

Impact of 'back to back' payment clause on the
cash flow of subcontractor in the UAE.

اثر الشرط التعاقدى "الوفاء المتبادل" على التدفقات النقدية لمقاولي الباطن في الامارات

By

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Abstract

Any default by the employer, by not paying on time or nonpaying at all, will adversely affect the parties down in the supply chain in construction project. The contractor tries to cope with such problem by limiting his liability via terms in the contract, such as back-to-back payment terms, with his subcontractors and suppliers. Back to back payment clause has different meanings and forms and its interpretation may vary among the different legal systems. Common law is inclined to invalidate such clause. The situation under the UAE law is different as there is no explicit term in the current law that invalidates the back to back payment clause.

The research aimed at investigating the impact of ‘back-to-back’ payment terms on the cash flows of subcontractors and main contractor’s and try to find solutions for securing the subcontractor payments. A total of 96 questionnaire responses were collected from different construction professionals involved in the contract administration or drafting in the UAE.

The research asserted that most of the professional participated in the survey felt uncomfortable with back to back payment term. Furthermore, most of the subcontractor participated in the survey have encountered problems due to back to back payment clause

Back to back clause has significant impacts in the cash flows of the main contractors and subcontractors. As 65% of the entire professionals participated in the survey claimed so. Furthermore, according to most of the respondents to the survey, back to back clause in unfair term and should be invalidated by the law

To conclude, it is worthwhile to the parties to be clear in their contract terms with regards to payment certification and mechanisms. In addition, the legislator should be inspired by the other common laws to adopt payment mechanisms and certainty in the construction industry.

الملخص:

أي تقصير من جانب صاحب العمل وذلك بعدم دفع مستحقات المقاول الرئيسي في الوقت المحدد أو عدم الدفع ، سوف يؤثر سلبا على جميع الأطراف ذات العلاقة بالمشروع وذلك يشمل مقاولي الباطن والموردين في مشروع البناء. المقاول الرئيسي عادة يحاول التغلب على هذه المشكلة عن طريق الحد من مسؤوليته عبر الاتفاق في العقد مع المقاولين من الباطن والموردين وتضمينه شروط خاصة مثل شرط الوفاء المتبادل والمتعلق باستلام المستحقات الماليه من المالك وانعكاس ذلك بالتبادل على دفعات المتعاقدين معه من الباطن والموردين. الوفاء المتبادل ممكن ان يأخذ عدة معاني والتي يختلف تفسيرها بين النظم القانونية المختلفة. دوليا يمكن القول إن معظم القوانين التي يحكمها نظام الكومنولث قد حرمت مثل هذه الشروط ولكن الوضع تحت القانون الإماراتي مختلف حيث لا يوجد نص صريح في القانون الحالي يبطل شرط الوفاء المتبادل بخصوص الدفعات المالية.

تهدف هذه الدراسة إلى البحث في أثر الشرط التعاقدى "الوفاء المتبادل" على التدفقات النقدية للمقاول الرئيسي ومقاولي الباطن في المشاريع الهندسية ومحاولة إيجاد حلول لتأمين دفعات مقاولي الباطن. تم عمل استبيان مكون من 26 سؤال تم توزيعه عبر الايميل على أصحاب الخبرات في إدارة العقود الهندسية في الإمارات العربية المتحدة و تم جمع ما مجموعه 96 رد.

نتائج الدراسة تشير إلى أن معظم من شارك في الاستبيان عبروا عن عدم ارتياحهم لشرط الوفاء المتبادل لما يحمله من اثار سلبية على المشروع كما أكد ذلك معظم مقاولو الباطن المشاركين في الاستبيان. كما ان 65% ممن شارك في الاستبيان رأوا ان شرط الوفاء المتبادل له اثار سلبية على التدفقات النقدية لمقاولي الباطن. كما ان اغلبية المشاركين في الاستبيان رأوا ان شرط الوفاء المتبادل غير عادل لمقاولي الباطن لذلك يجب إبطاله في الإمارات بقوة القانون. وختاما، فإنه من المفيد للأطراف المتعاقدة أن يكون شرط الدفعات المالية شرطا واضحا في العقد وكذلك فيما يتعلق بشهادة وآليات الدفع. وبالإضافة إلى ذلك، يجب ان يتم إعادة النظر بالقانون الإماراتي وذلك أسوة بالقوانين الأخرى على أن يتم توفير الحماية للمقاولين إذا تخلف الطرف الأخر عن دفع المستحقات المالية.

Dedication

This research paper is dedicated to my beloved parents (Fathi, and Ghalia), wife Refqa and Kids(Sara, Ahmed and Abdul Rahman .)

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Abbreviations:

DIAC Dubai International Arbitration Center

HGCRA Housing Grants, Construction and regeneration Act

JCT Joint Contract Tribunal

NEC New Engineering Contract

PBA Project Bank Account

UAE United Arab Emirates

Chapter 1

Introduction:

Subcontractors play key roles in the construction industry as the subcontracting work represents the major portion of construction projects. For instance, a study conducted in Australia found that 80-90% of the building construction projects were subcontracted.¹

Payment issues are considered to be one of the main causes for the delay of construction projects. In 2006, a study conducted in the United Arab Emirates (UAE) revealed that payment issues were ranked as the tenth leading cause of the delay of construction projects.² It may be argued that this view was changed upon the credit crunches in 2009 and the payment issues were expected to be the main reason for projects delay.³

It is the construction industry practice in the UAE that, 10% of the contract value is paid as in advance to the main contractor. Main contractors have to rely on their own financial resources to execute the works or depend on their sub-contractors and suppliers in executing the works and delivering materials in advance until the interim payments, which are usually planned on monthly basis, are issued.

¹ J Hinze, and A Tracy, 'The contractor-subcontractor relationship: the subcontractors' views' [1994] 2 Journal of Construction Engineering and Management 274.

² A sh Faridi, & S M EL-Sayegh, 'Significant factors causing delay in the UAE construction Industry' [2006] 24 Construction Management and Economics 1167.

³ J Palmos, 'Security of Payment' Construction Week (UAE, November 2010). <<http://www.constructionweekonline.com/article-10293-security-of-payment/1/print/>> Accessed 8 March 2013.

The interim payment, in return, is certified by the engineer who oversees the project and administers the contract. The payment is usually subject to many deductions for many reasons by the engineer such as; retention, defective works⁴, advance recovery⁵ if any, or any off-set between the employer and the main contractor for instance, liquidation and certain damages. Then the net amount is issued to the main contractor who in return, issues the payments to suppliers and sub-contractors.

Therefore, any default by the employer by not paying on time or nonpaying at all will adversely affect the parties involved down in the supply chain in the project. The contractor tries to cope with such problem by limiting his liability via terms in the contract, such as ‘back-to-back’ terms, with his sub-contractors and suppliers. However, in many cases it is onerous for suppliers and subcontractors to be aware of risk associated with acceptance of such terms since many sub-contract agreements are formed by exchange of letters or sending purchase orders which include such terms without peer review. Furthermore, the sub-contractors and suppliers, due to the construction market circumstances and credit crunch, may find themselves left with no choices but to accept these terms.

1.1 Research Issue

The Dubai Court of Cassation in case 281/1995 upheld that if sub-contractor completed his work then, the main contractor has to pay him his dues regardless of whether the main contractor has received his payments from the employer or not. However, the view has been recently changed as in Case 267 of 2007 the Dubai Court of Cassation impliedly upheld the term back to back payment clause as a valid term. Furthermore, by looking at different jurisdictions as will be explained later, the literatures provided that legality of ‘back to back’ terms depends on the

⁴ As per FIDIC 1987 4th Edition Clause 60.4: the interim payment can be corrected by the Engineer. ”...if any work is not being carried out to his satisfaction...”. Furthermore clause 49.3 the cost of remedying defective work shall be executed by the contractor at his own cost.

⁵ It means repayment of the advance.

substantial law where the cases are being handled and how the courts will construe the terms.

There is a general lack of research addressing the payments difficulties in the UAE. Therefore this research tries to bridge this gap by trying to investigate the impact of 'back-to-back' payment terms on the cash flows of sub-contractors and main contractors and try to find solutions for securing the sub-contractors' payments. In this research, a survey of 26 questions was distributed to different stakeholders involved in contract drafting or administration in the U.A.E.

1.2 Aim and objectives

The aim of this research is to investigate the impacts of the 'back to back' payment clause on the cash flow of sub-contractors in the UAE.

The objectives of the study are:

- To understand stakeholders' perceptions of the 'back to back' meaning and implications.
- To investigate the impact of the 'back to back' clause on the cash flows of main contractors and sub-contractors and the pricing of the project.
- To explore the remedies, under the UAE law, the sub-contractors have, if not paid due to the 'back to back' clause and to suggest methods to secure the sub-contractors' payments.

1.3 Research Question

Would the 'back to back' payment clause insecure the subcontractor payment?

1.4 Research Scope

The research's scope is limited to the 'back to back' payment clause in the UAE, taking in to consideration law provisions of other countries dealt with subcontractors' payments.

1.5 Dissertation structures:

This dissertation will be structured as follows: In the second chapter the Contractual chains and obligations of the contracting parties, payment mechanisms to subcontractors, incorporation of main contract terms into subcontract, different back to back forms and back to back clauses in the UAE will be discussed, then remedies that parties can refer to will be highlighted, next the methodology used to achieve the aim and the objectives will be discussed. Next the collected data will be analysed and finally conclusion and recommendation will be provided.

Chapter 2

The legal significance of ‘back to back’ payment’s terms in the UAE

This Chapter discusses the contractual chains in the construction industry and payment mechanisms to subcontractors. Additionally, it highlights different meanings and forms of ‘back to back’ payment clause.

2.1 Contractual chains and obligations of the parties:

The construction industry plays a key role in development of any country.⁶ Generally speaking, in construction contract, the employer enters into a contract with a constructor. The constructor covenants with the employer to execute and complete the work. The employer, on the other hand, covenants to pay money to the contractor. If either party fails to perform his obligation, then it is regarded as a primary breach of the contract.⁷

In construction projects, it is not uncommon for the main contractor to sublet most of the works to sub-contractors⁸. Furthermore, it is usual for sub-contractors to enter in to agreements with suppliers in order to meet their obligations. Sub-contracts may include mechanical, electrical, air-conditioning, joinery works, plaster painting works and others. The main reason for that is the need for specialist skills. Some sub-contracts such as mechanical works may include supply and installation while other subcontracts such as plaster work may include installation only.

⁶ For example in the United Arab Emirates, prior to 2005, the construction industry contributed with 13.8% to the GDP. In A sh Faridi, and S M EL-Sayegh, 'Significant factors causing delay in the UAE construction Industry' [2006] 24 Construction Management and Economics 1167.

⁷ H Singh, 'Construction of contingent payment clauses: Is there light at the end of the tunnel?' [2006] Malayan Law Journal Articles 3.

⁸ Sub-contracting is defined as ‘a delegation of part of the responsibilities acquired under a contract without transferring any of the contractual accountability.’ In P R Davis, *Learning Guide for Contracts Administration* 342 (University of Technology Western Australia 1999).

The sub-contract can be nominated or domestic. In a nominated sub-contract, the employer nominates the specialist sub-contractor. The special items are normally mentioned in the provisional sum items and the contractor aims at trying to ensure that the sub-contract is consistent with the main-contract's obligations. On the other hand, in domestic subcontract, the engineer has to check the prequalification and approve⁹ domestic sub-contractors although the employer has no right to choose them. It is worth mentioning that in both sub-contract types the contractor is still responsible¹⁰ for the act or default of sub-contractors.

It is important to note that there is no privity of contract between the employer and the sub-contractors which means that the sub-contractor, both domestic or nominated¹¹, has no other choice but to redress the main contractor in case of any default by the employer. On the other hand, when the performance of the sub-contractor is not matching the employer's needs, the contractual chain exists to accommodate such fault by providing the employer the right to take an action with the main contractor who consequently takes an action with the sub-contractor. Furthermore, the sub-contractor claims his payment from the main contractor who in turn claims the same from the employer.¹²

Payment is considered as the 'life-blood'¹³ of the construction industry, however in practice there are many issues associated with payment provisions in the contracts such as delay and non-payment. Many studies revealed that payment issues play a significant role in enhancing a dispute in the construction industry. For example, a

⁹ See for example clause 4.1 of FIDIC 1987, 4th Edition.

¹⁰ See Clause 4.4 of FIDIC 99 Red Book. See also UAE Civil Code Article 890.

¹¹ It is wise to mention that as per the FIDIC 1987 clause 59.1, the main contractor can object to employee a nominated subcontractor if he raises reasonable reasons.

¹² P R Davis, *Learning Guide for Contracts Administration 342* (University of Technology Western Australia 1999)

¹³ In *Dawnays Ltd v FG Minter* [1971] 2 All ER 1389, Lord Denning's observations in 1970: 'There must be a 'cash flow' in the building trade. It is the very lifeblood of the enterprise.'

study conducted in Malaysia showed that 51% of the construction disputes were due to payment issues in which most of the issues are relevant to payment issues from main contractors to sub-contractors.¹⁴ Furthermore, upon the 2009's financial crisis in Dubai, it was reported that the amount of construction claims filing at the Dubai International Arbitration Center (DIAC) about £3 billion.¹⁵

In order to ensure the continuity of the construction project, appropriate timing of payments should be considered as the payments flow starts from the employer to the main contractor then to the sub-contractors and finally to suppliers. Nevertheless, the main contractors usually transfer the risk of the employer's non-payment to sub-contractors. This is achieved via using 'back to back' terms.¹⁶

2.2 Payment mechanisms to the sub-contractors:

Broadly speaking, there are three fundamental methods which trigger the time or the condition for the sub-contractor's payments in consideration for the work done: 'payment upon certification', 'direct payment from the employer' and 'conditional payment.'¹⁷ These methods are explained below:

2.2.1 Payment upon certification: in this method the contractor will pay the sub-contractor's due amount after the consultant certifies that the main contractor's work done of which the sub-contractor's work is part of. Furthermore, the honoring period, mentioned in the sub-contract, which is irrelevant of the grace period mentioned in the main contract, to repay the sub-contractor should be considered. The time starts running with regards to fulfilling the main-contractor's obligations from the date of

¹⁴ A Supardi, H Adnan & F M Mohammed, 'Security of payment Regime in Construction Industry: Are Malaysian Sub-contractors Ready?' [2011] 4 The Built & Human Environment Review 122.

¹⁵ N Brendel, A Barrette, and W El Riachi, 'The Availability in the UAE of Liens to Secure Payment under Construction Contracts' 24(2010) Arab Law Quarterly 309.

¹⁶ A L May & K Siddiqi, [2006] 12 Journal of Architectural Engineering 158.

¹⁷ A Supardi, H Adnan & F M Mohammed, 'Security of payment Regime in Construction Industry: Are Malaysian Sub-contractors Ready?' [2011] 4 The Built & Human Environment Review 122.

the certification.¹⁸ It is worth mentioning that FIDIC Subcontract Form of Contract in its first edition published in 2011¹⁹ in Clause 14.6 provides that the certification of the sub-contractor works is required in order to enable the contractor to pay the sub-contractor's due amount. In addition, it provides the right to the main contractor to postpone sub-contractor's payment if the later works were not certified by the engineer or the work is certified by the engineer but not paid by the employer however it is not allowed to withhold the sub-contractor's payment if the non-certification or non-payment is due to a contractor's default. Furthermore, the contractor is obliged to verify with supporting documents the reason why some work done by the sub-contractor is not certified by the engineer or an amount was not paid by the employer.

2.2.2 Direct payment from the employer:

Under this method, the employer can pay directly to the sub-contractors. Usually this happens in the nominated sub-contractors cases where the main contractor fails to pay the due amounts to the sub-contractors. For example pursuant to clause 5.4 of FIDIC 99 Red Book, the employer can pay directly to nominated sub-contractor if the main contractor failed to pay his dues without justifiable reasons. The clause said: 'Before issuing a payment certificate which includes an amount payable to nominated Subcontractors, the Engineer may request the Contractor to supply reasonable evidence that the nominated Subcontractor has received all amounts due in accordance with previous payment certificates, less applicable deductions for retention or otherwise. Unless the contractor: (a) (i) submits the reasonable evidence to the Engineer, or (I) satisfies the Engineer in writing that the contractor is reasonably entitled to withhold or refuse to pay these amounts, and (ii) submit to the

¹⁸ H Singh, 'Construction of contingent payment clauses: Is there light at the end of the tunnel?' [2006] Malayan Law Journal Articles 3. In A Supardi, H Adnan and F M Mohammed, 'Security of payment Regime in Construction Industry: Are Malaysian Sub-contractors Ready?' [2011] 4 The Built & Human Environment Review 122.

¹⁹ FIDIC Subcontract 1st edition published in 2011.

Engineer reasonable evidence that the nominated Subcontractor has been notified of the Contractor's entitlement, then the Employer may (at his sole discretion) pay, direct to the nominated subcontractor, part or all of such amounts previously certified (less applicable deductions) as are due to the nominated sub-contractors and for which the Contractor has failed to submit the evidence described in subparagraphs (a) or (b) above. The contractor shall then repay, to the Employer, the amount which is nominated Sub-contractor is directly paid by the Employer.²⁰ It is worth to mention that the aforementioned clause provides a security mechanism as the employer, upon his sole discretion, pays to the nominated subcontractor where the main contractor illegitimately fails to pay to the subcontractor.

The UAE's Civil Code did not provide the sub-contractor the right to claim a payment directly from the employer. Based on the UAE Law there is one way in which the sub-contractor can seek direct payment from the employer, by providing at the outset of the contract agreement between the sub-contractor and the main contractor assignment clause which is subject to employer consent. Article 891 clarifies that: 'The second contractor may not make any claim against the employer for anything due to him from the first contractor unless he has made an assignment of it to him as against the employer.' Furthermore, Article 1106 of the UAE Civil Transactions Code²¹ provides that: 'an assignment is transfer of a debt and claim from the liability of the assignor to the assignee.' There is a condition in Article 1109 that needs to be met in order to validate the assignment; it requires all parties to agree on the assignment. It provides that: '(1) In order for an assignment to be valid, there must be the consent of the assignor, the assignee and the creditor. (2) A transfer made between the assignor and the assignee is dependent upon the consent of the creditor.'

²⁰ FIDIC Condition of Contract for Construction. 1999

²¹ Law o 5 of 1985 UAE Civil Code Articles 1106 and 1109.

Nevertheless, this is not the case under many other jurisdictions²², as these jurisdictions, under certain circumstances, provide the sub-contractor the right to claim payment directly from employer. For example, the Lebanese Code of Obligations and Contracts provides that ‘all individuals who have been employed to execute the constructed work have a direct action against the principal up to the amount that he owes to the contractor at the time when their action was initiated.’ The Law grants the sub-contractor the right to claim his amount directly from the employer if the main contractor did not pay the former’s dues due to bad faith, or become insolvent. However, the subcontractor’s claim from the employer should not exceed the due amount by the employer to the main contractor.²³ This subject will be highlighted in chapter 3.

2.3 Incorporation of main contract’s terms into the sub-contract:

Broadly speaking, standard forms of sub-contracts refer to the terms of sub-contract agreements regardless of whether the main contractor has received the payment from the employer or not, as the rights and obligations between the main contractor and sub-contractor should be performed as per the agreement. For instance, JCT 98 obliges the main contractor to pay the sub-contractor within 17 days from certification of the payment and the employer is obliged to pay simple interest if payment gets delayed.²⁴ However, many bespoke agreements intend to pass risk down to sub-contractors by providing precedent conditions via incorporating ‘pay when paid’ clauses in their agreement with sub-contractors²⁵, or provide that rights and obligations between the main contractor and sub-contractor should be as per the main contract agreement. Generally speaking, the sub-contract is usually formed by the exchange of letters, or via using purchase orders by the main contractor which in

²² Such as the Egyptian Code Article 662, Lebanese Code Article 678 and French Law Article 12

²³ Article 678 of Lebanese Code of Obligations and Contracts. In West Law Gulf 2013.

²⁴ See Clause 30.1 of JCT 98.

²⁵ R Knowles, *150 Contractual Problems & their Solutions* (2nd Edt Black well, Oxford 2005)

many cases may incorporate the terms of the main contract. However; practically speaking, many disputes may arise when trying to incorporate the main contract terms into the sub-contract.

It is worth mentioning that FIDIC published the first edition of standard form of subcontract in 2011. This form was proposed based on the 1999 FIDIC Red Book which is concerned with conditions of contracts for construction of building and design prepared by the employer. The main feature of this form was that it was drafted based on 'back-to-back' basis,²⁶ therefore, the risk was assumed to pass down from the main contractor to sub-contractor and the sub-contractor was considered to be aware of all main contractor's obligations and have information of the provisions of the main contract.²⁷

Spyrous²⁸ explains some common pitfalls of the 'back-to-back' as a general term such as; the contractor all risk insurance which is provided by the main contractor based on his scope of work is not the same scope of work carried out by the sub-contractor. Furthermore, the main contractor has provisions allowing interference with the sub-contractors' works in order to coordinate and supervise his work. This is not the case in the contract between the employer and the main contractor which usually has no such interference terms. Another pitfall is that capping the liability, the common practice is that the main contract between the employer and the main contractor usually has a clause limiting the liability²⁹ of the main contractor to the employer, which is normally a percentage of the contract's price. However, the

²⁶ The Form made it crystal clear in clause 2.2 that the subcontractor is obliged to perform 'all the obligations and liabilities of the contractor under the main contract.'

²⁷ S Thomas, 'The new first edition FIDIC sub-contract' available at <http://construction.practicallaw.com/blog/construction/pinsents/?p=143> > accessed 4 March 2013.

²⁸ P Masons, 'Subcontracting risks and opportunities' [2010] Construction Law 20.

²⁹ For example Clause 17.6 of FIDIC 99 Red Book provides that: 'neither party shall be liable to the other party for lossThe total Liability of the Contractor to the Employer,...shall not exceed the sum stated in the particular conditions...'

contract value of the sub-contractor is usually much lower than the main contractor's price. Additionally, Smith et al³⁰ highlighted issues in drafting sub-contracts which have the general term of 'back to back', these issues will be highlighted below.

2.3.1 Conditional Payment:

Under this type of payment to the sub-contractor, the payment provisions have one or more conditional clauses such as 'pay when paid', 'pay if paid'. The different forms of these clauses will be discussed later in this chapter. The purpose of such clauses is to aid the contractor to pass the risk of not getting paid from the employer to the sub-contractor. There are different views for these clauses, one of them is that the 'pay when paid' clause provides that conditional payment is a delaying payment. Another view is that the 'pay if paid' is a precedent condition to payment.³¹ On the other hand, there are many different courts' opinions in construing these terms, as will be explained later, so that the risk may be not transferred to the sub-contractors as expected by the contractor.³²

The FIDIC Subcontract Form 2011 made it crystal clear in clause 2.2 that the sub-contractor is obliged to perform 'all the obligations and liabilities of the contractor under the main contract.' Such general terms may imply many issues which has a potential to cause a dispute between the parties. In the next section some of these issues will be discussed.

³⁰ H Smith, P Godwin, D Roughton, D Gilmore and E Kratochilova, 'Back-to-back contracts' [2011] available at: <http://www.lexology.com/library/detail.aspx?g=d75e0cf3-eb8d-4ce5-b39a-13e7b9b4ec4e> accessed 4 March 2013.

³¹ C M Loulakis & S J Santiago, 'Court Rules Against Subcontractors in Contingent payment' [1998] 7 Civil Engineering 37. In A Supardi, H Adnan & F M Mohammed, 'Security of payment Regime in Construction Industry: Are Malaysian Sub-contractors Ready?' [2011] 4 The Built & Human Environment Review 122.

³² A L May & K Siddiqi, 'Contingent-payment Provision Puzzle- Safeguarding against an Unintended Outcome' [2006] Journal of Architectural Engineering 158. In A Supardi, H Adnan & F M Mohammed, 'Security of payment Regime in Construction Industry: Are Malaysian Sub-contractors Ready?' [2011] 4 The Built & Human Environment Review 122.

2.3.2 Amount of Retention:

In the case of *Geary Walker & Co Ltd. v W Lawrence & Son*³³ the following clause was mentioned in the contract: ‘terms of payment for the work ...shall be exactly the same as those set forth in clause 30 of the [main]...contract.’ The amount of retention under the main contract is usually more than the retention amount under the sub-contract. In the above case the Court of Appeal held that the above clause was valid and the retention should be deducted proportionally to the subcontract sum.

2.3.3 Contractual deadlines:

It is critical to make all deadlines in the sub-contracts coincide with the main contract. This may include, but is not limited to, the material and shop drawings submittal dates, claims notification periods and other factors. Clause 20.1 of FIDIC 99 provides that a contractor must give notice within 28 days of an event if he considers himself entitled for extra cost or money. However, if the main contractor is unaware of an event faced by the sub-contractor and the sub-contractor notifies him by the end of notification period, then the main contractor is left without time to notify the employer.

Furthermore, the FIDIC sub-contract 2011 provides the sub-contract the right for extension of time based on the reason given in the clause 8.4 (d) of the main contract.

2.3.4 Termination by employer for convenience:

Clause 15.5 of FIDIC Red Book 1999 introduced ‘termination by employer for convenience’, which enables the employer to terminate the main contractor agreement at any time. However if the sub-contract does not incorporate such clause,

³³ (1986) HBC 4th Edition Vol 2, page 382 CA. In *N Gould, Fenwick Elliott, the construction and energy law specialists [2011] ‘Subcontract’ < www.fenwickelliott.co.uk> accessed 10 March 2013.*

the main contractor will find himself liable to the sub-contractor. It is paramount to mention that the FIDIC Sub-contract in its first edition in 2011 recognized this point and it provides the contractor the right to terminate the sub-contract whenever the main contract is terminated.³⁴

2.3.5 The effects of renegotiating main contracts on sub-contracts:

It is vital to mention that in the recent years, upon the financial crisis, it appeared that many projects in the UAE are being terminated, suspended or slowed down due to extreme reductions in the material cost after the financial crisis. For example from my experience, the cost of steel reinforcement reached to more than 5,000 AED in 2008 then it dropped dramatically to less than 3,000 AED in 2009 . These two factors led to create a suitable environment to the employers and main contractors to renegotiate the contract prices and agreement terms. However, the parties should consider the agreement between the main contractor and sub-contractors before any amendment to the contracts between the main contractor and employer.³⁵

2.3.6 Dispute resolution:

Any dispute arising between the employer and the main contractor is consequently reflected in the relationship between the main contractor and sub-contractor and vice versa. It is worth mentioning that the arbitration clause shall be in writing and cannot be back-to-back. According to Article 203 of the UAE Civil Procedure Code³⁶: ‘1-The parties to a contract may generally stipulate in the basic contract or by a supplementary agreement that any dispute arising between them in respect of the performance of a particular contract shall be referred to one or more arbitrators and may also agree to refer certain disputes to arbitration under special conditions. 2- No agreement for arbitration shall be valid unless evidenced in writing...’

³⁴ Clause 15 of Conditions of Subcontract for Construction (First Edition, 2011)

³⁵ J Bertenshaw, ‘Negotiating contracts in the construction industry’ 250 Law Update 2012.

³⁶ The UAE Civil Procedure Code, Federal Law No. (11) of 1992.

Furthermore, in *Roche Products Ltd v Freeman Process System Ltd*³⁷, it was held that dispute resolution terms cannot be incorporated by reference to the main contract conditions.³⁸

As explained above the general incorporation of the main contract terms in sub-contract has many concerns. In the next section, I will focus on the meaning and forms of the ‘back to back’ payment terms.

2.4 Back to back forms and meanings:

‘It is a method where the terms of agreement in one step of the contractual pyramid are made a part of the agreement between the parties in the lower step.’³⁹ It is worth mentioning that the term ‘back to back’ is a broad term and has no defined legal meaning as its meaning depends on the construing of the relevant clause in the contract.⁴⁰ The main two types of the ‘back to back’ clause are: ‘back to back’ at provision level and ‘back to back’ at consequence level. The first type is concerned with the application of the same provisions of the main agreement into the sub-contract agreement. If this type of back to back term is incorporated into the sub-contract agreement as explained in the previous section, then special attention should be followed to check the scope of works, the time limits and rights and obligations towards the employer and other terms as those terms may affect the main contractor obligations.

³⁷ (1997) 80 BLR 102.

³⁸ T Starey, ‘FIDIC Condition of Subcontract for Construction, Test Edition 2009; An overview’ Legal updates May 2010.

³⁹ A Grette, ‘Coordination of agreements in construction projects-use of the back to back principle’ [2004] Real Estate and Property. Legal Development available at: http://update.legal500.com/index.php?option=com_content&task=view&id=348&Itemid=518 Accessed 3 March 2013.

⁴⁰ O Ch Kheng, ‘Pay when paid clauses in subcontracts’ [2005] International Forum on Construction Industry Payment Act and Adjudication.

The second type of ‘back to back’ term implies that it is the duty of the sub-contractor to perform his obligations properly in order to ensure that the main contractor achieves his full duties towards the employer. It may include strict liability such as: ‘The sub-contractor is entitled to have additional expenses only to the extent that the contractor has such expenses covered by the employer’ another example is: ‘The sub-contractor’s period allowed for notice of default shall be corresponding to the contractor’s period allowed for notice of default to the employer.’⁴¹ Such clauses imply risks for the sub-contractor since the money or the time which the sub-contractor, has no default toward it, may not receive or grant it if the main-contractor did not receive it from the employer. It is worth mentioning that in the ‘back to back’ term at consequence level, the sub-contractor depends on the main contractor’s follow up with the employer to make him perform certain duties. Thus it is recommended to reduce such risk by providing a provision in the sub-contract stating the scope of the contractor’s duty of loyalty.⁴²

In the recent case *Bringtin Engineering Ltd. v Cheerise Asia Ltd*⁴³, the sub-contract was a lump sum fixed price contract and ‘back to back’ with the main contract. The letter of the award provided that: ‘Cost saving based on Alternative Design as described in fax CLF/055 dated 21/08/07 (this confirmed that this cost saving will not be refund in case of your mentioned alternative Design is not to be approved by Building Department.’ A dispute arises with the concern that if the consultant disallowed the claim made by Cheerise in the name of the main contractor, then Cheerise will not be entitled for the compensation. Cheerise refused the statement and argued that: despite the fact that the contract is back to back, the responsibilities

⁴¹ A Grette, ‘Coordination of agreements in construction projects-use of the back to back principle’ [2004] Real Estate and Property. Legal Development available at: http://update.legal500.com/index.php?option=com_content&task=view&id=348&Itemid=518 Accessed 3 March 2013.

⁴² Ibid 44.

⁴³ [2011] HCCT 2/2010, In <http://www.hklawacademy.org/judgments/listjudgment.php?d=20110825> > Accessed 26 October 2012]

of the design was still the main contractor's obligation. There was differences in the parties' interpretations of the back to back clause. Brighton sought not to pay damages or grant extension of time to Cheerise since the claim was not approved by the consultant. Deputy Judge Cheng rejected the main contractor's arguments and the following findings of the court were as following:

‘1. The phrase ‘**back-to-back**’ can only mean that the rights to make claim and the principle of valuation of variations have to be the same as those in the main contract. ‘**Back-to-back**’ cannot possibly mean ‘*pay when paid*’ or ‘*pay if paid*’.

2. Clear words should be used if ‘**back-to-back**’ is intended to mean that the sub-contractor's entitlement will be lost if the main contractor is not entitled to compensation under the main contract. Such curtailment of entitlement to claim cannot be lightly implied.

3. The consultant's decision on the sub-contractor's claims made in the shoes of the main-contractor against the employer was relevant evidence, but not conclusive in the context of the sub-contract. The sub-contractor was still entitled to pursue the claims against the main contractor.

4. The passing on of the claims from the sub-contractor to the employer did not amount to the main contractor's admission of either liability or quantum. The claims under the sub-contract had to be established independently and neither party could rely on the passing on of the claims to the consultant nor the decisions of the consultant.⁴⁴

It is worth mentioning that in many common legal systems⁴⁵ ‘back to back’ general clause such as ‘This contract is based on back to back basis including payment

⁴⁴ Ch K Kit, 'Back to Back' (Costruction and Arbitration, September, Issue 2 of 2011) available at <http://www.deacons.com.hk/eng/knowledge/knowledge_439.htm> Accessed 6 January 2013.

⁴⁵ In Hong Kong and New Zealand. In Knowles R, *150 Contractual Problems & their Solutions* (2nd Edt Black well, Oxford 2005)

terms' cannot be considered as legal ground for the main contractor to not pay to the sub-contractor on the basis that he did not receive the payment from the employer

In the next section, different forms of 'back to back' payment clauses will be highlighted.

2.4.1 'Pay when paid' payment clauses:

Historically, in the 1960's, the management contracting procurement method was introduced. There was no contractual link between the employer and the sub-contractors despite the fact that the main contractor acted as a facilitator under this procurement type. Therefore, 'pay-when-paid' clause aimed to make the subcontractors participate with the main contractor to share the risk of employer insolvency.⁴⁶

According to Australia's Building and Construction Industry (Security of Payment) Act 2009⁴⁷, pay when paid provision of a construction contract means: 'a provision of the contract—(a) that makes the liability of 1 party (the first party) to pay money owing to another party (the second party) contingent on payment to the first party by a further party (the third party) of the whole or any part of that money; or (b) that makes the due date for payment of money owing by the first party to the second party dependent on the date on which payment of the whole or any part of that money is made to the first party by the third party; or (c) that otherwise makes the liability to pay money owing, or the due date for payment of money owing, contingent or dependent on the operation of another contract.'

⁴⁶ Gareth H, 'Pay when paid clauses'(1995) Construction Law Journal

⁴⁷ Building and Construction Industry (Security of Payment) 2009. Available at: <http://www.legislation.act.gov.au/a/2009-50/current/pdf/2009-50.pdf> Accessed 5 March 2013.

Under the English Law the first case recognized ‘Pay when paid’ was in 1974 in *Modern Engineering Limited v Gilbert-Ash Limited*.⁴⁸ The objective of this clause was to protect the main contractor’s cash flow. Thus, instead of the main contractor bears alone the risk of insolvency of an employer, it makes all sub-contractors in addition to the main contractor contributing to financing a project liable as well.

Under many common legal systems⁴⁹ such clause is considered as an outlaw. Section 113 of the Housing Grants, Construction and Regeneration Act 1996 (HGCRA1996), came into force on 1st of May 1998, invalidates ‘pay when paid’ clauses in the construction contracts with one exception that the employer becomes insolvent. Section 113 (1) states: ‘A provision purporting to make payment under a construction contract condition on the payer receiving payment from a third person is ineffective, unless that third person, or other person payment by whom is under the contract (directly or indirectly) a condition of payment by that third person, is insolvent.’⁵⁰ The Act provides that: ‘a company become insolvent on the making of an administration order against it under part II of the insolvency Act 1986 s113 (2)(a). The insolvency act 1986 was amended by the Enterprise Act 2002 in which the insolvency by self-certifying process beside the court decision were allowed. In the *William Hare Ltd and Sheferd Construction Ltd(2) CR Reynolds (Construction) Ltd v Sheferd Construction Ltd*⁵¹ case, the contract between the main contractor, Sheferd, and the sub-contractors, Hars and CR Reynold, did not have the Enterprices Act amendment thus only the employer insolvency via court order can be recognized for insolvency. The Employer- Trinity went into insolvency by the self-certifying route and the main contractor refused to pay the due amounts to the sub-contractors as a consequence of the pay when paid term. It was held that ‘if the main-contractor wishes to have an effective pay when paid clause in a subcontract, he must identify a

⁴⁸ [1974] A.C. 689 , 717B. In G Hevey, ‘Pay when paid clauses’(1995) Construction Law Journal

⁴⁹ Such as UK, Australia, and Singapore.

⁵⁰ In R Knowles , 150 *Contractual Problems & their Solutions* (2nd Edt Black well, Oxford)

⁵¹ [2010] EWCA Civ 283.

way in which the third party employer become insolvent, as defined in the legislation: if a main contractor chose a way which was not in accordance with the legislation because he mis-drafted the provision...that Lord Hoffmann's principles could come to his rescue. If a party seeks to relieve itself from legal liability, it must use clear words. Unclear words do not suffice: any ambiguity or lack of clarity must be resolved against that party.⁵² M. Martinez highlights that pay when paid clauses can be valid if the draft was clear.⁵³

It is worth mentioning that in 2009 the s 110 of HGCRA 1996 was amended by Local Democracy, Economic Development and Construction Act 2009. Consequently no more conditions for the payment where: the performance of obligations under another contract or a decision is required by a person like certifier as if the obligations under the contract were performed.⁵⁴ In other countries, such clause is usually dominant in many contracts although the sub-contractors do not prefer it. New York's highest court held that pay when paid is not enforceable.⁵⁵

In the *Durabella Limited v J Jarvis & Sons Limited*⁵⁶ case, which was before enforcing the Construction Act (HGCRA 96), the contractor incorporated the following clause into the sub-contractor's agreement: 'our liability for payment to you is limited to such amount as we ourselves actually receive from the employer in respect of your works under this order.' It was held that the contractor cannot depend on a 'pay when paid' clause against the sub-contractor if the main contractor was in default so that the employer cannot pay the main contractor the due amount that belongs to him. Furthermore, the clause implied that it is the duty of the main

⁵² *Dairy Containers Ltd v Tasman Orient Line CV* [2005] 1 WLR 215.

⁵³ M Martinez, 'Slow and steady wins the race' [2010] Construction Law Journal 21.

⁵⁴ E Robbins, 'Is Project Co cash flow safe?' [2010] Construction Law 23.

⁵⁵ ED Tobin, 'The Dreaded "pay when paid" clause' [2009] The Legal Side.

⁵⁶ [2001] EWHC 454 (TCC). In M Frisby, 'Pay when paid clauses in construction & Engineering Contract' [2001] Steven & Bolton.

contractor to do his best to obtain the payment otherwise the main contractor cannot rely on the 'pay when paid' clause.

Generally speaking, there are two arguments with regard to the 'pay when paid' clauses. The first one is that sub-contractor will get paid only after the main contractor gets paid so the risk of non-payment by the employer is borne by the sub-contractor. This argument is illustrated in the Canadian case *Timbro Developments Ltd. v. Grimsby Diesel Motors Inc. et al*⁵⁷ where the clause was upheld and the sub-contractor's claim was rejected. The opposing argument is that the 'pay when paid' clause is all about the time of the sub-contractor to get paid and this does not imply that the sub-contractor will lose his right of his payment if the employer did not pay. This argument is illustrated in *Arnoldin Construction & Forms Limited v. Alta Surety Co.*⁵⁸ It was held in favor of the sub-contractor that such clause was not clear enough to impose a condition that the sub-contractor's payment is conditionally on the main contractor being paid by the employer.

It is worth noting that in many countries, as will be explained hereafter, a literal approach is followed when interpreting the clause of 'pay when paid'. In *Hong Kong Teakwood Works Ltd v Shui On Construction Ltd*,⁵⁹ the payment provision was as follows: 'Within 14 days of the receipt by the main contractor of payment from the employer against any certificate from the architect, the main contractor shall notify and pay to the sub-contractor ..' the high court upheld the clause 'pay when paid' as it construed the word 'receipt' as actual receipt of money by the main

⁵⁷(1988), 32 C.L.R. 32 (Ontario Court of Appeal). In the subcontract between the contractor and the subcontractor it provided that: "Payments will be made not more than thirty (30) days after the submission date or ten (10) days after the certification or when we have been paid by the owner, whichever is the later." In this case the employer refused to pay to the main contractor, consequently the subcontractor was not paid.

⁵⁸ (1995) 19 C.L.R. (2d) 1 (Nova Scotia Court of Appeal). In this case the payment clause provided that: "The balance of the amount of the requisition as approved by the Contractor shall be to the Subcontractor on or about one day after receipt by the Contractor of payment by the owners....Final payment shall be made on acceptance of the work by the Contractor, Architects and/or Engineers, and Owners, and within 30 days after payment has been received by the Contractor."

⁵⁹ [1948] HKLR 235 9HC)

contractor. The courts in Hong Kong inclined to recognize pay when paid as pay if paid clause.⁶⁰

In Singapore, in the case *Brightside Mechanical and Electrical Services Group v Hyundai Engineering and Construction Co Ltd*.⁶¹, the court also upheld pay when paid clause.⁶² In another case⁶³ the judge mentioned that: ‘The most difficult situation concerns instances in which the owner or employer seeks to set-off payments due to the main contractor against some alleged debt owing by the latter to him. In such cases, the subcontractor is clearly an innocent party who would have done the work and is not being paid even though the employer is solvent. It is up to the parties to provide expressly in the contract, if they so wished, that the main contractor shall assume responsibility for payment to the subcontractor in this sort of event. In the absence of such express provisions the sub-contractor runs the risk that a plain reading of the ‘pay when paid’ clause in their contract leaves him with no remedy.’

On the other hand, in the New Zealand, in case of *Smith & Smith Glass Ltd v Winstone Architectural Cladding Systems Ltd*⁶⁴ the judge did not recognize the ‘pay when paid’ term however he mentioned that it specifies the time of the payment.⁶⁵ In

⁶⁰ O Ch Kheng, ‘Pay when paid clauses in subcontracts’ [2005] International Forum on Construction Industry Payment Act and Adjudication.

⁶¹ [1988] SLR 186 [HC]. O Ch Kheng, ‘Pay when paid clauses in subcontracts’ [2005] International Forum on Construction Industry Payment Act and Adjudication.

⁶² The payment clause provided: “Within five days of the receipt by the contractor of the sum included in any certificate of the architect the contractor shall notify and pay to the sub-contractor...”

⁶³ *Interpro Engineering Pte Ltd v. Sin Heng Construction Co Pte Ltd*, [1998] 1 SLR 694 (HC). In O Ch Kheng, ‘Pay when paid clauses in subcontracts’ [2005] International Forum on Construction Industry Payment Act and Adjudication.

⁶⁴ [1992] 2 NZLR 473 (HC)

⁶⁵ The Judge stated that: “While I accept that in certain cases it may be possible for persons contracting with each other in relation to a major building contract to include in their agreement clear and unambiguous conditions which have to be fulfilled before a subcontractor has the right to be paid, any such agreement would have to make it clear beyond doubt that the arrangement was to be conditional and not to be merely governing the time for payment. I believe that the

this case, the judge drew a line between the ‘if’ and ‘when’. As in the former part, the meaning is that if the main contractor will not get paid then sub-contractor will not receive a payment. Nevertheless, when the word ‘when’ is used, it implies that it is a matter of time in order for sub-contractor to receive his payment⁶⁶. In Australia, in the *Iezzi Construction Pty Ltd v Watkins Pacific (Qld) Pty Ltd*⁶⁷ case, the judge did not recognize the ‘pay when paid’ clause despite the fact the payment clause excluded the sub-contractor’s right to payment if the main contractor did not get his payment from the employer.

In an American case, *Aesco Steel Incorporated v Jones Construction Company & Fidelity and Deposit Company of Maryland* (1985), there was a sub-contract for supply steel decking by Jones. The contract incorporates the ‘pay when paid’ clause. The main contractor, Aesco, argued that the sub-contractor cannot be paid the full amount as the employer did not pay the full amount. The court upheld that the sub-contractor should receive its due in reasonable time.⁶⁸

2.4.2 ‘Pay if paid’ payment clauses:

‘Pay-if-paid’ provision intends to make a payment to sub-contractor conditioned on the main contractor receiving payment from employer. This provision has the potential to limit the main contractor’s liability and transfer the risk of the

contra proferentem principle would apply to such clauses and that he who seeks to rely upon such a clause to show that there was a condition precedent before liability to pay arose at all should show that the clauses relied upon contain no ambiguity.” In O Ch Kheng, ‘Pay when paid clauses in subcontracts’ [2005] International Forum on Construction Industry Payment Act and Adjudication.

⁶⁶ R Knowles , 150 *Contractual Problems & their Solutions* (2nd Edt Black well, Oxford)

⁶⁷ [1995] 2Q d. R. 350 (SC). In this case the payment clause mentioned: “The Builder shall make progress payments to the Subcontractor within fourteen (14) days after the Builder has received payment from the Proprietor in respect of the Work, the subject of the Subcontractor’s claim. It is expressly agreed that the Subcontractor’s right to receive payment is entirely dependent upon the Builder having already received from the Proprietor payment in respect of the work, subject of the Subcontractor’s claim, and that the Subcontractor shall have no other right to payment.” In *ibid* 68. Kheng, ‘Pay when paid clauses in subcontracts’ [2005] International Forum on Construction Industry Payment Act and Adjudication.

⁶⁸ R Knowles , 150 *Contractual Problems & their Solutions* (2nd Edt Black well, Oxford)

employer's nonpayment to the sub-contractors. It can take many forms such as 'condition precedent to receiving payment'. According to Al Tamimi, payment clause of "pay if paid" in sub-contract agreement was not tested in the UAE's courts and it may be considered as term against public policy. Therefore such clause may be rejected by the UAE courts.

In the United States, New York and California are the only states that have prohibited clauses such as the 'pay if paid' clause since it was considered to be against public policy, so the parties cannot agree against it. There is a difference between denying the party's right and mentioning the time for the payment as the latter was found to be not against public policy.⁶⁹ See for instances *Wm. R. Clarke Corporation v Safeco Insurance Company of America* , and *North Central Mechanical, Inc. v Hunt Const. Group*.

Furthermore, in the USA courts, if the 'pay-if-paid' clause was not clear in mentioning that the payment to the sub-contractor is a condition precedent and that the sub-contractor accepts this risk then the courts will interpret it as pay-if-paid which means that the main contractor's obligation to make a payment to sub-contractor is suspended for reasonable time, therefore, it is in turn, creating a timing mechanism to pay to sub-contractor. This concept was illustrated in *Fixture Specialist Inc. v Global Construction, LLC*.⁷⁰

A traditional sample of 'pay-if-paid' clause is⁷¹: 'Contractor's receipt of payment from the owner is a condition precedent to contractor's obligation to make payment to the subcontractor; the sub-contractor expressly assumes the risk of the owner's nonpayment and the subcontract price includes this risk. In entering into this

⁶⁹ ED Tobin, "The Dreaded "pay when paid" clause" [2009] The Legal Side.

⁷⁰ 2009 WL 904031 (D.N.J. 2009). In M Fiorito, 'Pay-If-Paid' AND 'Pay-When-Paid' Construction Contract' 2013 Clauses. Zetlin & De Chiara.

⁷¹ D C. Olson, and Brian M. Falcon, 'Asserting the Principal's Contractual Defenses—Always a Silver Bullet? An Examination of the Current Law on the Pay-if-Paid Clause' (2012) Fidelity and Surety Roundtable.

subcontract, the subcontractor is expressly relying upon the solvency and creditworthiness of the owner.’ In many U.S cases such clause was enforced and held as a clear provision. See for example: *L. Harvey Concrete v Agro Constr. & Supply Co*⁷².,

In addition, in the U.S case, *BMD Contractors, Inc., et al. v Fidelity and Deposit Company of Maryland*⁷³, the contract contains the following clause: ‘It is expressly agreed that owner’s acceptance of subcontractor’s work and payment to the contractor for the subcontractor’s work are conditions precedent to the subcontractor’s right to payments by the contractor.’ The claimant argued that the meaning of this clause was ‘pay when paid’ and the respondent on the other hand argued that it was a condition precedent for payment which shifted the risk of nonpayment downstream. The court held that the language of the term was very clear and established condition precedent for the payment. It cited *Mid America Construction Management, Inc. v Mastec North America, Inc.*⁷⁴, holding that ‘pay-if-paid’ clause was enforceable and stating that the clause need not include any magical language to demonstrate a condition precedent, but noting that terms such as ‘if’ , ‘provided that’ or ‘on condition that’ usually connote a condition rather than a mere promise.’

In the UK, Section 113 of the HGCRA has forbidden conditional payment provisions. It provides that: ‘A provision making payment under a construction contract conditional on the payer receiving payment from a third person is ineffective, unless that third person or any other person payment by whom is under the contract (directly in or indirectly) a condition of payment by that third person, is insolvent.’

⁷² 939 P.2d 811, 814-815 (Ariz. Ct. App. 1997).

⁷³ 2011 WL 6065104 (S.D. Ind. 2011)

⁷⁴ 436 F.3d 1257 (10th Cir. 2006)

2.5 Back to back clause in the UAE:

According to Dr. Adel Sinjakli, the UAE Civil Transactions Code, and many court judgments, it is provided that the main contractor shall be responsible for the act of the sub-contractor, whether domestic or nominated, and the subcontractor shall be paid by the main contractor once he finishes his work, irrespective of whether the main contractor has finished his work or not, or received his payment from the employer or not⁷⁵. In the UAE, in many projects, the employers are reluctant to pay due amounts to the main contractors. Furthermore, the employer sometimes faces financial issue which in turn leads to not paying the main contractor his payment. Therefore, the main contractor tries to pass down such risk to all sub-contractors involved in the project by incorporating the 'back-to-back' payment clause which can be general or it can some forms such as 'pay when paid' or 'pay if paid' in the subcontractors agreements⁷⁶.

In Constructing the Team Mr. Latham pointed out: 'No construction project is risk free. Risk can be managed, minimized, shared, transferred or accepted. It cannot be ignored.'⁷⁷ There are many benefits of setting up back-to-back terms, as such terms have the potential to provide fortunate consequences to the main contractor. For example, if the sub-contractor faces an event which entitles him for an extension of time, the same event does not provide entitlement to the main contractor for extension of time. Thus, in absence of back-to-back provisions, the main contractor will be exposed to double liabilities. The first liability results from the sub-contractor by granting him an extension of time. In addition, the main-contractor will suffer loss by paying liquidated damages to the employer due to the delay.⁷⁸ Additionally, The

⁷⁵ A Sinjakli 'Nominated sub-contractors under UAE Construction Law' 2003 Arab Law Quarterly.

⁷⁶ Al Tamimi, Construction Law.

⁷⁷ M Hackett, I Robinson & G Statham, *The Aqua Group Guide to Procurement, Tendering and Contract Administration* (Blackwell, Oxford 2007)

⁷⁸ Z Spyrou, 'Subcontracting risks and opportunities' [2010] Construction Law 20.

Union Supreme Court⁷⁹ in the UAE, pursuant to Article 887 of the UAE Civil Transactions Code, upheld that, in lump sum contracts, the main contractor has to execute the agreed plan and the contract will not be subject to variation by increase or decrease. However, this principle is not applied to the agreement between the contractor and sub-contractor, as Court defines that: ‘Article 887 of the Civil Transactions Code is designed to protect the Employer, who is usually a not-technical person with little experience. The purpose behind that provision does not apply to the relationship between head contractor and sub-contractor, because they are equal in their technical knowledge and expertise.’

This is the reason why the main contractor includes back-to-back clauses. To do so, the main contractor in many cases just renames the main contract as the sub-contract and replaces the name of the contracting parties, or by simply stating that the terms in the main contract in agreement with the sub-contractors will be applied as between the main contract and the employer. It is worth mentioning that in *Watson Building Services Ltd v Harrison*⁸⁰, the main contractor made an agreement with the sub-contractor mentioning that ‘This sub-contract is placed with your subject by and large to the same terms and conditions as the main contract’. The judge concluded that ‘any clauses are to be incorporated ‘by and large’ is ‘anybody’s guess and anybody’s guess is likely to be wrong... and it is not for me to guess which clauses of the main contract are to be ‘by and large’ incorporated ...’. Such provisions may not achieve the intended purposes of ‘back to back’ agreement.’ The Watson case shows that the back to back approach can lead to ambiguity in the contract which in turn gives space to the court for interpretation.

It is not uncommon to provide ‘back-to-back’ payment clause or ‘pay if paid’ clauses especially at sub-contracting level in the construction contracts in the U.A.E. It was

⁷⁹ Abu Dhabi Court of Cassation, 573/ Judicial Year 2. In Westlaw Gulf 2013.

⁸⁰ [2001] SLT 846.

unclear how the court or arbitral tribunal in Dubai in the context of freedom of contract and good faith principle would deal with these clauses. Difficulties of the back to back clause may arise if the wording was not clear due to poor drafting of the contract⁸¹. In case no 281/95, the sub-contractor had finished his work with value of 12,502,330 Dh as per the contract signed with the main contractor. However the paid amount was 10,757,836 Dh. The contract stated that: ‘any payment to the subcontractor would only be due and payable at the time that the payment is received by the main-contractor from its client.’

Dubai cassation court held that⁸²: ‘Thus, it is established in the jurisprudence of this court that if the wording of a contract is clear, it may not be departed from by way of interpretation to achieve the intention of the parties. However, if there is scope for interpretation, the mutual intention of the contracting parties must be ascertained without being restricted to the literal meaning of the words. In this regard, the nature of the transaction and the trust and confidence between the parties must be taken into consideration.’

In that case, the main contractor debated that this principle was applied to the retention of the performance money. The court of cassation in Dubai held that: ‘the sub-contractor will only be entitled to a proportional payment during the performance period from any payment received by the main contractor from its client, the same does not apply when a sub-contractor has completed all his work and delivered the project to the main-contractor. A sub-contractor has no obligation to wait for payment until such time as the main-contractor has been paid.’⁸³ It seems that the court differentiated between ‘back to back’ payment clause during the

⁸¹ E Toe and D O’leary, ‘Construction Disputes what are the Common Issues in disputes?’ (2010) Law Update Al Tamimi & Company.

⁸² Dubai Case no 18/2000. In Society of Construction Law Gulf.

⁸³ Dubai Court of cassation Judgment No. 281/95 dated 6 July 1996. In R Price and E Al Tamimi, United Arab Emirates Court of Cassation Judgment 1989-1997 (Kluwer Law International, Netherland 1998).

construction stages and back to back at final stage when the subcontractor completed its work and handed it over to the main-contractor. In my opinion, this is unfair as the subcontractor should receive its dues in all stages regardless of the main contractor received its payment or not. General clause of 'back to back' is a vague term therefore poor drafting of contracts by providing such term provides room for the court's interpretation. Article 265 of UAE's Civil Transactions Code provides that: '(1) if the wording of a contract is clear, it may not be departed from by way of interpretation to ascertain the intention of the parties. (2) If there is scope for interpretation of the contract, an enquiry shall be made into the mutual intention of the parties without stopping at the literal meaning of the words, and guidance may be sought in so doing from the nature of the transaction, and the trust and confidence which should exist between the parties in accordance with the custom current in dealings.' On the other hand, under the common Law legal system, the aim of interpreting a contract is to understand the intentions of the contracting parties. If the terms of the contract are clear and self-explanatory then the court will give the ordinary meaning of it and will consider it as the parties' intention. In this situation the court will not refer to external evidence, out of the contract, in order to understand the parties' intention.⁸⁴ If the terms are ambiguous on the other hand, the court may adopt the Contra Proferentem principle by construing the term against the party who drafted it, despite the fact that this principle is not applicable to a contract drafted by a professional body committee such as FIDIC, JCT or ICE. Furthermore, in the *Pioneer Shipping v BTP Toxide*⁸⁵ case, Lord Diplock mentioned that: 'What [each] party would have led the other to reasonably assume were the act he was promising to do or refrain from doing by the words in which the promise were expressed.'⁸⁶ Therefore, when the term is ambiguous, the common law applies an

⁸⁴ G Hevey, 'Pay when paid clauses'(1995) Construction Law Journal

⁸⁵ The Nema [1982] AC 724 at 726

⁸⁶ In John Adriaanse, Construction Contract Law (Palgrave Macmillan, New York 2010)

objective test which means that what the reasonable person who has the knowledge which would reasonably be available with the parties when they made the contract.⁸⁷

Proper allocation of risks between the main contractor and the sub-contractor by drafting clear and unambiguous payment clauses enhances the success of construction projects. The purpose of the 'pay when paid' clause in the UAE is to enhance the cash flow of the main contractor. However, such clause may adversely affect the financial position of subcontractors in a project⁸⁸. Under UAE Civil Transaction Code, Article 259 provides that: 'the implied shall be disregarded in the face of the express.' Furthermore, Article 257 mentions that: 'basic principle in contracts is the consent of the contracting parties and that which they have obligated themselves to the contract.' Additionally, Article 258 provides that: '(1) The criterion in the construction of contracts is intentions and meaning and not words and form. (2) The basic principle is that words have their true meaning and a word may not be construed figuratively unless it is impossible to give its true meaning.'

In a recent Commercial case no 240/2006, the respondent company filed a case against the appellant company, before the Dubai Court of Cassation, where the respondent company requested the court to order the appellant company to pay 1,221,285 AED and its interests as the appellant company entered in to agreement with the respondent company to execute Electromechanical works for 56 villas at the price of 2,090,000 AED in addition to works related to six villas so the contract value becomes 2,206,304 AED. The appellant company received only 985,018 AED. The letter of intent and following acceptance between the sub-contractor (appellant) and sub-subcontractor (respondent) include the following provision: 'the contract will [be] Back to Back as per our Contract with the main contractor.' Furthermore, the contract agreement between the appellant (sub-contractor) and the main

⁸⁷ *Investors Comensation Scheme Ltd v West Bromwich BS* [1998] 1 WLR 896. In John Adriaanse, *Construction Contract Law* (Palgrave Macmillan New York 2010)

⁸⁸ S Kerur and W Marshall, 'Successful Subcontracting' (2009) Construction Management Guide.

contractor included the following payment clause: ‘the payment shall be made after seven days from the receipt of the corresponding amounts from the customer in commensurate with the works done by the subcontractors.’ In fact, the appellant company did not receive his due payment from the main contractor and this was the reason behind the sub-contractor (appellant company) not paying to the sub-subcontractor (respondent company). The Dubai Court of Cassation upheld the above based on Article 130 which provides that: ‘A contract shall be made by virtue solely of the coming together of offer and acceptance, subject to the specific modalities laid down by law for making of the contract.’ and Article 131 which mentions that: ‘Both offer and acceptance are any expression of intention used to create a contract. The first to be uttered is the offer, and the second the acceptance.’

In addition, Article 132 mentions that: ‘An expression of intention may be made orally or in writing, and may be expressed in the past or present tense or in the imperative if the present time is intended or by such indication as is customary even by a person who is not dumb, or by an interchange of acts demonstrating the mutual consent or by adopting any other course in respect of which the circumstances leave no doubt that they demonstrate mutual consent.’ The payment clause provided in the letter of intent between the respondent and appellant companies was valid. It is established based on Article 243 which provides that: ‘(1) the contract shall govern the subject matter of the contract and the consideration therefore as soon as the contract is made, and shall not depend upon receipt of any other thing unless the law provides otherwise. (2) With regard to the rights (obligations) arising out of the contract, each of the contracting parties must perform that which the contract obliges him to do.’ and Article 420 which provides that: ‘A condition is a future matter upon the materialization of which the coming into being or ceasing to be of the governing force depends.’ and Article 423 which provides that: ‘In order for the suspension to be valid, the condition must indicate an event which has not taken place, but which could take place, has not materialized, and is not impossible.’ Furthermore, Article

425 states that: ‘a disposition dependent upon a condition not incompatible with the contract shall not become effective unless the condition materializes.’

The court mentioned that: ‘the effects of the contract, both rights and obligations, apply to the contracted matters and its equivalents once the contract is made without suspension of any other condition unless the law or the agreement stipulates otherwise. Such effects shall be complete and immediate if the contract was absolute and deferred to future term or pending on a condition which is a future event involving risk and not certain nor impossible. If the obligation is dependent on a suspension condition, the obligation shall not be liable except upon the occurrence of this condition. As before the occurrence of this condition, the obligation shall not be enforceable and the burden of proof that the condition occurred falls upon the creditor.’ Therefore the burden of proof that the sub-contractor had received his payment from the main contractor has fallen upon the sub-subcontractor.

Chapter 3

Remedies

This chapter discusses possible courses of actions in which the subcontractors and main-contractors may recourse to if their payments delayed or not paid based on the UAE Law. Furthermore I will look at other Laws in order to overcome the payment issues in the UAE.

3.1 Remedies under the contract:

It is imperative to mention that the contracting parties are the masters of their agreement and that the source for obligations and rights are the terms of their contract.

In order to reduce the contractor's risk of delayed payments or not getting paid, many standard forms of contracts provide clauses to enable the contractor to recourse to. For example, The FIDIC⁸⁹ Red Book 1999 Clause no. 14.8 provides that if the contractor was not paid within 56 days of the submission of his payment's application, then the contractor is entitled for a financial interest rate of the central bank of the country's currency used in the contract. Furthermore, Clause 16.1 states that the contractor has the right to suspend the work if the engineer fails to issue the payment certificate on time, or if the employer fails to provide financial statement, or if the employer fails to pay the contractor's due amount. The clause obliges the contractor to provide a 21 days' notice.⁹⁰ Additionally, Clause 16.2 provides that 'the Contractor shall have the right to terminate the Contract if: (c) the Contractor does not receive the amount due under an Interim Payment Certificate within 42 days after the expiry of time stated in sub-clause 14.7 [payment] within which payment is to be made (except for deductions in accordance with sub-clause 2.5 [Employer's Claim].'

⁸⁹ FIDIC Red Book 1999. Condition of Contract for Construction.

⁹⁰ This clause matches section 112 of HGCRA in the U.K.

Additionally, it is worth mentioning that under Clause 35.13 of JCT Form of Contract (1998) the employer can pay directly to nominated subcontractors under certain circumstances. This right is only valid where it is clearly mentioned in the contract. In *Milestone (JA) & Sons Ltd (in liquidation) v Yates Castle Brewery Ltd.*⁹¹ the court upheld that there was no implied condition that stated that the employer has to pay directly to a nominated subcontractor. Likewise, in FIDIC Form of Contract in the employer has the right to pay directly to nominated subcontractors if the contractor failed to pay to the nominated subcontractors their due payments without reasonable reason. It is the Employer's right to pay directly to nominated subcontractors however the subcontractors have no right to refer to the Employer in order to get payments.

3.2 Remedies under the UAE Law:

If the contract is silent with regards to an issue, then the parties may refer to the substantial Law in order to supplement their agreement. Under the UAE's Civil Transaction Code Article 879 mentions that 'If the work done by the contractor produces an effect on the property, he may detain it until the hire due to him is paid, and if it is damaged in his hands before payment of his hire he shall not be strictly liable for it, and he will not be entitled to the hire.' Despite the fact that this Article gives the right to the contractor who did not receive his due payment to keep the property under his control, it will not solve his cash flow issue. In fact, it may further burden the contractor to keep the property under his control where he will still have to provide running cost for security and maintenance of the building. However, this Article might improve the situation by imposing pressure on the employer to pay the

⁹¹ [1938] 2 All ER 439. In *N Gould, Fenwick Elliott, the construction and energy law specialists* [2011] 'Subcontract' < www.fenwickelliott.co.uk> accessed 10 March 2013.

contractor's due amounts.⁹² Thus it seems that this remedy may not be helpful for subcontractors.

It is worth mentioning that, under the UAE's Law there is another provision which ensures the security of the main contractor's payment for example: Under the Civil Code, 'collateral real property rights' (liens) include "mortgages for security, possessory mortgages, and priority rights."⁹³ A priority right is defined as 'a collateral real property right [(lien)] conferring upon the creditor a priority in obtaining his right subject to a transaction and determined by law."⁹⁴ The Civil Code further provides that 'All of the property of the obligor stands as security for the performance of his obligation.'⁹⁵

Finally, Article 1527⁹⁶ of the UAE Civil Transaction Code provide protection vehicle to the contractor if he did not get his payment. The Article provides that: '(1) Amount due to contractors and architects who have undertaken to construct building or other installations, or to reconstruct, repair or maintain the same, shall have status of a priority right over such structures, but to the extent to which the value of the land has been enhanced thereby as at the time of the sale.' The method used to enforce the priority right should be in accordance with the Civil Procedure Code.⁹⁷

Additionally, in the absence of the assignment of the right to the employer, the subcontractor cannot claim his due amount directly from the employer. Article 891 of the Civil Transaction Code provides that: 'A sub-contractor shall have no claim

⁹² N Brendel, A Barrette, and W El Riachi, 'The Availability in the UAE of Liens to Secure Payment under Construction Contracts' 24(2010) Arab Law Quarterly 309.

⁹³ UAE Civil Code, Article 110(2)

⁹⁴ UAE Civil Code, Article 1504.

⁹⁵ UAE Civil Code, Article 391(1).

⁹⁶ Corresponding article in Egyptian Code is 1148.

⁹⁷ N Brendel, A Barrette, and W El Riachi, 'The Availability in the UAE of Liens to Secure Payment under Construction Contracts' 24(2010) Arab Law Quarterly 309.

against the employer for anything done to him from the main contractor unless if assigned to the employer.⁹⁸ In case no 273/229/19 issued in 30/5/1999, Abu Dhabi's Supreme Court held up that: the subcontractor has no right to ask the employer to pay his dues from the main contractor's entitlement as the main contractor shall be responsible for the act and default of subcontractor this match the provisions of Article 890 of the UAE Civil Transaction Code.⁹⁹

However; if the subcontractor finished its work and handed it over to the main contractor, then its payment becomes due regardless of whether the main contractor gets its payment or not. In this case, the remedy available to the subcontractor is to file a case for such payment in order to request for provisional attachment on any assets that belong to the main contractor until pronouncement of the final judgment.¹⁰⁰

In addition, It is important to mention that the UAE Civil Transaction Code, there is no clear term that provides the subcontractor the right to suspend its work if he does not get its payment. The Code provides the contractor or subcontractor the right to refer to the court in order to oblige the defaulting party to perform its obligation or for an order to cancel the contract. The court has a discretion to look at the merit of the case and the circumstances of the project such as the stage of the project, financial capability of the project and the interest of the parties¹⁰¹. Furthermore, he may rely on Article 247 which provides that: 'In contracts binding upon both parties, if the mutual obligations are due for performance, each of the parties may refuse to perform his obligation if the other contracting party does not perform that which he is obliged to do.' Additionally, Article 414 states that: 'Any person who is obliged to perform a thing may refrain from so doing so long as the obligor has not discharged

⁹⁸ Article 891 of UAE Civil Code

⁹⁹ A Sinjakli 'Nominated sub-contractors under UAE Construction Law' 2003 Arab Law Quarterly.

¹⁰⁰ A Sinjakli 'Nominated sub-contractors under UAE Construction Law' 2003 Arab Law Quarterly.

¹⁰¹ O Al Saadoon, E Teo, and Z Anani, 'Surviving the slowdown' 2009 Law Update 214.

an obligation of his arising by reason of an obligation of the obligee and connected with it.’ According to commentary¹⁰², the above provisions are general and they are not aimed at highlighting the issues of nonpayment. They provide the right to the contracting parties to suspend their performance of their obligations as a respond to that the other party failed to discharge his obligations. However, when this issue comes to the payment, cautions should be taken by taking mitigation actions. According to the Dubai Court of cassation and in compliance with good faith principle, the court held that: ‘a party cannot invoke the right to suspend work if the other party has substantially discharged its part of the obligation leaving only a minor part of its performance.’

It is worth mentioning that, in my opinion, the above mentioned remedies may be mostly useful to the main-contractors but less useful to the subcontractors. This is because the subcontracts’ agreements are usually concluded by exchange of letters, local purchase orders or bespoke agreements in which the main contractors impose many terms on the subcontractors. Therefore, until clear provisions that protect subcontractors’ cash flows are incorporated in the law, as well as clear mechanisms that ensure that no delayed payments or non-payments occur, the construction industry will continue to suffer. In *Ellis Mechanical Services v Wates Construction Limited*¹⁰³, Lord Justice Lawton said: ‘The courts are aware of what happens in these building disputes; cases go either to arbitration or before an official Referee; they drag on and on; the cash flow is held up...that sort of result is to be avoided if possible.’ Therefore it is important to examine other jurisdictions to observe how they tackle concerns related to subcontractors’ payments.

¹⁰² E TEO, ‘Highlights of the Laws of the United Arab Emirates, the People’s Republic of China and the Common Law applicable to Construction Contracts- part 2’ 2011 Law Update.

¹⁰³ 1976, 2BLR 57. In L Michael, (1994) *Constructing The Team, Final Report of the Government / Industry Review of Procurement and Contractual Arrangements In The UK Construction Industry* HMSO, London.

3.4 Remedies under Common Laws:

It is paramount to state that, the importance of HGCRA Act which includes a provision for the payment enforcement and permits Adjudication in case of disputes. It is worth noting that the Act is very sophisticated as it provides certainty to the contractors and suppliers with regards to the payment which in turn has a potential to create a good environment in the construction industry. In addition, it provides adequate remedies to the contractor if the Employer failed to pay.

Likewise, in many Commonwealth countries such as Australia and New Zealand , one of the prime aims of the Construction Contracts Act 2002, issued in New Zealand, is to address cash flow issues in the construction industry. The main purposes of the Act were to introduce steady and timely payments among the parties involved in the construction industry and to provide suitable remedies for the recoveries of payments. Furthermore, ‘pay when paid’ and ‘pay if paid’ become invalid terms by the Law.¹⁰⁴

Furthermore, in the UK most of the standard form of contracts were revised in order to incorporate the Act requirements. However sometimes it is inevitably difficult to control all bespoke contracts or highly modified standard form therefore, in England and Wales, the Scheme for Construction Contracts regulations was issued in 1998. The scheme provided mandatory clauses which fill the gaps of the silent terms of agreement between the parties. The important advantage that the Act offered lies in the payment requirements. It provides a fixable time schedule for the payment provisions as it basically mentions that the parties are free to decide on the duration of the due payment to be paid and they are also free to agree on the amount of the payments provided that a mechanism that determines how these amounts are calculated is put in place. The Act mandated the Employer to give a notice in writing to the contractor within five days from the date of the payment. The notice should

¹⁰⁴ T Peters, J Glover and F Elliot, ‘New Zealand and UK Acts compared’ (2003) Construction Law 29.

confirm the amount to be paid. Moreover, in circumstances where the employer intended to deduct some of the amount as set-off, the Act mandated that the employer should give notice in advance to the contractor. The notice should be given before the date of the payment and it should specify the deducted amount and the reason for the deduction.¹⁰⁵

In 2012, the UK Government Construction Board Fair Payment User Group produced guides which enable government clients to use Project Bank Account (PBA) in their construction projects. The account can be authorized by the contractor alone or dually by the employer and contractor. The Project Bank Account aims to provide security of payments to the supply chain. According to research conducted by Fair Payment working group, there were many benefits of PBA as it reduced the disputes in projects and increased the productivity and reduced the cost.¹⁰⁶ Furthermore Clause Z of NEW Engineering Contract (NEC3) provides mechanisms and guides to the employer in matters related to sums and time of payments to contractors and subcontractors upon instruction by project managers or contract administrators.¹⁰⁷

Furthermore, In the U.K, the escrow account, has a potential to safeguard all payments or it may be utilized in case the employer failed to pay to the contractor any of the due payment under the building contract. The escrow account is usually control by documents such as: an escrow agreement which indicate the escrow arrangement. A letter instructing the escrow agent how to manage the account and an

¹⁰⁵ J Ramus, S Birchall, and Ph Griffiths, *Contract Practice for Surveyors* (Butterworth-Heinemann, Oxford 2006)

¹⁰⁶ A Guide to the implementation of Project Bank Accounts (PBAs) in construction for government Clients. 2012 Available < <https://www.gov.uk/government/>> accessed 31 August 2013.

¹⁰⁷ [New Engineering Contract\(NEC\). Clause z.](#)

amendment to the building contract to incorporate the payment term in to the contract considering the escrow arrangement.¹⁰⁸

It is worth mentioning that, recently the Government of Dubai adopted Escrow Law No. 8 of 2007, although it is limited to properties which are sold on an off-plan basis. The basic idea of the Law can be adopted to secure the payments in the construction industry in the UAE. It is worth noting that prior to the introduction of the Law, the developers could sell properties in Dubai on an off-plan basis and could directly collect the money from the investors. In many cases, the developer used to expand their business by buying new lands instead of constructing the project. All these issues were discovered after the credit crunch in 2009. The situation has changed since the introduction of Law no 8 of 2007 issued by Real Estate Regulatory Agency.¹⁰⁹ The Law mandates opening of Escrow Accounts by Real Estate Developers with the banks in order to control the flow of funds deposited by the investors. Money received from investors by registered developer for sell-off plan for approved project is considered as trust Money under the Law. The aim of the Law was to utilize the funds in the Escrow account for the construction of the project. The Escrow Agent should have qualified Engineers to deal with the payment issues to the parties of the project. Article 7 provides that ‘(a) The trust account shall be created under a written agreement between the developer and the trustee. Under the said agreement, the amounts paid by buyers of off-plan units or received from the financiers shall be deposited in a special account to be opened in the name of the real estate project.

(b)The said agreement shall set out the terms for managing the account, the rights and obligations of the contracting parties and other terms and conditions. A copy of the contract shall be lodged with the Department.’ Furthermore Article 10 provides

¹⁰⁸ RICS Draft Guidance Note, Construction security and performance documents (2013)

¹⁰⁹ Real Estate Regulatory Agency, (Law No. (8) of 2007 on Real Estate Development Trust Accounts in Dubai)

that: ‘A trust account shall be opened in the name of the project and shall be used only for the purposes of developing the real estate project. The amounts deposited in the said account may not be attached in favors of creditors of the developer.’

From my experience¹¹⁰, the Law provides significant security for the end user of the property in addition to the parties involved in the construction industry. Therefore, implementing similar procedures to include all construction projects can help overcome the problems associated with security of payments.

3.5 Security of subcontractors’ payments under other jurisdictions:

In France, Law No. 75-1334 was introduced in 1975, the law aimed to provide protection and security of payment for subcontractors. The Law was mandatory and any agreement against the Law’s provision was considered to be null and void. The Law provided three types of protections: payment bank guarantee or delegation, the employer’s liability and the right to request payment directly from the employer¹¹¹. Article 14 of the Law provided that: “the main contractor must provide the subcontractor with a bank guarantee covering all amounts due to subcontractor under the subcontract.” The court (cassation court)¹¹² in France upheld that the bank guarantee must specify the name of subcontractor and the amount of the guaranteed. Furthermore, if the guarantee was not issued according to Article 14 of the Law, then the subcontractor can request the cancellation of the subcontract within 5 years from the formation of the contract.

¹¹⁰ Since January 2009, I am working in Dubai Islamic Bank as projects Engineer in the ESCROW Unit. The unit was established since the introduction of the property Law no 8 of 2007 by M/s Real Estate Regulatory Agency (RERA).

¹¹¹ M Carole Malinvaud, ‘Overview of the protection of subcontractors under the French Law’ 2006 Society of Construction Law.

¹¹² Cour de cassation, 3rd Civil Chamber, decision of 18 December 2002, D.2002.IR.181 In M Carole Malinvaud, ‘Overview of the protection of subcontractors under the French Law’ 2006 Society of Construction Law.

The French Law was amended in 1986 to include the second protection provision to subcontractors which was the civil liability of the employer. Article 14.1 of the Law provides that ‘the employer who was aware of the existence of a subcontractor, is obliged to ensure performance by the main contractor of his legal duties regarding (i) the acceptance by the employer of subcontractor hired by the main contractor and (ii) the delivery of a bank guarantee/ delegation to subcontractor. If the employer fails to ensure compliance by the main contractor with these obligations, he will be liable to the sub contractor.’ Based on this Article the employer has duty to ensure the main contractor performed its duties with regard to guarantee.

The third type of protections is a direct claim against the employer, based on Article 12 of 1975 Law, ‘where the main contractor fails to pay the subcontractor within one month after formal notification, the subcontractor may request payment of all amounts due under the subcontract directly from the employer.’ Furthermore Article 13 of the 1975 law provides that: ‘the obligations of the Employer are limited to the amount he still owes to the main-contractor at the date of receipt of the copy of the formal notification [whereby the subcontractor requests payment from the main contractor].’ The Article provides the right to the subcontractor to claim his due amount directly from the employer however before he claims the amount, he should formally request the payment from the contractor and a copy of his request should be sent to the employer. This copy has the potential to freeze the money due to the main contractor up to subcontractor’s claim amount.¹¹³ Likewise Article 662 of the Egyptian Code provides the same meaning.

The French Law aimed to enhance the cash flows of subcontractors who are usually in weak bargaining positions by securing their payments which in turn affects the entire construction supply chain. However; it is worth noting that the characteristics of the construction industry can vary based on the country and the culture. From my

¹¹³ M Carole Malinvaud, ‘Overview of the protection of subcontractors under the French Law’ (2006) Society of Construction Law.

experience in the UAE, it may be very difficult for main contractors to arrange bank guarantees in order to ensure the subcontractors payment by providing bank guarantees, particularly after the credit crunch in 2009.

Chapter 4

4.1 Methodology

As mentioned before, the aim of this research is to investigate the impact of “back-to-back” payment clause on the cash flows of subcontractors and its effect on security of their payments.

Quantitative research was used to collect statistical data in order to correlate different variables with cash flows of the subcontractors. Quantitative research method is useful because it has the potential to avoid bias in collecting and presenting data. It aims to avoid subjectivity and attempts to find particular research issues.¹¹⁴

A draft of survey consists of 26 questions was distributed to three professionals¹¹⁵, who have experiences in survey research in addition to the research supervisor, to get their feedback on the clarity of the language and sequences of the survey in addition to know if there were any difficulties related to conducting the survey. Furthermore, it was very important to identify the validity, reliability and easiness of participating in the survey. The comments obtained from the reviewers were incorporated in the final version of the survey.

The first part of the questionnaire was distributed in order to collect general information about the participants. This information includes the nature of professional’s organizations, their role in the organization, the number of years of experience they have, and grade of their company and the types of subcontracts. The second part of the questionnaire related to the scope of the works conducted by subcontractors in addition to many questions investigating the perceptions of the

¹¹⁴ S Polgar, *Introduction to Research IN THE Health Science* (3rd edn Melbourne Churchill-Livingstone 2008)

¹¹⁵ Omer Al Zaher (M Sc of Architecture), Farah Yaseen (M Sc of interior Design) and Refqa Jamel (M Sc of pharmacist). All have experience in quantitative research.

parties, involved in the construction industry. of ‘back-to-back’ payment clause and the risks associated with them.

The survey was conducted using the World Wide Web based questionnaire. The Internet based survey has many Advantages such as: low cost, high speed in terms of collecting data and it gives time for thoughtful answers.¹¹⁶ The Survey link was sent to various professionals who worked in the construction industry in the U.A.E. The participants were asked to respond to the survey if they were dealing with contracts drafting or administration, otherwise to forward it to the concern person in the organization. The survey link was opened for 4 weeks, between 16 February 2013 to 14 March 2013. The number of participant was 192 sent with response rate 50%. In nut shell 96 participants responded to the survey. The SPSS statistical software version 17 was then used in statistical analysis of the data obtained from the questionnaire.

4.2 Ethical Research Considerations:

Prior to conducting the research, the researcher obtained the supervisor’s consent on the survey contents. Furthermore, the participants were provided some information about the topic and the objectives of the research. Additionally, the participants were given assurance that the data collected via the questionnaire would be anonym and used for the purpose of this research, and the data collected would be accessed only by the supervisor and the researcher. Finally, at the end of the questionnaire, the participants were asked to provide their e-mail address if they wish to receive a summary of the research results.

¹¹⁶ F Fowler, *Survey Research Method* (Sage Publications Inc, California 2002)

Chapter 5

Discussion and analysis:

5.1 Discussion Overview:

In order to study and analyze the impact of the ‘back-to-back’ payment clause on the cash flows of subcontractors in the UAE, and to investigate the perceptions of the parties involved in the construction industry, the data collected from the respondents by the survey were exported to the SPSS Statistics Software Version 17. Figure 1 shows that the percentage of participants in the survey. The participants consisted of 31 main-contractors, 14 subcontractors, 14 employers, 30 consultants/engineers and 6 other professionals. The mentioned professionals are the most influential important key players in the construction industry in the UAE.

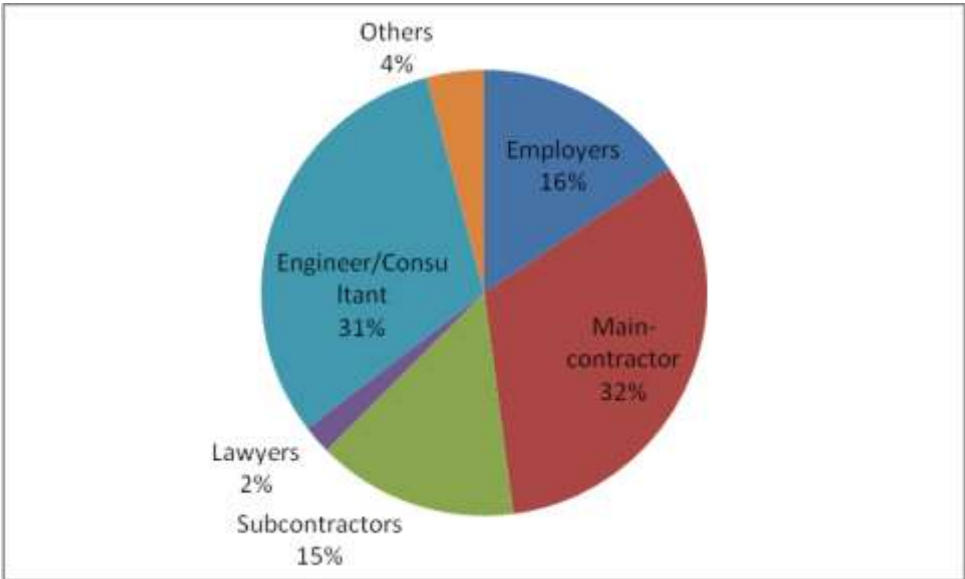


Figure 1: Professional practices of participants in the survey.

Figure 2 illustrates the years of experience the participants have. It shows that more than 57% of the participants have experience of more than 15 years which may sufficient to qualify them to make appropriate judgments in certain issues relevant to

the construction practice and challenges in the UAE. Furthermore, 5.2% of the participants have less than 5 years of experience.

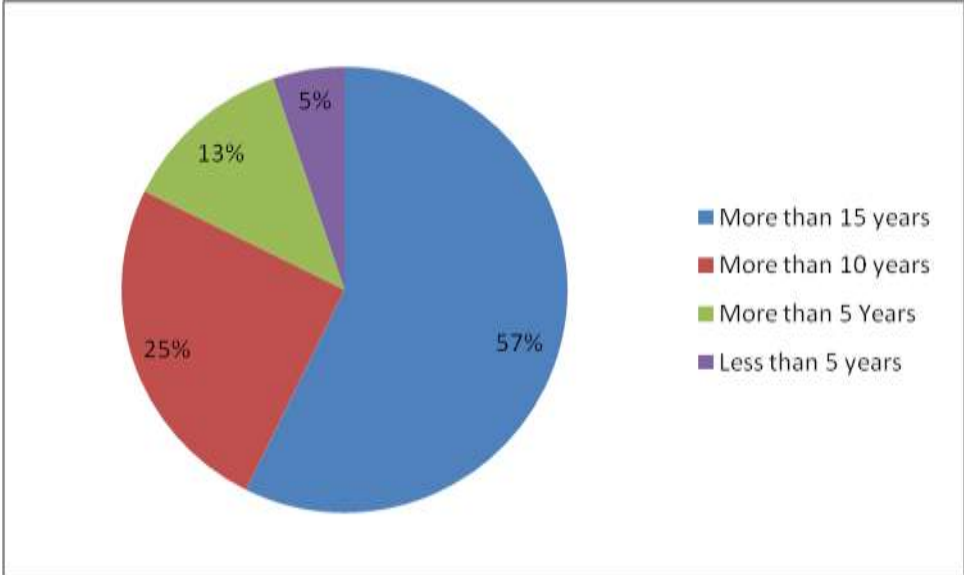


Figure 2 : Years of participants' experiences

5.2 Stakeholders’ perception of the meaning of ‘back to back’ payment clauses:

Figure 3 presents professionals’ understanding of ‘back-to-back’ payemnt clausees. It seems that the professionals’ perception is inclined towards the meaning of ‘back to back’ as pay if paid¹¹⁷. There are different understandings of the meaning of the ‘back to back’ payment clause, as 73% of the employers, 77% of the main-contractors, 67% of the engineers/consultants and 50% of the subcontractors understood the general meaning of ‘back-to-back’ payment clause as pay if paid. In other words, the subcontractors will receive their payments from the main-

¹¹⁷ The Chi-Square Test¹¹⁷ reveals that there are significant statistical differences between the understanding of the 'back to back' payment clause among the responses, (P value = 0.04) . “The chi-square test is always testing what scientists call the null hypothesis, which states that there is no significant difference between the expected and observed result”. In <http://www2.lv.psu.edu/jxm57/irp/chisquar.html> acceesd on [14 March 2013].

contractor if the employers paid the main-contractors’s dues, and if the employer does not pay the main-contractor’s dues, the subcontractor will not be paid. On the other hand, the other 50% of the subcontractors participated in the survey perceived that the general term of ‘back-to-back’ payment clause means ‘pay-when-paid’ clause, which means that: it is a matter of time and the subcontractor will get paid any ways, regardless of whether the main-contractor receives his dues from the employer or not.

It is worth mentioning that such differences in understanding and interpretations of the ‘back to back’ payemnt clause has a significant potential for a dispute should a payment is not paid or get delayed. In addition, this gap in the parties’ understanding of one of the most imporant terms of the contrcat shows that there is lack of awareness of the significance of the contract terms.

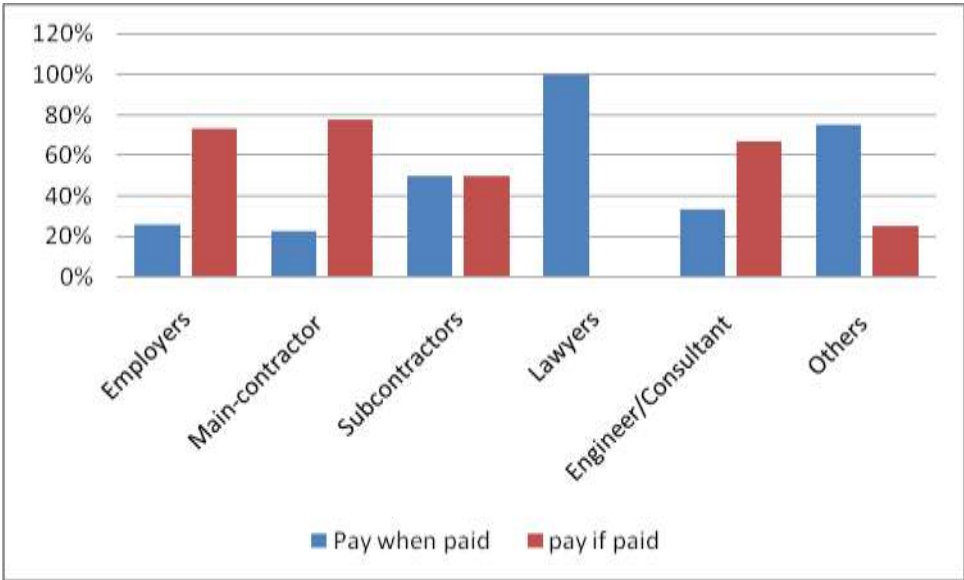


Figure 3: Meaning of the “back to back” payment clause.

5.3 Perception of the stakeholders of the ‘back to back’ general clause:

The participants were asked to confirm if the ‘back to back’ contract term is applicable to all terms mentioned in the agreement between the main contractor and subcontractors. Figure 4 shows that 54.7 % of the all participants believed that ‘back

to back’ was applied to all obligations between the main contractors and subcontractors. Among those participants, 68% of the main-contractors, 43% of subcontractors and 43% of the engineers believed that ‘back to back’ terms were applied to all obligations between the main-contractor and subcontractors. This difference in the perception is a key factor to avoid disputes between the parties. As discussed in the previous chapter, not all contract’s terms between the employer and the main-contractor can be ‘back to back’ between the main-contractor and subcontractor.

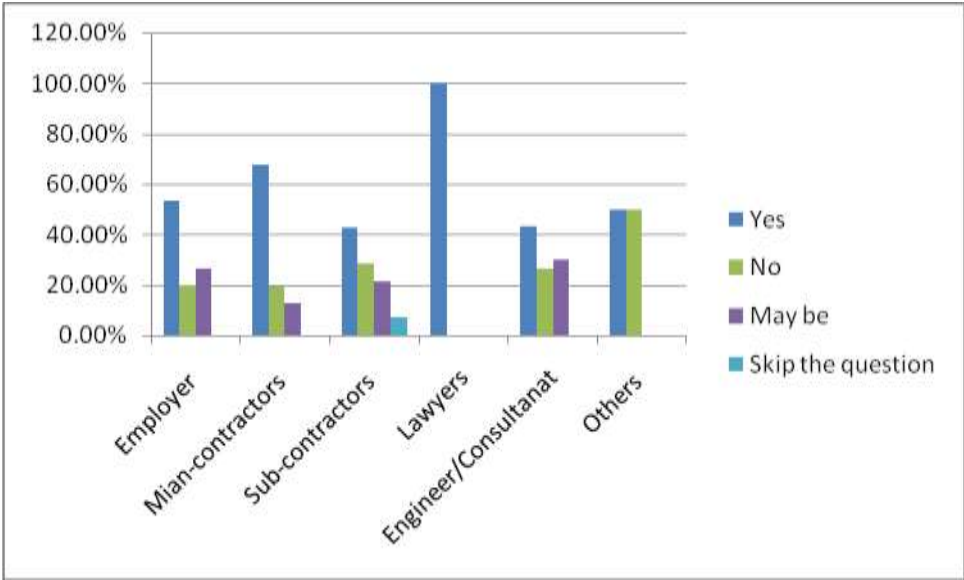


Figure 4: Stakeholders’ understanding of ‘back to back’ general term.

5.4 Problems and comfortability with ‘back to back’ payment clause:

The results revealed that most of the professionals participated in the survey felt uncomfortable with back to back payment clause except 61% of the main-contractors who felt comfortable with this clause. This may lead to a conclusion that this payment clause provides an uncomfortable environment between the parties which may introduce disputes between them. This result coincided with the relationship between the problems faced by the professionals due to the ‘back-to-back’ payment clause and professional types where 85% of the subcontractors countered problems

with this clause. Likewise, 40%, 45.2%, 36% and 75% of employers, main-contractors, engineers and other professionals, respectively, countered problems with this clause. See Figure 5

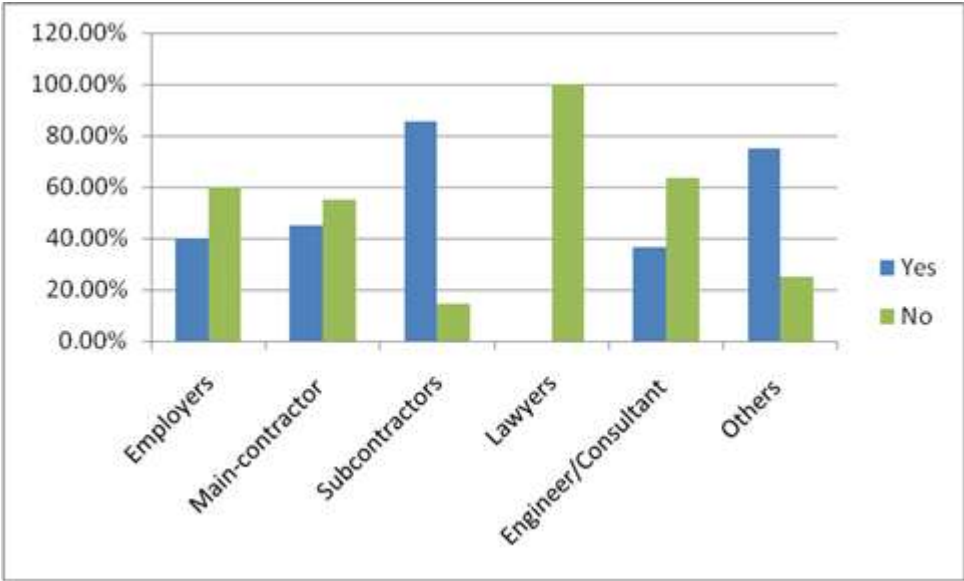


Figure 5: Problems those professionals faced in their projects

Figure 6 illustrates the relationship between the subcontract types and encountering problems due to the ‘back-to-back’ payment clause. It appears that the 80% of domestic subcontractors faced problems due to this clause. However, this was not the case with nominated subcontractors, as 30% only of nominated subcontractors faced problems with the clause. This result is expected, since the subcontractors are nominated by the engineer/employer, and as per the industrial customs there is a commercial relationship between the employers and nominated subcontractors. In addition, the employers have rights to pay directly to nominated subcontractors if the main-contractors did not pay the subcontractors dues without reasonable justifications as per FIDIC Red Book 99. Therefore, the nominated subcontractors are less vulnerable to payment issues.

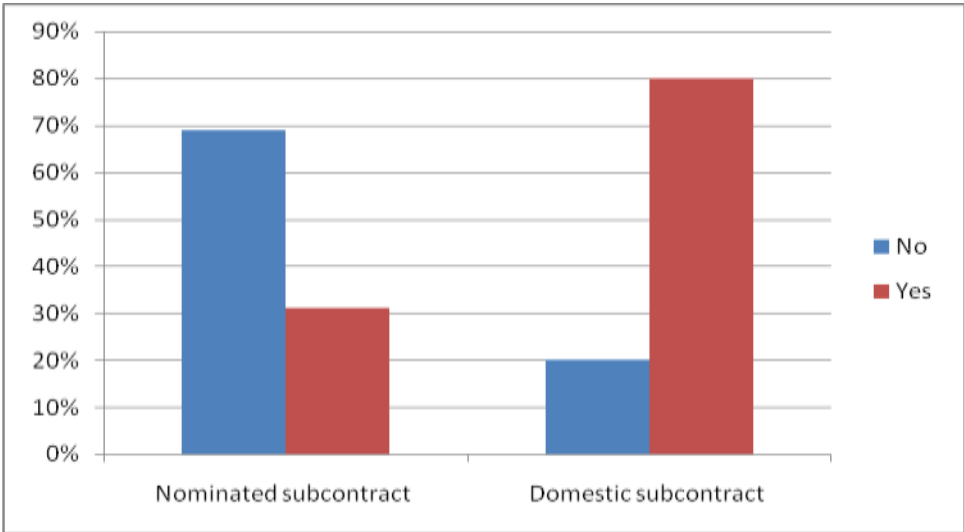


Figure 6: Type of subcontracts and its relationship with ‘Back to back’ payment clause problem.

Figure 7 presents the scopes of subcontractors participated in the survey; the figure shows that 87% of the participants’ scopes were supply and fix, 6% are suppliers only and 7% are fixers. The analysis showed that 53% of these supply and fix subcontractors faced problems with the ‘back to back’ payment clause. It is not uncommon that the payments to subcontractors for only supply or only fix are not subject to complex contract terms and most probably do not incorporate the ‘back to back’ payment clause.

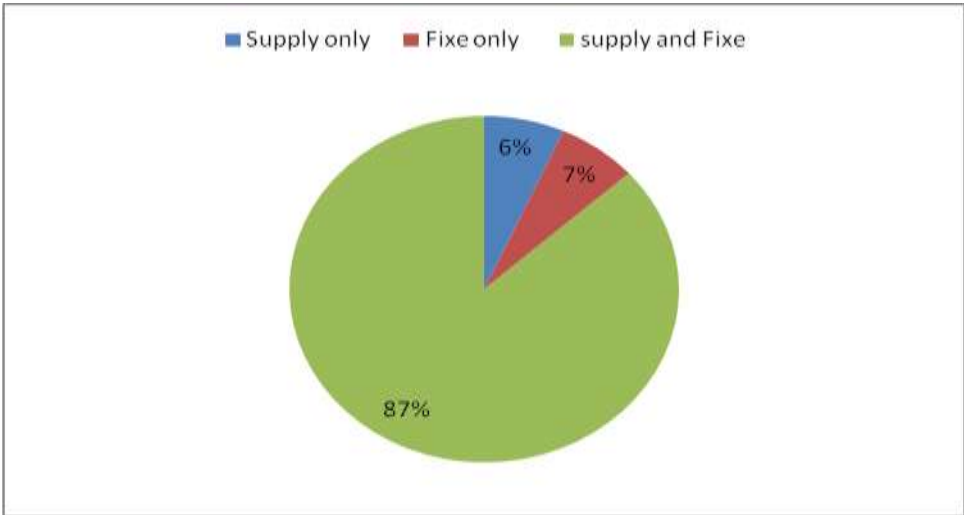


Figure 7: Scope of subcontractors

Moreover, the analysis reveals that no significant relationship between grade of main-contractors' companies and companies facing problems due to back to back payment clause. See Figure 8.

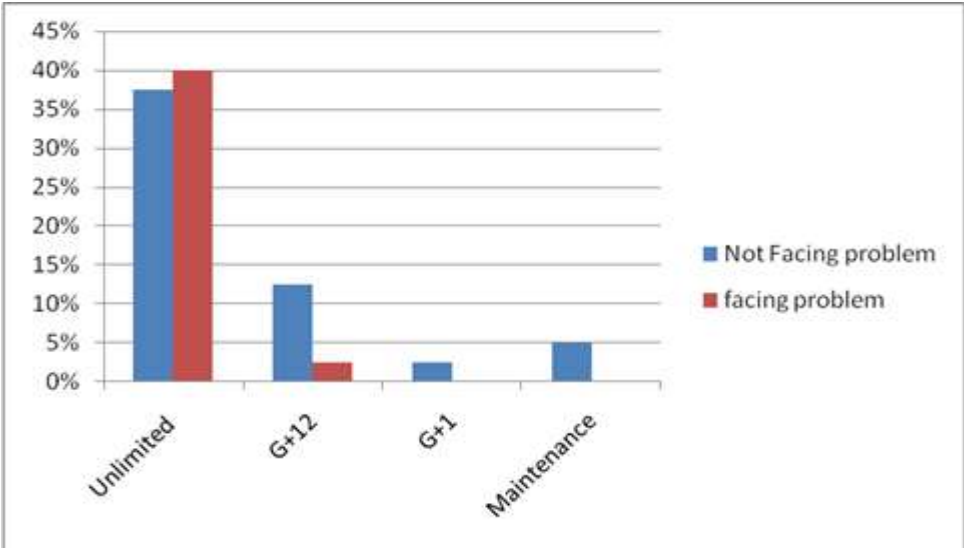


Figure 8: Relationship between the grade of main-contractors' companies and facing problem due to back to back payment clause.

5.5 Certification of the subcontractors work and feedback to subcontractors:

One of the main issues that subcontractors are facing in relation to the application of the 'back to back' payment clause is the difficulty in proving the amount certified by the engineer. Thirteen of the subcontractors participated in the survey responded to a question: if they received copies of interim payment certificates certified by the engineer or not? 71% of these subcontractors pointed out that they did not receive copies of the certified amounts, see Figure 9.

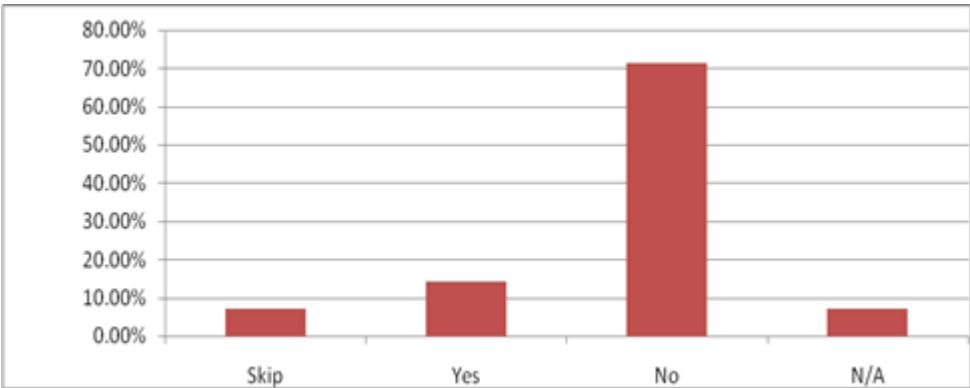


Figure 9: Wether Subcontractors receive a copy of the interim payment certified by the Engineer.

Furthermore, ten subcontractors participated in the survey classified the way in which they become aware of the certified amount by the engineer. Figure 10 shows that 40% of those subcontractors received verbal information about the certified amount, another 20% received the information during site progress meetings, another 20% said that they received official letters that indicate the certified amount by the engineers and the remaining 20% mentioned that they become aware of the certified amounts via other means.

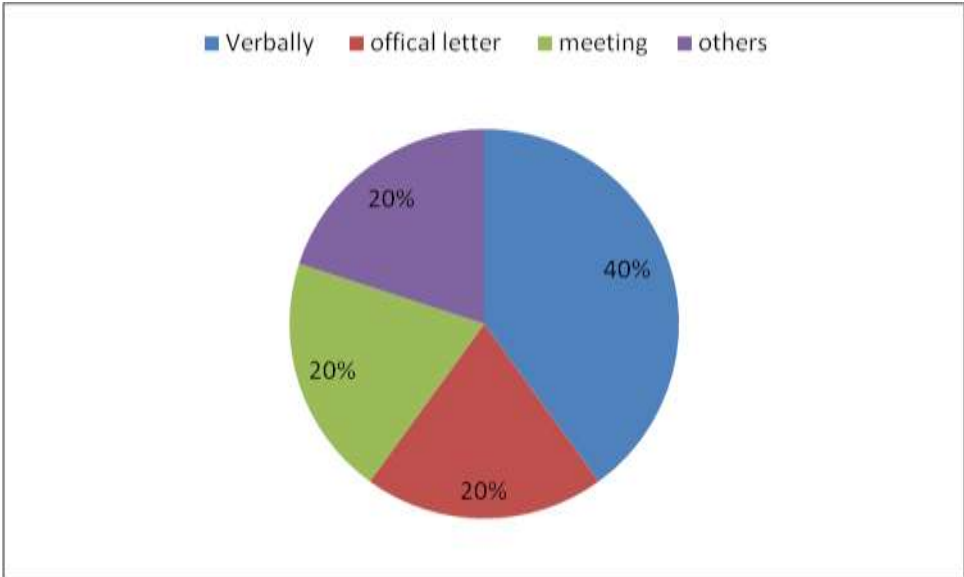


Figure 10: The methods by which subcontractors become aware of the certified amount by the engineer.

It is paramount to mention that one of the main significant issues associated with the application of the ‘back to back’ payment clause is the difficulty in proving whether the total work done by the subcontractors is certified by the engineer or not. This is the same for the payment received by the main contractor from the employer. As mentioned before, in case no 240/2006, where a payment clause was ‘back to back’ between the subcontractor and sub-subcontractor, the Dubai Court of Cassation held that ‘the burden of proof that the sub-contract had received its payment from the main-contractor fallen upon the sub-subcontractor.’ This, in practice, is very hard to prove in the absence of a clear mechanism, or clear obligation to provide an official document that indicates the certified/paid amount made to the party in the upper supply chain. In fact, according to Michael Tiplady¹¹⁸, one of the main reasons which trigger the invalidation of ‘back to back’ payment clause in the U.K was difficulties of proving whether the main-contractors received payments from employers or not.

5.6 The significance of the ‘back-to-back’ payment clause on the cash flows of subcontractors:

The participants were asked to express their opinion on the significance of the ‘back-to-back’ payment clause on the cash flows of subcontractors. Figure 11 illustrates their opinions. Scale 1 to 5 was used to explore the degree of significance, where 1 is the least value and 5 is the most significant value. It is obvious that more than 85% of subcontractors participated in the survey scaled the significance of the clause on their cash flow above 3. Furthermore, more than 65% of the all professionals, including the main-contractors, participated in the survey chose scales 4 and 5. As mentioned in previous chapters, the money is the blood of the construction industry therefore; subcontractors’ performances are expected to be severely affected in the absence of an effective cash flow and a method to secure the sub-contractors payments.

¹¹⁸ Owner, Wellesley Asset Management. Discussion through Construction Claims Network Group in LinkedIn.

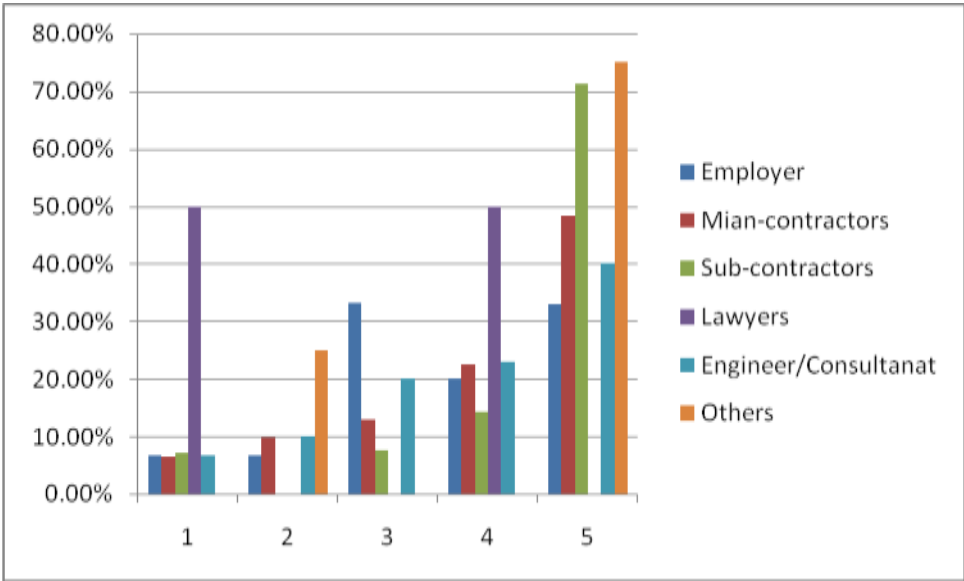


Figure 11: The Significance of ‘back-to-back’ payment clause on the cash flow of subcontractors (1 is least value and 5 is the most significant)

5.7 Consideration of the ‘back-to-back’ payment clause in tender pricing:

In response to the question if there is any contemplation to the ‘back to back’ payment clause in pricing the projects in tender stages, 31 main contractors and 14 sub-contractors responded. Figure 12 illustrates their feedback with this regard. The figure shows that 50% of the subcontractors considered the clause in their tender pricing, on the other hand 35% of the subcontractors did not consider the clause in their tender pricing. It is quite difficult for subcontractors to acknowledge such risk without responding to it. This could be due to the fact that the subcontractors are the weak party in the supply chain and usually conclude the contract by exchange of letters. It can also be caused by the market difficulties in finding a job due to financial crisis. However, regardless of the reason behind that, it is dangerous for subcontractors to enter into agreements without considering such risk, as it may put them out of business.

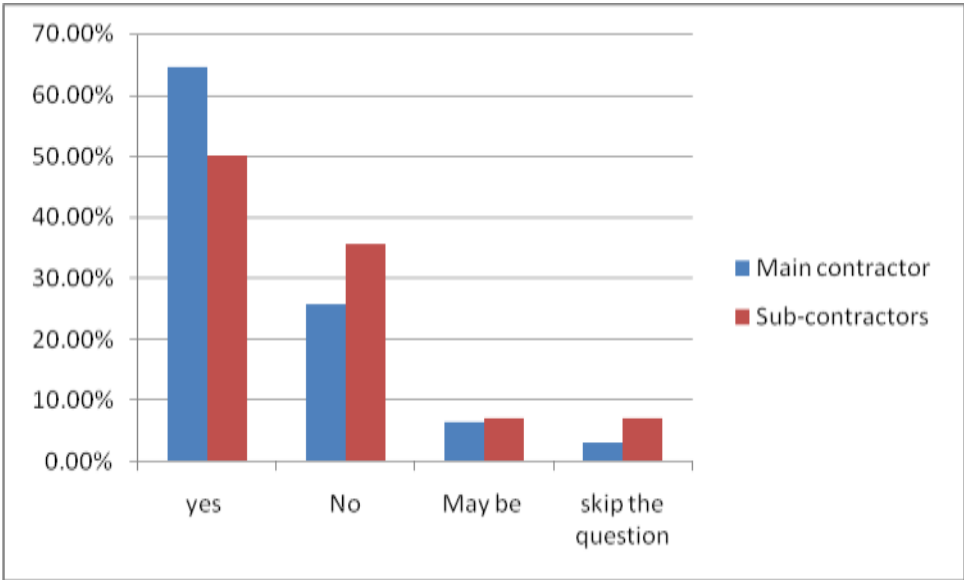


Figure 12: Consideration of ‘back-to-back’ payment clause in tender pricing.

5.8 Negotiability of the ‘back to back’ payment clause:

The results revealed that 45% of the main contractors participated in the survey suggested that the ‘back-to-back’ payment clause is not a negotiable term, which reflects the importance of such term to the main-contractor as it enhances their cash flows by correlating paying the subcontractors’ dues with receiving their dues from the employer. Furthermore, it is noted that; 50% of the subcontractors and 50% of the engineers who participated in the survey skipped this question, see Figure 13.

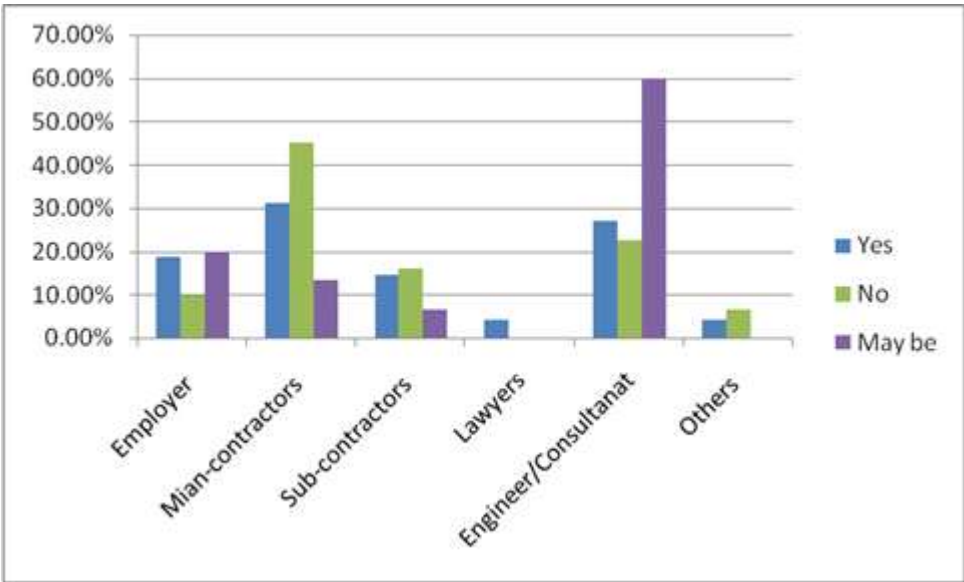


Figure 13: Negotiability of 'back to back' payment clause:

Additionally, it is interesting to note that 60% the engineers who responded to this question have doubt that this term is negotiable. In my opinion, it may be argued that the dominant factor that decides if any term is negotiable or not is the bargaining strength of the parties. Generally speaking, the sub-contractors are usually in a weak commercial bargaining position. Many terms may be imposed on them by the main contractor and they do not have a choice but to accept the term and to bear the risk.

5.9 Fairness of the 'back-to-back' payment term:

It is interesting to observe that only 7% of the subcontractors participated in the survey and 26% of the engineers and 42% of the main contractors believed that the 'back to back' payment clause is a fair term see figure 14

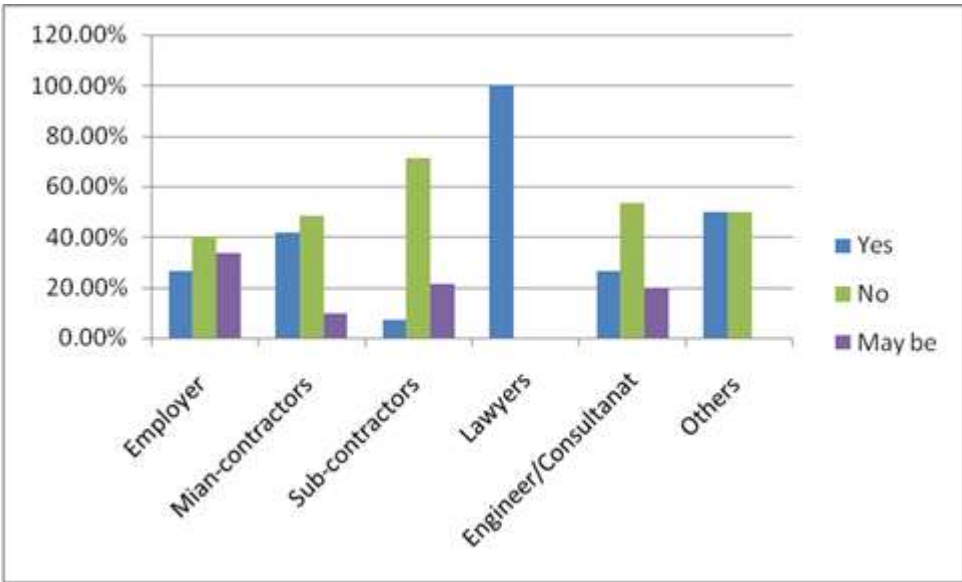


Figure 14: Fairness of 'back to back 'payment clause

This result coincides with 88% of the entire respondents who believed that the 'back to back' payment clause has advantages to the main-contractors. See figure 15.

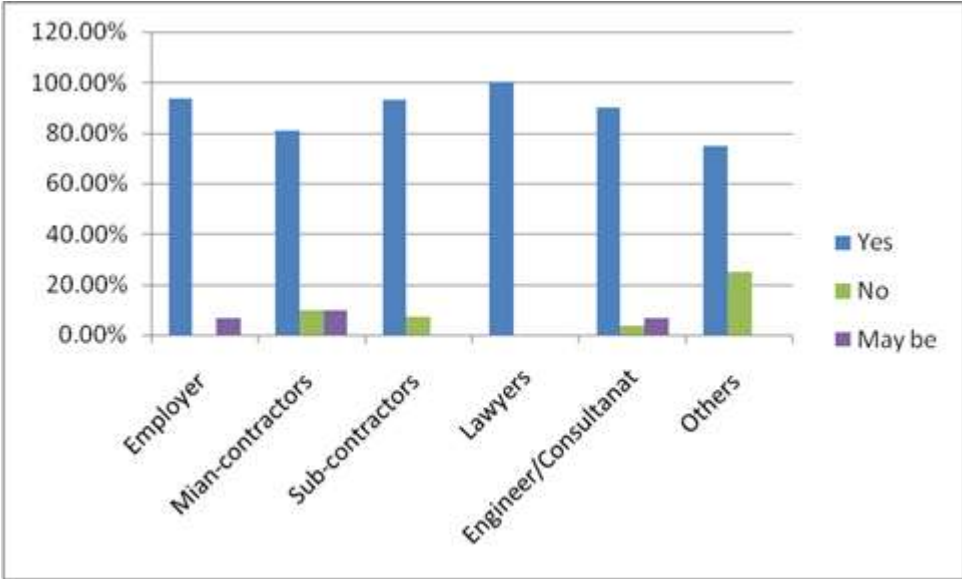


Figure 15: Advantages of the Back to back payment clause to main-contractors

Therefore, most of the respondents' opinions, as shown in figure 16, that back to back payemnt clause should be invalidated by the law

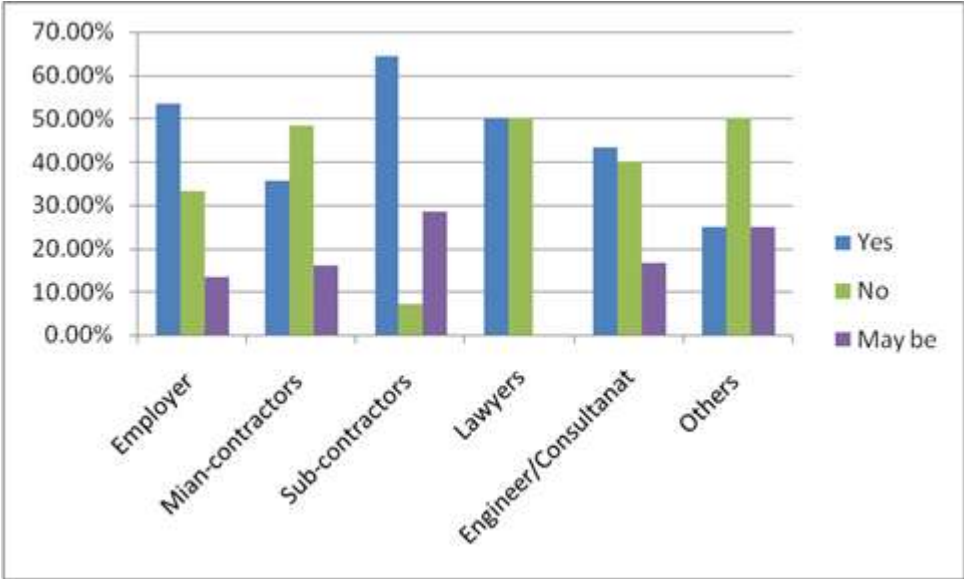


Figure 16: Stakeholders opinions in invalidation of 'back-to-back' payment clause in the UAE.

5.10 The effects of the 'back to back' payment clause if the main-contractor gets involved in litigation with the employer:

Only 25% of the all respondents believed that the back-to-back payment clause will not prevent the subcontractor from getting paid by the main contractor, if the latter gets involved in litigation or arbitration with the employer. On the other hand, 48% of the main contractors, 47% of the engineers, 50% of the lawyers and 64% of the subcontractors believed that this clause can prevent the subcontractors from getting paid if the main contractors become involved in litigations with the employers. See Figure 17.

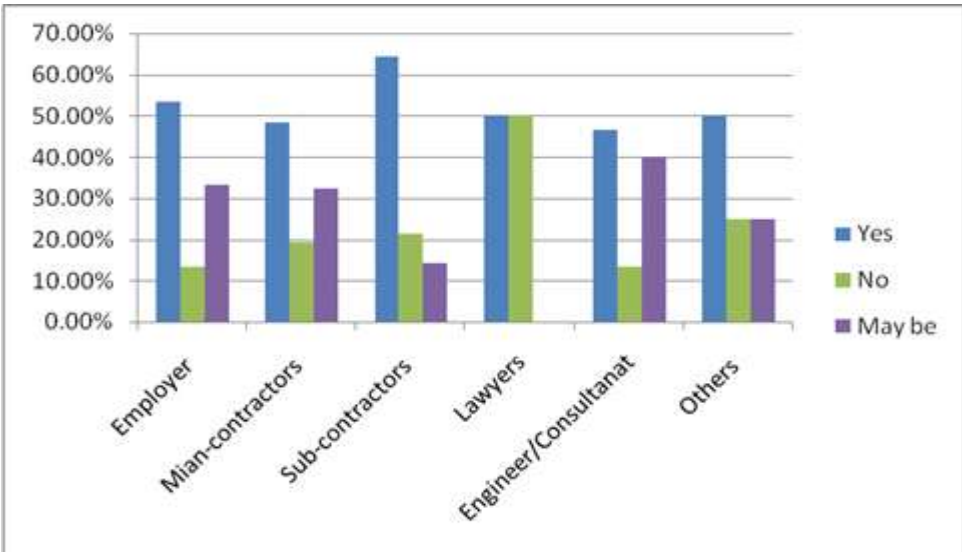


Figure 17: The impact of back to back payment clause if the main-contractor gets involved in litigation with the employer

This result agreed with another result which shows that 65% of respondents of subcontractors believed that their payments would be affected if the main-contract was terminated by the employer, see Figure 18.

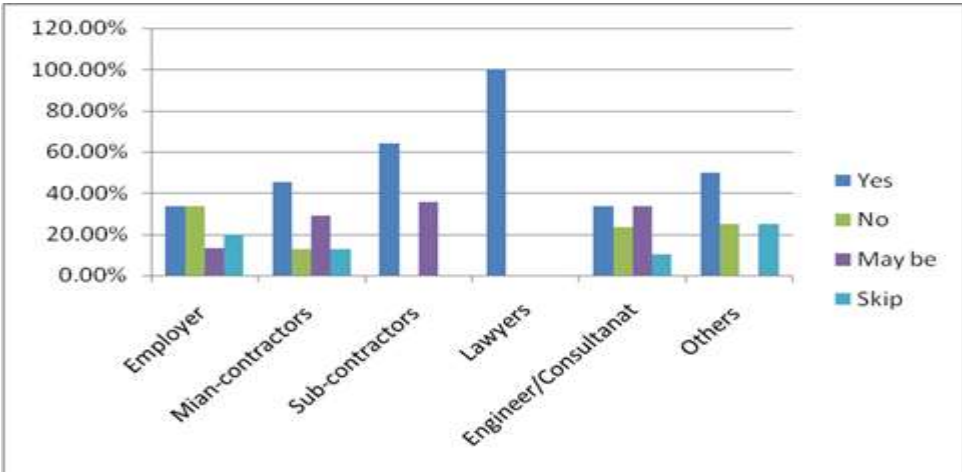


Figure 18: Effects of termination of Main-contract on subcontractor's payment.

This response indicates that the ‘back to back’ term is a very risky term if the sub-contractors do not consider it accurately during the pricing stage of the project. Furthermore, this feedback may be the reason behind the professionals' feeling that the ‘back to back’ payment term is an unfair term since if the subcontractor has no hand in the issue of the dispute between the main contractor and employer then why should his payment be withheld?

5.11 The effect of the main contractors’ follows up with the employer on the sub-contractors dues:

25% of the total responds only believed that the ‘back to back’ payment clause can not prevent sub-contractors from seeking their payments from the main contractors if the later did not pursue the employer for their dues. On the other hand, 73% of the employers, 48% of the main contractors, 71% of the sub-contractors, 50% of the lawyers and 60% of the others who participated in the survey believed that this payment clause has a potential to prevent the subcontractors from getting paid, by the main contractors, if the latter, for any reason, did not follow up with the employer to get their payments, see figure 19.

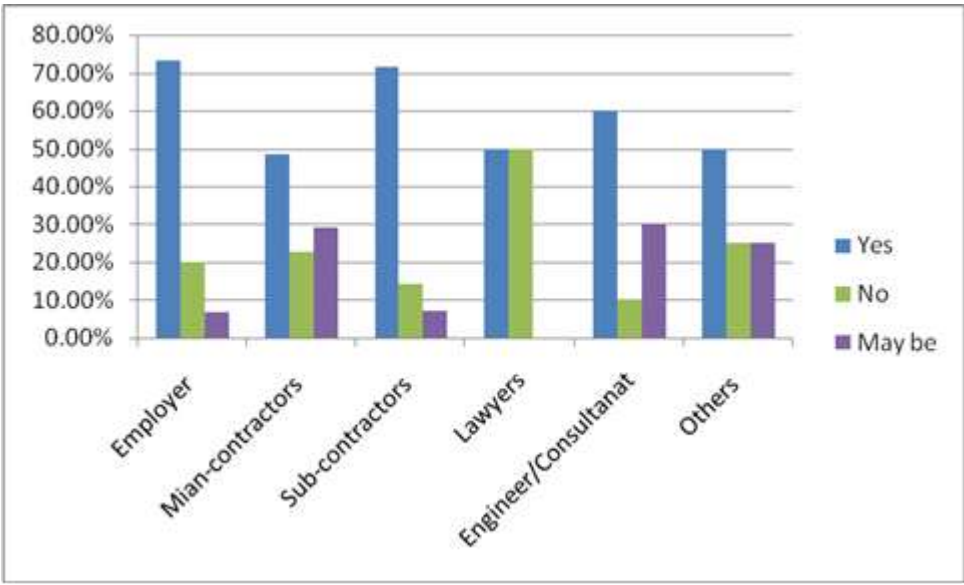


Figure 19: The Effect of main-contractor follow up, with the Employer, on the subcontractors dues.

From my experience in the UAE there is no Law that prevents the employer to work as a contractor while he, at the same time, works as a developer. In this case, it is highly possible that the main-contractor has no interests to follow up with him to get his payments. It is also highly possible that there is a set-off between the employer and the main-contractor whereas the subcontractor has no hand on it, therefore no reason to correlate the subcontractor's payment with main contractor's payment which needs a follow up by the main contractor to get its dues. Again it is worth mentioning that this reason may be one of the main reasons which made most of the participants felt that this term of contract is unfair.

5.12 The possibility subcontractors to seek directly pymnets from the Emplyer:

25% of the all resondents stated that the sub-contractors can directly seek payments from the employers where as 25% believed that the sub-contractors can not directly ask the employer for payemnts. It is noted that 50% of the received feedback show that the respondents have doubt as to whether the sub-contractors can seek payemnts from employers or not,see Figure 20.

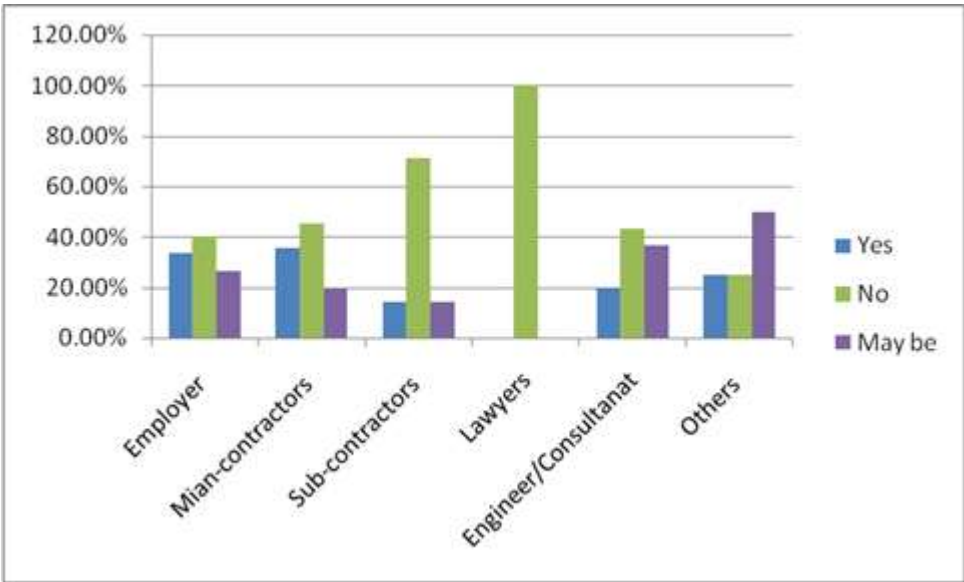


Figure 20: The possibility subcontractors to seek directly pymnets from the Emplyer.

It is worth to mention that, according to the UAE's Law, since no privity of contract between the subcontractors and employers, to this end, the subcontractors can not seek direct payments from the employers. It is important to mention that contracting parties should understand this issue which may reduce risk. Furthermore, the awareness of the stakeholders of this point is essential and may contribute to reduce the dispute among the parties.

5.13 Challenges of getting paid:

Figure 21 illustrates the challenges faced by main-contractors and sub-contractors because of payment defaults. From the subcontractors that participated in the survey, 7% mentioned that they faced problems in getting their interim payments, 21.4 % encountered issues of getting their final payments and 71.43% suffered to get both their interim and final payments. Likewise, 38.7% of main-contractors participated in the survey indicated that they countered problem of getting their payments. The results indicate a serious issue that is faced by the main-contractors and subcontractors. As mentioned before, the payments are the blood of the construction industry and without payments the construction production can not continue and the parties have no choice but to recourse to dispute resolution methods in order to overcome this issue. Therefore a piece of Law should be in place in order to regulate payment mechanisms and secure it which in turn may overcome this issue.

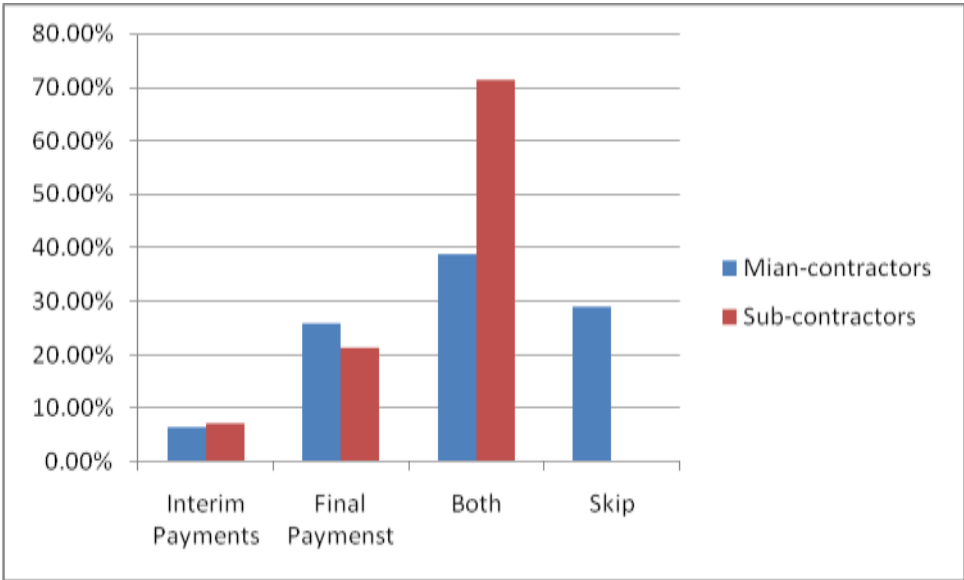


Figure 21: Challenges of Getting paid.

5.14 Actions by sub-contractors if they do not get paid:

Figure 22 illustrates the actions that could be taken by the sub-contractors, who participated in the survey, if the main contractors did not pay their dues due to the ‘back-to-back’ payment clause. 43% of the respondents provided that they slow down their works as a method to try to force the main contractors to pay their dues. Furthermore, 22% of the respondents mentioned that they could suspend their works, and 14% of the sub-contractors chose to continue their works. This result is reasonable since there is no consideration of the possibility of delayed or non-paid payments due to the 'back to back' payment clause. This outcome indicates a serious issue which is: if the parties have agreed on the ‘back-to-back’ payment clause, then for some reason the sub-contractors decide to suspend the work, this may lead to a breach of the contract which may cause major problems in the project. This in turn may force the main contractors to utilize security means such as performance bonds or to retain the retentions of the subcontractor in order to deal with this issue. Furthermore, this may be considered as the repudiation of the subcontract. These results show that there is a gap in the knowledge of sub-contractors which may contribute to an environment of dispute the construction industry.

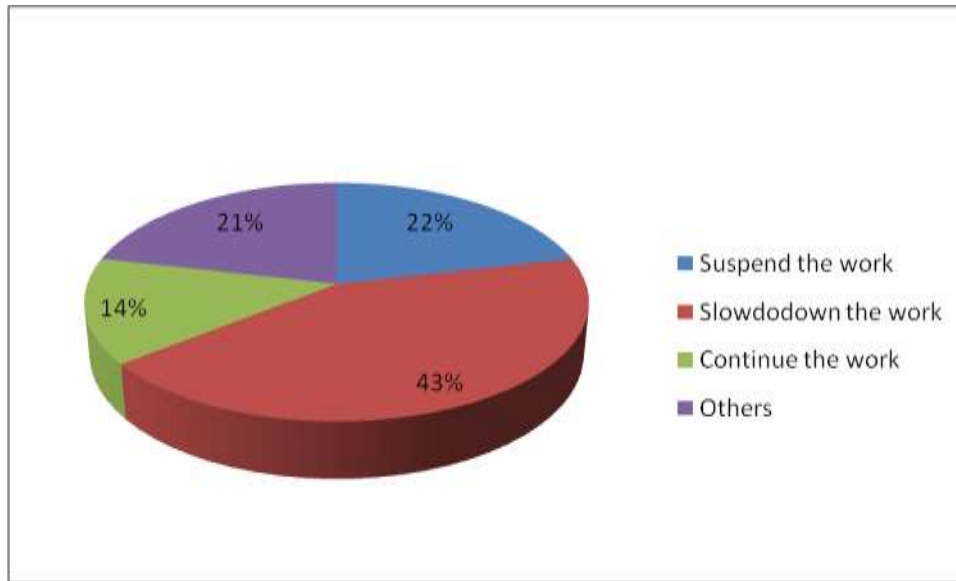


Figure 22: Actions by sub-contractors if they do not get paid.

Chapter 6

Conclusion and Recommendations:

Back to back payment clause has different meanings and forms and its interpretation may vary among the different legal systems. Common law is inclined to invalidate such clause. The situation under the UAE law is different as there is no explicit term in the current law that invalidates the back to back payment clause.

As highlighted in the survey's results, a total of 96 construction professionals from the UAE's construction industry contributed in to the survey and provided their expert judgments. One of the main payment issues is that the main contractor, and consequently the suppliers and subcontractors are suffering from is in getting their retention money. During the execution of the project, if there is a delayed-payment or non-payment at all, the contractors will slow down the works or at a certain stage will suspend the execution of the works as the second option. Likewise, the case is repeated for sub-contractors and suppliers. However, this is not the case if the project is handed over and the remaining due is only the retention money. At that stage, the contractor has no choice except to recourse to litigation or any dispute resolution mechanisms provided in the contract. It is significant to highlight that in other countries such as the U.K, there are many solutions which can be adopted in the U.A.E, such as Project Bank Account, or to extend the scope of escrow accounts in Dubai in order to solve the payment issues in the UAE. These mechanisms, in my opinion, can enhance the trust among the contracting parties.

The study shed light on the professional awareness of the professionals who are involved in contract administration in the UAE, as it seems that there is a lack of awareness of certain contracts clauses meanings and their implications, such as the back to back payment clause which needs to be addressed via training.

The study concluded that the back to back clause has significant impacts on the cash flows of the main contractors and sub-contractors, as 65% of the entire professionals

participated in the survey claimed so. Furthermore, according to most of the respondents to the survey, the back to back clause in an unfair term and should be invalidated by the law. Therefore, the back to back payment clause is expected to adversely affect the performance of the parties in the project should the payment get delayed. It is worth mentioning that in the absence of a clear provision under the UAE law to enforce the employers to pay the main contractors, and consequently the other parties in the supply chain, to be paid their dues within a certain time, or to provide suspension right to the contractor, then the back-to-back payment provision seems to be an inevitable provision in contracts between main contractors and sub-contractors. This in turn may lead the main contractor to utilize such provision to delay or not pay the sub-contractors' payments. It is important to highlight that if the sub-contractors consider such risk during the pricing of project tenders, then there is no doubt that the employer is paying for such risk. On the other hand, if the sub-contractors do not consider such risk in their prices, and if the employer did not pay the main contractor his dues, then the possibility of sub-contractors' insolvency at certain time during the construction of the project is very high.

The study revealed that most of the professionals that participated in the survey felt uncomfortable with the back to back payment term. Furthermore, most of the sub-contractors that participated in the survey have encountered problems due to the back to back payment clause. It is worth mentioning that the domestic sub-contractors are highly exposed to problems due to the back to back clause than the nominated sub-contractors. It is advisable that the contracting parties to provide clear payment terms. If the parties intend to provide the 'back to back' payment clause, then the clause should be clear enough to eliminate any unintended interpretations of the clause.

The study pointed out that 71% of sub-contractors did not receive copies of payment certificates. Therefore, in contracts that include the back to back clause, it is very

difficult for sub-contractors to prove their right should dispute arise before the courts. Therefore, it advisable that the parties should mention in the contract such need.

The future study should focus on the perceptions of contracting parties towards introducing new laws with regards to the enforcement of payment throughout the construction supply chain

To conclude, it is worthwhile to the parties to be clear in their contract terms with regards to payment certification and mechanisms. In addition, the legislator should be inspired by the other common laws to adopt payment mechanisms and certainty in the construction industry.

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