

# UAE & Chinese Construction Law

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## Highlights of the Laws of the United Arab Emirates, the People's Republic of China and the Common Law applicable to construction

This article is written for China Construction Law Review. It seeks to provide readers with an insight into some aspects of UAE law relevant to the construction industry by way of comparison with the law of the People's Republic of China. Given the prevalent use of FIDIC<sup>2</sup> standard forms of construction contract in the UAE and the strong presence of common law lawyers in the country, this article also compares the laws of the two subject countries with well known common law principles and relevant provisions of the FIDIC<sup>3</sup> Red Book conditions. In this first part of the article, an introduction to the relevant laws and issues relating to the principle of good faith and liquidated delay damages are discussed.

### Introduction

In the UAE, all commercial activities (including building or construction activities) are regulated by Federal Law No. 18 of 1993, also known as the UAE Commercial Transaction Law or the UAE Commercial Code. However, in practice, Federal Law No. 5 of 1985 also known as the Federal Civil Transaction Law or the UAE Civil Code is more regularly applied or referred to because it contains general and mandatory laws that govern contractual relationships in the UAE<sup>4</sup>. The UAE Civil Code has a specific chapter<sup>5</sup> under the heading called "Muqawala"<sup>6</sup> which contains provisions that govern the relationships between employers, contractors, subcontractors and engineers/architects. In the context of the People's Republic of China<sup>7</sup>, the relevant law is the Contract Law of the People's Republic of China<sup>8</sup> (中华人民共和国合同法) ("the PRC Contract Law"). Similar to the UAE Civil Code, the PRC Contract Law contains general and mandatory laws that regulate contractual relationships in the People's Republic of China, and it has two specific chapters containing provisions that are applicable to contracts of work and contracts for construction projects<sup>9</sup>.

Although the political structures of the two subject countries differ, their respective legal systems are similar to the extent that they both belong to the civil law family<sup>10</sup>. In the civil law system, unlike common law system, the principle of stare decisis<sup>11</sup> or case law precedent does not apply. For this reason, amongst others, judicial interpretations and decisions from civil law countries tend to be less prescriptive in that the civil law courts do not usually restrict themselves to the black letters of the law; instead, the meaning and intent of the law takes a central role. Notwithstanding that, in the UAE, as a matter of practice, lower courts do respect and tend to follow the principles and approaches laid down by the Court of Cassation the highest appellate court in the UAE<sup>12</sup>. To this end, the legal practice in the People's Republic of China is similar to the UAE because the writer is advised that judicial interpretations of the Supreme People's Court, which is the highest court in the People's Republic, are very helpful and persuasive.

In the context of construction law practice in the UAE, the writer finds that common law or English law principles are often referred to and sometimes erroneously relied upon. Indeed, in this regard, Essam Al Tamimi, a prominent UAE legal practitioner, said in his book<sup>13</sup>

"In addition, because of the nature of Dubai in particular as a commercial center and because of the presence of international law firms with "common law" roots, many contracts which have been drafted in the UAE appear to have been influenced by common law principles.

This has created difficulties in the application of the law to these contracts by the courts of the UAE since judicial authority does not recognise some of the principles or the practices of the common law system..."

Therefore, whilst foreign legal principles, including common law principles, may provide some guidance, they have no force in law in the UAE unless they are so widely used and recognised in the industry that they can be accepted as forming part of the local custom or practice<sup>14</sup>.

### Relevant construction issues

## **The Principle of Good Faith - 信義則**

The nature of a construction contract is such that it binds contracting parties to a long term legal relationship. Given the multitude of obligations that each party owes to the other under a typical contract, it is very important that parties act according to their promises to ensure that the objectives of the contract are achieved.

However, during the course of a construction project, which may run for several years, market conditions may change to the detriment of the parties; for example, prices for construction materials may rise or fall or the demand for the project may disappear. These changes may adversely affect the parties' relationship or may motivate one, or both the parties, to act in a manner that is not consistent with the objectives or promises made under the contract. In this regard, in the absence of an express term that requires contracting parties to exercise their duties and rights with good faith, or a term that creates a partnering or a pain-gain sharing type of relationship between the parties; does the law impose a duty of good faith on the parties?

There is a substantial volume of treatise and case law from common law jurisdictions that discusses the principle of good faith in the context of contractual relationships. The writer understands that at present there is no clear and overriding common law duty that requires parties to a construction contract to observe the requirements of good faith<sup>15</sup>. Arguably, this is attributable to the fact that the common law courts have not been able to prescribe a clear meaning or definition for the term "good faith"<sup>16</sup>. In the UAE, the UAE Civil Code imposes an obligation on contracting parties to abide by the terms of their agreement<sup>17</sup> and that they must discharge their respective obligations in a manner that is consistent with the requirements of good faith<sup>18</sup>. The principle of "good faith" is a common feature of the civil law system and is consistent with the principles of Islamic Shari'ah which underlies all laws in the UAE. However, there is no prescription on the requirements of good faith; it is a matter of judgment for the court to decide based on relevant facts and circumstances. It is perhaps easier to determine whether a party has acted in bad faith rather than whether it has acted consistent with the requirements of good faith. The writer submits that in deciding the issue of bad faith the court should be invited to look into the requirements of Article 106 of the UAE Civil Code. Pursuant to this article, a party is prohibited from exercising its rights if:

- it is intended to infringe the rights of another party;
- the outcome is contrary to the rules of the Islamic Shari'ah, the law, public order, or morals;
- the desired gain is disproportionate to the harm that will be suffered by the other party; or
- it exceeds the bounds of custom and practice.

The principle of good faith is also encoded in the PRC Contract Law. An English translation of Article 6 of the law states that "The parties must act in accordance with the principle of good faith, no matter in exercising rights or in performing obligations". Even though there is no single or specific provision in the PRC Contract Law that can be said to encapsulate similar provisions as those set out under Article 106 of the UAE Civil Code, the writer considers that one of the objectives of Article 106, which is to prevent a party from abusing its rights, can be found in a number discrete provisions in the PRC Contract Law. By way of example, Article 5 of the PRC Contract Law requires contracting parties to uphold the principle of fairness<sup>19</sup>, Article 60 requires the parties to perform their obligations based on the character and purpose of the contract or the transaction practices and Article 3 provides that contracting parties shall have equal legal status and neither of them may assert its will on the other<sup>20</sup>.

The PRC Contract Law also imposes a public duty on contracting parties which requires them to observe public laws and social ethics and prohibits them from disrupting socio-economic order or damaging public interests. It is interesting to consider what does the term "social ethics" (社會公德) encompass and whether the People's Court would accept that the abuse of one's contractual rights in disregard to the seriousness of the harm that the other party may suffer could be looked upon as a violation of social ethics.

## Liquidated Delay Damages - 损害赔偿

In the context of construction contracts, the agreed completion date or period is inevitably a fundamental term of the contract. To ensure that the agreed date or period is adhered to, contracting parties often agree in advance to a compensation mechanism or formula that will calculate the amount of compensation that a contractor must pay to its employer in the event of delay for which the contractor is culpable or responsible for (the liquidated delay damages)<sup>22</sup>. In practice, the compensation mechanism or formula is often fixed at a daily or weekly rate, for example, one hundred days of delay at a pre-agreed rate of \$1,000.00 per day will produce a liquidated delay damages of \$100,000.00.

Both the UAE Civil Code and PRC Contract Law allow contracting parties to fix a pre-agreed compensation mechanism or amount in their contract. However, unlike common law jurisdictions<sup>25</sup>, both laws allow their respective courts, upon the request of either party, to vary the pre-agreed amount of compensation or damages. In the context of the UAE Civil Code, the court may vary the amount so to make it equal to the actual loss or harm<sup>26</sup>. Official notes issued by the UAE's Ministry of Justice explained that in exercising the power to vary the pre-agreed amount of compensation the courts may either reduce or increase the amount; whereas under the PRC Contract Law<sup>27</sup>, it is expressly provided that the court may either reduce or increase the liquidated amount.

In English law it is an implied term that an employer to a construction contract must not prevent or hinder the contractor from completing the contracted work<sup>28</sup>. This is generally known in construction law study as the prevention principle<sup>29</sup> (防止). The effect of this principle is such that if the employer's action, or inaction, prevented or hindered the contractor from completing the works on time, and if there is no provisions in the contract that would allow the contractor an extension of time due to the employer's action, or inaction, then the agreed time for completion would be set at large, i.e. time at large. This in turns renders the contractual provisions for liquidated damages to be unenforceable. The follow on effect is that the employer can no longer resort to the liquidated damages mechanism to recover delay damages from its contractor; instead, it would have to bear the burden of proving and apportioning the actual damages that it has suffered as a result of the contractor's delays in order to recover its delay damages.

Contractors in the UAE would sometimes try to apply the prevention principle or the concept of time at large in their attempt to defeat liquidated delay damages imposed by their employers. Notwithstanding that it may be difficult to show that such principle and concept are customarily used or recognised in the local industry<sup>30</sup>, the writer considers that such argument is to a large extent irrelevant because, as explained above, UAE law allows the courts to review or vary the amount of liquidated damages to equal the actual loss in any event regardless of whether there was any act of prevention on the part of the employer. However, there may be a perceived advantage in arguing the applications of the said principle and concept because if the argument is successful the burden is then shifted to the employer for it to prove its actual losses arising from any delays caused by the contractor as opposed to the contractor having to show that the liquidated delay damages do not reflect the employer's actual loss or that it is excessively high – however, this remains to be seen.

This is the second and final part of the article written for China Construction Law Review which provides a brief comparison on some aspects of UAE construction law with PRC law, common law principles and provisions of the FIDIC Red Book conditions. In this part of the article, legal provisions relating to suspension of works, taking over of works, defects liability and subcontracting are dealt with.

## Footnotes

1- The writer does not claim expertise in the laws of the Republic of China. The analyses and comparisons set out in this article are based on his interpretation of the English translation of the relevant Chinese law which have been reviewed by Mr Sun Wei, General Editor of the China Construction Law Review ([www.cclr.org.cn](http://www.cclr.org.cn)) and Partner at Zhong Lun Law Firm, Beijing, China ([www.zhonglun.com](http://www.zhonglun.com)). The writer is grateful to Mr Sun Wei and Mr Dean O'Leary, Senior Lawyer at Al Tamimi & Company ([www.tamimi.com](http://www.tamimi.com)) for their inputs

and comments on this article.

2- FIDIC is the acronym for the French version of the “International Federation of Consulting Engineers” ([www.fidic.org](http://www.fidic.org)). The standard forms of contract published by this organisation are the most widely used standard forms of contract in the Middle East region.

3- The FIDIC Red Book form of contract is used for building and engineering works designed and supervised by engineers/architects employed by the employer.

4- With regard to government contracts, there are specific procurement laws that govern them.

5- Articles 872 to 896 of the UAE Civil Code.

6- Article 872, in translation, states that “Muqawala” is “a contract whereby one of the parties thereto undertakes to make a thing or to perform work in consideration which the other party undertakes to provide.”

7- Excluding the Special Administrative Regions of the People’s Republic, namely, Hong Kong and Macao.

8- Promulgated through Order [1999] No.15 of the President of the People’s Republic of China

9- Chapters 15 and 16 of the PRC Contract Law.

10- The UAE Civil Code is largely based on the Jordanian and Egyptian Civil Codes, which in turn, are heavily influenced by the French Civil Code; whereas laws in the PRC have Russian’s and German’s civil law influences.

11- Generally, this principle provides that the decision (ratio decidendi) of a court is binding precedent until and unless it is overturned or reversed by a higher court. Therefore, the decisions of the common law courts are an important source of law in the common law system; whereas, in the civil law system, previous decisions are persuasive and explanatory.

12- The courts in the emirate of Dubai are independent from the UAE federal court system, however, similar practice is also largely being followed in the Dubai courts.

13- At page 5, Practical Guide to Litigation and Arbitration in the United Arab Emirates, 1st Edition, Kluwer Law International.

14- Article 2(2) of the UAE Commercial Code and Articles 46, 50 and 246(2) of the UAE Civil Code recognise and uphold the binding effect of custom practice.

15- It is interesting to note that the Australian courts have, in limited circumstances, taken a more liberal approach on the question of good faith between contracting parties. However, this is by no means conclusive that there is a clear and overriding duty of faith in all cases in Australia.

16- Whilst there may not be an overriding duty of good faith imposed on contracting parties in most common law jurisdictions (if not all), there is an implied term under common law applicable to construction contracts that an employer must not prevent or hinder a contractor from completing its work. This implied term is further discussed in the following section.

17- Article 243(2) of the UAE Civil Code.

18- Article 246(1) of the UAE Civil Code.

19- An English translation of Article 5 reads “The parties shall abide by the principle of fairness in defining the rights and obligations of

each party”.

20- The writer is of the view that it is possible to extend the reading of this provision to mean that no party shall be allowed to unfairly assert its contractual rights against the other.

21- Article 7 of the PRC Contract Law.

22- See relevant contractual provisions at Clause 47 and Sub-Clause 8.7 of the 1987 and 1999 FIDIC Red Book Conditions respectively.

23- Article 390(1) of the UAE Civil Code

24- Article 114 of the PRC Contract Law

25- In common law jurisdictions, the courts will uphold pre-agreed liquidated damages unless it is deemed to be a penalty or, in some jurisdictions, deemed not to be a genuine estimate of the employer's losses.

25- Article 390(2) of the UAE Civil Code.

27- Article 114 of the PRC Contract Law.

28- Some relevant English cases are: Holme v Guppy (1838) M & W 387, Dodd v Churton [1897] 1 QB 566, Peak Construction (Liverpool) Limited v McKinney Foundations Limited [1970] 1 BLR 111

29- This general principle has been adopted by many common law countries, e.g. Malaysia, Singapore, Australia, Hong Kong, New Zealand, India and Canada.

30- Sub-Clauses 44.1(d) and 8.4(e) of the 1987 and 1999 FIDIC Red Book Conditions respectively allows a contractor to claim an extension of time for any delay, impediment or prevention caused by an employer. Therefore, it would be difficult for a contractor to succeed in arguing the application of time at large concept if the foregoing FIDIC conditions are present in the contract.