



## COVID-19: Effects on Contracts Governed by the Laws of the United Arab Emirates

The COVID-19 pandemic is having an increasing impact on economic life in the United Arab Emirates ("UAE"). Thus, corporations as well as small and medium-sized companies raise the question whether the COVID-19 pandemic and the measures taken by governments in this respect qualify as a case of force majeure under UAE law and, consequently, as a suitable justification for the termination of existing agreements, such as supply contracts. In this article, we will now inform you about the basic aspects:

### 1. How is force majeure treated under UAE law?

Like other legal systems, the legal system of the UAE recognises the concept of force majeure.

#### a. Definition

Local law does not determine what constitutes a force majeure event. The definition of the term force majeure is rather the responsibility of the UAE courts.

According to the criteria of local jurisdiction, an event of force majeure must be unforeseeable, unavoidable and beyond the defaulting party's control. Up to now, courts have accepted the concept of force majeure as justification for the non-fulfilment of a contractual obligation only in very limited exceptional cases, such as in case of physical impossibility, e.g. natural disasters, or in case of legal impossibility, e.g. a change in law.

#### b. Legal Consequences

If an event meets the required conditions for force majeure, the contract is deemed to be terminated by operation of law under Article 273 para. 1 Federal Law No. 5 of 1985 as amended ("UAE Civil Code") and the parties automatically revert to their pre-contractual positions. If automatic rescission is not possible, damages may be payable.

If the performance of the contract is only partially or temporarily impossible, the obligee is entitled to terminate the contract pursuant to the wording of Article 273 para. 2 UAE Civil Code. Whether a permanent impossibility exists, depends, amongst others, on the agreed contract period.

#### c. Distinction between Force Majeure and Hardship

Article 273 UAE Civil Code requires that the event of force majeure leads to the impossibility of fulfilling contractual obligations, i.e. prevents fulfilment entirely. Providing relevant evidence can prove to be difficult for the affected party.

Events which only impair the performance of one party or cause complications in the fulfilment of contractual obligations do not regularly lead to the impossibility of fulfilment and, thus, a force majeure event. Consequently, the contract will not be automatically terminated.

The same applies to events which cause mere hardship or an economic imbalance between the parties to the contract. Article 249 UAE Civil Code provides that if exceptional events of public nature which could not have been foreseen occur as a result of which the performance of the contractual obligation, even if not impossible, becomes onerous for the obligor so as to threaten him with grave loss, it shall be permissible to reduce the onerous contractual obligation to a reasonable level by judicial intervention if justice so requires. The UAE courts have been reluctant to apply this provision so far.

#### d. Contract Drafting

According to UAE law, the parties are free to contractually determine under which circumstances force majeure shall be deemed to have occurred and which legal consequences shall arise in an event of force majeure. Indeed, many local contracts contain force majeure clauses.

### 2. What should an obligor consider in an event of force majeure?

If you are unable to fulfil contractual obligations due to the COVID-19 pandemic and the measures taken by governments in this regard and you wish to invoke the existence of a force majeure event, the following must be observed.

#### a. Contractual Content

First of all, the contract governing your contractual relationship must be reviewed and established whether it contains provisions on force majeure.

If this is not the case, the provisions and principles of the UAE Civil Code as outlined above under section 1 apply.

#### b. Interpretation

If your contract contains provisions on force majeure, it is a matter of interpretation whether the COVID-19 pandemic as well as the respective government actions can be qualified as force majeure within the meaning of your contract. From your perspective, it would be beneficial if a corresponding clause explicitly referred to global epidemics, pandemics or diseases as well as to government measures. If this is not the case, it should be examined whether the current situation falls under any catch-all clause stipulated in your contract.



If you have only recently entered into a contract and now find yourself in the position to be unable to fulfil your contractual obligations due to the COVID-19 pandemic and subsequent governmental measures, assess whether your contract clause also recognises pre-existing events, i.e. events that already existed at the time when the contract was concluded, as possible force majeure events. If this is not the case, it is highly questionable whether you can successfully invoke force majeure as in such circumstances the criteria of unforeseeability is most likely not met. For contracts dated January and February 2020, the circumstances of the individual case are likely to be decisive due to the still comparatively strong regional characteristics of COVID-19 and the relatively low case numbers.

You should also check whether, according to your contract, the force majeure event must lead to the impossibility of performance or whether the occurrence of a significant delay or difficulty in performance is sufficient to meet the contractually agreed criteria of force majeure.

#### c. Contractually Agreed Legal Consequences

Furthermore, you need to consider the contractually agreed effects of a force majeure event. It is often stipulated that the party to the contract being unable to fulfil its contractual obligations due to force majeure is not liable for delays or failure to perform. In some cases, deadlines for the fulfilment of contractual obligations are automatically extended. In addition, the affected party is often granted a right to terminate the agreement.

#### d. Further Obligations

You should also pay particular attention to whether the contract requires you, being the affected party, to notify the other party of the event within a certain timeframe after becoming aware of it as well as to provide the other party with detailed progress reports at regular intervals.

Furthermore, contractual clauses may also require you to continue performing obligations that are not affected by the force majeure event.

Some clauses further oblige the defaulting party to use reasonable endeavours to mitigate disruptions caused by the force majeure event. In the event of a breach of such obligations, you may be prevented from invoking force majeure.

#### e. Burden of Proof

It is important to note that the burden of proof is on you as the party invoking force majeure. You need to demonstrate that and how the COVID-19 pandemic and its consequences have rendered it impossible for you to fulfil, either fully or partially, your individual contractual obligations, such as the obligation to supply. In this respect, the numerous reports of the World Health Organization, government decrees as well as instructions

from authorities to contain the COVID-19 pandemic would certainly be taken into account by a court.

#### 3. What should an obligee consider in an event of force majeure?

In the event that your counterparty refuses to fulfil its contractual obligations on the grounds of force majeure, you are well advised to first examine the contract to establish whether such contract indeed justifies the actions taken by the contractual partner. If the contract does not contain provisions on force majeure, the principles of the law governing the contract apply.

If UAE law applies and a case of temporary or partial impossibility exists, pursuant to the wording of Article 273 para. 2 UAE Civil Code, you as the obligee have a right to terminate the contract. However, you should only exercise this right if the conditions are actually met. Otherwise, you risk incurring a liability for damages on the grounds of unlawful termination.

It is also important that you request evidence and updates from your counterparty with respect to the alleged impossibility of performance.

If, under the agreement, you are obliged to make advance payments and have already fulfilled your payment obligations and if there are uncertainties as to whether the performance of your counterparty's obligations will become possible at all in the future due to the COVID-19 pandemic, you should contact your contractual partner in good time and work out possible solutions by way of an amicable settlement, at best negotiating the reimbursement of all monies paid. If partial payments are outstanding on your part and you are still interested in the delayed performance of the other party, you might want to consider renegotiating the agreement.

#### 4. What should you do next?

From our point of view and in light of the current situation, businesses are well advised to draw up an up-to-date inventory of existing contracts and outstanding receivables and liabilities. Additionally, businesses should contact debtors and creditors promptly, if and when necessary. Our recommendation would be to proceed as follows:

- Create a detailed overview of your receivables and liabilities currently due and becoming due in the near future.
- Review existing contracts for the existence and scope of force majeure clauses, termination clauses as well as clauses on jurisdiction and choice of law in order to assess your legal position.



- Take proactive steps at an early stage and openly discuss your financial situation with creditors and banks.
- Approach debtors in order to gain early knowledge of liquidity shortages and potential defaults as well as the underlying reasons. After carefully weighing up the pros and cons, consider entering into settlement agreements, providing deferments or initiating debt recovery proceedings.
- If you agree on settlements or payment plans with creditors or debtors, always document any such agreements in writing.
- Only enter into new agreements on the basis of a comprehensive risk analysis.
- Review the scope of coverage of all existing insurance contracts in the context of the occurrence of the COVID-19 pandemic and assess whether you have any business restriction or disruption insurance coverage that may apply.
- After obtaining the above information, prepare a budget plan to avoid own payment defaults and regularly adjust the plan.

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**Do you have questions? - We would be glad to answer them!**

From our office located in the heart of Dubai, our team of German attorneys has been advising small and medium-sized companies, corporations and individuals on the laws of the United Arab Emirates for more than a decade. Our areas of expertise include corporate and commercial law (in particular business set ups), commercial agency law, employment law as well as tenancy and real estate law. We would be happy to attend to your questions as well. Contact us!

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