

KHOSHAIM & ASSOCIATES

Contracting under COVID-19: Frustration and Force Majeure under Saudi Arabian Law

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Introduction

Our thoughts and prayers are with all those impacted by the current severe acute respiratory syndrome coronavirus 2 (SARS-CoV-2) pandemic (“**COVID-19 Pandemic**”).

In these times, we have focused on what we can speak on, and so we set out below an overview of the Saudi Arabian Law position and assessment of the potential impact of the COVID-19 Pandemic on the performance of contracts under Saudi Arabian Law.

For more information on the matters discussed herein, please send emails to our COVID-19 Pandemic Legal Response Team at Covid19@khoshaim.com.

Background

On 30 January 2020, the World Health Organization (“**WHO**”) declared that the SARS-CoV-2 epidemic constituted a public health emergency of international concern.

On 11 March 2020, the WHO declared the spread of the virus as a pandemic.

As a result, several countries, including the Kingdom of Saudi Arabia, have adopted measures restricting travel, business activities and movement of persons (the “**Government Measures**”).

Saudi Arabian Law: A Primer on Excusing Performance

Under Saudi Arabian Law¹, in principle, a contract constitutes the law between the parties – except if such contract violates *Shari’ah* or public order or enacted legislation – and therefore the relevant contracting parties are bound to fulfil their agreement.

Many commercial contracts that are governed by Saudi Arabian Law contain force majeure, material adverse event, change of law, or similar clauses (the “**Excuse Clauses**”) which excuse a party from performing its contractual obligations due to the occurrence of certain events.

Generally, a typical Excuse Clause is unlikely to itself contravene *Shari’ah*, public order or enacted legislation. However, each clause should still be examined on its own. For example, if an Excuse Clause is drafted in such a way as to render the agreement uncertain because the relevant events covered by such Excuse Clause include matters that are random (e.g., normal weather conditions, price of stock market, etc.), then such events may not be an enforceable trigger of an Excuse Clause as they would not comply with the prohibition under Saudi Arabian Law of including terms that introduce unreasonable uncertainty (*gharar*).

¹ See Annex I for definition.

Also, there is no general concept of “*force majeure*” in *Shari’ah*², but similar concepts can be understood from the general principles of how a calamity (*jawa’ih*) or valid excuse (*al-udhr*) impact performance under *Shari’ah*, as is detailed below. Therefore, even if an Excuse Clause did not include those general concepts of calamity (*jawa’ih*) or valid excuse (*al-udhr*)³, or if such concepts were explicitly disclaimed, those concepts may still be read into a contract governed by Saudi Arabian Law, and there may be a risk that a Saudi Arabian court or arbitral tribunal applying Saudi Arabian Law would apply those concepts.

Comparison Between the Shari’ah Concepts of Calamity (*Jawa’ih*) and Valid Excuse (*Al-Udhr*) and the Concept of Force Majeure

In some jurisdictions, we have come to understand that *force majeure* usually requires the following conditions:

1. The event to be exceptional and general – this too is required in *Shari’ah*, the examples of events given by Islamic scholars to illustrate the definition of calamity (*jawa’ih*) are such that they would affect everyone, including the contracting parties. Also, the general character of a valid excuse (*al-udhr*) is required by most Islamic schools of thought;
2. The event to be unforeseeable, unavoidable, and outside the control of the parties – this too is required in *Shari’ah*; and
3. The event causes the performance of the contract to be impossible – there is some debate on whether impossibility is the threshold, or substantial inability to perform or more onerous character of the obligation is sufficient. However, this would have to be determined on a case by case basis.

Assessment of the Covid-19 Pandemic on Contracts under Saudi Arabian Law

To analyze this issue, much will depend on the relevant contract. If the contract includes an Excuse Clause, then this clause would have to be reviewed first to determine if the conditions under such clause have in fact been triggered by the Covid-19 Pandemic or the Government Measures, together with a careful analysis of the facts relevant for that contract.

In most cases, the Covid-19 Pandemic may not on its own excuse performance of an obligation under contracts. This may especially be the case if the relevant performance of the contract is not impacted by the Covid-19 Pandemic (e.g., personnel performing under the contract have not themselves contracted the virus or at a serious risk of doing so). In that respect, we found at least one court case in which a Saudi Arabian court excused the performance of a contractor only when its own workers suffered from a localized fever epidemic, not the general population.

However, if the Government Measures impact the performance of the contract (e.g., by preventing ingress or egress from a certain area, ability to obtain goods or raw materials, ability to travel to perform the contract, etc.), then that may be sufficient to excuse performance under some Excuse Clauses.

Having said that, we note that the Saudi Arabian Government Measures that have been placed as of the date of this note explicitly carve out, from the restrictions noted therein, various sectors, including utilities, telecom, electricity, supply chain, manufacturing, food, healthcare, drug, servicing of essential and government facilities,

² However, we note that some Saudi Arabian legislation, like the Labor Regulations, the Saudi Arabian Grid Code issued by the National Grid SA, and some rules and regulations issued by the Communications and Information Technology Commission (CITC), include the concept of *force majeure* but without always defining it.

³ See Annex 2 for analysis of such concepts.

all amongst other sectors. Therefore, we do not think that contractors performing services under such sectors would be excused from performing their obligations in most case.

The Saudi Arabian Government Measures further allow businesses that do not fall under the above sectors to still maintain their “essential” functions and continue work. All this goes to support the conclusion that contractors may not be excused from performing their obligations in a broad manner.

To excuse performance resulting from a calamity or a valid excuse, a contracting party would likely have to show the following in relation to the Covid-19 Pandemic or the Government Measures:

1. That such events are beyond its control, which is most probably the case;
2. That such events are general in nature and impact everyone, including its workers;
3. That it entered into the relevant contract before these events and that it would not have been reasonable for it to have anticipated the effects of the Covid-19 Pandemic or the Government Measures to plan around them;
4. That the events rendered the performance of its obligations under the contract either impossible or significantly more onerous.

If a contracting party can demonstrate the above, then it may be able to convince a court or arbitral tribunal applying Saudi Arabian law that it should be excused from performing its obligations or allow for the adjustment or termination of the contract.

Actions Moving Forward

We suspect that most contracting parties will continue to monitor events surrounding the Covid-19 Pandemic and the Government Measures and respond accordingly given the fluid nature of the situation.

Furthermore, with respect to any future contracts, parties will likely start to include explicit language agreeing how similar events are to be dealt with, and whether they would excuse performance or lead to termination of the relevant contract.

We hope you found this document useful. For more information on the matters discussed herein, please send emails to our COVID-19 Pandemic Legal Response Team at Covid19@khoshaim.com.

Annex 1

Sources and Interpretation of Saudi Arabian Law

The paramount body of law in the Kingdom is *Shari'ah*. *Shari'ah* is comprised of a collection of principles derived from a number of different sources, which include the Holy Qu'ran and the Sunnah (the witnessed sayings and actions of the Prophet Mohammed (peace be upon him)). In addition to *Shari'ah*, Saudi Arabian Law is also comprised of enacted legislation. Such legislation takes various forms, the most common of which are royal orders, royal decrees, council of ministers' resolutions, ministerial resolutions and ministerial circulars. All such laws are ultimately subject to, and may not conflict with, *Shari'ah* and Saudi Arabian adjudicatory bodies are required to interpret enacted legislation accordingly.

References to Saudi Arabian Law in this memorandum includes *Shari'ah* as construed and applied in the Kingdom and all enacted legislation referred to above and having the force of law in the Kingdom (collectively **Saudi Arabian Law**).

Saudi Arabian Law does not contain a comprehensive civil or commercial code. Therefore, all contracts are subject to *Shari'ah* as construed and applied in the Kingdom and Saudi Arabian courts will interpret them accordingly. In practice, Saudi Arabian courts typically will not set aside contracts which do not materially conflict with the basic principles of *Shari'ah*. Accordingly, parties are free to contract as they wish, subject to the principles of *Shari'ah*.

Certain types of contracts may be governed by specific statutes in addition to *Shari'ah* principles. The most notable example of these are government procurement contracts, which are governed by the Government Procurement Law (Royal Decree no. M/128 dated 13/11/1440H corresponding to 16 July 2019G) and its Implementing Regulations (Minister of Finance Resolution no. 1242 dated 21/3/1441H corresponding to 18 November 2019G).

A Saudi Arabian judge is free to apply *Shari'ah* principles as he considers just and fair in the circumstances, and whilst a previous decision on the same set of facts may be persuasive, it will not be binding. In addition, the decisions of the various Saudi Arabian courts and adjudicatory bodies are not made public in a systematic manner. For the purposes of this note, we have relied on a small number of judicial precedents that have been made publicly available in various sources.

Annex 2

Frustration of Contracts in Saudi Arabian Law

1. Principle: contracts constitute the law between the parties

- (a) Under Saudi Arabian Law, in principle, a contract constitutes the law between the parties – except if such contract violates *Shari'ah* or public order or enacted legislation, and therefore the contracting parties are bound to fulfil their agreement.
- (b) This principle derives from:
 - (i) the sayings of Allah Almighty collected in the Qu'ran which may be translated as follows “*O you who believe, fulfil (your) obligations*” (Qu'ran 5:1) and “*And fulfil (every) covenant, verily the covenants will be questioned about (on the Day of Reckoning)*” (Qu'ran 17:34);
 - (ii) the witnessed sayings and actions of the Prophet Mohammed (peace be upon him) including the one in which he said “*Muslims are on (held to) their conditions*”⁴; and
 - (iii) the literal meaning of the Arabic word for contract (*'aqd*) which is knot, bond or tie.

2. Termination of a contract under Saudi Arabian Law

- (a) Amongst other things, under Saudi Arabian Law, a valid contract may be terminated or adjusted by some events or changed circumstances which are outside of the control of the parties to the contract.
- (b) Some Islamic scholars are, however, of the view that people are not obliged to go beyond the limits of their capability and endurance, and will not bear the consequences of things outside such capability⁵.
- (c) This is obviously not an excuse for any party to enter into a contract and then later decide that it is burdensome or not a good deal. Such events or changed circumstances can generally only fall within the following legal concepts⁶:
 - (i) calamity (*jawa'ib*); and

⁴ Narrated by Al-Tirmidhi, Hadeeth no. 1352.

⁵ This was also reflected in the decision 7 of the Islamic Fiqh Council during its 5th session in which the Islamic Fiqh Council explains what happens with contracts that are executed over a period of time, such as procurement and contracting, if the circumstances changed dramatically and unexpectedly in a way that would cause the contractor major loss, without any negligence or fault from the contractor. In those circumstances, the Islamic Fiqh Council considers that a judge can either (i) amend the liabilities of each party to ease down the loss on the contractor, or (ii) terminate the contract if that is easier for both parties. The judge can also give the contractor a grace period to execute the contract, if the unforeseen circumstances are expected to end soon and the other party will not bear a substantial loss from that delay. We note that while not having force of law in the Kingdom of Saudi Arabia, decisions and resolutions of the Islamic Fiqh Council are persuasive and often influence the approach of Saudi Arabian courts.

⁶ As the Kingdom of Saudi Arabia has not adopted civil or commercial codes, in the Kingdom of Saudi Arabia such matter remains only governed by Shari'ah, with the exception of some specific enacted pieces of legislations which have incorporated the concept of force majeure in their specific scope like Article 74 of the Labor Regulations which provide that an employment contract is terminated in case of “force majeure” but without further defining such concept and Article 87 of the Labor Regulations which allow full end of service benefit to an employee if he/she leaves work due to a force majeure beyond his/her control.

- (ii) excuse (*al'udhr*).

3. Termination or adjustment of a valid contract due to calamity (*jawa'ih*)

(a) Definition of Calamity (*Jawa'ih*)

In *Shariah*, a word or concept has usually two definitions: (i) a literal definition and (ii) a definition from a *Sharia'h* perspective.

(i) Literal definition:

Literally, in Arabic *Alja'ibah* (the plural of which is *jawa'ih*) means a calamity – usually natural or outside of the person's control – which eradicates substantially all or all of the wealth or ability of a person.

(ii) Definition from a *Sharia'h* perspective:

The classical Islamic scholars have provided several legal definitions of *jawa'ih*, but mostly agree that it would be a “disaster for which no human being can be held responsible”.

Imam ibn Yunus has also opined that the action of a ruler would also fall under the definitions of *jawa'ih*.

We are inclined to think that a Saudi Arabian court would see that *jawa'ih* is most probably not limited to natural disasters (e.g., epidemics, etc.) but may also include actions of human beings which cannot be avoided and for which no one can be held responsible (e.g., general government action that prevents movement).

(b) Effects of Calamity (*Jawa'ih*) on contracts

(i) Effects of a calamity on a sale contract

The Islamic scholars have distinguished several situations in which a calamity has an impact on a sale contract and applied a different ruling to each of these situations:

- (A) If the sold object is damaged by calamity after concluding the contract but before the buyer takes possession of that object, the contract shall be rescinded and the buyer is released from its obligations, and any paid consideration shall be returned. The buyer may also be offered a lower price for the damaged good at its option.
- (B) If the sold object is damaged by calamity after concluding the contract and after the buyer takes possession of that object, the contract shall not be rescinded and the buyer shall suffer the damages as the object is in its possession.

(ii) Effects of a calamity on a contract for lease / contracts for hire (services contracts)

As to the effects of a calamity on a lease agreement, most Islamic scholars have concluded that, if the premises of the lease contract are damaged by calamity after concluding the contract and after the lessee starts occupying the premises, the contract shall be terminated but the lessee shall pay the rent for the period during which it took advantage of the leased premises.

This theory may also apply to services contracts. However, it may be more appropriate to analyze the issue of any impact of changed circumstances under the concept of valid excuse (*al'udhr*) discussed below given its applicability to continuing contracts.

4. Termination or adjustment of a valid contract due to a general excuse (*al'udhr*)

(a) General Excuse:

- (i) General excuses are excuses which affect the entire people of a city, province, etc. and which have the effect of stopping, or substantially stopping, one or more of the parties from performing their contract. Examples include a general fear which prevents from living in a certain area, war, siege, etc.
- (ii) The Hanbali, Hanafi and Maliki schools consider that, as a result of a general excuse, the affected contract of hire is cancelled. The Sha'afi school of thought disagrees with such conclusion if the object of the contract has not itself been affected by the events or circumstances underlying such general excuse.
- (iii) We have found at least one decision of a Saudi Arabian court in which it accepted as a general excuse the presence of an actual fever epidemic at a construction site justifying the waiver of liability of a construction contractor for delay in performance under a construction contract.

- (b) **Effect:** Some Islamic scholars agree that any excuse which is related to the subject matter of the contract and makes performance impossible or onerous for one of the contracting parties is a sufficient reason for termination of the contract.

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