

COVID-19: enhanced powers granted to courts determining Saudi-law breach of contract claims

In late December 2020, the General Panel of the Saudi Supreme Court, the highest judiciary authority in the Kingdom of Saudi Arabia, issued a ruling addressing the impact of the coronavirus pandemic on contractual obligations (the “ruling”). In this memorandum we identify the key aspects of the ruling, and its impact on construction contracts governed by Saudi law.

This memorandum has been co-authored with Jade Laktineh, Founding Partner and Chairman of Laktineh & Co. Ltd.

I. Background

The ruling, which is issued pursuant to the general powers of the General Panel of the Supreme Court with a view to unifying the jurisprudence of the lower courts, applies not only to leases and property transactions, but also to commercial contracts (i.e. supply agreements and construction contracts) and other related commercial obligations. The ruling provides a general set of exceptions to the Saudi law principle that contracts are generally enforceable, to the extent the agreement complies with Sharia principles. The effects of the ruling are potentially far reaching, as it is arguable the ruling will apply to arbitrations as well as Saudi court proceedings - whether seated in the Kingdom of Saudi Arabia or elsewhere. In addition, it is potentially arguable that the ruling is applicable, even where the relevant contract is governed by foreign law.

II. Opinion

First, the Supreme Court has recognised the coronavirus pandemic as a force majeure event, where performance of contractual obligations have become impossible, and where:

1. The contract was entered into in advance of any restrictions being imposed in response to COVID-19 and its performance continued thereafter;
2. The pandemic has directly impacted performance of the contract – and this could not be avoided;
3. The impact on performance is solely attributable to the pandemic;
4. The counterparty has not waived, or otherwise settled, its rights in this regard; and
5. The impact of the pandemic has not otherwise been addressed pursuant to the decision of a competent authority, or a special law.

Secondly, and more radically, the ruling empowers courts to rewrite the parties’ contracts, including in relation to termination, even where these matters are expressly dealt with in the parties’ written agreements. By way of example, the ruling provides that during the force majeure event exclusion of liability clauses shall be without effect.

Specifically with respect to construction and supply contracts (and ‘similar contracts’, the scope of which presently remains unspecified), courts are now to issue the following orders.

1. Where the effect of the pandemic has increased the cost of performance (including the cost of materials, labour and operations), courts shall increase the contract sum – to the extent

that the increase in cost is considered to be beyond a customary increase. Where such an increase is ordered, however, the project owner is now entitled to request from the court the termination of the contract. In addition, however, if the period during which costs are increased is only temporary, the courts will instead order a temporary suspension of contract performance.

2. To the extent that the coronavirus pandemic has resulted in a decreased availability of goods required for performance of a construction or supply contract, courts are required to amend the contract – so as to reduce the supply obligation by an amount deemed sufficient to cure the prejudice otherwise so be suffered by the performing party.
3. To the extent that the coronavirus pandemic has resulted in a temporary lack of goods required for performance of a construction or supply contract, the remedy to be ordered is suspension of the contract. Where suspension would result in ‘gross and abnormal’ damage to the buyer/project owner, however, then termination of the contract can be sought. Moreover, to the extent that the lack of materials has made performance impossible, then on the application of either party to the contract, a court is required to terminate those obligations now determined to be impossible.
4. In respect of project delays caused by the coronavirus pandemic, courts are required to temporarily suspend performance or, where this would again give rise to ‘gross and abnormal’ damage to the buyer/project owner, termination of the contract may be sought.

With respect to pandemic-caused delays more generally, under the ruling, penalty provisions (likely including liquidated damages clauses) cease to have effect (in whole or in part). In addition, a project can not be withdrawn from a contractor, and a contractor can not be required to perform at its own cost, where performance has been pandemic-constrained.

Specifically with respect to leases (concerning both movable and immovable goods), the ruling provides that lease agreements impacted by the coronavirus pandemic can be amended, with rent payments to be reduced in correlation with any limitation on the use of the property (in whole or in part) flowing from the pandemic. In addition, a lease agreement cannot be terminated for non-payment, if the failure to pay corresponds to the period where use has been impaired by the pandemic – and again in whole or in part.

In terms of the general principles to be applied by courts in considering pandemic-related claims and defences, the ruling confirms that the party whose performance has been impacted bears the burden of establishing that the failure to perform flows from the effects of the pandemic.

III. Significance

Taken together, the Saudi Supreme Court’s ruling represents a comprehensive package of contract law reforms, designed to address the uncertainty and challenges faced by parties who have found that their original contractual bargain has been skewed beyond recognition in the current era. As stated in the ruling recitals, the purpose of these amendments is to achieve stability, avoid harm, and - perhaps most importantly – to permit contractual continuity by seeking to balance the interests of both contractual counterparties.

If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned in it, please do not hesitate to reach out to:

James Bremen

Email: jamesbremen@quinnemanuel.com

Phone: +44 20 7653 2270

Jade Laktineh

Email: jade.laktineh@laktineh.com

Website: www.laktineh.com

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