

SUBCONTRACTING IN THE CONSTRUCTION FIELD

التعاقد من الباطن في مجال البناء

by

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of the requirements for the degree of
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Abstract

This research attempts to discuss selected legal aspects of sub-contracting, and to set out recommendations for parties who are involved in the construction contracts and sub-contracts, regarding the mechanisms of drafting their contracts, specifically, clauses that are subject to cause more disputes, and the clauses related to key factors which affect the contractual relationships between the parties.

The research discusses the selection process of sub-contractors, and how this process and selection criteria influence the liability, rights, and obligations of the parties related to both main contracts and sub-contracts.

In addition, the research discusses the concept of back to back sub-contracts, and the effects of back to back payments on the construction main contract and sub-contract parties.

The recommendations of this research have been concluded, after thoroughly analyzing and studying courts decisions for cases related to each key factor that influences the contractual relationship between parties in the construction industry.

The main basis referred throughout this research were the UAE Civil Transaction Code and other UAE legislations, Common Law and UK acts and regulations, and other international laws and practices. In addition, specific consideration has been given to international standard construction contracts such as FIDIC construction contract form Redbook 2017, and FIDIC construction sub-contract form 2011, and other standard contracts such as JCT and NEC.

The significance of this research arises from the importance of proper contracts drafting, as the interpretation of the clauses included in a contract, substantially influences the liabilities, obligations, cashflows of a contract parties, and plays a significant role in avoiding disputes that may arise from poor drafting.

ملخص البحث

تم إعداد هذا البحث لمناقشة بعض المظاهر القانونية المرتبطة بقطاع المقاولات من الباطن، ومحاولة وضع توصيات للأطراف المتعلقة بعقود البناء الرئيسية والعقود من الباطن، فيما يخص آليات صياغة هذه العقود، وبشكل خاص، البنود التي يمكن أن تسبب النزاعات والخلافات، والبنود المتعلقة بالعوامل الرئيسية التي تؤثر على العلاقات التعاقدية بين الأطراف.

يناقش البحث عملية اختيار المقاولين من الباطن، وكيف تؤثر هذه العملية ومعايير هذا الاختيار على مسؤولية وحقوق والتزامات الأطراف المرتبطة بكل من العقود الرئيسية والعقود من الباطن، كما يناقش أيضاً صياغة العقود من الباطن بطريقة "ظهر بظهر" و تأثير صياغة بنود الدفعات بهذه الطريقة على المقاولين و مقاولي الباطن.

تم استخلاص بعض التوصيات بعد الانتهاء من البحث، بعد إجراء تحليل شامل ودراسة قرارات المحاكم للقضايا المتعلقة بكل عامل يؤثر على العلاقة التعاقدية بين الأطراف المرتبطة بقطاع البناء

تم تحضير هذا البحث استناداً إلى مراجع وأسس متبعة محلياً ودولياً؛ هي قانون المعاملات المدنية لدولة الإمارات العربية المتحدة وتشريعات إماراتية محلية أخرى، والقانون العام الانجليزي وقوانين ولوائح المملكة المتحدة، بالإضافة إلى قوانين وممارسات دولية أخرى، بالإضافة إلى بعض عقود البناء التعارف عليها دولياً مثل نموذج عقد البناء فيديك. الكتاب الأحمر 2017، والعقد الفرعي للإنشاءات فيديك لعام 2011

تتبع أهمية هذا البحث من ضرورة الحرص على صياغة العقود بشكل صحيح وواضح، حيث أن تفسير البنود المدرجة في العقد، يؤثر بشكل كبير على الالتزامات التعاقدية والتدفقات المالية لأطراف العقد، ويلعب دوراً مهماً في تجنب النزاعات التي قد تنشأ عن صياغة غامضة أو غير واضحة.

Dedications

إلى كواكب الأمل المُعلّقة في فضاء روحي، والحضن الذي أسند إليه رأسي عند شفاء الأيام؛ والدائي

إلى من أضاعت عتمة غربتي بنور قلبها، والتي لولاها لما عرفت معنى الأخت، أختي وقطعة من روحي؛
هزار

إلى من أنسوا وحدتي وغمروا قلبي بالدفء، من أحبوني على الرغم من أي شيء؛ صديقاتي: مجد، نور،
ميس، والجميع...

إلى الأرض التي عليها ما يستحق الحياة؛ فلسطين

شكراً لعائلتي الكبيرة، اللذين لولاهم أنا ما كنت أنا، وما رفعت رأسي بفخرهم بي

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Chapter 1 – Introduction

‘The construction sector is the third most important industry [in the United Arab Emirates] following oil and trade and consists of a total of around 6,000 companies, mostly located in Abu Dhabi’¹ , ‘Dubai is now the largest construction market in the region, additionally boosted by the major projects undertaken in the Emirate in the run-up to Expo 2020’² . In the vast majority of the construction projects, sub-contracting is widely used by main contractors, especially for complex and specialized projects, sub-contracting is an effective tool to increase the project performance and productivity, a risk sharing method, and it provides for specialized experience.

Hence, the significance of this research emerges; considering the lack of experience and the poor knowledge of main contractors and sub-contractors in relation to the legal aspects of sub-contracting, and the under estimating of the consequences of disputes arising out of such sub-contracting on their projects and business continuity, which usually leads to a waste of time, efforts, in addition to financial losses.

This research deals with selected legal aspects related to the sub-contracting practices around the world and in the UAE, in an attempt to conclude and provide for a legal framework and guidelines for main contractors and sub-contractors, to simplify and clarify the above-mentioned legal aspects, in order to minimize the disputes that may arise out of the interpretation of the sub-contract terms and provisions, and to assist in saving time, cost, and efforts endeavored by the sub-contract parties during the performance of their duties and obligations under the sub-contract.

1 'United Arab Emirates: Where Construction Never Sleeps - Ceramica.Info' (ceramica.info, 2020) <<https://www.ceramica.info/en/articoli/united-arab-emirates-where-construction-never-sleeps/>> accessed 06 May 2020.

2 'United Arab Emirates: Where Construction Never Sleeps - Ceramica.Info' (ceramica.info, 2020) <<https://www.ceramica.info/en/articoli/united-arab-emirates-where-construction-never-sleeps/>> accessed 06 May 2020.

Research Objectives

The main objectives of this research are summarized as follows:

1. To analyze and study the legal aspects and the factors that affect the contractual relationships between main contractors and the sub-contractors.
2. To discuss the effects of the selection criteria of sub-contractors, on the rights of the sub-contract parties, and the obligations towards each other's.
3. To highlight the significance of the proper drafting of sub-contract agreements, and the effects of ambiguous and poor drafting on the parties related to a construction contract.

Research Methodology

For this research, the doctrinal approach has been adopted as a methodology, specifically by recalling several general construction and contractual practices, discussing, and analyzing previous cases related decisions by several international courts such as, UAE, UK, and others, this has been carried out for the cases related to each discussed legal aspect which influences the contractual relationship between a sub-contract parties, specifically the drafting of the sub-contract agreements.

Research Structure

This chapter provides for an introduction and a brief of what is going to be discusses in the upcoming chapters in this research.

The remaining parts of this Dissertation are divided into five chapters; chapter two provides for an overview about construction contracts in general, and sub-contracting practice in the construction industry, in terms of the permissibility and restrictions of sub-contracting in which main

construction contracts may include, furthermore, the main reasons that main contractors resort to sub-contracting part or the whole of a project works had been summarized, then the major types of sub-contractors in the construction industry based on the selection criteria of the sub-contractor, had been identified and discussed with a specific reference to the contractual liability between the sub-contract parties, in addition to that, the relationship between the employer and the sub-contractor as a key factor which affects the whole contractual process, had also been discussed.

Then, chapter three discusses the payment mechanisms in sub-contracting practice, and direct payments issued by employers to nominated sub-contractors in specific, in addition to that, variation orders and extension of time claims have been outlined; the complications and the influences of the claims submitted by a main contractor to an employer, and by a sub-contractor to a main contractor.

Meanwhile, Chapter four describes the back to back concept in drafting sub-contract agreements, discussing in details the conditional payment clauses; several cases in the UAE, UK, and around the world have been reviewed and analyzed, then the effects of such back to back payment clauses on sub-contractors had been outlined, along with several recommendations for the main contractors and sub-contractors on how to properly draft their sub-contract provisions, in an attempt to avoid the disputes that may arise out of such agreements.

After that, Chapter five discusses the termination process of sub-contracts, in terms of the entitlement for parties to terminate a sub-contract, the risks and consequences of termination, the two main categories of termination, in addition to exercising good faith while terminating a contract for convenience in civil law and common law jurisdictions.

At the end, Chapter six summarizes the main outputs and conclusions of the research.

Chapter 2 – Legal Aspects of Subcontracting

2.1 Introduction and Subject Overview

This chapter discusses several legal aspects of sub-contracting in the construction industry, it is worth to be highlighted that even though payment, back to back sub-contract provisions, and termination of sub-contracts are also considered as legal aspects of sub-contracting, such aspects will be discussed and detailed in two separate chapters, due to the fact that they are considered as common sources of disputes in the construction industry rather than other legal aspects.

2.2 Construction Contracts

In legal terms, ‘a contract is a legally enforceable agreement’³ or ‘a promise that the law will enforce’⁴, an agreement means that there is an offer from one party to another, in which the other party to agree on the conditions of such offer, and in order for the agreement to be valid and enforceable, the acceptance by the other party shall be provided, taking into consideration that the contractual relationship between the contract parties shall begin only after the signature by both parties on a formal document which is called “the agreement”⁵. In the context of the method of agreement, it is worth to be mentioned that in practice, an agreement can be reached by a mutual agreement in exchanging emails. There are many definitions for a contract agreement, which delineates the major requirements that shall exist, in order that a contract to be valid and legally binding.

³ Will Hughes and John Murdoch, *Construction Contracts* (3rd edn, Taylor & Francis 2000),110.

⁴ Gail S Kelley, *Construction Law* (1st edn, Wiley 2013), 51.

⁵ Will Hughes and John Murdoch, *Construction Contracts* (3rd edn, Taylor & Francis 2000),110.

A contract is being formed when one party offers another party to carry out, deliver, or buy a well-defined object, and the other party accepts, such offer must be accompanied by a specific consideration for the contract scope that will be done, the parties reaching for a contract shall have the legal capability to sign a contract which is legally binding.’⁶

A construction contract is a type of the above defined contracts, which shall also be legally binding, and shall include a defined and detailed scope of works, along with the detailed obligations of each party towards the other, and the remuneration for the works to be carried out throughout the construction project period. ’⁷

With a specific reference to the UAE Civil Transaction Code, Article (872) defines a construction contract as an agreement between two parties in which one party is obliged to carry out specific scope of works or to create a defined object, whereas the other party shall pay an amount of remuneration for such works.’⁸

And according to sub clause 104(1) of the Housing Grants Construction and Regeneration Act (HGCRA) 1996, a construction contract is an agreement between two parties to perform a construction related works, or managing the performance of the scope of construction works which might be done by other parties or sub-contractors, utilizing a party’s labors or outsourcing other labors to perform the construction works, conducting architectural, structural design, or surveying works, and offering technical solutions and

⁶ John McGuinness, *The Law And Management Of Building Subcontracts*(Blackwell Pub 2007), 10.

⁷ 'Understanding Construction Contracts | Construction' (*Construction.laws.com*, 2019) <<https://construction.laws.com/construction-contracts>> accessed 26 June 2020.

⁸ UAE, 'UAE Civil Transaction Code' (1985).

advice related to the engineering industry which may include landscaping, buildings, interior and exterior design, or any other construction related discipline.⁹

A typical construction contract traditionally involves two parties; a contractor who undertakes to carry out the scope of the construction works as specified in the contract terms, and the project owner who guarantees to pay the agreed amount of remuneration to the contractor for the works which will be carried out by the latter, the construction contract would also include other details such as, the scope of works to be carried out, the quality standards and criteria related to the project, the project duration, the project amount along with the payment terms and conditions, and obligations and liabilities of both parties towards each other.¹⁰ This is emphasized by Article (874) of the UAE CTC which indicates that the construction related contracts shall have a well specified description of the scope of works, along with the details, specifications, types, performance methods, quantities, remuneration, and a specified duration for the works to be completed.¹¹

2.3 Sub-contracting

In the construction industry, it is very common for the main contractor to hire sub-contractors to carry out part or the whole of the works, such appointment may be subject to several restrictions, either by the governing law that regulates the contractual relationship or by the underlying main construction contract, sub-contracting may lead to several impacts on the project and the contracting parties both positive and negative impact;

⁹ English Arbitration Act, 1996 , s.104

¹⁰ *Gail S Kelley, Construction Law (1st edn, Wiley 2013), 51.*

¹¹ UAE, 'UAE Civil Transaction Code' (1985).

such impacts shall be identified, studied, and analyzed thoroughly before deciding to appoint a sub-contractor.

Nowadays, and due to the rising complexity of the construction projects, sub-contracting in the construction industry is becoming widely prevailing around the world, and as stated by Ibrahim ¹², specifically in complex projects which requires certain specialization, the contractor may not be able to manage to complete a project without engaging the services of a sub-contractor to carry out a selected scope of works.

And as stated by Gould ¹³, the concept of sub-contracting is not a new practice in the construction market; a project main contractor may assign a specific scope of works or the whole of the project works to be carried out by a third party, this concept is nowadays widely used as the construction projects are becoming more complex and require specialization.

And as per Masadeh ¹⁴, main contractors are barely carrying out and completing the works related to their construction contracts without the support of sub-contractors, this mainly occurs when the construction project requires a specialized experience such as the construction of factories, oil and gas projects, hospitals, and infrastructure projects, and the main contractor may not be able to provide such experience to be capable to complete the project successfully.

¹² Ahmed Ibrahim, 'Subcontracting Under UAE Law - Real Estate And Construction - United Arab Emirates' (*Mondaq.com*, 2015) <<https://www.mondaq.com/Real-Estate-and-Construction/419424/Subcontracting-Under-UAE-Law>> accessed 15 May 2020.

¹³ Nicholas Gould (*Fenwickelliott.com*, 2011) <https://www.fenwickelliott.com/sites/default/files/nick_gould_-_subcontracts_paper_for_university_of_vienna.indd_.pdf> accessed 15 May 2020.

¹⁴ Professor A. Masadeh 'Vicarious Performance and Privity in Construction Contracts' (2014) *International Construction Law Review*, v 31, 108

In addition to that, Uff ¹⁵ states that, despite the fact that the common practice in the construction industry is that the project works are assigned to a main contractor at the beginning of the project, the main contractor usually has the right to sub-contract a selected part of the project works, provided that the provisions of the main contract allows for that.

With reference to the above, it is worthy to highlight that sub-contracting is an effective tool which gives the chance to micro and medium companies in the construction field to participate in a large scale construction project, which will -in most cases- result in several business benefits for the construction project stakeholders. However, before deciding to sub-contract the whole or part of the works, the main contractor shall thoroughly review, evaluate, and analyze the scope of the works that is potential to be sub-contracted, in terms of examining whether sub-contracting such works is considered feasible and reasonable rather than performing such part by the main contractor itself, in addition to that, the main contractor shall have to make sure that under both the main construction contract and the law which governs the scope of works, it is permissible to sub-contract such works, and - in some cases - seek for the employer's consent in case it is mandatory under the main contract provisions.

2.4 Reasons to Appoint Sub-contractors:

From a main contractor's side, there are several reasons that motivates a company to appoint a sub-contractor to perform a specific scope of a project works, as sub-contracting provides for many benefits and opportunities to the main contractor, such reasons include but not limited to the following:

¹⁵ John Uff, Construction Law (10th edn, Sweet & Maxwell 2009), 325.

1. Sub-contracting - in most cases - is cost effective; in case of having a large scale project, to sub-contract a specific scope of works may be considered a worthy idea for cost optimization for a company rather than hiring new employees to perform such works, and despite the fact that sub-contractors' prices are relatively high when compared with carrying out the potential sub-contracted works by the company employees, sub-contracting is still considered as a cost effective method of performing a specific scope of works, due to many reasons such as; sub-contractors do not require benefits that the company employees have, and sub-contracting eliminates the project overhead cost, in addition to that, sub-contracting minimizes the headache of the recruitment and employment procedures. According to Stephen Tomicki 'hiring a subcontractor is about 20 to 30 percent more cost effective than hiring full time additional staff'¹⁶
Besides that, assigning a sub-contractor supports companies in avoiding long term commitment for hiring new employees to work for a specific project; when a company selects a sub-contractor to perform a specific scope of works, the contractual relationship between the company and the sub-contractor ends mostly after the completion of carrying out such works, in contrast, employment relationships with hired employees are more complicated to be ended by one party with - in most cases - no mutual consent to end such relationship, and thus, bringing such relationship to an end may lead to unnecessary disputes¹⁷ . Sub-contracting also decreases the cost and minimizes the risk resulting from purchasing, renting, and maintenance of the

¹⁶ Stephen Tomicki, '7 Reasons Why Subcontracting May Be Right For You' (*Hcr-llc.com*, 2016) <<https://www.hcr-llc.com/blog/7-reasons-why-subcontracting-may-be-right-for-you>> accessed 18 May 2020.

¹⁷ Stephen Tomicki, '7 Reasons Why Subcontracting May Be Right For You' (*Hcr-llc.com*, 2016) <<https://www.hcr-llc.com/blog/7-reasons-why-subcontracting-may-be-right-for-you>> accessed 18 May 2020.

- construction related equipment which, in case of sub-contracting, will all be incurred by the sub-contractor.
2. Sub-contracting provides for more expertise and specialized works; in some cases, and due to the nature of the project works, especially when the company staff do not have sufficient experience and are not capable to carry out the project works, it is usually preferable to assign a sub-contractor to carry out such works, due to the fact that sub-contractors will provide for specialized expertise in a specific specialty, and in this case sub-contracting ensures that the works will be performed in a manner and quality that might not be achieved if performed by the company employees, in most cases, when having no experienced staff to perform a specific unique works, the extensive experience in which the sub-contractors have in performing the same type of projects, and the similar projects performed previously by the sub-contractor will result that the sub-contracted works are performed efficiently and time effective.¹⁸
 3. Increasing productivity rates; sub-contractors are often more productive than the company employees, due to the extensive previous experience in performing similar projects, in addition to that, the contractual obligations which are imposed by the main contractor through the sub-contract agreement terms and conditions, obliges the sub-contractor to complete the works within the required time and quality, moreover, when a project or part of a project is sub-contracted, this distribution of the company workload allows for more focus by the company employees on the strategic business

¹⁸ Stephen Tomicki, '7 Reasons Why Subcontracting May Be Right For You' (*Hcr-llc.com*, 2016) <<https://www.hcr-llc.com/blog/7-reasons-why-subcontracting-may-be-right-for-you>> accessed 18 May 2020.

goals of the company and other running projects, and results that the sub-contracted works are done in a productive and time efficient manner.¹⁹

4. Risk Transfer: sub-contracting is considered as a risk response strategy for the project threats that contractors usually apply, it is a mechanism of risk allocation which transfers the risk associated with a specific scope of works from one party to another (usually from the main contractor to the sub-contractor), and if proper project management concepts are applied, the project risks shall be identified at an early stage, usually before signing the contract, and the risk response provisions - whether it was decided to be sub-contracting or any other mechanism – have to be included in the related construction contract.²⁰

2.5 Sub-Contracting Permissibility and Restrictions

The UAE CTC gives the right to the main contractor to sub-contract part or the whole of the works without the obligation to obtain the approval of the employer, this fact is emphasized through article 890 (1), which highlights that it is legally permissible for a company to assign a third party company to complete a specific part or the whole of the project works, however, if the underlying construction contract contains a provision which restricts the same, or unless it is required that the contractor shall perform the scope of works himself and by his own personnel due to the nature of the required works, the contractor will not be able to sub-contract such works.²¹ . However, article 83 of the Ministerial Decision No.20 of 2000, which applies to federal projects in the UAE, and

¹⁹ Stephen Tomicki, '7 Reasons Why Subcontracting May Be Right For You' (*Hcr-llc.com*, 2016) <<https://www.hcr-llc.com/blog/7-reasons-why-subcontracting-may-be-right-for-you>> accessed 18 May 2020.

²⁰ Rita Mulcahy Et. al, PMP Exam Preparation (10th edn, RMC Publications, Inc, 2013), 429

²¹ UAE, 'UAE Civil Transaction Code' (1985).

article 62 of law No.6 of 1997, which is applicable to contracts entered into by the government of Dubai, require a prior consent by the ministry or the governmental department and the concerned supervising consultant, to sub-contract any works. Moreover, sub-contracting is subject to be restricted by including a provision in the contract between the employer and the main contractor, especially if the main contractor has been appointed for having a special skill related to the performance of the project works, thus, the construction contract may be the source of restricting sub-contracting, either part or the whole of the project works, several standard forms of construction contracts includes provisions that restricts the application of sub-contracting; and referring to clause (5.1) of the FIDIC Red Book 2017²² which details the cases in which the main contractor is restricted to sub-contract the project works, the clause highlights that the contractor shall not have the right to sub-contract the works of a total amount which is higher than the agreed total contract value, as agreed in the contract provisions, this means that the contractor is restricted from sub-contracting the whole scope of the project, in addition to that, if it is clearly indicated in a provision in the contract general or particular conditions that it is prohibited to sub-contract a specific part of the works.

Sub-contracting is constrained by a construction contract when the contractor is under an obligation to get the approval of the employer to sub-contract a specific scope of works or the whole amount of the project works, and in some cases, the contractor may be required to seek for the employer or the employer's representative's approval regarding the sub-contractors details whom are intended to be assigned throughout the project, with minor expectances to the materials suppliers, and the named sub-contractors agreed and specified

²² FIDIC Contracts Red Book (3rd edn, 2017), Clause(5.1)

the conditions of the contract, it shall be noted that the approval of the employer or the employer's representative shall not be delayed more than 14 days after the contractor submits such details, otherwise the proposed sub-contractor shall be deemed to be approved, this is illustrated by clause (5.1) of the FIDIC Red Book 2017²³, and Ibrahim²⁴ recommends and supports the above discussed FIDIC clause stating that it is important that the main contract must include a provision to limit the time of the engineer's approval on the proposed sub-contractor, and that such approval shall not be withheld unreasonably. In the United Kingdom, the Housing Grants, Construction and Regeneration Act 1996, permits sub-contracting by clause (104) which clearly mentioned that part of a construction contract may include the management and the supervision of the construction related works by others, which means that the scope of construction works is eligible to be sub-contracted.²⁵

2.6 Amount of Works to be sub-contracted

The CTC provides for a flexibility for the contractor to sub-contract the whole or part of the works, unless the construction contract signed between the employer and the contractor states otherwise, this is illustrated by Article (890) of the CTC which states that ' A contractor may entrust the performance of the whole or part of the work to another contractor unless he is prevented from so doing by a condition of the contract, or unless the nature of the work requires that he do it in person.'²⁶

²³ FIDIC Contracts Red Book (3rd edn, 2017), Clause(5.1)

²⁴ Ahmed Ibrahim, 'Subcontracting Under UAE Law - Real Estate And Construction - United Arab Emirates' (*Mondaq.com*, 2015) <<https://www.mondaq.com/Real-Estate-and-Construction/419424/Subcontracting-Under-UAE-Law>> accessed 18 May 2020.

²⁵ English Arbitration Act, 1996 , s.104

²⁶ UAE, 'UAE Civil Transaction Code' (1985).

Moreover, the common law regulations, and As per Murdoch, the concept of sub-contracting is widely prevailing in the United Kingdom construction sector, as main contractors are recently preferring to appoint sub-contractors to carry out their project works rather than their own employees, as a result, the vast majority of the construction project involves the concept of sub-contracting.²⁷

Referring to the FIDIC standard forms of contract, the 1999 revision of the FIDIC Red book states clearly that it is prohibited to sub-contract the whole of the contract works, this is highlighted through clause (4.4) which states that ‘The Contractor shall not subcontract the whole of the Works.’²⁸ However, and unlike the 1999 edition, the FIDIC Red Book 2017 edition provides for limitations for sub-contracting the contract works as clarified in clause (5.1) and discussed previously, this clause clearly prohibits the sub-contracting of the whole works.²⁹

2.7 Types of Sub-Contractors

There are two major types of sub-contractors in the construction industry; domestic sub-contractors and nominated sub-contractors.³⁰

2.7.1 Domestic Sub-contractors

A domestic sub-contractor is a company selected by the main contractor, usually through the traditional tendering processes to sub-let a specific part of the project works to be performed, or materials to be supplied, noting that the employer does not interfere in the tendering and selection process of such sub-contractor, other

²⁷ Will Hughes and John Murdoch, *Construction Contracts* (3rd edn, Taylor & Francis 2000), 259

²⁸ FIDIC Contracts Red Book (2nd edn, 1999), Clause (4.4)

²⁹ FIDIC Contracts Red Book (3rd edn, 2017), Clause(5.1)

³⁰ There are other types such as named sub-contractors

than the usual obligation on the contractor to obtain the employer's approval on the selected sub-contractor (if such obligation is included in the contract provisions).

Generally, There are several international standard forms of domestic sub-contracts, each one is drafted to be used in parallel with a standard international main contract, however, it shall be noticed that domestic sub-contracts rarely involve the contract administrator related to the main contract (from the employer's side) while drafting the domestic sub-contract terms and conditions, in other words, the employer do not usually negotiate the terms of the sub-contract agreement with the main contractor and the sub-contractor, which results that matters which lead to disputes are left to be disputed upon between the main contractor and the sub-contractor at a later stage of the project.³¹

Liability of the domestic sub-contractors regarding the sub-contracted works arises either under the signed sub-contract (contractual liability), or under tort and negligence:

2.7.1.1 Contractual Liability:

The main contractor shall remain liable for the performance of the sub-contractor, as illustrated by clause (5.1) (2) of the FIDIC Red Book 2017, which states that the project main contractor shall remain liable towards the employer for all the sub-contracted works, which includes the management and supervision of such sub-contracted works, and shall also be liable for

³¹ Will Hughes and John Murdoch, *Construction Contracts* (3rd edn, Taylor & Francis 2000),265.

any defaults that may be done by any sub-contractor or their related personnel.³²

Furthermore, Article (890) of the UAE CTC emphasizes that the main contractor shall be liable towards the employer for the sub-contracted works, it states that ‘ (2) The first contractor shall remain liable as towards the employer.)’³³

2.7.1.2 Liability Under Tort and Negligence

The liability of the domestic sub-contractor towards the employer under tort may not be applied directly, as stated by Murdoch, the relationship between the domestic sub-contractor and the employer ‘is not normally of sufficient ‘proximity’ to carry with it a legal duty of care’³⁴.

However, decisions by courts held that it shall not be reasonable to release the sub-contractors from their liability for negligence, unless the underlying contract clearly states otherwise.³⁵

Referring to the decision issued by the House of Lords regarding the British Telecommunications PLC V James Thomson and Sons (Engineers) Ltd, which had considered the related contract signed between both parties, the House of Lords held that ‘a domestic sub-contractor who negligently causes

³² FIDIC Contracts Red Book (3rd edn, 2017), Clause(5.1)

³³ UAE, 'UAE Civil Transaction Code' (1985).

³⁴ Will Hughes and John Murdoch, *Construction Contracts* (3rd edn, Taylor & Francis 2000), 261

³⁵ Will Hughes and John Murdoch, *Construction Contracts* (3rd edn, Taylor & Francis 2000), 266

a fire will escape liability only for damage to the contract works; damage to existing structures will be the sub-contractor's responsibility³⁶.

2.7.2 Nominated Sub-contractors

Unlike the domestic sub-contractor, a nominated sub-contractor is a company selected by the employer to sign a sub-contract agreement with the main contractor, either to perform a specific scope of works or to supply materials for a project, FIDIC Red Book 2017 by clause (13.4), defines the nominated sub-contractor as the sub-contractor in which the employer or the employer's representative gives an instruction to the main contractor to assign as a sub-contractor to perform a specific scope of works.³⁷ Usually, the main purpose for nominating sub-contractors by employers is to guarantee the quality of the sub-contracted works and the supplied material, in addition to saving time and money; this saving will be achieved considering that the employer will nominate the sub-contractor during the tendering phase, instead of the long selection process when each contractor tries to get quotations from several sub-contractors before submitting the main tender prices to the employer, therefore, nomination will reduce the effort, time, and cost of the project tendering phase. Moreover, it is worth highlighting that when the sub-contractor is nominated by the employer, the main contractor's liability for the performance of the sub-contractor is less than in case of having a domestic sub-contractor.³⁸

³⁶ Will Hughes and John Murdoch, *Construction Contracts* (3rd edn, Taylor & Francis 2000), 266

³⁷ FIDIC Contracts Red Book (3rd edn, 2017), Clause (13.4)

³⁸ Will Hughes and John Murdoch, *Construction Contracts* (3rd edn, Taylor & Francis 2000),275.

In lump sum and cost plus fee contracts, when the main contractor's criteria in selecting sub-contractors is cost, then, in case the employer's nomination of sub-contractors leads to higher costs, the contractor may have the right to claim to adjust the contract price, in addition to the right to object upon any nominated sub-contractor, provided that there are strong grounds for such objection. However, if the project tender documents specify clearly from the beginning the list of the sub-contractors that the contractor is obliged to deal with throughout the project, then the contractor shall neither object upon any nominated sub-contractor included in the list, nor ask for any price adjustment resulting from nomination.³⁹

Almost all FIDIC contracts include a clause that gives the right to the employer to nominate a sub-contractor⁴⁰, clause (5.2) of the FIDIC Red Book 2017 illustrates such right for the sub-contractor nomination, and despite such nomination, the employer may exclude itself from the responsibility towards any act by the sub-contractor, even if the latter was nominated by the employer himself, this may be achieved by including a provision in the contract which states that if the nominated sub-contractor is selected to be engaged to perform agreed upon works, this shall not mean that there will be any contractual relationship between this sub-contractor and the employer, and will not eliminate the main contractor's liability for the defaults of the sub-contractor, even though the latter has been nominated by the employer.⁴¹ such liability is supported by clause (5.1) of the FIDIC Red book 2017

³⁹ Gail S Kelley, *Construction Law* (1st edn, Wiley 2013), 98.

⁴⁰ Giuseppe Broccoli, 'Subcontractor Selection In Construction Projects And The FIDIC Books' (*Blog.studiolegalemora.it*, 2016) <<https://blog.studiolegalemora.it/en/subcontractor-selection-in-construction-projects-and-fidic-books>> accessed 15 May 2020.

⁴¹ Giuseppe Broccoli, 'Subcontractor Selection In Construction Projects And The FIDIC Books' (*Blog.studiolegalemora.it*, 2016) <<https://blog.studiolegalemora.it/en/subcontractor-selection-in-construction-projects-and-fidic-books>> accessed 15 May 2020.

⁴², which states that the main contractor shall remain liable for the works performed by the sub-contractors, and for any defaults resulting from their works, however this clause have not drawn a distinction between the domestic and the nominated sub-contractor, therefore, it shall apply on both, regardless of the fact that the nominated contractor is selected by the employer. It shall be noted in this context, that the contractor shall have the right to object against any nominated sub-contractor by the employer, such right is supported by clause (5.2.2) of the FIDIC Red Book 2017 which states that, in the case that the main contractor has any issues or concerns to appoint a sub-contractor nominated by the employer, then the main contractor shall not be obliged to engage this sub-contractor, and in such case, the main contractor must provide a reasonable cause for his concerns upon the sub-contractor by sending an objection notice to the employer's representative which includes all the related details along with the grounds for such objection, within 14 days of receiving the instructions to appoint the sub-contractor from the employer's representative, this clause also specifies the reasons which makes the main contractor's objection reasonable, the reasons shall also include the supporting documents and evidences for each reason, such reasons are, but not limited to; the case when the sub-contractor is deemed to be incapable to perform the sub-contracted works, or when the sub-contractor does not have adequate resources to perform the works, in addition to the weak financial capabilities of the sub-contractor, which may adversely affect the project, moreover, the absence of an indemnification clause in the sub-contract agreement, which obliges the nominated

⁴² FIDIC Contracts Red Book (3rd edn, 2017), Clause(5.1)

sub-contractor to indemnify the main contractor in case of any defaults, mismanagement, or negligence by the nominated sub-contractor or his employees, this includes the design, the construction phase, and the management of the works to be undertaken by the sub-contractor.⁴³

Unlike the FIDIC form of contracts, the JCT standard form of building contract draws a line between the domestic and nominated sub-contractors, such difference is illustrated by clause (25.4.7), which provides that in case a domestic sub-contractor delays the progress of the project works, then the contractor shall be held responsible for such delay, and shall not be entitled for any extension of time or cost associated accordingly, in contrast, if the sub-contractor is nominated, the contractor will have the right for an extension of time in case of a delay occurred due to the acts of the nominated sub-contractor⁴⁴.

In some instances, and due to the above-discussed distinguishing between the domestic and the nominated sub-contractors that the JCT form of contract includes, arguments may arise whether a sub-contractor is domestic or nominated, in such case, several considerations shall be kept in mind to decide upon those argument cases, such as, figuring out whether the employer has given the contractor a list of proposed sub-contractors, in addition to the number of the sub-contractors included in the list, and whether the contractor had objected to appoint a sub-contractor but the same sub-contractor has been appointed despite such objection, such appointment will support the argument that the sub-contractor has been nominated,

⁴³ Giuseppe Broccoli, 'Subcontractor Selection In Construction Projects And The FIDIC Books' (*Blog.studiolegalemora.it*, 2016) <<https://blog.studiolegalemora.it/en/subcontractor-selection-in-construction-projects-and-fidic-books>> accessed 18 May 2020.

⁴⁴ Graham Cheeseman, 'Nominated Sub-Contracting' (*Cms-lawnow.com*, 2003) <<https://www.cms-lawnow.com/ealerts/2003/12/nominated-subcontracting>> accessed 18 May 2020.

in addition to that, the involvement of the employer in the selection procedures of the sub-contractor and the employer's participation in the process of negotiating the terms and conditions of the sub-contract agreement, strongly affects the decision whether the sub-contractor is domestic or nominated.⁴⁵

In order to transfer the potential risks resulted from sub-contractors performance, and the liability for the acts and defaults of the sub-contractors to the main contractor, employers may attempt to nominate sub-contractors but calling such sub-contractors domestic, however, the courts may look further behind the wording and the names in the agreements, and consider the sub-contractor's selection and procurement process and procedures while deciding in a related case, this had been discussed in *St Modwen Developments Limited v Bowmer & Kirkland Limited* [1996] case; the case was related to a building project which had consisted of provisional items to be performed by sub-contractors who were called domestic sub-contractors, typically, the procedure of selecting the sub-contractors should have been the same procedure included in the JCT form of contract, but such procedure had not been followed by the project stakeholders at the stage of the sub-contractors selection, in fact, the project engineer who was appointed by the employer, had provided the contractor with quotations from several sub-contractors, then instructed the contractor to agree with a specific sub-contractor to perform the related scope of works, accordingly, and after looking into the sub-contractor selection procedures, the court held that the sub-contractor was in fact a nominated sub-contractor but called in the agreement a domestic sub-contractor,

⁴⁵ Graham Cheeseman, 'Nominated Sub-Contracting' (*Cms-lawnow.com*, 2003) <<https://www.cms-lawnow.com/ealerts/2003/12/nominated-subcontracting>> accessed 18 May 2020.

and the judge had dealt with the case as having a nominated sub-contractor, so that the contractor would be entitled for his claim which is submitted in the raised case.⁴⁶ Liability for nominated sub-contractors for the contract works arises either under the signed sub-contract (contractual liability), or under tort:

2.7.2.1 Contractual Liability:

In the UAE, and despite the fact that the UAE CTC in Article (890) does not distinguish between a nominated sub-contractor and a domestic sub-contractor, Dubai court of cassation through its decision number 266/2008 had decided that article (890) shall not be applicable to nominated sub-contractors, and its enforcement shall be limited to domestic sub-contractors, moreover, the court had emphasized that the employers shall be liable for any acts or defaults by the nominated sub-contractors even if there were no direct contractual relationship between the employer and the sub-contractor, except in the case that such defaults had been caused by both the main contractor and the sub-contractor jointly, the court decided to reject the appeal, on the basis that this court had decided that the liability of the main contractor towards the employer for the sub-contracted works is only from the delay which have been caused by the sub-contractors assigned by the main contractor, and if such sub-contractors were nominated by the employer or by the employer's representative, the liability for the delay caused by the nominated sub-contractor shall be borne by the employer not

⁴⁶ Graham Cheeseman, 'Nominated Sub-Contracting' (*Cms-lawnow.com*, 2003) <<https://www.cms-lawnow.com/ealerts/2003/12/nominated-subcontracting>> accessed 18 May 2020.

by the main contractor, and the main contractor shall not be liable for any delay damages for the delay occurred if he can provide for any evidence which supports that the main contractor's failure to fulfil his obligations under the contract on time have occurred due to reasons which he could never had controlled.⁴⁷

2.7.2.2 Liability Under Tort and Negligence

In the case of nominated sub-contractors, and due to the fact that the sub-contractor is selected by the employer, this may result in a relationship of more 'proximity' than in the case of domestic sub-contractors, which may give the right to the employer for a duty of care in tort by the nominated sub-contractor, this is emphasized in the case of *Junior Books Ltd V Veitchi Co Ltd*, when a nominated sub-contractor had caused a harm in a new factory while performing the scope of the sub-contract works, the House of Lords held that however there is no contractual relationship between the employer and the nominated sub-contractor, the latter shall be directly liable towards the employer under tort and negligence, regarding the extra costs incurred to rectify the defects of the floor, in addition to the costs of the loss of production resulted during the defects repairing works⁴⁸.

⁴⁷ Michael Grose, *Construction Law In The United Arab Emirates And The Gulf* (John Wiley & Sons 2016) 142.

⁴⁸ Will Hughes and John Murdoch, *Construction Contracts* (3rd edn, Taylor & Francis 2000), 281

2.8 Relationship Between the Employer and the Sub-contractor

2.8.1 The Principle of Privity of Contract

When the contractor decides to sub-let a specific scope of works to a sub-contractor, the contractor shall be liable towards the employer for the acts or defaults by the sub-contractor, regardless of the fact that the contractor has not himself carried out such works, ; article 890 (2) of the UAE CTC states that ‘The first contractor shall remain liable as towards the employer’⁴⁹ this is known as the principle of privity of contract, which limits both the right and the obligations of third parties (parties having no direct contractual relationships), this is supported by the UAE CTC clause 252 which states that contracts shall not enforce any obligation towards third parties, however it may provide for rights for third parties.⁵⁰ in common law jurisdictions; ‘the rights of third parties act 1999’ had been issued to regulate the enforcement of contractual terms with third parties and to override the concept that the contract does not grant any rights to a third party to such contract.⁵¹ What happened in *Dunlop Pneumatic Tyre Company Ltd v Selfridge & Co Ltd* [1915] AC 847 case illustrates this concept; Dunlop was a manufacturer who had agreed with the purchasers not to sell the equipment in less than a specific price, and requested that each purchaser shall agree with their retailers regarding the minimum specified selling price, Selfridge was a retailer who violated the agreement and sold the equipment below the agreed upon price, therefore, Dunlop sued for the damages

⁴⁹ UAE, 'UAE Civil Transaction Code' (1985).

⁵⁰ UAE, 'UAE Civil Transaction Code' (1985).

⁵¹ Michael Grose, *Construction Law In The United Arab Emirates And The Gulf* (John Wiley & Sons 2016) 46.

related to such violation, in addition to requesting an injunction to prevent Selfridge from selling the equipment with that price again, after that, Selfridge objected that Dunlop shall not have the right to claim for damages as Dunlop is not a party of the contract between Selfridge and the purchaser, thus, there was no contractual relationship between Dunlop and Selfridge, the court decided that Dunlop shall not be entitled for any damages, as only a party to a contract is entitled to claim for damages resulting from a breach of such contract, Viscount Haldane LC stated that ‘only a person who is a party to a contract can sue on it. Our law knows nothing of a jus quaesitum tertio arising by way of contract. Such a right may be conferred by way of property, as, for example, under a trust, but it cannot be conferred on a stranger to a contract as a right to enforce the contract in personam.’⁵².

In fact, there is no direct contractual relationship between the employer and the sub-contractor, therefore, the sub-contractor shall not be entitled to claim for any due payment from the employer, and the employer shall have no obligations against the sub-contractor, this is supported by article 891 of the UAE CTC which states that sub-contractors shall not have the right to claim for a due payment or request for any work related issues from the employer, except in the case that the main contractor makes an assignment to the sub-contractor against the employer.⁵³, this fact had then been illustrated by a decision by the Union Supreme Court which stated that, supporting and emphasizing on Articles 890 and 891 of the Civil Transaction Code, as discussed above, there is no contractual relationship between the sub-contractor or any third party to the main construction contract and the

⁵² Dunlop Pneumatic Tyre Company Ltd v Selfridge & Co Ltd [1915] AC 847

⁵³ UAE, 'UAE Civil Transaction Code' (1985).

employer, the court highlighted that the main contractor shall remain liable for the employer for the acts done by any sub-contractor, provided that the sub-contractor shall have no right to claim for any rights or due payments to him from the employer.⁵⁴

On the other side, it is rare to happen or even impossible, that an employer has the right to sue the sub-contractor against any acts or defaults by the latter, however, employers may solve such restriction by imposing several types of agreements to be signed between the employer and the sub-contractor, such as collateral warranties, which -in turn- gives the employer the right to sue the sub-contractor based on such agreements terms rather than the typical contractual relationship.⁵⁵

2.8.2 Assignment

Assignment means that one party of a contract assigns a third party to have all or part of the rights in which the parties to a contract have, however, this acquisition shall not apply to the contract related obligations.

- Assignment under UAE Law:

Referring to the UAE laws and regulations, the principle of assignment related to construction projects is supported by the following articles, provisions, and court decisions:

1. UAE CTC in Article 891 which states that sub-contractors shall not have the right to claim for a due payment or request for any work related issues from the employer,

⁵⁴ Andrew MacCuish and Nicole Newdigate, 'Back To Basics - Players To A Construction Project – The Subcontractor In UAE Law - Real Estate And Construction - United Arab Emirates' (*Mondaq.com*, 2017) <<https://www.mondaq.com/Real-Estate-and-Construction/636332/Back-to-Basics--Players-to-a-Construction-Project-The-Subcontractor-in-UAE-Law>> accessed 20 May 2020.

⁵⁵ Andrew MacCuish and Nicole Newdigate, 'Back To Basics - Players To A Construction Project – The Subcontractor In UAE Law - Real Estate And Construction - United Arab Emirates' (*Mondaq.com*, 2017) <<https://www.mondaq.com/Real-Estate-and-Construction/636332/Back-to-Basics--Players-to-a-Construction-Project-The-Subcontractor-in-UAE-Law>> accessed 20 May 2020.

except in the case that the main contractor makes an assignment to the sub-contractor against the employer. ⁵⁶

2. Dubai Court of Cassation Decision No. 270/2001 which held that despite the fact that the sub-contractor shall not be entitled to claim for any rights or payments from the employer, as there is no contractual relationship between them, unless agreed otherwise, if the main contractor makes an assignment to the sub-contractor, this will provide the sub-contractor with the right to deal with the employer directly, and even with the absence of a contractual relationship. ⁵⁷
3. The federal supreme court had outlined several requirements to be achieved in order for an assignment to be valid under the UAE Laws, in a construction contract related case, the main contractor had assigned the right for the sub-contractor to receive the payments for the works which had been completed, the project was construction of a group of villas, the court had rejected the assignment by the main contractor due to the absence of the documentation and records related to the percent of the completed works, the payments amounts remaining to be paid, and the details of the concerned people. The court held that there is no real assignment by the contractor to the sub-contractor, as the requirements of assignment have not been met, and therefore the appellant's evidence shall be deemed insufficient to rely upon. ⁵⁸

⁵⁶ UAE, 'UAE Civil Transaction Code' (1985).

⁵⁷ Dubai Court of Cassation Judgment 270/2001

⁵⁸ Michael Grose, Construction Law In The United Arab Emirates And The Gulf (John Wiley & Sons 2016) 159, 160.

2.8.3 Decennial Liability

Decennial liability stands for the 10 years liability for total or partial collapse which affects the safety and the stability of a building, the entities which are responsible for the design and the construction of a building shall have decennial liability towards the owner of such building, decennial liability is a contractual duty which shall be jointly shared by both the designer and the construction contractor.

The concept of decennial liability does not exist in countries which apply common law jurisdiction; however, such concept applies in civil law countries.

As discussed previously, the main contractor shall be responsible towards the employer regarding the performance of any sub-contracted works, and as decennial liability is considered a contractual liability, then the terms and conditions related to decennial liability under a construction contract shall not be applied to sub-contracts, as the employer is not a party to a sub-contract, and decennial liability article included in the UAE CTC is drafted for construction contracts between the employer and the main contractor, this article states that when the contract is a construction related one, such as construction of a building, the design which is performed by an engineer or an architect, in which the works to be constructed by a contractor under the supervision of the engineer, then, both the engineer and the architect shall bear a joint liability towards the project employer for a 10 years duration starting from the date of the handing over of the works to the project owner, such liability stands for a compensation to the employer by the contractor and the engineer if the structure had any partial collapse or total failure, or any other defects which affects the safety and the stability of the structure of the building, the

construction contract may increase the period of 10 years, and parties may agree to decrease such period if the structure is designed to be used for less than 10 years.⁵⁹ However, most contractors cover themselves against the works performed by sub-contractors by imposing indemnity clauses into their sub-contract agreements, or they alternatively draft the provisions of the sub-contract agreements to be back to back with the main contract.

One of the strong and reasonable grounds that a main contractor may reject the appointment of a nominated sub-contractor, is the absence of an indemnity clause in the sub-contract provisions, as such clause shall protect the contractor from the liability towards the employer which results from the defective works carried out by the nominated sub-contractor.⁶⁰

⁵⁹ UAE, 'UAE Civil Transaction Code' (1985).

⁶⁰ Professor A. Masadeh 'Decennial Liability in Construction: Law and practice in the United Arab Emirates' 5,6

Chapter 3 – Payment

3.1 Introduction

One of the key clauses to be considered in any construction contract is the payment clause, as payment is generally a source for disputes in many practical aspects in most of the businesses around the world, therefore, specific attention shall be made for such clauses in order to maintain the project cashflow and to avoid any potential disputes. However, this chapter is not intended to cover all the legal related aspects of payment for sub-contracting purposes, as the major concern of this research is to specifically discuss the back to back approach in payments related to sub-contracts, which will be thoroughly discussed in the next chapter.

3.2 Payments to Sub-contractors, and Direct Payments by Employer

Generally, the employer shall have no obligation to pay sub-contractors, the contractor shall be responsible to pay the sub-contractors the amount of the works performed according to the payment terms included in the sub-contract agreement signed between both parties as specified in clause (5.2.3) of the FIDIC Red Book 2017 which states that according to the sub-contract terms, the main contractor shall be obliged to pay the due amounts to the nominated sub-contractor, along with any other entitled payments as specified in the conditions of the sub-contract'.⁶¹

However, in case the sub-contractor is nominated by the employer, the employer shall have the right to have an access to the main contractor's records regarding the payments issued to the nominated sub-contractors. Moreover, it is permissible that the employer

⁶¹ FIDIC Contracts Red Book (3rd edn, 2017), Clause (5.2.3)

may at certain circumstances issue the payment of the performed works directly to the nominated sub-contractor, such circumstances are illustrated in clause (5.2.4) of the FIDIC Red Book 2017, which states that the employer shall have the right to pay for a nominated sub-contractor, and before making a payment to the main contractor for any works which includes the works completed by the nominated sub-contractor, the employer has the right to request from the main contractor, the supporting documents and evidences related to the previous payments by the main contractor to the nominated sub-contractor, to ensure that the latter had received all the due payments for the works completed as per the payment certificates, along with any variations or retention monies, and in case the main contractor does not provide the required supporting documents, or convinces the employer or the employer's representative that he has the right to apply deduction or to withhold any due amounts, in such circumstances, the employer might issue any due payments directly to the nominated sub-contractor which the main contractor had not provided the evidences of the payments. Then, the employer or the employer's representative shall notify the main contractor of the payment amount issued directly to the nominated sub-contractor, and accordingly, this amount shall be deducted from the next interim payment applied by the main contractor.⁶²

Referring to FIDIC suit of contract forms, in addition to the UAE laws, direct payment by the employer is only applicable for nominated sub-contractors, for domestic sub-contractors, it shall only applicable in the case of assignment by the main contractor to the sub-contractor, as discussed previously in Chapter two.

⁶² FIDIC Contracts Red Book (3rd edn, 2017), Clause (5.2.4)

3.3 Variation Orders and Extension of Time Claims

The right to request changes to the original scope of works is granted to the contractor through the signed sub-contract agreement, therefore if this right is not expressly included in the sub-contract provisions, then the sub-contractor shall not be obliged to carry out the changed requested by the contractor. Most standard sub-contract forms include clauses that provides for the right to vary the scope of a contract works, such clauses include all the required details related to a variation order along with the procedures to start the request for variation.⁶³

Most sub-contract agreements include a provision which specifies the duration in which the sub-contracted works shall be completed within, however, in some circumstances and due to the nature of the project works, the original sub-contract duration and the agreed sequence of the project activities may be changed, therefore the contractor may instruct the sub-contractor to modify the project duration, and in case that the progress of the project works is interrupted, the sub-contractor may request an extension of time to complete the contract works.⁶⁴

Due the complicated contractual chain, main contractors usually get stuck between employers and sub-contractors, when a sub-contractor submits a claim for extension of time or a variation order, the main contractor may get confused whether to submit the claim to the employer to be reviewed, or to reject such claim without passing the same to the employer. However, it is not reasonable for the contractor to reject the sub-contractor's claim, then raise a claim to the employer on the same basis that the sub-contractor had

⁶³ John McGuinness, *The Law And Management Of Building Subcontracts*(Blackwell Pub 2007), 170.

⁶⁴ John McGuinness, *The Law And Management Of Building Subcontracts*(Blackwell Pub 2007), 183

submitted its claim on; referring to United States ex rel. W. P. Schaefer Construction Co. V. Veteraus Contracting Group Inc., there was a subcontract between the disputed parties; United States ex rel. W. P. Schaefer (the sub-contractor) and Veteraus Contracting Group (the main contractor) for a project to restore two roads in a New York national cemetery, the sub-contractor had sought for an extension of time along with additional cost due to several delay events which had arisen during construction, the main contractor had rejected the claim stating that the sub-contractor is responsible for such delay, and alleged that the sub-contractor had fallen behind the project schedule, thus, the main contractor terminated the sub-contract for default. Behinds that, the main contractor had claimed for extension of time based on the same grounds in which the sub-contractor had claimed upon. The court decided that the sub-contractor had not been in default, as the main contractor had successfully been granted an extension of time by the employer, furthermore, the court held that the main contractor had breached its duty of fair dealing and good faith. The court decided that the sub-contractor shall be entitled for damages due to the unfair termination for default by the contractor, and then rejected the claim for liquidated damages in which the main contractor had sought.⁶⁵

In terms of claims for additional payment and variation orders, Article (887) of the UAE CTC, governs the relationship between the employer and the main contractor in terms of variation orders, this article states that the contractor shall not have the right to claim for a price increase if the contract is a lump sum price contract with a specific scope and defined quantities, however, if such scope is being modified whether by addition or

⁶⁵ David G. Anderson (*Couchwhite.com*, 2014) <https://www.couchwhite.com/wp-content/uploads/2014/03/Court_Finds_Default_Termination_of_Subcontractor_Wrongful_Where_Prime_Contractor_on_Same_Facts_Obtained_Relief_for_Itself_from_Owner.pdf> accessed 26 June 2020.

omission by the employer, the price shall be subject to be re-estimated, And article (390) (2) of the same law which implies that taking into consideration the governing laws and regulations, parties to a construction contract may agree in advance by including a provision in the contract to specify the amount of the contract works, and in case one or both parties claims to vary such amount, the judge may agree for such variation, and if any construction contract contains a provision that contradicts this, it shall be deemed null and void.⁶⁶ The relationship between the main contractor and the sub-contractor is not governed by this article, and therefore, the general principles shall govern.⁶⁷

This concept is also illustrated by Abu Dhabi Court of Cassation Decision No. 573/2 held that related to variation orders and additional payment amounts, sub-contracts are not ruled by the same provisions as main contractors, and they shall be deemed entitled for additional payment resulting from a variation order only if such variation have been agreed upon.⁶⁸

⁶⁶ UAE, 'UAE Civil Transaction Code' (1985).

⁶⁷ Michael Grose, *Construction Law In The United Arab Emirates And The Gulf* (John Wiley & Sons 2016) 153.

⁶⁸ Abu Dhabi Cassation, 573/2

Chapter 4 – Back to Back Payment Clauses

As discussed in the previous chapters, and due to the fact that construction projects are complex in their nature, and their related contractual obligations are wide and extensive, a main contractor may assign all or part of its obligations towards the employer under the main construction contract to a sub-contractor, and even simple construction projects are subject to get all or part of the main contract works subcontracted. Sub-contracting is considered as a tool of risk transfer by the main contractor to other sub-contractor(s) as discussed in Chapter two.

A common practice in drafting sub-contract agreements, is that the agreement provisions, terms, and conditions are drafted to be back to back with the provisions of the main contract, this means that all or part of the main contract obligations are reflected in the sub-contract or sub-sub-contract agreements (if any). Back to back approach may also be applied to avoid having gaps in the contractual obligations between all the project parties.⁶⁹

As indicated in the previous chapter, a major part of the sub-contract agreement is the payment clause, which may be drafted back to back similar to the main agreement provisions, payment clause is usually a source of disputes between the contracted parties. Back to back payment approach simply means that the payment by the main contractor to a sub-contractor is conditional upon receiving the payment from the employer, which indicates that the main contractor shall have the right to withhold the sub-contractors' payments until the employer pays the equivalent related payment to the main contractor,

⁶⁹ Tom Bain, 'Back To Back Contracts: Some Problems And Pitfalls' (Construction Blog, 2015) <<http://constructionblog.practicallaw.com/back-to-back-contracts-some-problems-and-pitfalls/>> accessed 16 May 2020.

or in some specified cases, until the lapse of a certain period of time, as stated in the sub-contract Agreement.⁷⁰

However, while the back to back concept is simple and direct, disputes and conflicts which may arise during the application and interpretation of back to back provisions are complex, therefore, and in order to attempt to avoid or even minimize such disputes, back to back agreements shall be drafted in a way that reduces the probability of disputes occurrence, parties are advised to thoroughly study, analyze, and decide which obligations shall be assigned to a sub-contractor and which ones shall better remain with the main contractor, in addition to that, risk assessment and allocation shall be conducted for all the terms and provisions related to the works to be carried-out by the sub-contractor, and such terms shall be drafted in a comprehensible and straight forward way.⁷¹

There are two major types of conditional payment clauses; ‘pay-when paid’; and ‘pay if paid’, as will be detailed and discussed in the upcoming sections.

4.1 ‘Pay when paid’ Clause:

This provision is intended and interpreted to be a time mechanism clause, which relates the payment by the main contractor to a sub-contractor, to the time of the payment by the employer to the main contractor, such clauses are often accompanied by a clause which specifies a deadline for the main contractor’s payment to the sub-contractor, therefore, It does not excuse the main contractor from the obligation to pay the sub-

⁷⁰ Tom Bain, 'Back To Back Contracts: Some Problems And Pitfalls' (Construction Blog, 2015) <<http://constructionblog.practicallaw.com/back-to-back-contracts-some-problems-and-pitfalls/>> accessed 16 May 2020.

⁷¹ Tom Bain, 'Back To Back Contracts: Some Problems And Pitfalls' (Construction Blog, 2015) <<http://constructionblog.practicallaw.com/back-to-back-contracts-some-problems-and-pitfalls/>> accessed 16 May 2020.

contractor, and even in case the main contractor does not receive the related payment from the employer under the main contract.

In spite of the fact that ‘pay when paid’ clauses provide the main contractor with the ability to manage their own cashflow, and further distribute the project related risks to sub-contractors, such clauses may cause substantial financial pressure on sub-contractors and may – in some cases – lead to subcontractors’ insolvency when main contractors withhold the due payments unreasonably.

According to Robert Brundell⁷², ‘Pay when paid’ clauses application and enforcement have been restricted in several countries’ jurisdictions such as the United Kingdom, Singapore, Australia, and Ireland, but when companies are moving out of those countries to carry out external projects in other countries, they are shocked that ‘pay when paid’ approach still exists, applicable, and enforceable.⁷³

FIDIC Conditions of Subcontract for Construction published in 2011 clearly permit the application of back to back approach, through sub-clause (14.6) which indicates that, under certain circumstances and jurisdictions, the sub-contractor shall receive their payments only when the payment to the main contractor by the employer is issued, in addition to that, this sub-clause states that this is only a timely conditional payment clause and not a ‘pay if paid’ clause, considering the fact that the contractor is only permitted to hold the payment for a period of 84 days after the expiry date of the defects notification period related to the sub-contract agreement, regardless whether the main contractor had received the related payment from the employer or not.⁷⁴

⁷² Robert Brundell, 'Pay-When-Paid Clauses | Lexology' (Lexology.com, 2016) <<https://www.lexology.com/library/detail.aspx?g=52fe012a-cd37-4b80-8aff-c98ff3989f17>> accessed 20 May 2020.

⁷³ Robert Brundell, 'Pay-When-Paid Clauses | Lexology' (Lexology.com, 2016) <<https://www.lexology.com/library/detail.aspx?g=52fe012a-cd37-4b80-8aff-c98ff3989f17>> accessed 20 May 2020.

⁷⁴ FIDIC Subcontracts Red Book (1st edn, 2011), Clause (14.6)

The JCT Standard Building sub-contract forms separate the relation between the payment terms of the main contract and the sub-contract, therefore, the risk of non-payment is not transferred to the sub-contractor, this standard contract form states that the main contractor shall pay the sub-contractor not later than 21 days after the issuance of the payment certificate related to the main contract, and in case of the employer insolvency, the payment may be entitled even before the 21 days, as per what happened in *Scobie & McIntosh Ltd v. Clayton Brown Ltd (1990)* case.⁷⁵

4.1.1 International application of ‘Pay when paid’ clauses

‘Pay when paid’ clauses are commonly included in a sub-contract agreement to protect the cashflow and the budget of the main contractor against the employer’s non-payment, and to share, transfer, or shift the risk of the employer’s insolvency, specifically when such insolvency occurs after the scope of the sub-contracted works have been carried out, completed, and approved, and the main contractor had not been paid for such works. In one hand, this way of shifting such risk to the sub-contractor have been considered unfair and restricted by several jurisdictions as mentioned previously, on the other hand, Hong Kong and Singapore courts have considered such clauses as applicable and enforceable in terms of protecting the main contractor’s cashflow by postponing the right of the sub-contractor to receive its payment; in *Wo Hing Engineering Ltd v Pekko Engineers Limited* case in Hong Kong, the judge had emphasized that the ‘pay when paid’ clause shall include clear wording to be appropriately interpreted by the court as a conditional payment clause

⁷⁵ J. Roger Knowles, *200 Contractual Problems And Their Solutions* (3rd edn, Wiley 2012), 249.

which means that the main contractor shall not be obliged to pay the sub-contractor except when he receives the related payment from the employer, rather than merely specifying a time limit for issuing such payment.⁷⁶ Whereas, courts in the United States and New Zealand have interpreted the back to back clauses in a way that balance the risk of the employer's insolvency, those courts have highlighted that the condition of pay when paid shall definitely not mean pay if the main contractor is paid.⁷⁷

In the United States, in *Thos J. Dyer Co. v Bishop International Engineering Co*, a conditional payment clause indicated that the sub-contractor's payments shall be due after 5 days of the employer payment to the main contractor, after that, a dispute has arisen regarding a refusal by the main contractor to pay an amount due to the sub-contractor on the basis that the employer had not paid the related amount to the main contractor, provided that the employer had become insolvent at that time; The court decided that it is not fair to completely shift the risk of the Employer's insolvency to the sub-contractor, even if there was a conditional payment clause included in the sub-contract agreement, and such clause had not specifically outlined what would have been done in case of the employer's insolvency, such clause had just delayed the time for payment to a reasonable time after the completion of the related works.⁷⁸

New York courts, In *Otis Elevator Co. v. Hunt Const. Group*, had rejected to enforce a 'pay when paid' clause, the court had highlighted that such clause

⁷⁶ *Wo Hing Engineering Ltd v Pekko Engineers Limited*

⁷⁷ Will Hughes and John Murdoch, *Construction Contracts* (3rd edn, Taylor & Francis 2000), 268,296.

⁷⁸ *Thos J. Dyer Co. v Bishop International Engineering Co*

included in the sub-contract agreement, had only intended to regulate the time for payment between the main contractor and the sub-contractor, and shall not oblige the sub-contractor to bear the risk of non-payment by the employer.⁷⁹

The Irish Construction Contracts Act 2013, clearly prohibits the conditional payment concept, it specifically states that if the construction contract contains a provision which states that a payment which is entitled to a party shall not be paid except after the other party received the related payment by another party under another contract, such payment shall not also be withheld, even for a specific duration.⁸⁰

In Australia it was highlighted in a high court case decision, in *Maxcon Constructions Pty Ltd v Michael Christopher Vadasz* case, that ‘pay when paid’ clauses should be deemed null and void, and it was emphasized that a back to back provision shall not be applicable if it intends that the payment or the date of payment is related or depends on the payment under another contract.⁸¹

Meanwhile in Germany, ‘Pay when paid’ clauses are not forbidden under German law; however, such clauses are uncommon to be used in construction contracts. Moreover, referring to the German Civil Code BGB, specifically in section 305, conditional payment clauses are considered null and void if applied in business related contracts.⁸²

⁷⁹ *Otis Elevator Co. v. Hunt Const. Group*

⁸⁰ 'Construction Contracts Act 2013, Section 3' (Irishstatutebook.ie, 2013) <<http://www.irishstatutebook.ie/eli/2013/act/34/section/3/enacted/en/html#sec3>> accessed 24 May 2020.

⁸¹ *Maxcon Constructions Pty Ltd v Michael Christopher Vadasz*

⁸² 'Country Comparative Guides' (*Inhouselawyer.co.uk*, 2020) <http://www.inhouselawyer.co.uk/wgd_question/are-pay-when-paid-clauses-i-e-clauses-permitting-payment-to-be-made-by-a-contractor-only-when-it-has-been-paid-by-the-employer-permitted-are-they-commonly-used/> accessed 21 May 2020.

In Malaysia, the common Malaysian Law differentiates between the conditional payment clauses ‘pay when paid’ and ‘pay if paid’ clauses, and referring to CIPAA (Construction Industry Payment and Adjudication), specifically, section 35, which states that all conditional payment clauses shall be null and void if the construction contract have been signed after 15th April 2014 (the date on which the CIPAA came into force) as the act clearly prohibits the application of such clauses, and even before the act had come into force, Malaysian courts have mostly been unwilling to enforce those conditional payment clauses.⁸³

Referring to *Globe Engineering Sdn Bhd v Bina Jati Sdn Bhd*, this case had passed through the Malaysian courts from the high court, to the court of appeal, up to the federal Malaysian court who had -at the end- issued its decision, which had provided a guidance to figure-out whether the payment clause is a ‘pay when paid’ or ‘pay if paid’. The high court have considered the payment clause in the agreed subcontract as ‘pay when paid’ clause; as it was not clearly stated that Bina Jati (the sub-contractor) shall not be paid if Globe (the main contractor) had not received its payment under the main contract. However, the court of appeal had decided that the payment clause shall be interpreted to be ‘pay if paid’ which shall provide an excuse to Globe from any due payment to Bina Jati, in case Globe had not received its related payment from the Employer. After that, and after performing thorough analysis, and comparing the similar clauses in the United Kingdom and the United States and other countries, the Federal Malaysian Court stated that differentiating

⁸³ 'Country Comparative Guides' (*Inhouselawyer.co.uk*, 2020) <http://www.inhouselawyer.co.uk/wgd_question/are-pay-when-paid-clauses-i-e-clauses-permitting-payment-to-be-made-by-a-contractor-only-when-it-has-been-paid-by-the-employer-permitted-are-they-commonly-used/> accessed 25 May 2020.

between the above-mentioned two types of conditional payment clauses shall be based on the drafting, language, and the construction and wording of the clause itself. The Federal Court highlighted that if the payment clause is drafted properly and it is clear that a 'pay when paid' clause means and is interpreted as 'pay if paid', then such 'pay when paid' clause shall be considered and enforced as 'pay if paid clause', even if the intention of any party or both parties was the opposite. At the end, the Malaysian Federal Court had accepted the appeal of the sub-contractor, and the high court decision had been restored and enforced by the Federal Court.⁸⁴ Another Malaysian case which highlights the impact of the drafting of the sub-contract agreement clause on the interpretation of such clause is *Antah Schindler v Ssangyong* case; where a Subcontract Agreement was signed between Ssangyong Engineering & Construction (the Contractor) and Antah Schindler SDN BHD (the Sub-contractor) to perform part of Menara Landmark Johor Bahru Project, for Yetcom Investment (the Employer), the sub-contractor had performed its obligations under the Sub-contract, which had been approved and certified by the project architect as per the sub-contract agreement, however, few payments have been withheld by the contractor. The sub-contractor had submitted a claim for the non-paid amounts relying on clause (11) (b) of the sub-contract which stated that when the main contractor receives a payment from the project employer, the main contractor shall be obliged to pay the sub-contractor the related agreed amount not later than 14 days from receiving such payment amount.⁸⁵, the contractor had

⁸⁴ 'The 'If' And 'When' Of A 'Pay-When-Paid' Clause | Skrine - Advocates & Solicitors' (*Skrine - Advocates & Solicitors*, 2014) <<https://www.skrine.com/insights/newsletter/september-2014/the-'if'-and-'when'-of-a-'pay-when-paid'-clause>> accessed 17 May 2020.

⁸⁵ Wilson Ho Sheen Lik, 'The Pay-When-Paid Clause - Corporate/Commercial Law - Malaysia' (*Mondaq.com*, 2016) <<https://www.mondaq.com/CorporateCommercial-Law/467518/The-Pay-When-Paid-Clause>> accessed 18 May 2020.

argued that the provisions of the main contract have already been reflected in the sub-contract agreement, and all parties have agreed that payments shall be issued to the sub-contractor only after the contractor receives the related payment from the employer. After that, the court of appeal decided that clause (11) (b) in the Subcontract clearly identifies a time frame for the payment, and shall be considered as a 'pay when paid' clause, as there was no further constraints or obligations imposed regarding the payment to be made by the main Contractor, except the – fourteen days – time limit specified after the issuance of the project Architect certificate related to the performed works, and in case one party or all parties have other intentions or obligations to be applied regarding the Sub-contractor's payment, such requirements should have been stated in a clear and unambiguous language in the Payment clause included in the Subcontract Agreement.⁸⁶

In *Asiapools (M) Sdn. Bhd. V IJM Construction Sdn. Bhd* case, a Sub-contract Agreement was signed between *Asiapools (M) SDN BHD* (the Sub-contractor) and *IJM Construction SDN BHD* (the main Contractor) to construct a swimming pool for *Ng Chee Yew SDN BHD* (the Employer) in which the sub-contractor was nominated by the employer. The sub-contractor had completed the construction works of the swimming pool but had not received the final payment since the contractor has not been paid by the employer. The sub-contractor raised a claim to get the final payment arguing that according to the sub-contract agreement, the final payment claimed shall not be considered in the 'pay when paid clause' as the clause only includes the interim payments, the Payment Clause in the main contract, clause

⁸⁶ Wilson Ho Sheen Lik, 'The Pay-When-Paid Clause - Corporate/Commercial Law - Malaysia' (*Mondaq.com*, 2016) <<https://www.mondaq.com/CorporateCommercial-Law/467518/The-Pay-When-Paid-Clause>> accessed 18 May 2020.

(13.01), specifies that, apart of the clause related to the payment for the nominated sub-contractor regarding the completed works, in case there are any interim payment certificates related to sub-contracted works for the nominated sub-contractor, the payment of such works shall be issued to the sub-contractor not later than 14 days upon receiving the related payment from the employer, the contractor responded and argued that the clause shall include the final payment too. At the end, the Court of Appeal had decided that the payment clause in the sub-contract agreement is broad to cover and include the final payment, the court had also decided that it is understood and interpreted as per the payment clause that the sub-contractor shall only receive the payment after the contractor receives the related payment from the employer under the main contract. The payment clause in that case was interpreted to be 'pay if paid' and not 'pay when paid' due to the language and drafting of such clause.⁸⁷

In New Zealand, and referring to *Smith & Smith Glass Ltd v Winstone Architectural Cladding Systems*, the conditional payment clause stated that 'We will endeavor (this is not to be considered as a guarantee) to pay these claims within 5 days after payment to Winstone Architectural Limited of monies claimed on behalf of the subcontractor'⁸⁸, the court had decided that the drafting of such clause is not clear enough to entitle the main contractor to withhold the sub-contractor's payment as a result of non-payment by the employer, in addition to that, the judge highlighted that contracting parties are free to agree upon any conditional payment clause in

⁸⁷ Wilson Ho Sheen Lik, 'The Pay-When-Paid Clause - Corporate/Commercial Law - Malaysia' (*Mondaq.com*, 2016) <<https://www.mondaq.com/CorporateCommercial-Law/467518/The-Pay-When-Paid-Clause>> accessed 15 May 2020.

⁸⁸ *Smith & Smith Glass Ltd v Winstone Architectural Cladding Systems*

their agreements, however, the interpretation of such clauses may not be concluded as per the parties' intentions, which shall be drafted clearly and unambiguously.

Referring to the common law jurisdictions, and specifically as applied in the United Kingdom, before the issuance of the Housing Grants Construction and Regeneration Act 1996 (HGCRA), sub-contract agreements had contained back to back payment provisions. No standard sub-contract form in the United Kingdom had imposed such provisions, even though several main contractors were imposing back to back provisions at that time.⁸⁹

Latham Report 1994 had strongly dissented and restricted the application of back to back provisions, and accordingly recommended that such clauses shall be prohibited.⁹⁰

After that, 'pay when paid' clauses are clearly restricted by the (HGCRA) "the Construction Act", specifically, in S.113 which states that any provision included in a construction contract which indicates that the payment of one party to another is conditional upon the payment being issued by a third party related to another contract shall be deemed null and void, and the only exception for that, is that the third party has become insolvent.⁹¹, such prohibition, and even the narrow application of the exception stated in S.113, are clearly highlighted and emphasized in William Hare Ltd v Shepherd Construction case, which had highlighted that in some cases, even when the employer becomes insolvent, the 'pay when paid' clause may be considered null and void, according to the related drafting and referred laws,

⁸⁹ Will Hughes and John Murdoch, *Construction Contracts* (3rd edn, Taylor & Francis 2000), 268,296.

⁹⁰ Sir M. Latham, *Constructing the Team* (ISBN 0 11 752994 X, UK, HMSO, 1994), 37

⁹¹ English Arbitration Act, 1996, s.113

acts, and legislations issued and applied in the United Kingdom; In 2009, a subcontract agreement was signed between William Hare (the subcontractor), and Shepherd Construction (the contractor), to perform specific works for Trinity Walk Wakefield Limited (the employer), the subcontract agreement had been drafted based on the HGCRA 1996 and the English insolvency act 1986, without considering the amendment issued to the insolvency act in 2003 (5 years before the subcontract agreement is signed), during the performance of the Project Works, Shepherd had issued a withholding notification for a payment application requested by Hare, relying on the fact that Trinity had become insolvent, as per subclause 32 in the signed subcontract agreement, however that clause had been drafted based on the insolvency act 1986 and the amendments issued to the act in 2003 have not been incorporated. Therefore, the judge held that Hare's payment applications shall be enforced, the reason behind such decision was that Shepherd had issued the notification to withhold the payments of Hare based on an exclusion to S.113 of the HGCRA which entitles the contractor to apply a 'pay when paid' clause in the case of the insolvency of the employer, but the improper drafting of clause 32 of the sub-contract which had not reflected the amendments issued to the insolvency act, have led to the court's decision to consider the 'pay when paid' clause to be null and void.⁹²

In the Gulf region, 'Pay when paid' clauses are commonly used in practice, however, there is no specific statutory regulation to govern such conditional

⁹² William Hare Ltd v Shepherd Construction

payment clauses, such clauses are governed by the general rules of contracts under the related Civil Transaction Codes.⁹³

4.2 Pay if Paid' Clause:

This conditional clause means that the contractor shall not be bound to pay the sub-contractor in case the employer had not paid the related payment under the main contract, and shall be obliged to pay the sub-contractor only when such payment is issued by the employer. In case the employer fails to pay the main contractor, the latter shall not be obliged to pay the sub-contractors⁹⁴, it is a conditional clause and not a time-related clause that regulates the payment process between the main contractor and the sub-contractors.

Alabama Supreme Court in Lemoine Co. of Alabama, L.L.C. v. HLH Contractors, Inc. case highlights the difference between 'pay when paid' clauses and 'paid if paid' clauses, and how proper drafting of back to back clauses affects the rights of the parties, in this case, the back to back clause has been drafted in a way that the payment clause was interpreted to be a 'pay if paid' clause, which had relieved the main contractor from its obligations to pay the sub-contractor, the court's decision was based on the drafting and wording of the clauses of the subcontract, thus, it is concluded that improper drafting, and ambiguous language may lead to misinterpretation of the back to back payment clauses, and thus, unfair enforcement decisions.⁹⁵

⁹³ Michael Grose, *Construction Law In The United Arab Emirates And The Gulf* (John Wiley & Sons 2016) 160,161.

⁹⁴ 'Back To Back Payment Clauses And UAE Law - STA Law Firm' (*Stalawfirm.com*, 2015) <<https://www.stalawfirm.com/en/blogs/view/pay-when-paid-pay-if-paid.html>> accessed 05 May 2020.

⁹⁵ Alabama, L.L.C. v. HLH Contractors

Nevada Supreme Court, in the USA, stated in *McGovern Bovis vs. Bullock Insulation* that when the sub-contract parties have signed the agreement, the concept of pay if paid have not yet been recognized or defined in the country's legislations, and it have not been decided yet whether such concept shall be deemed enforceable, as the pay if paid provision deprives the sub-contractor from getting paid for the works which he already had completed, Nevada's public policy supports that sub-contractors and suppliers to secure their payments, and therefore, it is clear that pay when paid payment clauses shall be deemed unenforceable, as they are considered as a breach to USA public policy.⁹⁶

4.3 The United Arab Emirates Perspective:

As discussed previously in chapter two, Article 890 (1) of the UAE CTC - which clearly states that provides for a permission to assign specific works to a sub-contractor, unless it is prohibited by the main underlying contract to sub-contract such works; the UAE Union Supreme Court emphasized that under the UAE law, it is permitted for the contractor to assign a third party to perform the whole or a specific part of the works, unless it is prohibited by the provisions and conditions of the main construction contract, or unless the nature of the project works requires that the main contractor shall perform the works by himself utilizing his own company resources⁹⁷. However, employers may impose a clause in their contracts which prohibits subcontracting the whole of the works, such as clause (5.1) of FIDIC Red Book 2017 which delineates the circumstances under which the contractor may not sub-contract the works.

⁹⁶ *McGovern Bovis vs. Bullock Insulation*

⁹⁷ Andrew MacCuish and Nicole Newdigate, 'Back To Basics - Players To A Construction Project – The Subcontractor In UAE Law - Real Estate And Construction - United Arab Emirates' (Mondaq.com, 2017) <<https://www.mondaq.com/Real-Estate-and-Construction/636332/Back-to-Basics--Players-to-a-Construction-Project-The-Subcontractor-in-UAE-Law>> accessed 08 May 2020.

As highlighted previously, pay when paid clauses are commonly used in the payment provisions in most of the sub-contract agreements. The main objective of such clauses is to maintain the parties' cashflow, and to share the risk of non-payment between the project parties. The drafting of such clauses and the applicable laws, strongly affect the application and the enforcement of conditional payment clauses.⁹⁸

The decision of Dubai Court of Cassation No. 281/95, had discussed the effect of the language and interpretation of the payment clauses upon the application and enforcement of such clauses; a sub-contractor had raised a case against the main contractor to claim for an entitled payment, the main contractor defended himself based on the payment term included in the signed sub-contract agreement, which stated that the payment to the sub-contractor shall be made upon the payment by the employer to the main contractor. Despite the fact that the employer had not paid the main contractor even after five years of the completion and handing over of the project, and even the payment clause was drafted to be a conditional payment clause, the court had considered the meaning, intention of the parties, and interpreted the meaning of the clause to achieve the common interest of the parties, the court have not just looked at the wording of such clause, therefore, considering that the sub-contractor had performed all of its obligations under the contract, and referring to the rule that states that 'no harm shall be done nor harm done in return', the court at the end had decided that the main contractor shall not have the right to hold the payment of the sub-contractor after the project have been completed, as the sub-contractor does not have

⁹⁸ Michael Grose, *Construction Law In The United Arab Emirates And The Gulf* (John Wiley & Sons 2016) 160,161.

to encounter difficulties due to reasons he had not caused.⁹⁹ In contrast, Dubai Court of Cassation case 267/2007 had supported the pay when paid clause, by deciding that the sub-contractor's claim for a payment was pre-mature, as such payment was conditional upon the main contractor receiving the related payment from the employer.¹⁰⁰

Another decision of Dubai Court of Cassation provides for guidelines on the interpretation of back to back clauses; a sub-contractor had raised a case against a main contractor to claim for an entitled payment related to performed and completed works, the main contractor defended and argued that the employer had not paid the related amount, and referring to the back to back clause, the sub-contractor shall not be entitled to claim for the payment, therefore, such case was premature. The Court of First Instance had approached an expert to analyze the project cashflow status, the resulted expert report indicated that in reference to the completed sub-contracted works, the payment received by the main contractor from the employer were a little bit higher than the payments received by the sub-contractor by the main contractor, the Court of First Instance rejected the argument of the main contractor and decided that the main contractor is obliged to pay the sub-contractor the claimed amount and as indicated in the expert report, in addition to a 9% legal interest. The main contractor challenged the decision of the Court of First Instance before the Court of Appeal, based on the back to back clause, and requested to appoint another expert, however, the Court of Appeal reverted the case to the previously appointed expert, who had in turn insisted on the expert report issued previously. Despite the errors that had been found out in the expert

⁹⁹ Michael Grose, *Construction Law In The United Arab Emirates And The Gulf* (John Wiley & Sons 2016) 160,161.

¹⁰⁰ Dubai Cassation, 267/2007

report, and that the main contractor had proved his success in an arbitration case against the employer but still had not been paid yet, the Court of Appeal decided that the main contractor shall be obliged to pay the sub-contractor. The main contractor appealed the decision of the Court of Appeal before the Court of Cassation, on the grounds of the back to back clause, the errors in the expert report submitted to the Courts , and the rule that the burden of proof lays on the claimant – the sub-contractor – who had not proven that the condition of the payment described in the payment clause had been met. Finally, the Court of Cassation had decided to reject the sub-contractor’s claim, based on the fact that the claim is premature, in addition to the back to back clause included in the sub-contract Agreement.¹⁰¹

The Decision of the Court of Cassation was based on the UAE Civil Transaction Law No. (5) of 1985.

Referring to Dubai Court of Cassation case No. 633/2018, the court had appointed an expert at the beginning of the case investigations, after that, the appellee had objected on the decision of the court, therefore the court had appointed a panel of three experts to investigate in the details related to a dispute occurred between a main contractor and a sub-contractor regarding a payment entitled to the sub-contractor while carrying out works related to an infrastructure project, one of the main issues that the main contractor argued about, is that the sub-contract agreement was on back to back basis, and accordingly, the payment shall be considered to be paid back to back. At the end, the court decided that back to back approach does not apply to the payment clause in

¹⁰¹ Diego Carmona, Mohieeldin ElBana and Mohamed Selim, 'The Dubai Court Of Cassation Clarifies The Position On The Interpretation Of Back-To-Back Clauses - Al Tamimi & Company' (*Al Tamimi & Company*, 2019) <<https://www.tamimi.com/law-update-articles/the-dubai-court-of-cassation-clarifies-the-position-on-the-interpretation-of-back-to-back-clauses/>> accessed 29 May 2020.

the sub-contract agreement, as the back to back condition had only been included in the document that describes the scope of the project works, and therefore, the sub-contractor's payments shall not be related to the payment by the employer to the main contractor.¹⁰²

4.4 Effects of back to back payment clauses on sub-contractors:

There are several reasons behind the sub-contractors accepting back to back payment term which may be considered unfair, such reasons extend to, the lack of experience with the economical current situation, maintaining the business continuity, lack of negotiation experience and skills, in addition to the negligence to review the contractual terms in the sub-contract agreement. The acceptance of such payment terms will adversely impact the sub-contractor, it may cause all, or any of the following:

1. Substantially impact the sub-contractor's cashflow which may decrease the planned profit along the duration of the project.
2. When the sub-contractor's cashflow is affected, this will automatically cause a delay in the completion of the project deliverables and milestones
3. Another adverse impact of the disrupted cashflow is that the cash deficiency may lead the sub-contractor to purchase less expensive material with poor quality, along with appointing cheap and non-qualified workmanship, which -in turn- will affect the quality of the project's deliverables adversely.¹⁰³

4.5 Recommendations for Drafting of Conditional Payment clauses

¹⁰² Dubai Cassation, 633/2018

¹⁰³ Roshan de Silva (*Slqsuae.org*, 2014) <<http://www.slqsuae.org/wp-content/uploads/2014/12/Article-by-Roshan-2014.pdf>> accessed 11 May 2020

In light of the above-discussed cases, and in order to avoid any potential disputes that may result due to misinterpretation of the payment clauses, the conditional payment clause shall be drafted in a way that provides for financial protection to parties, and proper risk allocation not merely a risk transfer, in addition to achieving a balanced contractual relationship between the project parties, such recommendations for drafting criteria may include, but not limited to the following:

1. It is recommended that the conditional payment clause shall be accompanied with an obligation on the contractor to seek for the entitled payments from the Employer, even with a legal intervention if required, in order to get such payment and pay the sub-contractor accordingly.
2. To reserve the rights of the sub-contractors, the conditional payment clause shall also contain an obligation that the information and status of the payments related to the subcontracted works – between the employer and the main contractor – shall be available to the sub-contractor.
3. An obligation in the sub-contract agreement shall regulate the application and enforcement of the conditional payment clause, which shall be suspended in case there were any disputes between the employer and the main contractor which were not caused by the sub-contractor, and had occurred due to a breach or default by the main contractor.
4. In addition to the above, it is recommended that the conditional payment clause to be drafted as ‘Pay when paid’ which imposes a limit upon the period that the main contractor is entitled to withhold the sub-contractor’s payment.¹⁰⁴

¹⁰⁴ Michael Grose, Construction Law In The United Arab Emirates And The Gulf (John Wiley & Sons 2016) 160,161.

Chapter 5 – Termination of Subcontracts

5.1 Termination Significance

A contract termination means ceasing to perform the scope of works related to the contract before approaching the contractual end date of such contract, and prior to the completion and handing over date of the works, the same definition applies to sub-contracts termination, usually, the main contractor is the party who has the right

to terminate the sub-contract, According to Nelson ¹⁰⁵, the sub-contractor is only entitled to abandon the sub-contract in case of a breach by the main contractor, but – unlike the main contractor – the sub-contractor shall not be entitled to terminate the sub-contract upon his own discretion (convenience).

Termination of any type of contracts / sub-contracts whether it was a construction related or not, shall be done with due care and following the related terms and conditions of the signed contract, in addition to the law that governs the contract works, in order to avoid extensive claims for the damages resulting from an unfair termination. Construction contracts usually contain provisions that clearly identify the grounds that the contract termination shall be based on, in addition to the procedure that shall be followed for a proper contract termination.¹⁰⁶

5.2 Entitlement to Termination

Termination of subcontracts, in terms of entitlement for such termination, is generally classified into two main categories.

5.2.1 Termination for convenience:

Entitlement to termination for convenience is usually included as a major clause in most of the sub-contract agreements, which provides the main contractor for the right to terminate the sub-contract at any time and upon his own discretion, even when the sub-contractor is not in default and had not breached any of its obligations under the sub-contract. In case the sub-contract does not include a termination for

¹⁰⁵ Michelle Nelson, 'How To Terminate A Contract' (*Construction Management Guide*, 2009) <<http://www.cmguide.org/archives/1218>> accessed 26 June 2020

¹⁰⁶ Michelle Nelson, 'How To Terminate A Contract' (*Construction Management Guide*, 2009) <<http://www.cmguide.org/archives/1218>> accessed 26 June 2020.

convenience clause, the contractor may have the right to terminate the sub-contract by law (depending on the governing law), however, the contractor may put himself in a breach of contract situation, which will potentially result in an obligation to pay for damages to the sub-contractor in addition to the profit of the remaining non performed works.

Despite the high risk that a termination for convenience clause may impose on the sub-contractor, subcontractors usually agree on agreements containing such clauses in order to maintain their business.¹⁰⁷

There are several potential risks on sub-contractors that termination for convenience may result in; such as loss of profit, supply agreements signed with suppliers or sub-sub-contractors, and high price materials and equipment orders which cannot be cancelled, in this case, the sub-contractor is advised to negotiate to add an obligation to the termination for convenience clause which manages and allocates the cost risk of the materials which have been ordered specifically for the project, which states that the contractor shall be responsible to pay for all the related costs and damages resulting from the termination, and if imposing such a clause was not possible, the terms of the sub-contractor's agreements with the suppliers is recommended to be back to back with the terms of the sub-contract agreement with the main contractor, in order to share the risk of any potential sudden termination.¹⁰⁸

¹⁰⁷ 'RESOLVING CONSTRUCTION DISPUTES AND CLAIMS - PART 8: SUSPENSION, TERMINATION AND DEFAULT CLAIMS - Metropolitan Engineering Consulting & Forensics Services' (*Sites.google.com*) <<https://sites.google.com/site/metropolitanenvironmental/resolving-construction-disputes-and-claims---part-8-suspension-termination-and-default-claims>> accessed 25 June 2020.

¹⁰⁸ 'RESOLVING CONSTRUCTION DISPUTES AND CLAIMS - PART 8: SUSPENSION, TERMINATION AND DEFAULT CLAIMS - Metropolitan Engineering Consulting & Forensics Services' (*Sites.google.com*) <<https://sites.google.com/site/metropolitanenvironmental/resolving-construction-disputes-and-claims---part-8-suspension-termination-and-default-claims>> accessed 25 June 2020.

The above is illustrated by a termination of a sub-contractor case in the UAE, which clarified the termination entitlement, court decision, and damages entitled to the sub-contractor as a result of termination; after a main contractor had terminated a sub-contract agreement for no default done by the sub-contractor (termination for convenience), the sub-contractor had raised a case against the main contractor claiming for the remaining payment amount as per the signed sub-contract and a percentage of the loss of profit due to the termination, the sub-contract scope was the supply for lights and accessories for a project, the sub-contractor started the manufacturing and production process as per the agreed specifications, and the products have been made ready to be delivered, the main contractor had paid the sub-contractor a specific amount of the contract and refused to pay the remaining amount, which had resulted that the sub-contractor became unable to pay for the materials suppliers, which had in turn harmed the sub-contractor's reputation in the market. On the other side, the main contractor had defended himself by alleging that the production commencement and the related payment for the delivery of the materials on site have been agreed to be conditional upon approval by the employer on the same. Moreover, the main contract between the employer and the contractor had been terminated by the employer, therefore, and highlighting that the sub-contract was drafted on a back to back basis with the provisions of the main contract, the sub-contract shall be terminated accordingly, in addition to that, the main contractor highlighted that he had notified the sub-contractor several times to hold the process of manufacturing and production till further notice. The court had consulted an independent expert to assist in deciding upon the matter, and at the

end, the court held that even though there is a rule stating that parties shall be bound by their contract provisions and conditions, and neither party shall withdraw from the performance from the commitment to perform its obligations or vary such conditions, such rule has an exception which gives the right to the employer to terminate the contract before it had been completed or before it comes to its end, however, the court may at certain circumstances protect the sub-contractor's rights in case of such termination, by imposing an obligation on the employer to pay the sub-contractor the costs incurred for the execution of the project in addition to the loss of profit which may have been earned if the termination had not occurred, the same concept is applicable in the dealings between the main contractor and the sub-contractor when works are sub-contracted, the main contractor in such situation will act as the employer, and therefore, shall have the right to terminate the sub-contract for its convenience. During the execution of this project, the main contractor had informed the sub-contractor to hold the production process, in addition, the main contractor had communicated the termination letter of the project main contract, and requested the sub-contractor to provide the details of the materials and the manufactured accessories, in order to be used to support the main contractor's claim against the employer.

The court held that after the termination of the main contract, the main contractor is no longer obliged to pay the sub-contractor for the period after termination,

nevertheless, the main contractor shall compensate the sub-contractor for the costs incurred plus the loss of profit.¹⁰⁹

5.2.1.1 Exercising Good Faith duty in termination for convenience:

While discussing the duty of good faith concept, it shall be highlighted that good faith arguments and explanations are not valid in some statutes and regulations, for example common law do not apply the good faith perspective, English Courts which relies on the common law principles, do not apply the duty of good faith concept, and in case the contracting parties desire to include such, they shall draft the wording of their contract clauses to be interpreted in good faith, however, English Courts would not consider such wording to rule above a contractual right, for example, a right for termination for convenience.¹¹⁰ Therefore, arguing that termination for convenience had been done in bad faith will not be considered for contracts regulated by common law, this is obvious in *Monde Petroleum SA v Westernzagros Ltd* [2016] EWHC 1472 (Comm) case; the high court held that a commercial contract would not contain a provision which obliges a party not to terminate a contract in bad faith, or that such contract would be considered incomplete if it is not containing a provision related to good faith, and there shall be no special requirements to impose or explain including such clause in a commercial contract.¹¹¹

¹⁰⁹ Faisal Attia and Zane Anani, 'Terminating Construction Contracts For Convenience In The UAE - Al Tamimi & Company' (*Al Tamimi & Company*, 2013) <<https://www.tamimi.com/law-update-articles/terminating-construction-contracts-for-convenience-in-the-uae/>> accessed 25 June 2020.

¹¹⁰ Claire King, 'Good Faith: English Law V The UAE Civil Code' (Fenwick Elliott) <https://www.fenwickelliott.com/research-insight/newsletters/international-quarterly/good-faith-english-law-uae-civil-code#footnote11_9800215> accessed 25 June 2020.

¹¹¹ Sarah Garvey, 'No Implied Duty Of Good Faith In Termination Clause - Allen & Overy' (Allen Overy, 2016) <<https://www.allenoverly.com/en-gb/global/news-and-insights/publications/no-implied-duty-of-good-faith-in-termination-clause>> accessed 25 June 2020.

As illustrated by Grose ¹¹², the duty of good faith has no significant role in the common law jurisdictions, as per what had happened in Walford v Miles Case¹¹³, in which the House of Lords held that considering good faith in negotiating agreements shall not be enforceable.

Conversely, the UAE Civil Transaction Code allows the application of good faith when it comes to termination for convenience, it is worth in this context to highlight that the duty of good faith shall be applied to the performance of an obligation rather to the obligation itself. ¹¹⁴, as discussed in the previously detailed case, the employer / the main contractor have the right to terminate the contract / sub-contract for convenience, however, if it had been proven that this right had been used to terminate the contract in bad faith, then the courts may not accept such termination and may hold that the termination is null and void¹¹⁵. After proving the bad faith termination, the grounds for the contractor / sub-contractor's argument against a bad faith termination will be Article (246) of the UAE CTC which states that the obligations under a contract shall be performed as per the requirements of good faith, and as per the contents of such contract. ¹¹⁶, In addition to Article (106) which states that an individual shall be responsible for any illegal exercise of its rights, such exercise may be held illegal where there is a clear and intended breach, or when the outcome of such exercise contradicts the regulations of Islamic shariah, the governing laws and

¹¹² Michael Grose, Construction Law In The United Arab Emirates And The Gulf (John Wiley & Sons 2016) 49

¹¹³ Walford v. Miles

¹¹⁴ Claire King, 'Good Faith: English Law V The UAE Civil Code' (Fenwick Elliott) <https://www.fenwickelliott.com/research-insight/newsletters/international-quarterly/good-faith-english-law-uae-civil-code#footnote11_9800215> accessed 25 June 2020.

¹¹⁵ Claire King, 'Good Faith: English Law V The UAE Civil Code' (Fenwick Elliott) <https://www.fenwickelliott.com/research-insight/newsletters/international-quarterly/good-faith-english-law-uae-civil-code#footnote11_9800215> accessed 25 June 2020.

¹¹⁶ UAE, 'UAE Civil Transaction Code' (1985).

regulations, the public order and morals, and if such unlawful exercise may cause any damage to others.¹¹⁷

Referring to Dubai court of cassation decision No. 313 of 2007, the court through this case had attempted to decide whether the termination for convenience clause is valid, the court's decision had been affected by Article (218) of the UAE CTC which states that '(1) A contract shall not be binding on one or both of the contracting parties despite its validity and effectiveness if there is a condition that such party may cancel it without mutual consent or an order of the court.

Each party may act unilaterally in cancelling it if by its nature the contract is not binding upon him or if he has made it a condition in his own favour that he has the option to cancel.'¹¹⁸

5.2.2 Termination for breach:

This occurs when a party to a contract breaches its obligations under the contract, which may give the right to the other party to terminate the contract, such termination will be assessed by courts based on the terms and conditions of the underlying contract, whether it includes a clause which provides the innocent party for the right to terminate the contract for the reason of breach, in addition to that, the severity of the breach occurred will also be considered; whether the breach would give the right for a party to terminate the contract based on the governing law or not.

¹¹⁷ UAE, 'UAE Civil Transaction Code' (1985).

¹¹⁸ UAE, 'UAE Civil Transaction Code' (1985).

In order for a sub-contract to be terminated, the sub-contract agreement have to include a clause which specifies the circumstances under which a breach shall be considered as a reason to lay on to start the process of termination. However, in case that the sub-contract does not include a termination for breach clause, or the breach which had occurred does not constitute a reason for termination under such clause, there are types of breach that shall give the right to the innocent party to terminate the contract, such types will depend on the governing law of the contract; for example, a breach of a contract condition and a breach of intermediate term of the contract are considered to be strong termination grounds under the common law, which shall entitle the innocent party to claim for termination for breach even outside the contract termination clause.¹¹⁹

Termination for breach claims, impose a high risk on the terminating party when the termination claim is subject to be determined by either arbitration or litigation, in such case if the termination is deemed to be wrongful, this will result in failure by the terminating party to collect the entitled remaining payments, in addition to the obligation to pay the other party for damages resulting from the wrongful termination, such damages may include payment for loss of profit of the non-performed works.¹²⁰

FIDIC forms of Contracts and sub-contracts include termination clauses which details the termination process, specifying the grounds allowable to terminate the

¹¹⁹ Morgan McIntosh, 'When Can You Terminate A Construction Contract For Breach Of Contract?' (*Turtons.com*, 2019) <<https://www.turtons.com/blog/when-can-you-terminate-a-construction-contract-for-breach-of-contract>> accessed 24 June 2020.

¹²⁰ 'RESOLVING CONSTRUCTION DISPUTES AND CLAIMS - PART 8: SUSPENSION, TERMINATION AND DEFAULT CLAIMS - Metropolitan Engineering Consulting & Forensics Services' (*Sites.google.com*) <<https://sites.google.com/site/metropolitanenvironmental/resolving-construction-disputes-and-claims---part-8-suspension-termination-and-default-claims>> accessed 24 June 2020.

contract for, in addition to the procedures that shall be followed to commence a termination process, this is clearly described through clause (15.6) in the FIDIC form of sub-contract 2011.

Furthermore, the UAE Civil Transaction Code includes specific articles related to termination; Article (892)¹²¹ states that a construction contract is ended in two cases, the first one is when the scope of the contract works is completed, the other one is when the contract is terminated by agreement between both parties or by a court decision. Moreover, the CTC provides for a right for both parties to terminate the contract for convenience, this is specified in Article (893) which indicates that in case there is any reason, or special circumstances occurred during the performance of the project, which obstructs the performance and the completion of the works, either party shall have the right to agree to bring the contract to an end.

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Referring to DeAvila v. Espinoza Metal Building & Roofing Contractors case, a sub-contract agreement was signed between Espinoza Metal Building & Roofing Contractors (the contractor) and DeAvila (the sub-contractor) concerning the installation of a special type of roofing system, the contract value was a lump sum amount, and no detailed programme of works had been agreed upon, however, it had been highlighted that the project duration is considered to be critical, the sub-contract agreement contained a clause that allows the main contractor to terminate the contract upon his discretion and even with no reason for termination, provided that the main contractor shall give a written notice to the sub-contractor 48 hours

¹²¹ UAE, 'UAE Civil Transaction Code' (1985).

¹²² UAE, 'UAE Civil Transaction Code' (1985).

before such termination. The scope of the sub-contract works had almost been done at the time when the main contractor had decided to request for some major changes to the scope of works, therefore, the sub-contractor had submitted a variation order claim based on the requested changes, the main contractor – after several months – had rejected the claim as the prices were found high, then the sub-contractor had revised and resubmitted the claim as per the price adjustment imposed by the main contractor, after that, suddenly the sub-contractor had noticed that some of his materials and instruments were removed out of site and called the police regarding this matter, without knowing that the main contractor had removed the material, then, and without giving any notice or intention for termination, the main contractor had appointed another sub-contractor to perform the same scope of works, as result, the sub-contractor had raised a case to the court against the main contractor for breach of the sub-contract, the main contractor argued that the sub-contract provides him with flexibility to terminate the sub-contract at any time, and therefore, the removal of the sub-contractor’s materials from site shall not be considered as a breach to the contract.

The Court held that the removal of the material shall be considered as a breach of the sub-contract, as it occurred before any intended termination by the sub-contractor, in addition to that, the court held that, even though the main contractor has the right to terminate the sub-contract at his own convenience, the agreed upon notice of 48 hours should have been sent to the sub-contractor before hiring another sub-contractor to complete the works.¹²³

¹²³ J. Kent Holland, 'Termination Of Subcontractor Was Improper | Construction Risk' (*Constructionrisk.com*, 2019) <<https://www.constructionrisk.com/2019/03/termination-of-subcontractor-was-improper/>> accessed 24 June 2020.

Chapter 6 - Conclusion

Due to the complexity of the construction projects, and the involvement of several specialized disciplines in most of such projects, in most jurisdictions around the world, and if permitted by the underlying contract, the main contractor is allowed to assign a sub-contractor to carry out part or the whole of a project works.

Sub-contracting broadens the chance for small companies to participate in large and complex projects, it also provides for several benefits to main contractors including time and cost saving, providing for more professional and specialized services than carrying out the project works by the main contractor himself, furthermore, sub-contracting increases the productivity and the efficiency of the performance of the sub-contracted works, and gives the main contractor the chance to transfer the project risks to a sub-contractor. However, it is recommended to main contractors to study and analyze the scope of their projects, in order to decide which scope to be specifically assigned to a sub-contractor, in order to optimize the benefits of sub-contracting and furthermore to minimize the disputes that may arise out of such assignment.

It is understood that in most cases, and whether the sub-contractor is domestic or nominated, the main contractor shall remain liable towards the employer for the sub-contracted works, and shall bear the contractual liability for the acts of the sub-contractor. However, some standard forms of construction contracts apply several restrictions to the entitlement of a main contractor to any variation order or extension of time claim resulted by a domestic sub-contractor.

Due to the fact that there is no contractual relationship between the employer and the sub-contractor, the main contractor shall usually be responsible to pay the sub-contractor, however, the employer may -in some cases- pay directly to the sub-contractor; when the sub-contractor is nominated by the employer, or if there was an assignment by the main contractor to the sub-contractor to receive payments from the employer.

Main contractors are advised to ensure that the right to vary the scope of the sub-contracted works is clearly included and drafted in the terms of the sub-contract agreement, as such variations may be requested by the employer, and submitted by the main contractors as variation orders under the main contract.

In construction projects, and in order to minimize the disputes that may arise throughout the project, a key factor to be considered when deciding to appoint a sub-contractor, is the drafting of the sub-contract agreement, specifically the terms and conditions related to the payment mechanism.

Main contractors prefer to draft their sub-contracts provisions on back to back basis, in order to protect their cashflow and to shift the risk of non-payment by employers to sub-contractors, or at least keep such risk shared, however, back to back payment clauses may have several adverse impacts on sub-contractors, such as poor cashflow throughout the project which may lead to serious delays in performing the works, and may oblige the sub-contractor to use poor quality materials and labor, sub-contractors are advised to negotiate a provision in their sub-contracts which specifies a time limit for the main contractor to withhold a payment, in addition to convincing the main contractor -in case of non-reasonably withholding a payment- to seek for such payment from the employer, even if this requires a legal interference. Back to back payment clause shall be drafted clearly to avoid misinterpretation by either the other party or by courts.

The application of the principle of back to back payment is restricted and prohibited in several jurisdictions such as the United Kingdom, Germany, Ireland, and Australia, on the grounds that it is considered unfair, as it may negatively impact sub-contractors, specifically in case main contractors withhold the payments unreasonably and for long periods, some other jurisdictions permits the conditional payment clauses but interpret such clauses in a way that balances and distributes the risk resulting from such clauses fairly such as the United Arab Emirates, Malaysia, Singapore, and New Zealand.

JCT forms of contracts allow for the application of back to back payment clauses, but restrict the time for payment to not later than 21 days after the related payment is issued under the main

contract, and obliges the main contractor to pay the sub-contractor even in the case of insolvency, however, FIDIC forms of contracts allows for more time for the contractor to withhold the sub-contractor's payment, but this time shall not exceed 84 days after the elapse of the Defects Notification Period of the sub-contracted works.

It is recommended that the termination clause included in the sub-contract to be drafted properly; setting clear ground and procedures to be followed for termination, as the absence of proper termination clause, or not standing on strong grounds and following the agreed procedures, may lead to disputes and may incur the terminating party extra costs either for damages or for loss of profit of the other party.

End of Dissertation

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