

Dubai: Pay when paid clauses

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In this case, the Main Contractor was unable to pay an outstanding amount owed to the Subcontractor as a result of not receiving his payment from the Project Owner.

A 'pay when paid' clause in a back to back agreement is a provision making payment under a construction contract conditional on the payer receiving payment from a third person (typically the project owner).

In this case, the Main Contractor argued that the action be stayed or dismissed pending the resolution of the arbitration matter which they brought against the Project Owner.

Facts of the case

The Claimant (a subcontractor) was a company specialized in the installation of glass and aluminum who initiated legal action before the Dubai Court of First Instance against the Respondent (the Main Contractor) seeking a court order obligating the latter to pay the amounts due to the Claimant plus legal interest.

The Claimant agreed to undertake all aluminum and glass works for the project within ten days from the date of meeting with the Respondent on the understanding that the former would not incur any fines and that all amounts due to the Claimant would be released.

After completing the work, the Claimant informed the Respondent of the completion and the project consultant issued a completion certificate.

While the Respondent paid part of the outstanding amounts owed to the Claimant for the completed work, the Respondent did not settle the outstanding balance due as a result of their inability to pay. The Respondent had not received payment from the project owner.

Procedural History

The Court of First Instance

Before the Court of First Instance, the Respondent pleaded lack of capacity and requested that the court dismiss the case or alternatively, to stay the action pending a decision in the arbitration case brought by the Respondent against the Project Owner.

The Court of First Instance appointed an expert, who examined the case. The expert gave his decision and the Court ordered the Respondent to pay the outstanding amount calculated by the expert in his report in addition to payment of legal interest.

The Respondent appealed before the Dubai Court of Appeal seeking to overturn the lower court's decision on the following grounds:

The appealed judgment in its reasoning relied on a flawed expert report that did not examine the payment

mechanism agreed upon between the Claimant and the Respondent and separately between the Respondent and the Project Owner. The Claimant and the Respondent agreed that the amount owed to the Claimant will be paid by the Respondent when the latter's dues are paid by the Project owner i.e. pay when paid.

As the Respondent's dues were not settled by the Project Owner, the Respondent argued that the Court of First Instance erred by rejecting their plea in relation to lack of capacity. The Respondent also argued that filing the case was premature because of the non-fulfillment of the condition precedent.

The Respondent further argued that they had a direct relationship with the Project owner and the case is conditional upon the Respondent receiving payment from the latter. In this regard, the appealed judgment erred by not ordering that the action be dismissed or stayed pending the court's decision in the case between the Respondent and the Project owner.

Furthermore, the appealed judgment erred in rejected the Respondent's request to join the Project owner to the proceedings.

The Respondent concluded their argument before the appeal court by requesting that the lower court's decision be overturned or alternatively for the matter to be referred to a different court appointed expert to establish the existence of a 'pay when paid' clause in the agreement concluded between the Respondent and the Claimant.

The Court of Appeal

The appeal court appointed a different engineering expert, and after submitting his report the court held that:

It has been established by the cassation court that a clause allowing the main contractor to pay his subcontractor only when the former has been paid by the project owner renders the obligation of the main contractor subject to a condition precedent. Such condition must be fulfilled before the subcontractor has the right to be paid by the main contractor. As such, the burden of proving that the condition has been fulfilled rests with the creditor.

In this case, the Claimant and the Respondent concluded in their agreement that all terms of the subcontract shall be performed back to back with the main contract (between the Project Owner and the Main Contractor). Additionally, the Claimant did not object to the clause and did acknowledge that they received the project progress payments on a 'pay when paid' basis.

In light of the above, the Respondent (a main contractor) made payments to the Claimant conditional on receipt of payment by the Project Owner. The Respondent's obligation therefore is subject to a condition precedent and consequently the Claimant cannot claim outstanding payments as long as that condition has not been fulfilled.

The appeal court found that the lower court is contrary to the sound interpretation of the agreement between the disputing parties and the clauses included therein.

Consequently, the appeal court overturned the lower court's decision and dismissed the action as premature.

Practice note:

In this case the court classified a 'pay when paid' clause as a condition precedent. The sub contractor can claim any outstanding payment owed to him by the main contractor only when the condition precedent is fulfilled.

Any legal action initiated before the fulfillment of a pay when paid clause can be dismissed as premature.