

Negotiating contracts in the Construction industry

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The global economic crisis that began in late 2008 sparked an increase in construction contract re-negotiations in Dubai and the UAE as a whole in the months that followed of 2009 / 2010.

Numerous projects were put on 'hold' for long periods of time before developers who were still able to proceed with their projects lifted those suspensions and at the same time sought a revised (typically reduced) contract price, changes in the construction programme (some requiring acceleration of the, by then, severely delayed projects) and a renegotiation of the original contractual and commercial terms.

Four years later, the same questions are still being posed but not just by the developers to their contractors, consultants and suppliers. The shoe is now also seen on the other foot, perhaps as a result of a suspension of services by a contractor, consultant or supplier where the developer is delaying progress of the project. The renegotiation of construction contracts is not only an issue in the UAE; recent announcements in the regional industry press of USD\$133 billion worth of projects having been put on hold in Saudi Arabia and numerous other projects in the region currently on hold, such as those in Kuwait (as announced last summer following the Arab Spring) means that the matter of re-negotiating contracts is going to become a familiar issue for construction industry players in the region to have to address, albeit subject to the various applicable local laws and varying degrees of commercial standing that those companies currently maintain.

In this article we will look at the position relative to the UAE Laws taking the view point of a contractor considering the renegotiation of an existing contract on a stalled project. Similar issues will need to be addressed by consultants, sub-contractors and suppliers.

There are a number of points to consider when contemplating the renegotiation of your contract. Are you contractually obliged to re-negotiate? Probably not. Are you legally obliged to do so? Again, probably not. In fact, the UAE Civil Code provides that parties to a valid contract may only alter it in certain limited circumstances. However, if you don't agree to a re-negotiation, there is the risk that you will lose the work and a valuable commercial relationship going forward. The risk for the developer is that his contractor may opt to terminate its contract forcing him to go back to tender and find a suitable replacement. Those companies that have survived the global financial crisis and have maintained a base in the Middle East maybe more inclined to consider termination following the events of recent years. In certain circumstances, you may therefore need to consider such a re-negotiation but be clear, is it a renegotiation of an existing contract, or putting in place a new contract?

Contractual considerations

Firstly, insofar as you are able to, you should use a re-negotiation to ensure that any outstanding claims are agreed and paid up to date. You can then draw a line in the sand and proceed with a fresh perspective on the project, free of those niggling outstanding claims, which should help maintain a good working relationship between the parties.

Before you agree to a revised contract price check the payment terms. Is there a clause in the existing contract that only permits interim payment applications to be made for a minimum amount? If so, you may need to reduce that limit proportionately, or remove the provision altogether and replace it with perhaps a regular monthly application for payment.

Consider the implications to your cash-flow of the revised price contract. Further, are there any set-off or abatement provisions in the current contract? If such a provision was to be implemented during the course of the contract, will you have enough funds to continue with and complete the works on this basis?

Ensure that any time related obligations in the revised contract are updated to accommodate changes to the construction programme and completion date, so that you don't prematurely trigger any contractual delay penalties. Also, check that the extension of time provisions remain suitable and amend them if necessary.

Occasionally, some developers will attempt to reduce the scope of the works by utilising the variation provisions under the contract. You may therefore have to accept a reduction in the scope of the works to ensure that you are engaged to complete the remainder of the contract works. However, you must be protected going forward. For example, avoid provisions that give the developer the option to further reduce the scope of works at will and re-tender a portion of the works package in anticipation of finding a cheaper contractor further down the line.

In addition, check that you have suitable rights to suspend and/or terminate the works. Are your demobilisation and re-mobilisation costs adequately covered? If not, then now is a good time to discuss them.

You may also wish to revisit your dispute resolution provisions, to ensure that in the event of a dispute in the future, perhaps as a result of the suspension of the project, or a disagreement about any of the revised terms of the contract you will then have adequate mechanisms in place to handle any disagreement or dispute as efficiently as possible. It could be that new alternatives have become available since you originally entered into your contract. For example, you may wish to opt into the jurisdiction of the DIFC Courts following the issue of Law No 16 of 2011 last October, for the resolution of contractual disputes.

Commercial considerations

Savings on material prices are likely to be first on the agenda. Likewise, any savings on labour costs that you are able to secure may also need to be accounted for. However, should the costs of such elements rise significantly during the remainder of the contract, then you are likely to be left out of pocket. Therefore, make sure there is a fluctuation clause in the renegotiated terms to accommodate this possibility.

It is essential to ensure that all of the agreed revised terms / additional terms are set down clearly in writing and that the supplementary agreement is properly executed by the parties to give certainty as to the contractual relationship going forwards. This is even more important in jurisdictions such as Saudi Arabia where the local laws are not as well developed as other jurisdictions that you might have greater experience of; implied local law provisions that are enjoyed in a jurisdiction you are familiar with may not necessarily be in place in another.

In parallel to the revisions being agreed with the developer you should also review any relevant conditions that need to be revised in the contracts agreed with your subcontractors and suppliers. Make the necessary revisions to those contracts, and obtain written agreement from the relevant parties to ensure you are able to meet the new obligations under your own contract. Consider what cost savings are reasonably attainable and what other terms of the subcontracts and supply agreements may need to be revised in turn.

Have you already provided a performance bond and/or advanced payment bond? If so, consider re-negotiating the terms of the bond. A conditional bond will be preferable to an unconditional bond, however, this is likely to be a matter for spirited commercial negotiation. Most importantly, ensure that all bonds are revised, updated and re-issued to reflect the re-negotiated terms.

Finally, remember to notify your insurer of the changes to the contract so that your insurance cover is revised as appropriate.

It is vital to ensure that all amendments work effectively within the existing contract terms. Failure to ensure appropriate drafting could well negate both parties' efforts. It is therefore advisable to take legal advice to ensure that the intended amendments work properly and comply with the local laws in the jurisdiction that applies to your contract. Al Tamimi & Company has 10 offices in 6 Middle Eastern jurisdictions (UAE, Qatar, Iraq, Saudi Arabia, Jordan and Kuwait). The Construction and Engineering team can offer advice and assistance in the renegotiation of your contracts across the region. If re-negotiation of your contract is something that you are considering, please contact the author.