



## Article

# Procurement of public infrastructure in the Kingdom of Saudi Arabia – The Public Works Contract

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### Background

Over the coming decades, the Kingdom of Saudi Arabia proposes to implement an infrastructure program of unprecedented scale. The commercial opportunities for the international construction industry have been well-publicised, however there has been less discussion of the legal regime that would govern such arrangements.

The first in a two-part series focusing on public infrastructure procurement in the Kingdom, this paper focuses on the "Public Works Contract", which all government entities are required to use on construction projects, and discusses notable aspects of the risk allocation and contractual mechanisms. The focus of the next paper will be the draft "Public Construction Contract", which the Ministry of Finance intends will replace the "Public Works Contract" as the mandated standard form contract sometime in the future.

First, it is necessary to put the "Public Works Contract" in context. The "Government Tenders and Procurement Law" (2006) ("**GTL**") governs all public construction works in the Kingdom. That law – which is aimed at promoting honesty, transparency, economic efficiency and competition – is stated to apply to all government authorities, ministries, departments, public institutions and public bodies with independent corporate personality.

The GTL requires that government entities use approved contract forms to engage third parties to perform public works. Furthermore, the GTL requires that government entities submit all draft contracts to the Ministry of Finance for approval prior to them being signed (unless the contract duration is less than one year and the contract value is less than SAR 50 million). The currently approved contract form under the GTL is the "Public Works Contract".

Notwithstanding that its use is mandated by law, the "Public Works Contract" is an old document. It was drafted on the basis of the 1977 FIDIC construction contract and has been the compulsory standard form contract in the Kingdom since 1988. Some amendments were made in 2007, however aspects of the risk allocation and contractual mechanisms remain somewhat at odds with what the international construction industry may be used to. The purpose of this paper is to explore those aspects and in particular, the following:

- Site risks
- Subcontracting
- Security
- Time and penalties
- Variations
- Payment
- Defects liability
- Claims
- Suspension
- Termination
- Disputes

### Site risks

Under the "Public Works Contract", the Contractor is obliged to inspect the site and notify the Employer of any latent adverse physical conditions within 10 days after they are discovered. A failure to do so waives any right to compensation that would otherwise arise. The Contractor is also obliged to review the architectural and technical designs and details, along with the soil tests, and immediately notify the Employer of technical errors affecting safety or errors in the specifications or plans.

## Subcontracting

As is usually the case, the Contractor is responsible for the performance of all of his Subcontractors. However, a foreign Contractor is also required to employ Saudi contractors for not less than 30% of the works (unless a specific exemption is obtained from the Ministry of Finance). A foreign Contractor is also obliged to purchase particular services (i.e. transportation, insurance, airlines etc.) from local Saudi establishments and also to give preference to national products and services generally.

## Security

The standard form provides that the Employer may make an advance payment to the Contractor for up to 5% of the contract value, provided that it does not exceed SAR 50 million. The advance payment is made against an advance payment guarantee of the same value and is recovered by deductions from certified payments at the same rate.

Within 10 days of his bid being accepted, the Contractor is obliged to provide an irrevocable bank guarantee of 5% of the contract value, which guarantee must remain in place until final acceptance of the project. The guarantee must comply with a particular form issued by Ministry of Finance and the Saudi Monetary Agency. The standard form does not say anything about the circumstances in which the guarantee can be called by the Employer or specify any pre-requisites to such a call being made.

## Time and penalties

Not surprisingly, the Contractor must submit a work programme and work method statements to the Employer and must commit to a set contract duration after the Employer gives him access to the site. However, a failure by the Contractor to complete the works on time gives rise to liability for both delay penalties and supervisor's costs and fees.

The Contractor is entitled to claim an extension of time on the basis of unforeseen circumstances or reasons beyond the Contractor's control, however the Contractor may only assert such a claim after preliminary handover of the works. In addition, the Engineer has no role in relation to extensions of time, as these are to be determined and granted by the Employer directly.

Separate to the Contractor's entitlement to an extension of time, the Employer has a discretion to extend the term of the contract when:

- the Contractor has been instructed to perform additional works;
- the works are suspended for reasons not attributable to the Contractor; or
- the funds allocated to the project are not sufficient to complete the work within the specified time.

In the event of culpable delay by the Contractor, delay penalties are levied for each day of delay, calculated by reference to the average daily cost of the project (i.e. the contract value divided by the contract duration). More particularly, delay penalties ratchet up as follows:

- Up to the 15<sup>th</sup> day of delay or 10% of the contract term (whichever is the longer), delay penalties are levied at a rate of one quarter of the average daily cost.
- Up to the 30<sup>th</sup> day of delay or 15% of the contract term (whichever is the longer), delay penalties are levied at a rate of one half of the average daily cost.
- After the 30<sup>th</sup> day of delay or 15% of the contract term (whichever is the longer), delay penalties are levied at a rate of the full average daily cost.

In all cases, the maximum amount of delay penalties that the Employer may levy is 10% of the contract value.

In addition, the Contractor is liable to reimburse the Employer for the costs of supervision during any period of culpable delay. This includes supervision by the Employer itself (i.e. no consultant appointed) and the contract provides a formula for such costs to be calculated.

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## Variations

Variations may be instructed by the Engineer. However, the Engineer is obliged to obtain the prior agreement of the Employer before instructing any change. There is no statement in the contract that the Contractor may assume that all instructions by the Engineer are authorised by the Employer. Accordingly, the Contractor bears the risk of the Engineer acting beyond his authority.

All variation instructions must be in writing but must not either change the object of the contract or overstep set limits. These limits are that the contract value may not be increased by more than 10% or decreased by more than 20%.

The Engineer is to value variations to the works by reference to any applicable rates in contract. If no rates are applicable and a fair price cannot be agreed, the valuation is to be made by the original bid examination committee.

It is a prerequisite to the Contractor being entitled to payment for variations that he include details of his variation claim in the monthly report to the Employer. Failing to do so means that the Contractor loses the right to payment for those works.

## Payment

The standard form contract is based on estimated quantities that are subject to remeasurement by the Engineer. Payment applications and certifications are to be issued monthly, with payment to follow no more than 30 days later.

The Contractor's final payment application is to be not less than 10% of the contract value and payment of that amount is deferred until provisional acceptance of project is completed and the submission of certificate from Zakat & Income Tax Department. The final account is to be settled and the performance bond returned upon completion of the project.

## Defects liability

The "maintenance period" – which runs from provisional acceptance to final acceptance – is a defects notification period by another name. The standard form does not stipulate a standard duration for the maintenance period.

During the maintenance period, the Contractor is bound to execute rectification works according to written demands from the Engineer or the Employer. The Engineer may also instruct the Contractor to search for defects at its own cost. Failure to do so gives the Employer the right to engage third party contractors and to claim / set off the costs of rectification works from the Contractor.

The Contractor also provides a guarantee of the works against partial or total destruction for 10 years resulting from a defect, unless the parties agree a shorter period. This is consistent with decennial liability obligations commonly imposed on contractors in the Middle East in other jurisdictions (albeit that the obligation set out in the GTL relates to public works only).

## Claims

The Employer is obliged to perform the contract in good faith and the Contractor has the right to claim damages for any breach of the contract by the Employer. That said, the Contractor must make its claim for damages within 30 days of the claim having arisen, otherwise the contract stipulates that he has waived his right to compensation.

## Suspension

The Employer has a right to suspend the works indefinitely but must pay the cost of suspension, unless it:

- was provided for in the contract, or
- was necessary for the proper execution of the works, by reason of climatic conditions, by reason of default on the part of the Contractor or for the safety of the works.

The Contractor has no express contractual right to suspend. In addition, as there is no civil code in the Kingdom, no right to suspend would appear to arise at general law in the event that the Employer fails to perform his obligations (unlike the UAE for example).

## Termination

The Employer may withdraw the works from the Contractor, and engage an alternative contractor to complete the works at the Contractor's cost, in the following circumstances:

- the Contractor bribes or attempts to bribe an employee of the Employer;
- the Contractor delays commencement or progress or otherwise breaches the contract and does not remedy this upon 15 days' notice;
- the Contractor assigns the contract or improperly subcontracts its execution;
- the Contractor is subject to an insolvency event; or
- the Contractor dies (or ceases to exist).

The Contractor has no express right to terminate the contract. Again, this is an area in which the absence of a civil code in the Kingdom bites. In other Middle East jurisdictions (such as the UAE), the general law supplements the contract by specifying certain termination rights.

## Disputes

The standard form provides that all disputes are to be resolved by the Board of Grievances, which is part of the local court system in the Kingdom. There is no provision for a multi-tiered dispute resolution process (i.e. Engineer's decision, followed by amicable settlement etc.) and there is no reference to arbitration.

## Concluding remarks

The "Public Works Contract" is the starting point for new entrants to the construction industry in the Kingdom understanding what sort of contractual arrangement government entities are likely to expect them to sign up to. No doubt there will be subtle amendments made to the standard form to tailor it to specific projects, either by amendments to the contract itself or through special conditions. However, on any public infrastructure project in the Kingdom, contractors should look out for the specific matters listed above, which have the potential to be different to what they are used to seeing in other jurisdictions.

As noted above, the second paper in this series will focus on the draft "Public Construction Contract", which the Ministry of Finance has released in contemplation of it replacing the "Public Works Contract" as the standard form mandated by the GTL sometime in the future.

## Further information

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