

## CONSTRUCTION IN KSA Proceed with Caution

Recent drops in public expenditure in the Kingdom of Saudi Arabia have raised the risks for contractors in the country. Riaz Hussain QC shares his thoughts on the developments.



It has been reported that, according to a circular issued by the Saudi Minister for Municipal and Rural Affairs, the Government has decided to "stop" or postpone all new projects. The only exceptions given are those around Haj and Umrah infrastructure, as well as any additions or extensions to existing projects.

Reports also suggest that the Ministry is assessing the priority of the existing projects as per the recommendations of the Council of Economic and Development Affairs. The review is looking to optimise the budgets of the projects and match the pace of current development trends.

The exact workings of the circular and the process of halting these new projects is still unclear at this stage. However, there is still understandable concern amongst contracting bodies as to how best to cope with existing projects against the backdrop of narrowing budgets caused by the Saudi economic downturn.

As oil prices continue to be depressed, the Saudi economic downturn endures. Indeed, reports have indicated that the transport and infrastructure budget for 2016 has been reduced by 60 per cent from 2015, falling from USD16.8 billion to just USD6.4 billion. As a large part of the Saudi projects

market relates to public works, with the Government assuming the role of the Employer, this tighter public expenditure will weigh heavily on public works contracts.

There are a number of more general problems that arise in construction projects when economic downturn hits: irregular or delayed payments, employers' reluctance to accept change orders and to seize on any perceived claims against contractors. But there are also specific vulnerabilities here brought about by the Saudi contractual regime.

Public Works contracts in Saudi Arabia fall under the Implementing Regulations for the Government Tenders and Procurement Law 2006, which forbids contractors from suspending works when non-payment occurs. In other jurisdictions this is considered one of the biggest weapons for contractors to avert non-payment by the employer, but this isn't the case in Saudi Arabia.

In a non-payment situation, a contractor can pursue relief under the 2006 Law by seeking redress or compensation from a Committee to be set up considering contractor grievances and claims (according to Articles 54 and 78 of the Law). A contractor is entitled to an extension of the time for completion (amongst other grounds) if the funds allocated annually for a project are insufficient for the completion of the works by the specified time. If the funds have simply not been paid, however, a contractor can't turn to this process. Article 51 of the 2006 Law could provide an avenue for relief – this enables an extension of time and the waiver of delay penalties if the delay is judged to be outside the control of the contractor.

At the outset, it is wise to factor the likelihood of non-payment or deferred payments into bids for projects and, indeed, how these bids are priced. It has been widely reported that major project financing will become more even more difficult to achieve as public expenditure budgets are squeezed. Therefore, contractors relying on loans or project financing should seek to build in extra flexibility in repayments in case non-payment occurs.

With regards termination of existing contracts in the economic downturn, a number of other concerning aspects of the 2006 Law are worth noting. Under Saudi Law, the Contractor's loss consequent on termination are not recoverable in light of Islamic Jurisprudence; this is in stark contrast to English Law, where the employer is liable to pay the loss, acting as a powerful disincentive to any termination. Consequently in Saudi Arabia, an employer has relatively little to lose from an unlawful termination of the contractor's employment. And there is no option to dip into English Law here. It is ultimately Saudi Law which contractors have to use – the Saudi standard form contract requires its application.

According to reports, more privatisation and public-private partnerships could be on the horizon, driven by this pressure on public works budgets.

In this scenario, an option for contracting parties could be to pursue a mutual suspension or extension of projects on agreed terms. But these should be carefully worded, taking into account all the different eventualities.

An altogether different law governs private contracts. The wording of Article 38 of the Saudi "New Arbitration Law" allows parties to choose the substantive law of their contract, requiring arbitrators to apply that law. There is one crucial caveat – the substantive law must be applied in a way that does not violate *Shari'ah* Law or the public policy of



**In a non-payment situation, a contractor can pursue relief under the 2006 Law by seeking redress or compensation from a Committee to be set up considering contractor grievances and claims.**



the Kingdom. It is worryingly difficult to predict with any certainty what actually constitutes a violation, which would ultimately be decided by a Saudi Court in the absence of any doctrine of judicial precedent. Similarly, the New Arbitration Law allows contractual parties to pick a seat for the arbitration outside of Saudi Arabia if the situation escalates into a legal dispute. It has however been

noted in some quarters that Saudi Courts have generally been suspicious of awards issued in non-Islamic jurisdictions. Their concerns relate to the fact that the awards may not be compliant with *Shari'ah* principles.

From a general international contracting perspective, traditional protections Contractors can rely on in for example the International Federation of Consulting Engineers (FIDIC) standard forms and also more generally in a number of Western jurisdictions are not present under Saudi Law. Inevitably therefore, contractors have substantially less protection against non-payment, deferral and termination of projects in a time of economic downturn. These risks should be taken seriously by contractors looking to bid for, or already involved in, projects in the Kingdom. 🏗️



Text by:  
**RIAZ HUSSAIN QC**, barrister, *Atkin Chambers*