

# The Availability in the UAE of Liens to Secure Payment under Construction Contracts

Neal R. Brendel\*, Amy L. Barrette\*\* and Wadih El-Riachi\*\*\*

*K&L Gates LLP, The Gate Building, Level 12, Dubai International Financial Centre  
P.O. Box 506826, Dubai, UAE*

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## Abstract

While much attention has been devoted to curbing the rise of lawsuits surrounding Dubai's struggling construction industry, surprisingly little attention has been focused on another option available to contractors who seek payment for failed or troubled projects. Contractors, architects, and engineers may find relief under a seldom-reported UAE federal law that establishes qualified rights for contractors to secure payment for work under non-governmental contracts by filing a priority lien against the project itself. This article discusses the remedy, known in many common-law jurisdictions as 'mechanic's liens' or 'builders' liens', and why it is important for contractors to be familiar with the applicable Civil Code and Civil Procedure Code provisions. Those who first exercise their lien rights and seek to register liens with the Land Department will be treading new ground and will want to be well-prepared and educated on their rights provided under existing law.

## Keywords

construction disputes; liens; project; contractors; contracts

## 1. Introduction

The popular and trade press have recently detailed how Dubai's construction industry has been severely impacted by the global economic downturn and liquidity crisis with reports of many project delays as well as outright project cancellations. It has been reported that Dubai is struggling under a £3 billion mountain of construction claims with a trebling of claim filings at the Dubai International Arbitration Centre (DIAC),

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\* Partner, e-mail: [neal.brendel@klgates.com](mailto:neal.brendel@klgates.com).

\*\* Associate, e-mail: [amy.barrette@klgates.com](mailto:amy.barrette@klgates.com)

\*\*\* Associate, e-mail: [wadih.elriachi@klgates.com](mailto:wadih.elriachi@klgates.com)

the leading arbitration centre in claim volume in the UAE. The Association of Consulting Engineers reports that its members alone are owed in excess of £400 million.<sup>1</sup> According to a report published in *The National*, Japanese builders are “owed billions of dollars” on such prestige projects as the Dubai Metro and the Palm Island.<sup>2</sup> As the Emirate is flooded by disputes lawyers hoping to surf the expected wave of litigation and arbitration, Dubai’s ruler, Sheikh Mohammed bin Rashid Al-Maktoum, has announced a new law that is expected to establish a new alternative dispute resolution centre in a bid to stem the increase in litigation.<sup>3</sup>

Although substantial attention has been given to the rise in the number of contentious construction and real estate disputes, and the various proposals to stem that rise, surprisingly little attention has been focused on the unglamorous but often effective remedy of priority liens against the project work to secure payment in favor of architects and contractors. In many common law jurisdictions, there is a well-developed body of law surrounding the creation and enforcement of so-called ‘mechanic’s liens’ or ‘builders’ liens’ as an effective means for contractors and architects to secure payment against the project itself. As discussed in more detail herein, although the authority is sparse and the reported exercise of such rights is virtually non-existent, UAE federal law creates qualified rights for contractors and architects to secure payment for improvements and work through the filing of a priority lien.

The UAE Federal Law No. 5 of 1985 Promulgating the Civil Transactions Code of the UAE, as amended (the ‘Civil Code’) provides for the physical attachment of property to enforce payment for a contractor’s work, the filing of priority rights (liens) as a means to secure payment for improvements and work of contractors and architects, and the right to enforce such interests through a forced sale of the property. These provisions apply to contracts with non-governmental bodies only, as the Civil Code precludes any such attachments or lien filings against government property.

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<sup>1</sup> Joey Gardiner and Roxane McMeeken, “Dubai legal body ‘swamped’ as dispute backlog hits £3bn”, *Building Magazine*, 14 August 2009, p. 13.

<sup>2</sup> Tom Arnold, “Japanese builders owed billions”, *The National*, 8 November 2009, p. 1.

<sup>3</sup> Sofia Lind, “Dubai launches new ADR centre in effort to cut back on court litigation”, *legalweek.com*, 8 October 2009; <<http://www.legalweek.com/legal-week/news/1557684/dubai-launches-adr-centre-effort-cut-court-litigation>>

## 2. Relevant Background Law

The UAE is a Civil Law country. As a result, the primary source of law is a statutory code.<sup>4</sup> The local and federal courts of the UAE apply UAE federal laws. The base law of the UAE is the Civil Code. The Civil Code provisions apply where there is no specific legislation to the contrary and where specific legislation is silent on a point in issue. The Civil Code must be reviewed in connection with the UAE Federal Law No. 18 of 1993, issuing the Commercial Transactions Code of the UAE, as amended (the 'Commercial Code'), which applies to certain contracts that meet the requirements of a 'commercial contract'. With respect to procedure, the UAE courts are governed by the UAE Federal Law No. 11 of 1992, issuing the Code of Civil Procedure of the UAE, as amended (the 'Civil Procedure Code').

When analyzing a potential dispute, it is important to consider the aforementioned legislation as well as any relevant local Emirate law, Ministerial Decrees, and Specialized Decrees. Such laws include Dubai Law No. 6 of 1997 Concerning Contracts with Government Departments in the Emirate of Dubai, as amended (the 'Dubai Law No. 6 of 1997'), which concerns the substantive and procedural legal framework for government contracts in Dubai.

### 2.1. Construction Contracts with Non-Governmental Bodies

Because the Courts recognize the parties' right to contract, the provisions of the contract will, for the most part, set forth the manner in which the parties are required to resolve disputes arising from the contract. Mandatory provisions of law, however, will take precedence over stipulations in a contract. (i.e., "Any agreement the purport of which is to exempt the contractor or architect from liability, or to limit such liability shall be void.")<sup>5</sup>

The rights and obligations of contractors, owners and engineers are governed by Articles 872 through 896 of the Civil Code, which pertain to *Muqāwala*, or contracts "to make a thing or to perform a task". Specifically, Article 872 defines *muqāwala* as a "contract whereby one of the

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<sup>4</sup> There is no system of case reporting in the UAE. When deciding cases, the judges are under no obligation to follow past precedents; although in practice the UAE courts, particularly the lower courts, often take previous decisions into consideration and show deference to previous judgments made by the courts of appeal and cassation.

<sup>5</sup> Civil Code, Article 882 (relating to the mandatory application of Article 880).

parties thereto undertakes to make a thing or to perform work in consideration which the other party undertakes to provide”.

The provisions concerning obligations and rights of engineers include liability for design defects<sup>6</sup> and the ability to recover damages under certain circumstances (i.e., an engineer “shall be entitled to fair remuneration for what he has done” if “any unforeseen event occurs which prevents the completion of the performance of the work in accordance with the plan prepared.”).<sup>7</sup>

## 2.2. Construction Contracts with Governmental Bodies

Article 2 of Dubai Law No. 6 of 1997 provides that the provisions of Dubai Law No. 6 of 1997 shall apply to, among other things, contracts entered into by any government department,<sup>8</sup> for the execution of works. Articles 60 through 72 of Dubai Law No. 6 of 1997 set forth applicable procedures regarding such contracts.

Pursuant to Dubai Law No. 6 of 1997, the terms of the contract govern the manner in which parties will be required to resolve any disputes.<sup>9</sup> The law requires that any contracts made by any government department shall include “all points of agreement”, including, but not limited to: (i) “[p]unitive procedures and penalties applied in the case of delay in execution, withdrawal or suspension of execution for any reason”; (ii) “[p]rovisions governing contract termination by revocation, withdrawal or cancellation”; and (iii) “[p]rovisions pertaining to resolution of disputes between the parties and courts of jurisdiction”.<sup>10</sup>

Thus, it is essential that the parties follow the specific requirements of the contract with respect to the preservation of claims and the method and manner of dispute resolution. As noted above, attachments are prohibited with respect to public property, i.e., all “real property or movables

<sup>6</sup> Civil Code, Articles 880-882.

<sup>7</sup> Civil Code, Article 889(2).

<sup>8</sup> According to Article 2 of Dubai Law No. 6 of 1997, the term “government department” includes: “the establishment, the body, or the authority which belongs to the government in the emirate of Dubai.”

<sup>9</sup> According to Dubai Law No. 3 of 1996 Concerning Government Claims, as amended by Dubai Law No. 4 of 1997 and Dubai Law No. 10 of 2005, a legal claim against the Government of Dubai or any of its departments including its establishments or institutions should be filed against the Public Prosecutor as a representative of the Government of Dubai in legal claims by following the procedures set out by this law.

<sup>10</sup> Dubai Law No. 6 of 1997, Article 35.

owned by the State<sup>11</sup> or public juridical persons,<sup>12</sup> allocated in fact or in law for the public benefit”.<sup>13</sup> Article 3 of Dubai Law No. 3 of 1996 Concerning Government Claims, as amended by Dubai Law No. 4 of 1997 and Dubai Law No. 10 of 2005 (‘Dubai Law No. 3 of 1996’) provides that “[i]t is not permitted to recover a debt or a payment obligation from the Ruler<sup>14</sup> or the Government<sup>15</sup> through: seizure or attachment of the Ruler or the Government’s properties and possessions; selling such properties and possessions through auction; or obtaining possession of such properties and possessions by any other legal process, whether or not a judgment in connection with such debt or payment obligation has been issued.” As a result, contractors may not attach property in connection with governmental contracts.

Contractors and other professionals may face additional hurdles in collecting payment following a judgment against a governmental body because property owned by the State,<sup>16</sup> or any Emirate,<sup>17</sup> is not subject to seizure under the provisions for execution of judgments.<sup>18</sup> Therefore, the discussion with respect to liens and the physical attachment of property hereinafter relates only to contracts with non-governmental bodies.

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<sup>11</sup> Although the term ‘State’ is not defined in the Civil Code, the term ‘State’ is customarily applied to mean the UAE.

<sup>12</sup> The term ‘public juridical persons’ is not defined in the Civil Code. However, the Civil Code provides a list of entities comprising ‘juridical persons’ which list includes the following: public departments, authorities and bodies, and public institutions and establishments upon which a judicial personality is conferred by law. One should logically assume that any interpretation of ‘public juridical persons’ should include such juridical persons in order for the Civil Code to be internally consistent.

<sup>13</sup> Civil Code, Article 103.

<sup>14</sup> According to Article 2 of Dubai Law No. 3 of 1996, the term ‘Ruler’ includes ‘the Ruler of Dubai, the Vice Ruler of Dubai and the Crown Prince of Dubai’.

<sup>15</sup> According to Article 2 of Dubai Law No. 3 of 1996, the term ‘Government’ means ‘the Government of Dubai or any of its departments including its establishments or institutions’.

<sup>16</sup> Although the term ‘State’ is not defined in the Civil Procedure Code, the term ‘State’ is customarily applied to mean the UAE.

<sup>17</sup> Although the term ‘Emirate’ is not defined in the Civil Procedure Code, the term ‘Emirate’ is customarily applied to mean any of the emirates making up the UAE.

<sup>18</sup> Civil Procedure Code, Article 247(1).

### 3. Statutory Authority for Liens in Connection with Non-Governmental Construction Projects

Under the Civil Code, “collateral real property rights” (liens) include “mortgages for security, possessory mortgages, and priority rights”.<sup>19</sup> A priority right is defined as “a collateral real property right [(lien)] conferring upon the creditor a priority in obtaining his right subject to a transaction and determined by law.”<sup>20</sup> The Civil Code further provides that “[a]ll of the property of the obligor stands as security for the performance of his obligation.”<sup>21</sup> Although the Civil Code clearly contemplates the use of liens, the lien provisions specifically relating to secure payment to contractors, engineers and architects are sparse. Indeed, there appear to be only two provisions potentially applicable: (i) Article 897 of the Civil Code, which addresses physical attachment of the property; and (ii) Article 1527 of the Civil Code, which specifically addresses the perfection of priority rights with respect to work performed.

#### 3.1. *Article 879 of the Civil Code*

Article 879, Section 1, of the Civil Code provides, in relevant part, that: If the work of a contractor produces (a beneficial) effect on the property in question, he may distrain it until the consideration due is paid, and if it is damaged in his hands prior to payment of the consideration, he shall not be liable for the damages, nor shall he be entitled to the consideration.

The physical attachment authorized by Article 879, Section 1, of the Civil Code is a form of ‘self-help’ that a contractor may exercise in an effort to secure payments owed. Physically attaching property pursuant to Article 879, Section 1, of the Civil Code may involve significant costs, such as additional labor, and impose additional risk that undermines the purpose of the lien. Indeed, invoking ‘self-help remedies’ may have serious unintended consequences as owners may take aggressive steps to eject the contractor from the property and potentially expose the contractor (and its officers and employees) to retaliatory civil and/or criminal actions. Thus physically attaching property is a high-risk endeavor and generally does not appear to be an effective way to secure payment. Article 879,

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<sup>19</sup> Civil Code, Article 110(2).

<sup>20</sup> Civil Code, Article 1504.

<sup>21</sup> Civil Code, Article 391(1).

Section 1, of the Civil Code may have some limited utility as an additional vehicle to protect the contractor's rights or to create leverage in exigent circumstances where immediate self-help action may be required in order to preserve any prospect of recovery.

### 3.2. *Article 1527 of the Civil Code*

In addition to the statute providing for the physical attachment of property, a contractor or an architect may protect its rights in a more conventional manner by registering a priority right over buildings or other works in order to secure payment for the improvements and work performed on such building or works.

Specifically, Article 1527, Section 1, of the Civil Code provides that:

Amounts due to contractors and architects who have undertaken to construct buildings or other installations, or to reconstruct, repair or maintain the same, shall have the status of a priority right over such structures, but to the extent to which it exceeds the value of the land at the time of sale, by reason of such works.

As is typical in other jurisdictions recognizing contractor liens, in the UAE: "Such priority right must be registered and it shall rank as from the time of registration."<sup>22</sup> Dubai Law No. 7 of 2006 Concerning Land Registration in the Emirate of Dubai (the 'Dubai Law No. 7 of 2006') appears to require the Land Department to register priority rights. Specifically, Article 9 of Dubai Law No. 7 of 2006 provides, in relevant part, that "[a]ll transactions that create, transfer, change or cancel rights over Land shall be recorded in the Land Register...". Additionally, Article 24(2) of Dubai Law No. 7 of 2006 provides that "[i]n the Land Unit record shall be set out any conditions, promises or restrictions concerning Rights over Land and other obligations".

### 3.3. *Enforcement of Priority Rights*

Once a priority right is duly registered, the Civil Code provisions relating to 'pledges for security' apply to such rights over real property to the extent that they do not conflict with the nature of such rights.<sup>23</sup> These provisions authorize a pledgee to "take steps to divest the ownership of

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<sup>22</sup> Civil Code, Article 1527(2).

<sup>23</sup> Civil Code, Article 1508(1).

the property pledged and to sell the same if the debt has not been paid at the due time, after giving notice to the debtor and the person in possession of the land in accordance with the procedures laid down in the law of procedures before the civil courts, and special laws".<sup>24</sup>

The mechanics for the enforcement of a priority right should be implemented according to the Civil Procedure Code which prescribes detailed procedures for enforcing rights and duties.<sup>25</sup> Accordingly, the enforcement of a priority right on real property should be effected through the sale of the real property through auction<sup>26</sup> under the supervision of an execution judge assigned at the venue of each court of first instance. Although the perfection of a priority right on real property does not relieve an architect or contractor from the necessity of commencing a civil suit to reduce the claim to final judgment in order to avail itself of the execution provisions of the Civil Procedure Code, it will provide the architect or contractor with a priority position in any proceeds resulting from a forced sale by the architect or contractor itself or by a third party creditor as a result of a separate proceeding.

#### **4. Conclusion**

In summary, although the authority is sparse, UAE law provides an architect or contractor with the qualified right to perfect a lien against buildings or other works in order to secure payment for improvements and work performed. If payment is not forthcoming, procedures exist to compel a court supervised auction sale in order to liquidate the claim once the claim is reduced to judgment. These remedies are not available in contracts with governmental bodies or with respect to public property and advance analysis should be undertaken to ensure that the subject of the proposed lien is a non-governmental project.

In view of the many distressed projects in Dubai and the substantial fees and progress payments outstanding, it is only a matter of time before contractors and architects begin to avail themselves of the remedies described above in order to secure payment against what may be the only viable source of payment—the equity in the project itself.

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<sup>24</sup> Civil Code, Article 1430.

<sup>25</sup> Civil Procedure Code, Articles 219-331.

<sup>26</sup> Article 298 of the Civil Procedure Code provides that "[a] real property can only be sold to a UAE national subject to the rules on the transfer of real property ownership".

As Dubai has only recently experienced its first severe economic dislocation in the real estate and construction sectors, those who first exercise their lien rights will be treading new ground and must be prepared to educate the Dubai Land Department, the Courts and owners as to the rights provided in existing law.