

Kluwer Arbitration Blog

Building Bridges, Resolving Conflicts: Government Construction Contracts and Arbitration in the UAE

Mahiya Shah · Tuesday, December 26th, 2023

In a region characterized by infrastructure projects and ambitious architectural feats that shape the nation's skyline, arbitration has emerged as a common choice in the industry for settling construction disputes. This preference arises as foreign parties can sidestep entwining with local courts, enjoy privacy, and present their matters to arbitrators who are well-versed with the technical intricacies in construction disputes. Given the region's booming construction industry, governments (or government-owned entities) are often the primary stakeholders in large-scale construction projects. A corollary of that involvement is that governments tend to play an active role in overseeing and regulating construction contracts. Therefore, it becomes vital for contractors, developers, and industry professionals operating in the Middle East not only to understand the dynamics of government involvement in construction but also dispute resolution processes under those contracts.

Construction Contracts and Arbitration

The FIDIC suite of contracts is widely used as the standard form of construction contracts in the UAE. In Abu Dhabi, specific contract templates have been developed for projects within the Emirate, which includes a construction works contract based on the FIDIC 1999 Red Book and a design-and-build contract based on the FIDIC Yellow Book and these contracts are mandatory for agreements between the private sector and the government.

FIDIC contracts follow a multi-tiered dispute resolution process, with an emphasis on the amicable settlement of disputes. The process typically first involves submitting disputes for adjudication by an Engineer or a Dispute Board. If either party is dissatisfied, they are given time to reach an amicable settlement. If the dispute remains unresolved during this period, the final stage is arbitration. Failing to follow this procedure can impede the formation of a valid tribunal. For instance, in Dubai Cassation Case No. 167/1998 it was held that the requirement to refer a dispute to the engineer under the FIDIC Conditions 4th Edition is binding, before referring the dispute to arbitration.

Any waiver or right to recourse to the courts in the UAE is required to be established with a higher degree of certainty than other "less fundamental rights." However, with regards to construction disputes, the Dubai Court of Cassation (*see* Appeal No. 581/2003) ruled that incorporation of

FIDIC Conditions by reference is sufficient to create a binding agreement to arbitrate. Hence, a right to arbitrate arises by default. The primary legislation of significance concerning construction and engineering undertakings is the [Civil Transactions Law \(Civil Code\)](#), which outlines available remedies should a contractual breach occur. A widely referenced provision in construction contracts is Article 246, which mandates that contractual parties fulfill their obligations with integrity and in alignment with both the contract's stipulations and the precepts of good faith. This blog post further provides that the parties' responsibilities extend beyond explicit contractual provisions, encompassing essential requisites mandated by law, custom, and the essence of the transaction.

Contracting with the Government

Challenges and complexities can arise when contracting with the government in the UAE in the form of strict formalities and regulations, lengthy approval processes, and potential limitations on legal actions. Depending on the Emirate in which the entity is incorporated, obtaining specific authorization may be necessary for arbitration, including choosing an arbitration seat outside of that Emirate.

At the federal level, it is mandated that the UAE government seek approval from the Ministry of Justice before entering into any arbitration agreement, as specified by the Council of Ministers Decision No. 406/2 of 2003. This requirement underscores the significance of compliance and due diligence when entering into contracts within the UAE. Parties should therefore ensure that such approval has been obtained before entering into any arbitration arrangement.

In Dubai, it is important to note that if one wishes to take action against a Dubai government entity, the complainant is obligated to submit a statement of case to the Dubai Legal Affairs Department. Furthermore, contracts cannot stipulate all conditions from FIDIC international contracts without the [approval of the Ruler of Dubai](#). This is particularly significant for parties in the construction sector as compliance with FIDIC contracting standards, such as dispute resolution, is not guaranteed. Moreover, [Law No. \(6\) of 1997 Concerning Contracts of Government Departments in the Emirate of Dubai](#) provides that dispute resolution clauses must opt Dubai as the seat of arbitration. It is to be noted that [Dubai Decree No. 34 of 2021](#) abolished the LCIA-DIFC arbitration centre, and clarified that if the arbitration seat is located in 'onshore' Dubai, as opposed to the DIFC, the award's enforcement would be under the jurisdiction of the Dubai courts. Parties should thus make sure accurately to state their seat of choice when formulating their arbitration agreements.

According to [Article 257 of the UAE Civil Code](#), the general principle in the UAE legal system is that parties to a contract have the freedom to determine its terms, including the choice of governing law. However, [Article 19\(1\) of the UAE Civil Code](#) outlines specific instances where the governing law in a dispute must be that of the UAE. This requirement applies when the property or project is located within the UAE and when the construction contract involves a government or quasi-governmental body of the UAE. In such cases, the parties do not have the freedom to select a foreign governing law. To solidify this position, Cabinet Resolution No. 32 of 2014 sets out that parties are allowed to agree to arbitration outside of the UAE; however, the substantive law of the contract must be UAE law, and any provision stating otherwise will be considered invalid.

As for enforcement, [Article 41 of the UAE Constitution](#) provides that every person has the right to submit complaints to the competent authorities, meaning Emirati State parties are not immune from suit however, they do enjoy immunity from execution. This immunity arises from [Article 106 of the Cabinet Resolution No. 57 of 2018](#) which stipulates that both public and private properties owned by the UAE or any specific Emirate are protected from seizure. Any debts owed by the UAE governments, their entities, or corporations cannot be recovered through legal proceedings, even if the judgment debtor has signed a waiver of sovereign immunity. Courts are likely to refrain from enforcing such waivers on the grounds of public policy as per Article 53 of the [UAE Arbitration Law](#). Hence practically, the procedure of initiating legal proceedings against a government entity can be demanding and relatively time-consuming.

Exploring the Scope of State Immunity in DIFC Law

According to the [International Chamber of Commerce dispute resolution statistics](#), there has been an increase in the cases of state entities and state-owned parties being involved in arbitration proceedings. The ICC reports a 67% increase over the past five years, with 20% of cases involving such entities in 2019. The trend towards state-owned entities' involvement in arbitration is anticipated to narrow state immunity assertion, excluding enforcement immunity for specific assets.

However, neither the UAE nor the DIFC has specific laws addressing sovereign immunity to foreign states. Through [Arbitration Law No. 1 of 2008](#), which is based on and recognized by the UNCITRAL Model Law, the DIFC exercises its jurisdiction mainly when it is the seat of arbitration or when the arbitration is seated elsewhere but recognition or enforcement of an award is sought in the DIFC. The DIFC Court thus has the authority to address matters concerning immunity, including its existence, extent, and waiver. This was discussed in the 2018 case of [Pearl Petroleum Company Limited & Others v. Kurdistan Region of Iraq](#), where Justice Sir Jeremy Cooke ruled against the Kurdistan Regional Government of Iraq (KRG), rejecting their claim of state immunity.

The Court ruled that the KRG had explicitly waived immunity for both itself and its assets, highlighting the significance of comprehensive immunity waivers in contracts. It debunked the argument that sovereign immunity couldn't be waived through prior written agreements, aligning with international standards and promoting a pro-arbitration stance.

Further, in another significant case of [Fal Oil Company v SEWA](#), the DIFC CFI provided insights into the application of state immunity within the DIFC and the UAE. The Court ruled that the doctrine of state immunity did not apply inter-emirate per the UAE Constitution. While state immunity was rejected in this instance, the Court seemingly acknowledged that the doctrine is part of the common law as applied in the DIFC, an aspect left open in *Pearl Petroleum*.

The Court agreed with the argument that state immunity could not be invoked by SEWA because the dispute arose from a commercial transaction rather than a public one. The Court did not differentiate between commercial claims and actions to enforce commercial judgments and applied an international understanding of "commerciality." In this regard, a narrow and commercial interpretation of state immunity was embraced, emphasizing the nature of the transaction rather than the identity of the publicly owned party or their perceived purpose of the transaction.

While there has been some discussion on the matter, the issue is far from resolved. Unfortunately, Justice Cooke's decisions (which excluded the principle of state immunity from DIFC law) and the subsequent CFI decision (which included it) are obiter dicta and therefore not legally binding. There remains significant uncertainty regarding the existence of a consistent body of principles as a result of which, we can expect future cases to arise and address the nature and extent of this doctrine as it applies to the procedural law of the DIFC.

An arbitration clause within a contract typically serves as a foundational element for waiving state immunity from suit, often granting a tribunal jurisdiction to adjudicate disputes. However, an explicit waiver of state immunity offers enhanced protection and clarity beyond implicit clauses. With so many construction projects being implemented by the government, the existence of an explicit waiver is favourable to a party contracting with the government as for commercial parties, construction projects often involve significant investments, and disputes can have substantial financial implications. It assures commercial parties that the state entity will engage in fair and efficient dispute resolution. Given the international nature of many construction contracts, including a state immunity waiver can make choosing arbitration in favourable jurisdictions more appealing to commercial parties with significant investments at stake.

Conclusion

Navigating construction disputes that involve state entities can be a complex endeavour, particularly due to the intricacies of inter-jurisdictional proceedings and the necessity to adhere to specific legal mandates. Given the multifaceted nature of contracting with state entities, the prevalence of government involvement in numerous construction projects accentuates this challenge.

From the Civil Transactions Law that underpins contractual obligations to the nuances of state immunity waivers within arbitration agreements, each facet shapes the dispute resolution landscape. Although lacking specific legislation, cases in the DIFC underscore the value of well-drafted waivers and alignment with international arbitration norms. This evolving perspective strengthens the enforceability of arbitration agreements involving states within the UAE jurisdiction. However, the issue of state immunity remains pertinent in such proceedings, necessitating carefully structured arbitration clauses covering both immunity from suit and execution.

There has been a rise in arbitration cases involving state entities and this trend is expected to limit state immunity claims, particularly regarding the enforcement immunity of certain assets. In this evolving landscape, commercial parties engaging with government entities must acquaint themselves with jurisdiction-specific rules and adopt effective dispute resolution strategies to navigate disputes while optimizing protection opportunities.

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