

Pay-when-Paid Clauses in the UAE: Is there a way around for a Subcontractor?

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A 'pay-when-paid' clause is used by contractors to make payment to the subcontractor conditional upon payment of the corresponding sum from the employer.

These clauses are infamous within the construction industry, especially at the subcontracting level. There are a number of jurisdictions (e.g., UK, Singapore, New Zealand and certain states in Australia) where contractual 'pay-when-paid' types of arrangements are either void or looked at with suspicion by the courts.

These conditional payment mechanisms work to the advantage of the contractors but may put a serious financial obstruction on the subcontractor's cashflow. In the UAE, the law accentuates the impact of these clauses as the Civil Code prohibits subcontractors from claiming directly against the employer unless the main contractor has assigned its rights against the employer to the subcontractor.

Keeping in mind the practical reality of a subcontractor being at the bottom of the payment food chain, what steps can a subcontractor take to minimize the risk created by pay-when-paid clauses?

Some options which a subcontractor can use when faced with a pay when paid scenario are set out below.

Direct Payments by the Employer

Bargaining and negotiating terms of a subcontract are difficult for any subcontractor. The practical reality is that power lies with the main contractor/employer, being the entity paying the money.

That being said, sometimes a subcontractor can successfully obtain a direct payment obligation from the employer, at least for certified amounts, thus bypassing the main contractor.

The Civil Code states that a subcontractor shall have no claim against the employer for anything due to him from the contractor unless the contractor has made an assignment to him against the employer.

If a subcontractor has this type of arrangement, care is needed to ensure the terms agreed with the employer do not leave the subcontractor with other legal hurdles (e.g. disputes under local courts and not arbitration).

Contractor Pursuing the Claims of the Subcontractor

The subcontractor should ensure that there is a clause which states that the contractor shall pursue the claims of the subcontractor to the fullest extent permissible by law. Bolstering this clause ensures that the subcontractor can put pressure on the contractor to go after the employer to secure payment of its claims. The Civil Code lends credence to this approach and states that a condition must be observed and fulfilled as far as possible.

It is also advisable to include a clause which provides for the contractor to update the subcontractor

of its pursuit of the subcontractor's claims. This can be done by way of a clause which provides for the contractor to send a copy of all documents relating to the subcontractor's claim between the contractor and the subcontractor to the Employer. This would ensure that the subcontractor is aware of the progress of matters and can accordingly put pressure on the contractor to pursue its claims more aggressively if that is already not the case.

An important point for the subcontractor to note is that the success or failure of its claims to a large extent would depend on the evidence. This means that letters, correspondence, payment applications evidencing the subcontractor's compliance with its obligation in time should be properly recorded, filed and maintained.

Suspending works

Subcontractors should seek a right to suspend works on account of non-payment by the contractor. Irrespective of a pay-when-paid clause, suspension of works is a powerful weapon which can strong arm a contractor to pursue the subcontractor's claim diligently and pressure the employer into paying for work which is not in dispute.

In time sensitive projects, a robust right to suspend can coerce an employer to pay as a delay would mean incurring late completion damages. A right to suspend works however should be exercised only after fulfilling the primary obligation of performance of the condition under the subcontract. UAE law does not give the right to suspend to a party who has not fulfilled its primary obligation.

Limiting the effect of pay-when-paid regime

It is common practice for contractors to deny a claim for an extension of time or additional cost due to delay if a reciprocal entitlement has not been provided to the contractor under the main contract. This is so even if the subcontractor is not at fault.

The right to claim additional cost or an extension of time should not be subject to the contractor having a similar right under the main contract where the delay is not on the contractor's critical path (that is causing a delay to the whole project) or where the delay is caused by something at the contractor's risk under the main contract.

Conclusion

There are ways around a pay-when-paid regime. From the subcontractor's perspective, the impact of these clauses can be made more reasonable, if not completely negated. A subcontractor should try to manage its risk by insisting on the inclusion of all the options discussed above. While a contractor may be unlikely to agree to all proposed changes, the inclusion of just one will go a long way in providing comfort to the subcontractor.