

Highlights of the Laws of the United Arab Emirates, the People's Republic of China and the Common Law applicable to construction contracts - Part 2

Eric Teo

e.teo@tamimi.com

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.

The Right to Suspend Work

It goes without saying that cash flow is vital for any business venture, construction projects in particular. It is an industry practice that, save for any advance payment of between 10% and 20% (depending on the nature of the project), contractors would have to use their own finances, or at the very least, financially expose themselves to subcontractors and suppliers by producing or delivering material and execute works in advance for their employers for a fixed period of time (usually monthly) or until a certain stage of completion is reached before they get paid, and even then contractors don't get paid in full¹.

Therefore, in the effort to reduce the contractors' risk in relation to payment, construction contracts usually provide a number of potential remedies in the event employers fail to make payment in accordance with the agreed time or schedule. The remedies include the right to recover late payment interest or financing charges ², suspend work³ or reduce the rate of work and exercise termination for default provision⁴. Of the three foregoing remedies, the right to suspend work is perhaps the more commonly used remedy given that the right to receive interest does not, in any significant way, compel employers to pay on time, and contractors are wary about terminating contracts for fear of losing the opportunity to complete the works and realise the profit that they had initially bargained for.

In the UAE, in the absence of a contractual right to suspend work for non-payment, a contractor may rely on Article 247⁵, and to some extent, Article 414⁶ of the UAE Civil Code. The right to suspend work under these provisions however are more general in scope and are not specifically intended to address situations of non-payment. What they do provide though is that a contracting party may withhold or suspend the performance of its obligation if the other party fails to discharge a mutual or corresponding obligation that has since become due for performance. Translating this to a construction setting, it would mean that a contractor would be entitled to suspend work if it has not been paid by the employer for any claims that have been certified or accepted despite the contractor's continued performance beyond the due date for payment.

However, before exercising the right to suspend work a contractor should take into consideration and address any issues that the employer may have raised as justifications for non-payment. This is so that the contractor is not taken to have acted in bad faith. It is to be noted that the Dubai Court of Cassation decided in a case that the requirements of good faith under Article 246 is applicable to the right to suspend performance. In this case, the Court held that a party cannot invoke the right to suspend work if the other party has substantially discharged its part of the obligations leaving only a minor part of it unperformed; in other words, the de minimis approach applies.

Unlike the standard FIDIC provisions, the UAE Civil Code does not expressly provide that a contractor is

entitled to receive an extension of time and payment in respect of additional costs caused by the suspension or reduction in the rate of work⁷. To address this, it is arguable that, on the basis of the requirements of good faith, the employer would not be able to recover any liquidated delay damages from the contractor for delays attributable to the contractor's suspension (or reduction in the rate of work) due to non-payment; and that the contractor would be able to recover the additional costs incurred or losses suffered as a result of the suspension (or reduction in the rate of work) by way of damages⁸.

It is interesting to note that under the standard provisions of the 1999 FIDIC Red Book conditions, the additional costs that a contractor is entitled to recover in the event of suspension or reduction in the rate of work for non-payment include an allowance for reasonable profit which appears to be more favourable than the provisions of the UAE Civil Code given that there is no clear and express provision under the Code to enable a contractor to recover reasonable profit in such circumstances.

Under the PRC Contract Law⁹, a contractor may prolong the construction period and claim compensation for work stoppages, idling costs, re-mobilisation costs, material storage costs and other resulting costs and expenses if the employer fails to supply or deliver items that it has agreed to provide in accordance with the requirements of the contract (which include funds or payments). Although the relevant provisions do not expressly provide that a contractor may suspend or reduce the rate of work on the basis of an employer's failure to make payment, the fact that a contractor is entitled to prolong the construction period and recover costs and expenses for work stoppages would mean that it is entitled to suspend or slow down work progress.

Taking Over Completed Works

Under the UAE Civil Code¹⁰, an employer is obliged to take delivery of completed contract works and pay the contractor the agreed price accordingly. This requirement is normally supplemented or amended according to the contract of the parties where elaborate procedures and conditions for handing over and taking delivery of completed works are often specified in the contract¹¹.

The UAE Civil Code further provides that if there is no valid reason for an employer not to take delivery of the completed works, the risk or care of the completed works shall be deemed transferred to the employer. In the local construction scene, it is not unusual to find an employer refusing to take delivery of completed works or preventing its technical consultant from issuing a taking over or completion certificate due to financial difficulties. Otherwise to do so the employer will have to incur the cost of maintaining the works or project and, if FIDIC Red Book conditions apply, pay the contractor half of its retention money¹². Therefore, in specific circumstances, the relevant provisions of the Civil Code may be relied upon by a contractor as a ground for transferring the risk and care of the completed works to an employer despite the latter's refusal to take over the works or the absence of a taking over or completion certificate¹³.

Similar to the FIDIC taking over of works regime, the PRC Contract Law require a process of inspection to be carried out, however, it goes a step further by imposing the need for the works to be in compliance with the "inspection rules" and "quality standard" issued by the government. Whilst one may say that it is given that completed works must, as a matter of right, be in conformance with the applicable building or construction code before it can be accepted as completed¹⁴, problem may still arise in a situation where a contractor argues that certain requirements of the local authorities or government agencies are additional or a variation to its original scope of works¹⁵.

Defects Liability

In the event a contractor is carrying out works defectively the UAE Civil Code¹⁶ allows an employer to cancel the contract immediately if it is impossible to remedy the defective works; otherwise, the employer should give the contractor a reasonable period of time to remedy the defective work¹⁷. If a contractor fails to remedy the defect within the said period an employer may request the court to cancel the contract and allow it to engage a third party to remedy the defect at the contractor's expense. However, Dubai Court of Cassation has held that in case of urgency an employer may proceed to engage a third party to

remedy the defect without the need to obtain prior permission from the court.

Turning to the PRC Contract Law, an employer also has the right¹⁸ to require a contractor to remedy defective works within a reasonable period of time. If the contractor fails to do so after it has been urged, the employer may terminate or rescind the contract¹⁹. Similarly, under Sub-Clause 15.2(c)(ii) of the 1999 FIDIC Red Book conditions, an employer may terminate the contract if a contractor fails to comply within 28 days from receiving a notice under Sub-Clauses 7.5 or 7.6 to remove, re-execute or remedy defective works or execute any urgent work²⁰.

One important distinction between the two laws in respect of defect liability is that under the UAE Civil Code the contractor, design architect/engineer and supervising architect/engineer are jointly liable to the employer for the structural integrity of the building or installation for a period of 10 years from the date of handing over, unless, such building or installation are intended to remain for less than 10 years²¹. The liability imposed under this mandatory law on the liable parties is popularly known as the Decennial Liability. It is a strict liability that does not require the employer to show negligence or default on the part of any of the liable parties²².

Under Decennial Liability, an employer has 3 years from the total or partial collapse of the building or installation, or the discovery of the structural defects in the building or installation, to seek compensation against the liable parties. This would mean that the liable parties will have 13 years of liability over buildings or installations that have been handed over. Any agreement to exempt or limit such liability is unenforceable at law²³. It should also be noted that defects in the land upon which the building or installation is located, or the fact that, the employer has consented to the construction of the building or installation does not excuse the liable parties from the liability²⁴.

Subcontracting

It is of course common practice for a contractor to subcontract parts of its works. There are several reasons for a contractor to sub-let its works, it may be the case that certain parts of the works require specialist knowledge or skills of certain subcontractors, or it may also be the case that the contractor wishes to spread its risk by dividing the works into smaller portions to several subcontractors.

The UAE Civil Code allows a contractor to sub-let either the whole or part of the works unless prohibited by the terms of the contract or the nature of the works is such that the contractor must personally perform it²⁵. Under the Code, a subcontractor has no right against an employer²⁶, all rights and liabilities in relation to the sub-let portion of the works will be a matter between the contractor and its subcontractor. In the UAE, it is common for an employer to request specialist subcontractors to provide a collateral or direct warranty to the employer with regard to the quality and/or fitness of the subcontract work²⁷. This, however, does not in itself give any right to a subcontractor to have direct recourse against an employer²⁸.

Based on the standard FIDIC Red Book Conditions²⁹, a contractor must obtain the Engineer's consent before it is allowed to sub-let any part of the Works and it will remain liable for the acts and defaults of all subcontractors including nominated subcontractors (□□□□), however, a contractor is prohibited from sub-letting the whole of the Works³⁰. There is serious implication if a contractor fails to comply with the restrictions in relation to subcontracting because it may give the employer the right to terminate the contract³¹.

Unlike UAE law, a contractor under the PRC Contract Law has lesser freedom to sub-let works. Although a contractor may, with the consent of the employer, sub-let part of the works to a third party it may not sub-let the whole of the works or divide the works in order for several subcontractors to complete the whole of the works³². This begs the question whether does this restriction means that the PRC Contract Law does not allow Construction Management or Management Contracting type of contracts to be implemented in the PRC? Generally, these types of contract entail a main contractor³³ sub-letting the whole of the works (either as agent of the employer or in its own capacity) to several trade or specialist contractors for the execution of the whole of the works. Perhaps, in the writer's view, this type of contract is not deemed by the PRC Contract Law to be a construction contract for the purposes of Chapter 16, but more so of a contract providing consultancy services³⁴.

Further restriction is imposed under the PRC Contract Law whereby a subcontractor is not allowed to further sub-let its works. There is no such prohibition either under UAE law or within FIDIC standard conditions. Another notable difference between the UAE and PRC laws is that under the latter regime, a contractor and all its subcontractors are jointly and severally liable to the employer. In other words, an employer may pursue or claim against a subcontractor jointly with the main contractor for any of the subcontractor's defaults; whereas in the UAE, unless a subcontractor has provided a collateral or direct warranty to the employer, or there exist some special circumstances that create a legal relationship between them, an employer will not have the right to pursue claims directly against a subcontractor.

Conclusion

The UAE is a melting pot of different cultures. This also applies to the local construction industry with its players (developers, consultants, contractors, suppliers, etc) having originated from different parts of the world. In this regard, Chinese contractors are certainly not newcomers to the UAE. They have, along with other foreign contractors, made significant contribution to the development of UAE's real estate and infrastructure, and they continue to do so despite the current lull in the market.

However, a rich mix of cultures is also a recipe for construction disputes when the industry players do not give sufficient regard to local law and issues. Ideally, the provisions of construction contracts should apportion and allocate all conceivable commercial or legal risks between the contracting parties. But they are often fraught with ambiguities and pitfalls partly due to the fact that the contracting parties fail to address local law and issues.

In light of the sluggish construction market that the UAE is currently experiencing (especially within the real estate sector³⁵), the shortcomings in many of the local construction contracts are now the subject of legal disputes. As a result, the awareness and the need to take cognisance of local law amongst the construction industry players have increased during these difficult times. This is a positive development as further appreciation of local law will contribute to the maturity of the construction industry as a whole.

Footnotes

1. Progress payments are usually subject to retention sum and evaluation by a third party consultant, namely "the Engineer" if it is under FIDIC Red Book conditions.
2. See Sub-Clauses 60.10 and 14.8 of the 1987 and 1999 FIDIC Red Book conditions respectively.
3. See Sub-Clauses 69.4 and 16.1 of the 1987 and 1999 FIDIC Red Book conditions respectively.
4. See Sub-Clauses 69.1(a) and 16.2(c) of the 1987 and 1999 FIDIC Red Book conditions respectively.
5. Article 247, in translation, reads "In contracts binding upon both parties, if the mutual obligations are due for performance, each of the parties may refuse to perform his obligation if the other contracting party does not perform that which he is obliged to do".
6. Article 414, in translation, reads "Any person who is obliged to perform a thing may refrain from so doing so long as the obligor has not discharged an obligation of his arising by reason of an obligation of the obligee and connected with it".
7. See Sub-Clauses 69.4 (a) & (b) and 16.1 (a) & (b) of the 1987 and 1999 FIDIC conditions respectively.
8. A contractor may rely on Articles 338 and 389 of the UAE Civil Code to recover compensation as a result of the employer's failure to make payment in accordance with the contract.
9. Articles 283 and 284 of the PRC Contract Law.
10. Articles 884 and 885 of the UAE Civil Code.
11. For example Clauses 48 and 10 of the 1987 and 1999 FIDIC Red Book conditions respectively.
12. Under the FIDIC Red Book regime, a Taking-Over Certificate will trigger the contractor's entitlement for the release of the first half of its retention money; it also marks the end of the construction period and the contractor's responsibility for the care of the works followed by the commencement of the Defect Liability Period.
13. However, the contractor would need to be mindful of issues relating to insurance coverage for the completed works and the project site.
14. Sub-Clauses 26.1 and 1.13 of the 1987 and 1999 FIDIC conditions respectively require a contractor to

- comply with all laws including any applicable regulations or by-laws of the relevant local authorities.
15. This may occur in situation where there are conflicting or competing building codes imposed by different local authorities with no clear distinction as to which one takes priority.
 16. Article 877 of the UAE Civil Code.
 17. What amounts to a reasonable period of time is a question of fact. The writer submits that the extent and seriousness of the defects and its impact on the safety of the works and people at the project site would be relevant factors to be considered.
 18. Articles 262 and 281 of the PRC Contract Law.
 19. Article 94(3) of the PRC Contract Law.
 20. Sub-clause 63.1(c) of the 1987 FIDIC Red Book conditions provides similar remedy to an employer.
 21. Articles 880 and 881 of the UAE Civil Code.
 22. Article 883 of the UAE Civil Code.
 23. Article 882 of the UAE Civil Code.
 24. Article 880(2) of the UAE Civil Code.
 25. Article 890 of the UAE Civil Code.
 26. Article 891 of the UAE Civil Code.
 27. This practice takes place more often in the case of a nominated subcontractor.
 28. Unless there are special circumstances where a legal relationship can be established between the employer and the subcontractor.
 29. Sub-Clauses 4.1 and 4.4 of the 1987 and 1999 FIDIC Red Book conditions respectively.
 30. Save for certain conditions specified in the relevant sub-clauses.
 31. See Sub-Clauses 63.1(e) and 15.2(d) of the 1987 and 1999 FIDIC Red Book conditions respectively.
 32. Article 272 of the PRC Contract Law.
 33. Sometimes known as the Construction Manager or Management Contractor.
 34. However, even if this view is correct there appears to be another issue to overcome because the same law also prohibits an employer from dividing up the works in a construction projects so to be undertaken by several contractors. Presumably, the way to overcome this prohibition is to only employ one contractor to carry out the whole of the structural works of the project as required under Article 272 of the PRC Contract Law.

The real estate sector in Dubai in particular has gone through significant legislative changes which has in some ways influenced the local construction market. See Lisa Dale, "Eight Years in Review – Legislating for Dubai's First 'Boom and Bust' Cycle," Al Tamimi Law Update (<http://altamimi.newsweaver.ie/Newsletter/kalr5lz78an>).