# THE AMERICAN CONTRACTOR'S GUIDE TO NAVIGATE THE INTERCONNECTED WEB OF RISK IN INTERNATIONAL CONTRACTING

~ Charting the Middle Eastern markets of Israel and Saudi Arabia

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## INTRODUCTION

A contractor is like a card player who never shuffles, cuts the deck, or deals; he plays the hand he is dealt. At its core, it is a risky game, played by risk takers. As economic globalization steadily evolves, and domestic growth rates steadily shrink, large-scale contractors from Europe, and elsewhere, are looking beyond their borders to survive. An Australian joint venture is building the Indiana turnpike. A Spanish contractor built Florida's I-595 expressway. American contractors face increasing competition from their international counterparts. With substantial risk abroad, American contractors hesitate to leave the safe harbor of American jurisdictions. But what exactly are the risks that lie beyond the horizon? American contractors need a simple guidebook to help them chart the interconnected web of risk in international contracting. This paper provides a basis for such an understanding.

The paper begins with an explanation of the international legal framework, issues, and risks that American contractors face when completing construction projects internationally. To illustrate, special attention is paid to the Middle East. The paper explains the legal risks that exist in both the global marketplace, and the Middle East. An American contractor with the resources, the will, and the wisdom to expand beyond its jurisdiction and seek opportunity in the Middle East will confront a legal environment that is different. To effectively shift, contain, avoid, and manage its legal risk, the contractor must understand the jurisdictions' basic principles.

Construction law is highly specialized. It synthesizes numerous bodies of law including agency law, environmental law, tort law, legislative law, to name a few, ultimately creating a complex legal environment. Construction law confronts numerous legal areas, but it is fundamentally based in contract law. As in America, where each State in the union applies its own, sometimes unique, legal principles relating to contract law, so too do Middle Eastern

nations. To illustrate jurisdictional differences, this paper performs a comparative analysis of Israel and Saudi Arabia. From political instability in Israel to legal uncertainty in Saudi Arabia, each Middle Eastern nation presents unique national risks. Finally, the paper establishes an elementary strategy to handle national risks, and ultimately proposes which Middle Eastern marketplace, from a macro perspective, is most favorable to American contractors with a global reach and a long-term vision.

If an American contractor wants to remain competitive, it must look beyond the horizon. While an American contractor cannot completely immunize itself from risk when abroad, by implementing basic risk handling strategies, in the long-term, the Middle East, and Saudi Arabia in particular, likely presents an interconnected web of risk worth navigating.

## I. Surveillance Of The Complex Legal Landscape In International Business

An American construction company with the resources and the will to expand beyond its borders and into the Middle East will confront a legal environment that is different. To effectively avoid, shift, contain, and manage its risk the contractor must first gain a basic understanding of the complex legal landscape in international business, beginning with how the World Trade Organization ("WTO") helps to resolve international disputes.

### A. The World Trade Organization And Dispute Resolution

The WTO, which aims in part to help producers of services, has 164 member nations. The WTO helps producers of services, in part, by providing a dispute resolution process. The primary purpose of WTO's dispute resolution function is to resolve disputes between *state actors*, but it can also help to resolve disputes between a nation and an industry, or a state actor and a private company.

1. How The WTO Helps To Resolve Disputes

Close relationships covey benefit, but also friction. As international trade increases, so too does the risk of dispute. In the past, international deals that led to dispute resulted in serious conflict. Today, tensions are reduced because nations (and private companies) can turn to organizations like the WTO to settle their disputes.[2]

Before World War II, there was no internationally recognized forum for global trade negotiations, and no legal procedure for settling disputes. After the war, the world's community of nations negotiated trade rules under the General Agreement on Tariffs and Trade ("GATT"), but which are now entrusted to the WTO. Dispute settlement is sometimes described as the jewel in the WTO's crown, and is its unique contribution to the stability of the global economy. Over 400 disputes have been brought to the WTO since it was established in 1995. The increasing number of disputes brought to the WTO does not reflect increasing tension in the world. Rather, it reflects closer economic ties throughout the world, the WTO's expanding membership, and the fact that countries have faith in the system to solve their differences.[3]

Understanding the WTO's role in dispute resolution is important, especially considering the significant differences between the legal principles applied in American jurisdictions and those applied in Middle Eastern jurisdictions.

**B. Overview Of The Differences In Middle Eastern Jurisdictions**

Construction law is a highly specialized field, but fundamentally rooted in contract law. Like individual American state jurisdictions, each Middle Eastern nation applies unique contract law principles. Since contractors establish and protect their rights through contracts, when abroad, American contractors must understand how contractual rights are protected.

[2] https://www.wto.org/english/thewto_e/whatis_e/10thi_e/10thi02_e.htm
[3] *Id*.

1. Overview Of Israel's Three Tiered Court System

Like America, in civil cases, Israel has a three-tiered court system, beginning with district courts, followed by appellate courts, and finally a supreme court. District courts are courts of first instance, but also hear appeals from magistrate courts, municipal courts, and various administrative tribunals. Israel's twenty-eight magistrate courts constitute the most basic level of the civil court system. The second tier of the civil court structure consists of six district courts. District courts hear civil cases outside the jurisdiction of lower courts. At the top of Israel's court hierarchy is the Supreme Court, located in Jerusalem and composed of eleven justices determined by Israel's parliament. The Supreme Court has appellate and original jurisdiction, hears appeals from lower courts in civil cases, and there is no appeal from its decisions.[4]

Unlike the American judicial branch, the Israeli judicial branch does not have the power of judicial review and cannot invalidate parliament's legislation. As the highest court of the land, the Supreme Court may also rule on the applicability of laws in a disputed case and on jurisdictional disputes between lower civil courts.[5]

2. Increasing Certainty In Israeli Contract Law

Israel, soon after its founding in 1948, began to construct the framework for its current legal system. The footprints of various legal systems exist: the codification of private law mirrors European civil law; public law is judicial like the common law tradition; and the emerging constitution is influenced by American law. Jewish law is sometimes referred to in civil courts.[6]

Contract and commercial law has also been influenced by Israel's constitutional transition from a parliamentary democracy to a constitutional democracy in 1992. Freedom of contract and

[4] http://countrystudies.us/israel/84.htm
[5] *Id.*
[6] http://www.nyulawglobal.org/Globalex/Israel1.html#TheLegalSystem

freedom of enterprise are now recognized as having constitutional status. Although the essential legal fields of contracts, quasi-contracts, remedies, sales, etc. are covered by legislation, courts and the Supreme Court in particular have been very active in further developing both doctrine and jurisprudence. Judicial precedents are now indispensable. Israeli commercial legislation is comprehensive. Around the central piece of legislation in contract law are arranged several statutes that regulate specific contracts such as international sales, agency, contracts of adhesion, etc., as well as remedies for breach of contract and quasi-contractual interactions.[7]

While religious law has some formal standing in Israel, it is generally limited to specific areas and—unlike in Saudi Arabia—is irrelevant to contract law.

3. Saudi Arabia's Legal System Is Rooted In Islamic Law

The Kingdom of Saudi Arabia's legal system is based in Islamic *Sharia* law. Saudi legislation is derived from a variety of sources including Royal Orders, Royal Decrees, Council of Ministers' Resolutions, Ministerial Resolutions and Ministerial Circulars. However, they are all subject to, and cannot conflict with, *Sharia* law.[8] Islamic Law does not establish a complete theory of contract law. It deals with certain contracts, such as sales, and agency. Accordingly, for example, certain rules that apply to contracts of sale do not necessarily apply elsewhere.[9]

4. In Saudi Arabia Justices Have Broad Judicial Discretion

In Saudi Arabia the principle contained in the maxim "The Contract is the Law of the Parties" has gained some acceptance. Parties to a contract are free to agree to the terms of their choosing, provided these terms are not at odds with established Islamic Law principles.[10]

[7] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1139775
[8] https://uk.practicallaw.thomsonreuters.com/Document/
[9] *Id.*
[10] *Id.*

For example, contracts including "riba," which means, "increase," (i.e. interest), for the receipt or payment of interest are unenforceable, even if referred to by some synonym, such as "commission." Additionally, contracts must be free from "gharar," which means "risk" or "uncertainty." Nabil Saleh, a Saudi legal scholar, stated: ". . . any transaction should be devoid of uncertainty and speculation." For a contractual obligation to be enforceable in Saudi Arabia, it must be clearly defined. An agreement to "negotiate in good faith" parts of a contract on which agreement was not reached at the time of its conclusion is not enforceable under Islamic Law. [11]

The rule against risk and uncertainty also affects damages. Damages for loss of anticipated future profits, loss of business reputation and loss of goodwill are not ordinarily recoverable through the Saudi Arabian courts because claims of this nature are considered speculative and uncertain. Conversely, penalty clauses, limitation of liability provisions, and liquidated damages agreements import certainty into a contract by defining the contracting parties' rights and obligations, and are therefore valid and enforceable under Islamic Law.[12]

### C. Bilateral Trade Agreements With Middle Eastern Nations Are In Effect

America has trade agreements with most nations in the Middle East, including Israel and Saudi Arabia. These agreements can have an effect on international contracts. American contractors should have a basic understanding of these agreements.

#### 1. The American-Israeli FTA Has Improved Economic Relations

The American-Israeli Free Trade Agreement ("FTA") was the first FTA entered into by America. It continues to serve as the foundation for expanding trade between America and Israel by reducing barriers and promoting regulatory transparency. The oversight body for the FTA is the United States-Israel Joint Committee. In December 2009, the Committee met to exchange

[11] *Id.*
[12] http://www.saudilegal.com/saudilaw/02_law.html

views on issues and concerns. Both governments acknowledged the progress that has resulted from the FTA.[13]

2. The American-Saudi Arabian TA Strengthens Long-Standing Alliance

America, first through its oil industry and then via government contacts, established a relationship with Saudi Arabia's founder, King Abdulaziz, and his successors that evolved into a close alliance. American businesses have been involved in Saudi Arabia's oil industry since 1933, when Standard Oil of California (now Chevron) won a concession to explore in eastern Saudi Arabia and discovered oil in 1938.[14] The existing trade agreement acknowledges prior bilateral agreements, including the Provisional Agreement, signed on November 7, 1933, and the Joint Statement on Cooperation signed June 8, 1974.[15] American contractors should have a general understanding that American trade agreements are in effect in most Middle East nations.

## II. Comparing Substantive Legal Distinctions Amongst Middle Eastern Jurisdictions

International contracting is a complex endeavor, and as the complexity of construction increases, so too does the risk of litigation. Abraham Lincoln once said: "persuade your neighbors to compromise, point out to them that the nominal winner is often the real loser; in damaged relationships, fees, expenses, and a waste of time." In the Middle East, Abraham Lincoln might have added legal uncertainty to his list of reasons to avoid litigation.

### A. Highlighting Jurisdictional Differences In Rights And Remedies

The primary goal of any legal system is to provide parties with a reliable system to bring finality to their disputes. But when courts, including those in Israel and Saudi Arabia, seek to provide finality *and* justice to the resolution of disputes, rights and remedies often diverge.

[13] https://ustr.gov/trade-agreements/free-trade-agreements/israel-fta
[14] http://www.cfr.org/saudi-arabia/us-saudi-relations/p36524
[15] ustr.gov/sites/default/files/uploads/agreements/tifa/asset_upload_file304_7740.pdf

1. Saudi Arabian Jurisprudence Influenced By Islamic Law

In Saudi Arabia, legal and equitable remedies are not as available as they are in American courts. For example, specific performance, injunctive relief, and rescission are only allowed under specific circumstances, like when unforeseen circumstances prevent contract completion.

In accordance with Islamic law, remedies in contract are restricted to direct and actual damages. The courts will not recognize economic loss of chance, interest, and other speculative awards, which are sometimes provided by American courts. Saudi Arabian courts also preclude consequential damages based on anticipated profits. As such, contracts involving relationships over time such as continuous supply of goods will not attract full liability if wrongfully terminated. Courts would only award reparations for direct damages.[16]

2. Israeli Jurisprudence Influenced By Civil Law Traditions

In Israel, remedies for contractual breach are set out in the Civil Code, which is currently being drafted. The Code defines key contract law concepts like "Breach." For example, instead of the current definition of "Breach" in Israel's Remedies Statute ("an act or omission contrary to the contract") a wider definition is used, "an act or omission contrary to an obligation.[17] The purpose of the Code is to enable a clear analogy between torts, breach of contract, and any other possible type of violation of civil rights.[18] The Code sets out two main substantive principles. First, the draft announces the right of a person suffering a breach to enjoy the remedies afforded by the Remedies Statute. Second, it provides a guideline according to which the aggrieved party is entitled to choose his remedy.[19]

[16] en.wikipedia.org/wiki/Contract_Law_of_Saudi_Arabia#Remedies_for_Breach_of_Contract
[17] weblaw.haifa.ac.il/he/Faculty/Adar/Publications/Final%20Tulane%207%20Aug.pdf
[18] *Id.*
[19] *Id.*

Islamic Law and Civil Law traditions are fundamentally different than the Common Law tradition familiar to American jurisprudence. American contractors should ensure they have the right to avoid the legal uncertainty altogether, through alternative dispute resolution provisions.

### B. Circumventing Uncertainty Through Alternative Dispute Resolution

Due to international conventions, the potential for enforcing arbitral awards worldwide is much greater than that for court judgments. The ease of enforcement often conclusively determines the choice of arbitration for international contracts.

#### 1. The New York Convention Is A Landmark Treaty In International Contracting

There is no wide-ranging convention providing for the enforcement of *court* judgments (the closest being the Brussels Regulation, which is limited to parties in Europe). The most important enforcement convention is the 1958 United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "New York Convention"). More than 150 nations, including America, Saudi Arabia, and Israel, are party to the New York Convention, each of which broadly agrees to enforce arbitral awards made in other contracting nations.[20] Since the New York Convention, the number of international arbiters has grown significantly. Today, international contractors have a wide range of choice. The world's most used arbiter is the International Chamber of Commerce ("ICC").

#### 2. Cursory Review Of Alternative Dispute Resolution In Saudi Arabia

In Saudi Arabia, alternative dispute resolution typically happens through the formation of *ad hoc* committees, where representatives meet to negotiate a resolution. Failing this, local courts are used to resolve disputes. Arbitration is becoming an increasingly common form of dispute

[20] Latham & Watkins | Guide to International Arbitration

resolution.[21] In 2013, the Saudi Arbitration and Enforcement Law came into effect, which provides parties with a higher level of certainty that foreign arbitral awards will be enforced.[22]

However, the Enforcement Law does not completely guard against the legal uncertainty that exists in the Saudi Arabian jurisdiction. The new Enforcement Law still allows courts to refuse to enforce arbitral decisions if public policy issues are found in awards rendered by foreign arbitrators not versed in Islamic concepts. In such cases, judges may require the entire damages aspect of an arbitration to be reheard, especially, for example, where the payment of interest is not severable from the award. Nonetheless, the new Enforcement Law remains a further step toward adopting international legal principles.[23] The following case illustrates an International Court of Arbitration Award, based on a ruling made by the ICC.

3. A Case Study In International Arbitration

In Architect (USA) vs. Company (Saudi Arabia), a dispute arose between the claimant (the "American Architect") and the defendant (the "Saudi Arabian Company") after completion of the first of two contracts. The American Architect claimed that it had been underpaid, and the Saudi Arabian Company issued a counter-claim that the Architect had been over-paid. Both contracts contained a clause providing for disputes to be settled by ICC arbitration in Geneva.

The American Architect, which was based in Georgia, USA, executed two contracts to provide services for the Saudi Arabian Company. The first contract, which was substantially performed, was for the preparation by the Architect of building plans and other work, which was to be substantially carried out in Georgia. The second contract, which was never executed by the parties, was to involve consultation in negotiations with third-party contractors for the

[21] *International Commercial Arbitration*, Gary Born
[22] Construction and projects in Saudi Arabia: overview
[23] http://www.jonesday.com/files/Publication/

construction of a proposed building, which would have taken place in Saudi Arabia. The Tribunal found that not only was there no choice of law provision in either contract, but it had never in fact been discussed. The Tribunal reasoned that since no express agreement existed, *lex mercatoria* (Merchant Law) should *not* apply. The arbitrators reasoned that because national courts do not uniformly recognize the existence of Merchant Law, arbitrators should not apply it unless they have an explicit mandate from the parties to the arbitration.[24]

The Tribunal performed a balancing test to determine the applicable law. It reasoned that Georgia (USA) law should apply, since the characteristic work performed under the first contract was predominantly to be performed there. The Tribunal relied on principal rules of conflict of laws in its reasoning, pointing to performance as the main factor.

The case illustrates that an American contractor working with a Saudi Arabian company can rely on international arbitration to resolve its disputes. But it also illustrates that arbitrators are keen to ground their decisions in a specifically applicable law. Choosing the law that applies in contract is part of a basic strategy in international contracting.

## III. Navigating The Interconnected Web Of Risk In International Contracting

Like any business transaction, dealmakers must balance risk and reward. Before an American contractor implements a comprehensive risk management strategy, if it intends to expand to the Middle East, then it must first understand the inherent national risks.

### A. Middle East Nations Present Unique And Diverse National Risks

Each Middle Eastern nation presents a unique risk profile; from Israel where political risk is particularly severe to Saudi Arabia where legal risk is particularly severe. The following

[24] ICCA YB Vol. XII, 1987, pp 111-112

highlights and presents a basic strategy to handle the three major national risks facing an American contractor in the Middle East: (1) legal risk, (2) political risk, and (3) economic risk.

1. Elementary Strategy To Handle Legal Risk In Unfamiliar Jurisdictions

The New York Convention recognizes contracting parties' right to choose the law that applies to their contract. If a Middle Eastern entity demands the contract apply its domestic law, an American contractor will find its rights and remedies unfamiliar.

For example, unlike America, in Saudi Arabia, courts allocate risks such as design, site risk, and structural collapse to the contractor, *even if* a contract shifts those risks. As another example, under the Government Tender and Procurement Law, which is applicable to all tenders and procurements undertaken by government entities in Saudi Arabia, a 10% liability cap is typically placed on non-public construction contracts. However, despite this law, courts can adjust liability caps (such as liquidated damages) to the actual loss incurred, rather than enforce the contractual provision.[25] These examples illustrate how active the Saudi government and judiciary are in the marketplace. The result is a high degree of legal uncertainty in Saudi Arabia.

American contractors must avoid, manage, and mitigate these risks. A basic strategy includes: (1) providing parties with the right to take disputes to binding arbitration, (2) including a "choice of law" provision in the contract, and, (3) procuring liability insurance. Like any contract performed in an American jurisdiction, in the Middle East, managing risk through liability insurance is fundamental, but beyond the scope of this paper.

As important as liability insurance is the right to take a dispute to arbitration. Because differences between contract law principles applied in Middle Eastern jurisdictions and

[25] Construction and projects in Saudi Arabia: overview

American jurisdictions exist, to avoid the legal uncertainty, construction contracts should include a binding arbitration clause, stating something to the effect:

> Should any dispute concerning the construction, validity, interpretation, enforceability, or breach of the Contract not be resolved within thirty days after notice of dispute, the complaining party may seek remedies exclusively through binding arbitration. A party may apply to any court with jurisdiction for interim or conservatory relief, including a proceeding to compel arbitration.

Both Israel and Saudi Arabia have ratified and are members of the New York Convention; therefore, (with certain exceptions) both jurisdictions would give effect to a provision to the effect of the above. Including a binding arbitration clause in contract, which provides either party with the discretionary authority to resolve its dispute through arbitration, allows international contractors an ability to avoid the risk of legal uncertainty. While a binding arbitration clause provides international contractors a way to avoid Middle Eastern courts altogether, without a choice of law provision, an equally unjust outcome could result.

In Seller, Texas (USA) vs. Buyer, Ministry (Syria), the contract at issue did not include a choice of law provision. A dispute arose between the claimant (the "Texas Company") and the defendant (the "Syrian Government"), which was submitted to arbitration under the ICC Rules. The facts showed that the Texas Company executed a contract with the Syrian Government for the sale and shipment of a number of prefabricated houses from a Texan port to a Syrian port. The contract required the Texas Company to unload the shipment upon arrival in Syria, to provide transport to the construction sites, and to effect construction. Finally, the contract required the Texas Company to provide an engineer and four technicians for a period of two to six months for technical assistance.

The Tribunal held that the dispute was of a standard commercial character, and it was accordingly susceptible to resolution by reference solely to the parties' contractual stipulations, and the conventions of international commercial transaction, which were applicable to their relations.[26] Surprisingly, the Tribunal decided *not* to refer to any particular legal system to resolve the issue. The Tribunal considered that reference to a national law was entirely unnecessary, and that international commercial custom was a sufficient basis for resolving the dispute. The decision was based entirely on purported international commercial practice, *lex mercatoria*.[27] This ruling illustrates how arbitration rulings can be vague and ambiguous.

Parties to a typical construction contract performed in America usually gloss over the choice of law provision, considering it "boiler plate." After all, individual State jurisdictions apply similar contract law principles, with certain exceptions. Not so in the Middle East. To avoid being subject to the whims of an arbitrator, international contractors should choose the law that applies. An American contractor can handle legal risk through a combination of liability insurance, binding arbitration provisions, and choice of law provisions. However, even when legal risk is handled prudently, political risk could result in substantial damages.

2. Elementary Strategy to Handle Political Risk In Volatile Markets

No contractor can completely immunize itself from the potential political risks inherent in Middle Eastern nations like Israel and Saudi Arabia. But it must have a plan to address it. A basic strategy includes two tactics: (1) shifting risk through a *force majeure* indemnity provision; and (2) managing risk through political risk insurance ("PRI").

The Kingdom of Saudi Arabia was established by King Al Saud in 1932, and is one of the main players in the Arab world. Its stature is built on its geographical size, its prestige as the

[26] Award in Case No. 4338 in 1984 published in JDI 1985, pp 981-985
[27] *Id.*

custodian of the birthplace of Islam and its colossus status as an oil producer—with a quarter of the world's proven reserves under its deserts. Its importance as an oil-exporting nation has made economic interdependence with the West—where the main consumer demand is found—a necessity. This, in turn, has led to strong political relationships, which has been a source of awkwardness for both sides. It stands out for its espousal of a puritan version of Sunni Islam, including harsh punishments such as public beheadings and restrictions on women.[28] Saudi Arabia is named after the ruling Al Saud family, and is an absolute monarchy. Since King Saud's death in 1953, Saudi Arabia has been ruled by a succession of several of his sons.

The March 1, 1992 Basic Rule of Governance established that the Holy Quran and Sunna are the constitution of the country as well as the basis of Islamic law. A national Consultative Council was formed in 1993, and the King appoints all 150 members, who have an increasingly important advisory role to the Cabinet and have powers to review and provide consultation on issues of public interest. Local government is administered through general municipal councils, district councils and tribal and village councils. Two thirds of each council is elected and a third appointed. Political parties are banned by law.[29] The country is divided into 13 provinces, each with a prince (who performs the role of governor) and deputy governor. Each province has its own council that advises the governor and deals with the development of the province. These councils deliberate on their constituency needs, work on development budgets, consider future development plans and monitor ongoing projects. The governor and deputy governor of each province serve as chairman and vice-chairman of their respective provincial councils.[30]

[28] http://www.bbc.com/news/world-middle-east-14702705
[29] *Id.*
[30] http://www.saudiarabia1stedition.doingbusinessguide.co.uk/the-guide/introduction/

In stark contrast to Saudi Arabia's government, Israel is governed by a more familiar democratically elected parliament, with a traditionally high participation in elections. The head of state is the President, elected by parliament to serve a 7-year term, however, executive power tends to lie with the Prime Minister and the Cabinet. Over the past 30 years no single party has gained a majority in the 120-seat parliament, so Israel has been governed by a succession of coalitions.[31] While Israel's government is familiar in structure, some of its governmental objectives have resulted in instability. Israel's armed forces occupied the West Bank, the Syrian Golan Heights and the Gaza Strip (along with the Sinai Peninsula) in 1967. Israel subsequently withdrew from Sinai in 1982 and from Gaza in 2005, but has formally annexed East Jerusalem and the Golan Heights. The international community has not recognized this annexation, which considers all territory captured by Israel in 1967 as occupied and the status of Jerusalem as the capital of Israel as subject to negotiations with the Palestinians.[32]

Israel governs under a democracy, yet this fact alone does not predict a high degree of political stability. In fact, according to The World Bank's international political stability rankings, Saudi Arabia was ranked *higher* in political stability than Israel. The World Bank, which based its rankings on data collected between 1996 and 2014, ranked Saudi Arabia 121 out of 191 nations analyzed.[33] Israel, on the other hand, ranked 166.[34] Despite their relative rankings, the fact is that Israel and Saudi Arabia present certain unavoidable political risks.

These risks, which lie beyond the control of contracting parties, may prevent the parties from fulfilling their duties and obligations. To avoid a resulting breach of contract, parties should ensure contractual obligations are excused to the extent that they have been affected by political

[31] www.gov.uk/government/publications/overseas-business-risk-israel/overseas-business-risk
[32] *Id.*
[33] http://www.theglobaleconomy.com/Saudi-Arabia/wb_political_stability/
[34] http://www.theglobaleconomy.com/Israel/wb_political_stability/

instability. International customary law recognizes France's theory of *force majeure*, which derives from France's *Code Napoléon*.[35]

Force majeure is a legal doctrine covering an event that is unforeseeable, unavoidable, and which makes contractual execution impossible. In order to avoid the uncertainties and delays involved in relying on the applicable law, contracts should provide for a specific regime for *force majeure*, along with a definition of which events qualify for special treatment. Generally, *force majeure* means what the contract says it means.[36] An American contractor working in the Middle East should include a robust definition of *force majeure* in its contract, such as the following:

> For the purpose of this Contract, an "Event of Force Majeure" means any circumstance not within the reasonable control of the party affected, but only if and to the extent that (i) such circumstance, despite the exercise of reasonable diligence and the observance of good practice, cannot be, or be caused to be, prevented, avoided or removed by such party, and (ii) such circumstance materially and adversely affects the ability of the party to perform its obligations under this Contract, and such party has taken all reasonable precautions, due care, and reasonable alternative measures in order to avoid the effect of such event on the party's ability to perform its obligations under this Contract and to mitigate the consequences thereof. Events of Force Majeure shall include, but not be limited to the following *Political* Force Majeure Events: to the extent they take place in Saudi Arabia, acts of terrorists, blockade, embargo, riot, public disorder, violent demonstrations, insurrection, rebellion, civil commotion and sabotage; to the extent that they are politically motivated, strikes, lockouts, work stoppages, labor disputes, or such other industrial action by workers; expropriation or compulsory acquisition of the whole

[35] http://siteresources.worldbank.org/INTINFANDLAW/Resources/Forcemajeurechecklist.pdf
[36] http://siteresources.worldbank.org/INTINFANDLAW/Resources/Forcemajeurechecklist.pdf

> or any material part of the party; any legal prohibition on the party's ability to conduct the party's Business, including passing of a statute, decree, regulation or order by a Competent Authority prohibiting the party from conducting the party's Business.[37]

Such a clause effectively compartmentalizes certain major unavoidable political risks. But even with a well-crafted *force majeure* clause, contractors still face damages. For unavoidable damages, American contractors should turn to Political Risk Insurance to protect their investments. While public entities have traditionally filled this need, private players are increasingly participating in the PRI industry.[38] An investor that values speed and does not wish to be monitored for compliance with social and environmental standards would likely prefer a private PRI policy, whereas an investor concerned particularly with expropriation risk who values the deterrent effect of the World Bank's backing would likely opt for a Multilateral Investor Guaranteed Agency PRI policy.[39]

Compartmentalizing political risk through *force majeure* provisions and managing risk through PRI is an elementary strategy to handle the inherent political risks that exist when working in Middle Eastern nations like Israel and Saudi Arabia. Building work in the Middle East might be a proverbial minefield, but it presents great long-term opportunity.

### B. Construction Spending In The Middle East Is Set To Rise

As international competition increases in America, in effect, an American contractor subjects itself to increased risk by *not* seeking opportunities abroad. Geoff Mulgan, Professor at the London School of Economics, has said:

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[37] https://ppp.worldbank.org/public-private-partnership/ppp-overview/practical-tools
[38] James J. Waters, A Comparative Analysis Of Public And Private Political Risk Insurance Policies With Strategic Applications For Risk Mitigation
[39] *Id.*

> So is a businessman prepared for the future? Probably not. Most organizations have to live hand to mouth, juggling short-term funding and perpetual minor crises. Even the bigger ones rarely get much time to stand back and look at the bigger picture. Many are on a treadmill chasing after contracts.

While the United States remains the world's largest economy, in 2015, the United States grew at a meager 2.41%, ranking it 101st in the global marketplace.[40] With slow growth rates becoming the domestic norm, and American contractors' margins being squeezed by international competition, American contractors would be wise to explore beyond their borders. Middle Eastern markets offer a wide rage of long-term economic opportunity.

1. Large Oil And Gas Reserves Discovered In Israel

Israel is the world's 35th largest economy.[41] However, in 2015, it grew at a rate of only 2.49%, ranking it 99th worldwide. In the short term, Israel's economy does not offer significant incentive for American contractors per *se*, but there are nevertheless some positive aspects.[42]

Overall, Israel, has strong economic performance indicators, and rates well for ease of doing business.[43] Israel is a technologically advanced market economy with rapidly developing service sectors and is a world leader in telecommunication. Its economy functions like those in Western Europe, and its gross national product of $25,318 USD per capita exceeds those of several EU Member States.[44] In 2015 Israel ranked 18th among 187 nations on the UN's Human Development Index, which places it in the category of "Very Highly Developed", and its

[40] http://www.theglobaleconomy.com/rankings/Economic_growth/
[41] http://statisticstimes.com/economy/countries-by-projected-gdp.php
[42] http://www.theglobaleconomy.com/rankings/Economic_growth/
[43] https://www.gov.uk/government/publications/overseas-business-risk-israel
[44] *Id.*

economy was the 35th freest in the 2015 Index of Economic Freedom.[45] Recent discoveries of large natural gas reserves off Israel's coast have the potential to make a significant contribution to energy independence for the country and a major positive impact on its economy.[46] This discovery could offer significant business opportunities for American companies in the Oil and Gas sector as Israel seeks to develop its gas finds.

2. Construction Spending In Saudi Arabia Set To Rise

Saudi Arabia is the world's 20th largest economy.[47] Saudi Arabia grew at one of the fastest rates in the Middle East in 2015, at 3.49%.[48] Not only does Saudi Arabia present moderately better growth rates, construction spending is set to increase. Saudi Arabia is considered to be a key future market for construction. With a huge pipeline of schemes, particularly in the transport sector, being held back by low oil prices, contractors are expecting to capitalize on the opportunities once price recovery has been sustained.[49] When oil prices rise again, construction spending will invariably increase. In a global marketplace, American contractors should prepare themselves when these opportunities materialize.

### C. American Contractors Should Prepare For Opportunities Abroad

American contractors can find opportunity in Middle Eastern markets. But deciding to invest resources in any Middle Eastern market requires an American contractor to implement a strategy to handle certain major risks.

[45] *Id.*
[46] *Id.*
[47] http://statisticstimes.com/economy/countries-by-projected-gdp.php
[48] http://www.theglobaleconomy.com/rankings/Economic_growth/
[49] https://www.arcadis.com/media/

1. Oil And Gas Contractors Should Stay Tuned To Israel's Off Shore

The most attractive aspect of Israel's jurisdiction is that it provides American contractors with a degree of legal certainty. The fact that Israel has ratified and is a member of the New York Convention further mitigates Israel's legal risk. The same cannot be said about the political risk in Israel. Israel governs under a familiar democratic system, but according to The Global Economy, is highly unstable, ranking 166 out of 191 nations analyzed for political stability.

Israel's circumstance presents unique risks, and Israel's economy does not overcompensate. While Israel is the world's 35th largest economy, in 2015, it grew at rate of only 2.49%. This ranks it nearly the same as America. From a macro perspective, in the short term, an American contractor will likely find more favorable conditions in Saudi Arabia. However, recent discoveries of large natural gas reserves off Israel's coast have the potential to offer significant business opportunities for American Oil and Gas contractors.

2. Saudi Arabia's Market Presents Attractive Long Term Prospects

Saudi Arabia's least attractive market characteristic is its legal unfamiliarity and uncertainty. In Saudi Arabia, courts, which enforce Islamic Law, have relatively broad equitable powers. Saudi Arabia's courts are not timid to revise contractual provisions if they deem it just. In Saudi Arabia, the freedom to contract is certainly not absolute. Saudi Arabia has a high degree of political instability, but according to The Global Economy, Saudi Arabia is ranked significantly higher in political stability than Israel, at 121 out of 191 nations analyzed.[50]

Saudi Arabia offers a market that's growing more rapidly than Israel, and one of the strongest in the Middle East. Saudi Arabia is the world's 20th largest economy, and in 2015 grew

[50] http://www.theglobaleconomy.com/rankings/Economic_growth/

at one of the fastest rates in the Middle East, at 3.49%. From a macro perspective, with higher projected growth rates, Saudi Arabia's economy presents attractive long-term prospects.

## CONCLUSION

In its report, "Global Construction 2030," Global Construction Perspectives and Oxford Economics forecasts that the worldwide volume of construction output will grow by 85% to $15.5 trillion by 2030, with China, America, and India leading the way.[51] The global study shows average global construction growth of 3.9% to 2030, outpacing that of global GDP by over one percentage point, driven by developed countries recovering from economic instability and emerging countries continuing to industrialize.[52] The report states that American markets will only represent a 15% market share.[53] In other words, there is opportunity abroad.

But building relationships takes time, and a guidebook cannot replace experience. An American contractor seeking to build work in the Middle East has to get on the ground, improve its understand of local customs, the labor force, the jurisdiction, and other national risks. The international construction industry remains one that spawns significant disputes in number and amount at issue.[54] This is especially true in the Middle East, where national risks are significant. Neither Saudi Arabia nor Israel offers a clearly favorable market for American contractors. In Israel, political instability is an ever-present threat. In Saudi Arabia, the broad equitable powers of judges and the application of Islamic law provides legal uncertainty.

In either jurisdiction, an American contractor must implement a strategy to navigate the interconnected web of risk in Middle East markets. An elementary strategy includes managing

[51] https://www.thebig5hub.com/news/2015/november/in-pictures-top-10-world-s-largest-construction-markets-in-2020/
[52] *Id.*
[53] *Id.*
[54] http://fidic.org/sites/default/files/2%20jaffe09.pdf

legal risk with liability insurance, avoiding legal risk by including a binding arbitration clause in contract, and containing arbitration uncertainty with a choice of law provision. An elementary strategy also includes containing political risk through a robust *force majeure* provision, and managing political risk through a public or private political risk insurance policy. Consider these strategies as basic and as essential as travelling abroad with a passport and a credit card.

American contractors are facing increased competition in domestic markets from international builders, and must adapt. Successful contractors are ones who can look down the road, who can ask and better answer the essential question, "What if?" If an American contractor wants to survive, and maintain its growth rates, it must look beyond its local jurisdictions, and as it always does, go where the work is. While an American contractor cannot completely immunize itself from risk when abroad, by implementing basic risk handling strategies, in the long-term, the Middle East and Saudi Arabia in particular likely presents risks worth navigating.