

Coronavirus



FEBRUARY 8, 2021

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Judicial Guidance on the Impact of COVID-19 on KSA Construction Projects

INTRODUCTION

The COVID-19 pandemic has had, and continues to have, an obvious impact on construction and other projects throughout the Middle East. As far back as March 2020, those involved with managing construction projects would have been reviewing their various agreements and trying to predict, and prepare for, the inevitable time and cost impacts the pandemic might cause. Those entering into new contracts would likely have started negotiating clauses dealing expressly with COVID-19.

The focus of much of this attention was, rightly, on the available force majeure provisions which existed either in the relevant contract itself and/or as a matter of the applicable law.

In Saudi Arabia, the concept of force majeure or “emergencies” has generally been recognized by *Shariah* rules and a number of Saudi Arabian laws, such as the Labor Regulations and the Government Procurement Regulations. The Government Procurement Regulations, which apply to contracts between government agencies and contractors allow government agencies to terminate contracts on the occurrence of force majeure events. Contractors may request an extension of time or an exemption from the delay penalties in certain events, including emergencies. There is no clear definition of force majeure under these regulations. However, court decisions offer some guidance on applying such concepts to contractual arrangements.

SAUDI COURT'S APPROACH TO FORCE MAJEURE

The courts in Saudi Arabia have defined a force majeure/emergency event as an event that (i) is public and is not a result of the parties' actions, such as wars, floods or earthquakes and alike; (ii) it is beyond the control of the parties; and (iii) happens suddenly and is not foreseeable or avoidable.



In the context of growing difficulties in performing contracts due to the COVID-19 pandemic, a recent resolution from the General Commission of the Supreme Court of the Kingdom of Saudi Arabia (Decision Number (45/M) on 08/05/1442H (23 December 2020)) (“**Supreme Court Decision**”) set out guidance to courts with some judicial principles. It may also be that this guidance will be applied by arbitral tribunals applying Saudi law (whether seated in KSA or otherwise).

While this decision will provide welcome guidance to those working in or advising the construction sector in Saudi Arabia, there is also the possibility of some uncertainty. We look at some of the key takeaways below.

SUPREME COURT DECISION

General Principles

The starting point of the decision is that the COVID-19 pandemic might fall under two separate categories.

- **First**, the pandemic would be considered an ‘exceptional circumstance’ in the event that the performance of the contractual obligations would result in an ‘unusual loss’. Whether this is limited to financial losses or might include some other loss was not discussed in the judgment, but in our view some non-financial loss would likely be included within the scope of the guidance.
- **Second**, the pandemic may amount to an event of force majeure if the performance of a party’s contractual obligations became impossible.

In order to consider what category would apply, the Supreme Court set out the following conditions:

- **First**, the relevant contractual obligation must have (i) been entered into prior to onset of the COVID-19 pandemic, and (ii) continued after the imposition of various measures as a result of the pandemic;
- **Second**, the effects of the relevant COVID-19 measures were unavoidable;
- **Third**, the parties were not able to perform their respective duties solely because of the COVID-19 pandemic;
- **Fourth**, the relevant parties had not managed to resolve their subsequent dispute or waived their rights in this regard; and
- **Fifth**, the effects of the pandemic were not otherwise addressed in a specific law or decision of a relevant authority.

While the above guidance appears straightforward, there may still be instances which do not neatly fall within the above considerations. In our view, however, much will depend on the relevant facts on a case-by-case basis.

Saudi Government Procurement Regulations

In this regard, contracting parties with the Saudi Arabian government should also consider the specific rules under the Government Procurement Regulations on force majeure. These Regulations allow contractors to request an extension of time or an exemption from the delay penalties when the delay (i) is attributed to the government or to ‘emergencies’; and (ii) is caused by reasons which are beyond the contractor’s control. Further, the Implementing Rules of the Government Procurement Regulations refer to force majeure and allows government agencies to terminate a contract if the performance of the obligations became impossible due to force majeure.

These Regulations do not define force majeure or ‘emergencies.’ However, the Saudi Ministry of Finance, which is responsible for government contracts, confirmed in a circular dated 20/08/1441H, that the delay in executing works due to COVID-19 related measures, then Article 74 of the Saudi Government Procurement Regulations can apply, allowing government agencies to extend the term of a contract and grants exemptions from delay penalties. It further allows them to suspend all or part of the work, as necessary.



Amending contractual obligations

The Supreme Court also confirmed that the relevant court had certain powers to amend the parties' contractual obligations to achieve an equitable resolution based on fairness after considering all the relevant facts and circumstances of the dispute. This includes those clauses that deal with termination and any limitations on liability.

For construction and supply chain contracts, the Supreme Court provided the following guidance:

- **Increased Costs:** In the event the pandemic resulted in material, labour or operational costs increases, the court was entitled to increase the contract price. This was, however, subject to: (i) the contractor/supplier bearing the proportion of the rises that are caused by normal market increases, but (ii) the owner/customer bearing the risk for anything in excess of the usual market conditions. However, the Supreme Court considered that the owner/customer could request that the relevant contract be terminated in the event of a substantial increase.

We do see this guidance having the potential to result in various disputes, particularly as to (i) whether an increase in price is the result of the usual market increases or as the result of the pandemic, (ii) whether this guidance displaces the relevant terms of the contract in the event that it already assigned to one party or another the risk of such price increases, (iii) in the event alternate suppliers/materials might be utilized for a reduced rate (for example, outside a preferred vendors list) and (iv) what constitutes a “*substantial increase*” which would justify termination of the contract?

- **Shortages of goods:** In circumstances where the COVID-19 pandemic resulted in a shortage of goods or materials on the market, the court could decrease the quantity under the contract to the extent required.

Similarly, we see this guidance creating potential for disputes where a party argues, for example, that the counterparty could (and should) be obtaining the goods from an alternative supplier, or if a specific quantity of goods are required for the performance of the relevant obligations.

- **Unavailability of materials:** If COVID-19 resulted in a temporary unavailability of materials, the court could suspend the relevant contractual obligations that were dependent on those materials for a temporary period if the suspension would not harm the non-defaulting party. However, in the event the suspension did substantially harm the non-defaulting party, then it could request the court to terminate the contract.

Alternatively, if the unavailability of materials resulted in the impossibility of performance of a party's obligations, then the court could revoke or remove from the contractual scope those obligations that are impossible to perform.

This guidance is particularly relevant to construction contracts, and will be welcome news for (sub-)contractors in particular (or employers/owners with a free issue materials obligation). However, we do see that there may be practical difficulties in implementing this guidance, particularly where the temporary unavailability of materials will have a flow-on effect to other aspects of a project or trades. Parties will have to work together to seek to avoid any unintended and flow-on consequences.

- **Delays:** Finally, the Supreme Court held that, in the event the pandemic resulted in delays to the performance of a party's obligation, the court could temporarily suspend the relevant obligation. However, if such a suspension would cause the non-defaulting party harm, that party could request the court to terminate the contract.

Essentially, in our view the Supreme Court was, in effect, giving a party a right to seek an extension of time in the event that it was delayed by the impact of the pandemic. While that will be welcome relief to (sub-)contractors, the Supreme Court's guidance does not go into circumstances where, for example, the contractor was already in delay



before the effects of the pandemic were felt. Disputes might arise as to whether the contractor will be entitled to an extension of time in such circumstances, where this would have the effect of excusing the contractor's own delays.

- **Expert:** Finally, the Supreme Court directed that the time and extent of the relief will only be available for the period where the relevant obligations are impacted by the pandemic. Further, that an expert would be used to determine these impacts.

Liability

Importantly, the Supreme Court also confirmed that:

- **First**, the courts should not apply liquidated damages or penalty clauses if the pandemic was the cause of the relevant defaults. This has the potential to create further uncertainty, however, insofar as the guidance is in conflict with the provisions of the relevant contract (which the parties may have already been operating).
- **Second**, those clauses that release a party from liability upon the occurrence of an exceptional circumstance or a force majeure event, then the provision will be set aside. We take this to mean that the Supreme Court's guidance above will override any contractual provisions, to the extent that they impose a different outcome. In addition, by liability we understand the Supreme Court's guidance to mean any liability that might arise from the failure to perform a party's obligations as a result of the force majeure event.
- **Third**, the burden of proving the default or impossibility of performance arose as a result of the pandemic rests with the defaulting party. It will be interesting to see how the courts or tribunals approach a situation such as the example above where the contractor is already in delay at the time the impacts of the pandemic were first felt. It may be that the court or tribunal will relieve the contractor for any time and/or cost impact greater than those for which it was already responsible, but not the whole amount or period (although quantification difficulties might arise where the pandemic has exacerbated the existing delays or cost overruns).

COMMENT

It is anticipated that the Saudi Arabian courts will be required to determine a myriad of issues arising out of the COVID-19 pandemic. While the practical implications of the Supreme Court Decision are yet to be seen, the guidance that the court has provided is a welcome development for those in the construction industry with contracts governed by Saudi Arabian laws.

The impact of the guidance will of course need to be assessed on a case-by-case basis, taking into consideration the relevant factual circumstances and any contractual provisions that might apply. Further, it is important to note that the pandemic itself may not necessarily be a force majeure event; instead, the relevant event will be the particular disruption that has arisen as a result of the pandemic, such as travel restrictions, regulatory controls or other government measures. Therefore, the question of what actually caused a delay or an impossibility to perform contractual obligations should be carefully examined. In this regard, parties are required to demonstrate a causal link between a particular event and the impact this event has on the performance of the contractual obligations. This is consistent with the Supreme Court Decision.

The extent to which the Saudi Arabian courts (or a tribunal applying Saudi Arabian laws) will interpret the various measures taken to curb the spread of COVID-19 as being caused by the pandemic and, therefore, fall within the guidance of the Supreme Court Decision is likely to be tested over the coming months and years



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