

Snapshot of Construction Law Issues in Saudi Arabia

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Saudi Arabia's legal system is based on the principles of Sharia Law which, following the Hanabali school of Islamic interpretation, adopts a fundamentalist and literal interpretation of the teachings of the Qur'an.

The way in which Saudi courts regulate contractual relationships is therefore strikingly different from the common and civil law systems. Parties are of course free to contract with each other; however, the degree of freedom with which they can do so is governed by certain prohibitions in the Qur'an. Generally speaking, contractual provisions that violate the fundamental principles of Sharia law will not be enforced by the Saudi courts.

There is no construction law in Saudi Arabia, therefore all construction agreements in the private sector are subject to the parties' consent, provided that the agreement does not contradict Sharia Law. However, there are some specific rules that apply to public sector contracts pursuant to the Government Tenders and Procurement Law 2006 ("the Procurement Law") issued by Saudi Arabia Royal Decree No. M58/1427, which was introduced to promote transparency, honesty, economic efficiency and competition in the Kingdom.

A brief snapshot of some of the key issues facing contractors in Saudi Arabia is set out below.

Contracts and regulations

- For public works contracts, the Saudi Arabian government uses its own standard form of contracts (generally available at www.saudiembassy.net). Public works contracts are subject to the provisions of the Procurement Law.
- For private contracts, the standard form of contract tends to be the same for both local and international contractors. FIDIC contracts are widely used throughout the region.
- Any contractor designing or building in Saudi must abide by the Saudi Building Code, which is a set of technical, legal and administrative regulations regarding the minimum construction standards.

Duty of good faith

- The principles of Sharia Law place great importance on the duty of good faith. Whether a party has acted in good or bad faith will depend on the particular facts and circumstances of each case.

- One such example is a breach of the duty to warn. If the contractor was aware of an error or defect but continued work without informing the employer or the engineer they are likely to have acted contrary to the duty of good faith.

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Limitation/time bars

- In common and civil law jurisdictions, if a claim is time-barred this will provide the defendant with a very strong defence. However, there is no statutory limitation period in Saudi Arabia. Saudi courts will uphold contractual limitation periods if they accord with Sharia Law principles.
- For example, Saudi courts may refuse to dismiss a claim on the basis of a limitation argument in circumstances where (i) it would be unfair to the claimant, and (ii) rights should not be lost with the passage of time, both of which would contravene the principles of Sharia Law. Allegations of fraud and bad faith are not subject to limitation periods.

Remedies for breach of contract

- Sharia law prohibits riba (unjust enrichment) and gharar (speculation). Therefore contractual remedies are limited to direct and actual damages suffered and damages cannot be claimed for indirect or consequential losses, loss of business, loss of profit, economic loss of a chance or any other type of speculative or uncertain losses. Similarly, specific performance and injunctive relief are generally unavailable.

Delay, disruption and acceleration

- Article 52 of the Procurement Law permits extensions of time if the contract is extended because: (i) the employer requests additional works; (ii) the annual budget allocated to the works is insufficient for completion by the original completion date, and (iii) the relevant public authority suspends the works through no fault of the contractor.
- A disruption claim will only be successful if the loss suffered was direct, fair and proportionate, and that the contractor took reasonable steps to mitigate the losses. As set out above, Sharia Law prohibits unjust enrichment and speculation, therefore a contractor may only recover damages for the amount of loss actually incurred.

Liquidated damages

- Liquidated damages clauses are generally permitted but are subject to the principles of Sharia Law set out above. Therefore they will only be enforceable to the extent that the amount of delay damages accurately reflects the actual damages incurred.
- In relation to public sector contracts, Articles 48 and 49 of the Procurement Law stipulate that delay penalties should be subject to 10% liability cap for all tenders and procurements undertaken by government entities and a 6% cap for supply contracts.

Termination

- For public works contracts, the government has the right to terminate the contract in certain circumstances, as set out in Article 53 of the Procurement Law. The circumstances include (i) bankruptcy of the contractor; (ii) assignment or subcontracting the contract without permission of the government; (iii) the contractor's failure to rectify delay or breach of contract within 15 days of the government's notice to do so, and (iv) if the contractor commits bribery. Article 54 entitles a contractor to damages if the government authority terminates the contract with no valid grounds.
- The Saudi courts will generally uphold the termination provisions for private contracts. The courts will also permit termination for reasons not stipulated in the contract if there are valid grounds.

Force majeure

- Force majeure provisions are recognised in Saudi law; however, the courts will only recognise exceptional events beyond a party's control that make performance absolutely impossible rather than overly burdensome.
- However, for public sector contracts Article 51 of the Procurement Law provides that a contract will be extended (and the penalty waived) if the delay is due to unforeseen circumstances or reasons beyond the contractor's control.

Variations

- In relation to public works contracts, variations are permitted under Article 36 of the Procurement Law. An increase in the scope of work is permitted up to 10% of the contract value whereas omissions are capped at 20%. In relation to private contracts, the courts will generally uphold the provisions of the contract provided that they do not violate the principles of Sharia Law.

Completion of the works

- There are no specific rules governing completion of the works save for (i) Article 53 of the Procurement Law which confirms that in relation to public projects, the government has the right to withdraw work from a contractor and rescind the contract or execute it at its own cost if the contractor abandons the project without completing, and (ii) Article 40 of the Procurement Law which provides that the last payment (not less than 10% for public sector contracts and 5% for private sector contracts) should be paid after the initial handover of the works.

Dispute resolution

- Construction disputes can be heard by the Sharia Court, the Board for the Settlement of Commercial Disputes, the Board of Grievances and the Labour Courts.
- In the private sector, parties are free to litigate or arbitrate (pursuant to an arbitration agreement) in accordance with the terms of the contract. As per Article 11 of the New Arbitration Law 2012, parties are bound by their agreement to arbitrate but can also bring parallel proceedings in the Saudi courts if there are issues of Sharia Law that

must be resolved. It is worth noting that domestic arbitration is governed by the Board of Grievances and can therefore be just as costly and time consuming as litigation. Mediation is typically only used where mandatory under statutory requirements.

- In the public sector, an ad hoc committee will be formed to hear disputes concerning (i) an alleged breach of contract by the government body; (ii) an alleged breach of contract by the contractor; (iii) defective performance by the contractor, and (iv) fraud, deceit or manipulation, but only on the part of the contractor. Either party can appeal the committee's ruling to the Board of Grievances within 60 days of the decision.

Bankruptcy/insolvency

- Bankruptcy or insolvency of the contractor is grounds for termination in a government contract pursuant to Article 53(d) of the Procurement Law.
- In relation to the private sector, the parties are free to include termination provisions in the contract in the event of bankruptcy or insolvency. There is no provision in Saudi law that automatically treats a contract as void or voidable in those circumstances.

For more information on any of the issues discussed in this article, please contact [xxxxxx].