

# What happens when it all goes wrong? Terminating a construction contract from a UAE law perspective

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If the Employer is the terminating party, there will almost inevitably be a delay in engaging a replacement contractor while the difficult question of addressing the interface between the works performed by the terminated contractor and the replacement contractor needs to be dealt with.

Alternatively, any termination by the Contractor is likely to emanate from the nonpayment of sums due to the Contractor. Even if the Employer has the means to pay, there will almost inevitably be a reason for non-payment.

On account of the many difficulties arising out of most terminations, it is advisable for contracts to contain “early warning” mechanisms that alert the parties to breaches and allow opportunity for the breach to be cured (or for negotiations to occur) prior to the breach becoming a ground for termination. That said, termination can be the only viable option in certain situations (i.e. insolvency or perhaps it is patently apparent that the Contractor lacks the skills and resources to perform the works) and this article briefly addresses some important things to know and consider about termination of construction contracts and its consequences under UAE law.

## **Ensure you have the right to terminate**

Prior to terminating a contract, the terminating party must ensure that it has the legal right to do so and strictly follows any contractually agreed procedures (such as notice requirements).

It is not uncommon for parties to incorrectly assume that they have a right to terminate in a particular situation and to purport to terminate the contract without any legal right to do so. This can result in the termination being ineffective and the terminating party being exposed to a damages claim. In other words, rather than being the innocent party, the party who ineffectively terminates the contract unwittingly becomes the party in breach.

## **Contract termination rights**

In accordance with the principles of freedom of contract, parties to construction contracts frequently agree on the circumstances upon which the construction contract may be terminated, together with the compensation regime. Indeed, this is the position under standard form contracts (such as the FIDIC suite).

## **The impact of UAE Law**

The right to terminate is however subject to UAE Law. The UAE Civil Code addresses the termination of muqawala contracts (i.e. contracts for the carrying out of works) and provides that “*a contract of muqawala shall terminate upon completion of the works agreed or upon cancellation of the contract by consent or by an order of the court*”.

As well as clearly setting out contractually agreed termination rights, it is important that the contract provides that it may be terminated without a court order. If the contract does not have such a clause, the terminating party is required to notify the other party of its intention to terminate the contract before proceeding to seek the court's consent to terminate the contract. This step obviously costs time and money.

Pending a court's order to terminate the contract and if there are no applicable suspension rights, the parties may be required to continue to perform their contractual obligations. This can lead to obvious complications. However, if the drafting provides that a no court order is required, the contract will terminate in accordance with its terms without any further formality.

Alternatively, if a contract does not contain any contractually agreed termination rights (or if the contract fails to provide that it may be terminated without a court order), a party wishing to terminate the contract is required to seek the consent of the court.

The court will consider all relevant circumstances (particularly the seriousness of the breach) before determining whether or not to order termination of the contract. Depending on the circumstances, specific performance may be ordered as an alternative to termination while an extended cure period may be implemented as a precondition to any termination. Prior to the court issuing its termination order, the breaching party may remedy any breach (and thus avert any termination).

The final ground for termination prior to completion of the works arises by operation of law if, for example, performance is rendered impossible on account of the occurrence of an event that is not attributable to either party (i.e. an event of force majeure).

### **Consequences of termination and damages**

Closely connected to termination is the question of damages.

The guiding principle is that compensation should be equal to the quantum of the harm suffered. Under the Civil Code, a party is entitled to be compensated for the "damage, in fact, suffered at the time of the occurrence of the breach". In the absence of fraud and gross negligence, directness and foreseeability are required in order to recover damages for breach of contract. This corresponds with the position under many standard form contracts which typically exclude liability for indirect and consequential losses.

In order to manage the process following termination, parties frequently agree on a contractual mechanism that applies to the transition. For example, if an Employer terminates on account of a Contractor's breach, it is common for the Employer to not be required to make further payment to the Contractor until the cost of completing the works (and therefore of engaging an alternative contractor) has been determined. The intention of such wording is to ensure that the Employer is not out of pocket on account of having to engage a replacement contractor.

An Employer should also have the contractual right to recover from the Contractor (and use) any designs or other deliverables, together with the ability to take over key subcontracts.

A Contractor who terminates on account of the Employer's breach is typically entitled to immediate payment of sums due to it under the contract, together with out of pocket expenses (including its demobilisation costs) and interest. Parties are free to agree the applicable rate of interest on the late payment of debts, subject to a cap of 12%. If the contract fails to prescribe a rate of interest, a default rate of 9% is often implied.

### **Conclusion**

At the time a construction contract is entered into, parties are usually focused on the construction project itself rather than what happens if things do not go according to plan. Unfortunately, construction projects

frequently encounter troubled waters and it is therefore important that parties spend the time to agree well drafted termination clauses to facilitate the challenging process of termination.