

Can We Really Limit Liability?

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Introduction: Limitation of liability (LOL) clauses are commonly used in construction related contracts in the UAE and indeed in most parts of the world.

By using LOL clauses, the contracting parties seek to limit their overall loss exposure to a fixed (pre-agreed) amount. LOL clauses can provide certainty and assist the parties in managing and allocating risk when entering into new transactions. The key is in ensuring that the LOL clause is enforceable under UAE law.

Civil liability

Civil liability under UAE law is either a matter of contract or tort. A tort is a civil wrong that is not contract based. For example, negligence is a type of tort based liability. Unlike tort based liability, contractual liability can be excluded or limited, subject to certain exceptions. The rationale behind permitting the limitation of contractual liability is that the source of this liability is the contracting parties' consent, i.e. the contracting parties create contractual liability by entering into a contract. Thus, contracting parties are free to agree on certain limits to their liability. At least in theory. Under UAE law, however, LOL clauses will not always be upheld by the Courts (or Arbitral Tribunal, as the case may be) and are subject to exceptions. The exceptions may be consensual or statutory.

Consensual exceptions

As contractual liability is formed by contracting parties entering into contracts, the contracting parties may agree on a liability cap. If the contracting parties agree to exclude certain claims from this liability cap, such agreement would be enforceable. An example would be where the parties agree that a LOL clause will not apply to claims arising out of breach of confidentiality obligations or the infringement of intellectual property rights. In such circumstances, a breach of confidentiality claim, for example, would not be within the agreed cap and there would be no limitation on the liability of the party at fault.

Statutory exceptions

Statutory exceptions to the limitation of contractual liability can be found in numerous UAE laws, including for example, those laws codified in the Law of Civil Transactions (the Civil Code), environmental laws and employment laws. For present purpose we will only consider the exceptions expressed in the Civil Code.

Tort based liability

There are important differences in the tests in establishing liability in contract and tort. For contractual liability to apply there must be:

- a breach of contract by one of the parties;
- loss sustained by the other party; and
- a causal link between the breach and the loss

For tort based liability (or a "harmful acts" using the terminology of the Civil Code) to be

established, there must be:

- a breach of a duty/obligation imposed by law;
- loss sustained by a party; and
- causation between the breach and the loss

The tests are similar. However, and as already noted, the key distinction between contract and tort based liability is that tort based liability cannot be excluded or limited. Article 296 of the Civil Code provides that “any agreement purporting to provide exemption from liability for a harmful act shall be void.”

Although Article 296 only refers to the exemption of liability, it is beyond doubt that this rule also applies to the limitation of tort based liability.

The inability under UAE law to limit tort based liability is particularly significant given that the scope of tort based liability is broader than contractual liability in the sense that tort based liability may give rise to both foreseeable and unforeseeable damages, whereas contractual liability does not expose a party to unforeseeable or consequential damages.

The other significant difference between the contract and tort based liability is that contractual claims will be time-barred within 15 years (or within 10 years in respect of claims arising out of commercial transactions), whereas tort based claims will be time-barred within 3 years from the discovery of damage.

As a general rule, a tort based claim cannot be invoked where there is a contractual relationship between the concerned parties. The exception would be in cases of fraud and gross breach of duty. Fraud or gross breach of duty amounts to a breach of legal duty which triggers the application of tort based liability, notwithstanding the existence of a contract.

Decennial liability

Article 880 of the Civil Code (based on our Arabic translation of the text), provides:

“The Engineer and the Contractor are jointly and severally liable for a period of ten years for the total or partial demolition of constructions or other permanent works erected by them, even if such destruction is due to a defect in the ground itself, and even if the Employer authorised the erection of the defective construction, unless, in this case the constructions were intended by the parties to last for less than ten years.

The warranty imposed by the preceding paragraph extends to defects or collapse which are arising out of a defect in the ground or that the employer consented to the construction of the defective buildings.

The period of ten years runs from the date of delivery of the works”.

On the basis of Article 880, both the contractor and engineer are jointly liable for a period of 10 years to compensate the employer for any total or partial collapse of the works. The scope of decennial liability includes (i) total collapse of the works; (ii) partial collapse of the works; and (iii) any defect which threatens the stability or safety of the work.

In respect of the engineer’s decennial liability, there is a distinction between where the engineer:

- produces the design and supervise the works, in which case he shall be liable for both structural defects and design defects; and
- produces the design (without supervising the works), in which case he shall be liable for design

defects only as provided for in Article 881 of the Civil Code.

Decennial liability under Article 880 is essentially strict, no fault liability. In other words, the employer will not have to establish fault but only that the circumstance giving rise to liability under 880 has occurred.

Equally, the contractor and the engineer may not deny their liability under Article 880 on the basis that they committed no fault. Rather, they can only deny their liability on the basis of force majeure, the employer's fault or a third party's fault.

Decennial liability is mandatory in the sense that the contracting parties cannot opt-out of Article 880. In this regard, Article 882 of the Civil Code provides;

"Any agreement tending to exclude or limit the decennial liability of the engineer and the contractor shall be void".

The duration of decennial liability, 10 years, cannot be reduced but can be extended by agreement. The liability commences from the date of final delivery (not provisional delivery) of the works. Under Article 883 of the Civil Code, any claim for decennial liability must be brought within 3 years from the date of the collapse or the date of the discovery of the defect, as the case may be.

There is limited guidance offered by the UAE Courts (to the extent any decisions might offer persuasive authority) on what type of defects fall within the scope of Article 880. The Federal Supreme Court has described the requirements as follows:

"Likewise, the liability of the contractor and the engineer supervising the construction of the building is restricted to any total or partial collapse, or any defects that may appear that threaten the soundness and stability of the building. This liability does not extend to every defect that may be discovered in the building, unless such defect threatens the soundness and stability of the building".

On the latter point, only decennial liability claims would not be subject to a liability cap. Accordingly, LOL clauses should apply to claims related to defects that do not threaten the safety and stability of the building (i.e. non decennial liability claims).

Adjustment of pre-agreed limit

Article 390 of the Civil Code provides that:

"(1) The contracting parties may fix in advance the amount of compensation either in the contract or in a subsequent agreement, subject to the provisions of the law.

(2) The judge may in all cases, upon the request of either of the parties, vary such agreement so as to make the compensation equal to the loss, and any agreement to the contrary shall be void".

An LOL clause may be construed as an agreement to fix in advance the value of compensation.

Article 390(2) gives the court the ultimate right, upon the request of one of the parties, to increase or decrease the amount of pre-agreed compensation in order to reflect the actual loss suffered by the other party. The UAE courts have certainly reduced the amount of pre-agreed compensation on the basis on Article 390(2). The situation is less clear when it comes to increasing the pre-agreed compensation i.e. removing the limitation.

The official commentary on the Civil Code, issued by the UAE Ministry of Justice, provides (concerning Article 390):

“If the compensation is due and the same is equal to the loss sustained, then the liquidated damages agreement in question shall be upheld. However, if the due compensation is not equal to the loss sustained, the judge shall have the right, upon the request of one of the parties, to increase or decrease the amount of such compensation in order to reflect the loss. This is in line with the Shari’ah principles under which compensation shall be equal to actual loss suffered”.

In principle, at least, the UAE Courts remains empowered to increase the limit of liability on the basis on Article 390(2).

Conclusion

LOL clauses in construction contracts in most cases will be enforced by UAE Courts (or Arbitral Tribunals applying UAE law). However, it is clear under UAE law that certain claims will not be subject to these clauses. It is obviously critical that contracting entities understand what liabilities can and cannot be limited in a contract and the circumstances in which a limit of liability clause may be unenforceable.