractor a sum of AED 5,352,291 plus interest and that all bonds (whether held by the employer or the project consultant) must

- be returned to the subcontractor; and
- In response to the main contractor's appeal, that the action against the owner of the main contractor was to be dismissed."

Federal Supreme Court

The employer predictably appealed the decision of the Court of Appeal, arguing that the Court of Appeal's reasoning was flawed for the following reasons:

- The Court of Appeal had incorrectly understood that a contractual relationship existed between the employer and the subcontractor^[1], meaning that there was no privity of contract between the employer and the subcontractor;
- The subcontractor had issued its payment applications to the main contractor, who in turn, paid some of the invoices presented by the subcontractor. The employer was therefore not involved in making any direct payments to the subcontractor (thus reaffirming the absence of a contractual nexus between the employer and the subcontractor); and
- The subcontractor could not directly claim any dues from the employer as the main contractor had reserved its right to do so under the main construction contract with the employer.

The Federal Supreme Court found in favour of the employer and granted the appeal.

In doing so, the Federal Supreme Court reaffirmed the importance of Articles 872, 890 and 891 of the UAE Federal Law No. (5) of 1985 on the Civil Transactions Law of the United Arab Emirates (otherwise more commonly known as the "**UAE Civil Code**") as being settled law. In summary:

- Article 872 provides that "a muqawala is a contract whereby one of the parties thereto undertakes to make a thing or to carry out work against a counter value undertaken [to be provided] by the other party";
- Article 890 provides that "(1) The contractor may entrust the performance of all or part of the work to another contractor unless a condition in the contract prohibits him from so doing, or unless the nature of the work is such as to require him to do it in person [...]" ; and
- Article 891 provides that "The second contractor may not make any claim against the employer for anything due to him from the first contractor unless he has made an assignment of it to him as against the employer".

Based on these provisions, the Federal Supreme Court concluded that the subcontractor could not directly claim from the employer any sums otherwise due to it from the main contractor, unless: (i) the subcontractor concluded a direct contract with the employer (i.e. thereby creating privity of contract between the two parties); or (ii) the main contractor had assigned its right to seek payment from the employer to the subcontractor. Neither of these preconditions had occurred in this case.

Practical Considerations

The Federal Supreme Court's judgment provides helpful clarification of the limited circumstances in which a subcontractor may claim against an employer under UAE law.

From a practical perspective, subcontractors may therefore wish to consider the following points:

- ⇒ If the subcontractor has completed and handed over to the main contractor its scope of work in accordance with the subcontract, UAE law prescribes that the subcontractor may seek a provisional attachment in respect of undisputed amounts owed to the main contractor by the employer (or indeed from other third parties) until a final judgment has been issued;
- ⇒ Where a pay-when-paid clause is included in a subcontract (as is typically the case), the subcontractor

my try to mitigate the impact of such a provision by seeking:

- To limit the scope of a pay-when-paid mechanism (i.e. by including thresholds in respect of when a pay-when-paid payment regime applies and/or time limits);
- To negotiate clauses to incentivise the main contractor to make payment (i.e. by reserving a right to decelerate or suspend in the event of non-payment, notwithstanding the pay-when-paid clause);
- To require the main contractor to update it regularly as to the steps that it is taking to procure payment from the employer (and to prohibit the main contractor from 'writing off' the subcontractor's payment claim);
- Transparency as to when payments are received from the main contractor; and
- To stipulate that it is entitled to payment when the main contractor receives payment for the works performed by the subcontractor (so that the subcontractor is shielded from disputes regarding works packages that do not concern the subcontractor's specific scope).

Concluding Remarks

The Federal Supreme Court's important judgment is a timely reminder to all stakeholders in the UAE construction market of the central importance of *pacta sunt servanda* and privity of contract under UAE law. It is clear that the UAE courts will not impose payment regimes that differ from those expressly agreed between the parties in accordance with the relevant underlying contract. Consequently, we recommend that parties keenly negotiate their contractual 'red-lines', particularly in respect of payment terms.

[1] Although a conditional letter of acceptance had been concluded between the Employer and the Subcontractor, this agreement never actually entered into effect.

Al Tamimi & Company's Construction and Infrastructure team regularly advises on all elements of the construction procurement process. For further information please contact [Euan Lloyd](#) or [Leith Al-Ali](#).