

Terminating construction contracts for convenience in the UAE

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In accordance with Article 267 of the UAE Civil Code unilateral termination of a contract can have no legal effect in the UAE, but the practice of the UAE Courts show that the employer in construction cases can be entitled to unilaterally terminate a contract. In a recent Court of Appeal judgment it was held that “the reason behind this exception is that muqawala contracts often take a long time to complete and circumstances may change in the period between contract formation and completion of the contract work”. This exception has its roots in Egyptian law. In this case, the court held that when a main contractor gives notice of termination to the subcontractor, the muqawala contract terminates and the main contractor must compensate the subcontractor for the expenses incurred, any work already performed and loss of profit which the subcontractor expected to earn by undertaking the work.

This decision applies a provision found in Egyptian law which is not available under UAE law. Pursuant to Article 663 of the Egyptian Civil Code:

“(1) An employer may terminate the contract and stop the work at any time before the completion of the works, provided that he compensates the contractor for all expenses he has incurred, for the work that he has done and the profit that he would have made if he had completed the work.

(2) The Court may, however, reduce the compensation due to the contractor for loss of profit if the circumstances justify such reduction. In particular, the court shall deduct from such compensation any savings realized by the contractor as a result of the rescission of the contract by the employer and any profit which the contractor could have made by employing his time otherwise.”

In the UAE, the primary source of law is statutory code and judges, therefore, do not make law. However, the UAE legal system has been influenced to a large extent by the Egyptian legal system, courts and practice. In this case, the UAE Court looked to the practice of the Egyptian courts because of the absence of a provision in the UAE Civil Code specifically dealing with the unilateral termination of muqawala contracts.

Background

The claimant (a subcontractor) sued the defendant (the main contractor) seeking judgment against them for AED 8,739,230 plus 12% interest per annum from the due date until payment. According to the contract, the parties agreed that the subcontractor was to supply lights and their accessories for AED 10,378,800. The subcontractor commenced manufacturing, and produced a batch of items in accordance with the conditions and specifications agreed upon and prepared them for delivery to the main contractor in accordance with the timetable. The subcontractor also purchased the necessary quantity of raw materials to manufacture all the items agreed upon. The main contractor received a batch as scheduled in the delivery timetable on site but did not receive a further batch that was ready for delivery so the main contractor asked the subcontractor to store the items until further notice. The main contractor paid AED

544,928 out of the total cost of the contract items and AED 8,739,230 remained outstanding. The subcontractor argued that the main contractor's unwarranted breach of contract harmed the subcontractor who was unable to meet their commitments towards their raw material suppliers, to the detriment of their business reputation.

Main contractor's arguments for termination

The main contractor argued that production, delivery and payment were conditional on the approval of the project consultant and the employer and that the contract in question, a subcontract, was back-to-back with the main contract which, having been terminated, meant that the subcontractor could not assert any claims against the Main Contractor. The Main Contractor argued that he repeatedly notified the subcontractor to stop production and deliveries due to financial difficulties experienced in the project, but to no avail.

The Court subsequently appointed an engineering expert who submitted a report concluding that the subcontractor had obtained the necessary approvals from the main contractor for the materials that were to be used in the project as the Main Contractor would send confirmation to the subcontractor via inspection requests.

The Court's final decision

The judgment referred to Article 872 of the Civil Code which provides that a "muqawala is a contract by which one of the parties thereto undertakes to make a thing or to carry out work for consideration which the other party agrees to provide."

The Court also held that it is judicially established that the employer may, for any reason, terminate the muqawala contract before it has been fully performed. This is an exception to the rule that the contract is binding on its parties and may only be revoked or varied by mutual agreement. As mentioned in the introduction, the reason behind this exception is that muqawala contracts often take a long time to complete and circumstances may change in the period between contract formation and completion of the contract work. In the interests of ensuring that the employer (or main contractor) does not have to bear unnecessary costs, the courts have given the employer the legal option of unilaterally terminating the muqawala contract while at the same time safeguarding the subcontractor's interests by requiring the employer to compensate the subcontractor for expenses incurred, work already performed as well as loss of profit which the contractor expected to earn by undertaking the work. This applies where the main contractor has subcontracted work such that the main contractor is considered the employer in the relationship with the subcontractor and thus is entitled to terminate the subcontract before completion of the work. This option may be exercised regardless of the method of payment involved (whether lump sum or unit prices under an itemized list).

In this particular case it was clear from the main contractor's correspondence that they had notified the subcontractor to stop production and deliveries. This was followed up with a letter giving notice of termination of the master project and requesting from the subcontractor a list of manufactured items to support the main contractor's claims for compensation against the employer. The muqawala terminated upon notice of termination. As a result, the main contractor's responsibility to continue making payments under the contract and the subcontractor's obligation to complete the work ceased as well. However, the main contractor would have to compensate the subcontractor as mentioned above.

Conclusion

Unilateral termination (or termination-for-convenience) can be an attractive option where grounds for termination are uncertain or the project is no longer feasible. The terminating party is not faced with making the argument that a material or fundamental breach giving rise to termination rights has occurred, but must be prepared to compensate the subcontractor for loss of profit and the expenses incurred at the date of termination.