

Liquidated Damages

Justin Ede - Senior Counsel - Arbitration / Mediation / Construction and Infrastructure
- Dubai International Financial Centre

Where the contractor has failed to complete by the scheduled completion date, he will be liable to a claim for liquidated damages either by way of action, by deduction or by a set-off. There can be no inquiry into the actual loss suffered. The advantage to an employer is that he will not need to prove the loss suffered. The most common default by a contractor that will give rise to a claim for liquidated damages is a failure to reach completion or to achieve specific milestones.

The contractor may have a defence to the claim by proving that the agreed sum is a penalty. In order to establish a penalty, the contractor will need to demonstrate that the predominant contractual function of the provision was to deter it from breaking the contract, rather than to compensate the innocent party for the breach. Proportionality of the damages to the costs reasonably anticipated to be incurred is key to maintaining a valid liquidated damages claim. If successful in establishing a penalty, the contractor could, however, still be vulnerable to a claim for unliquidated (general) damages.

The FIDIC Red Book, 1987, provides at clause 47.1 for “Liquidated Damages for Delay”, while the 1999 edition provides at clause 8.7 for “Delay Damages”.

When contractors are contemplating signing a contract for work in the UAE and the contract is to be governed by UAE law, however, they need to take heed of the local laws that apply to this subject.

The UAE Civil Code

Article 390(2) of the UAE Civil Code addresses the issue of the enforceability of liquidated damages in the UAE. In our translation, the Article provides:

- The contracting parties may fix the amount of compensation in advance by making a provision in the contract, or by later agreement, subject to the provisions of the law
- The court may, on the application of either party, vary such agreement so as to make the compensation equal to the loss and any agreement to the contrary shall be void.

Under UAE law, despite what the parties may have agreed, the court (or an arbitrator) has the ability retrospectively to change that agreement, to ensure that the damages are equal to the loss that has been suffered. The parties are not able to contract out of this.

Interpretation by the Court

Dubai Court of Cassation judgment 138/94 shows how the Court will view liquidated damages and penalties. While decisions of the Courts in the UAE are not binding, Court of Cassation judgments are certainly persuasive and often followed by lower Courts.

In this case, there was a dispute between a contractor and a subcontractor regarding delay to completion. The contract between the parties contained a “penalty clause” for delay to completion and the Claimant sought to recover the penalty in full.

The Court confirmed its general power to reduce the amount of damages agreed in the contract, where it is evident that the actual loss suffered is less than the total amount of damages agreed in the contract. A wide discretion is certainly alive and well.

It seems in fact that Courts in the UAE do not draw a distinction between a pure penalty and a pure

liquidated damages provision and indeed the terms penalty and damages were used interchangeably during the hearing. It is correct to assume that the distinction between the two terms made in common law jurisdictions is not significant in the UAE, due the overriding nature of the power of the courts under Article 390 of the Civil Code.

Conclusion

Parties entering into contracts need to be aware that the liquidated damages number that is 'hotly' negotiated and agreed, may be varied by a judge or arbitrator where the contract is governed by UAE law. There is discretion under UAE law for a judge or arbitrator to revise the damages up or down so as to match the actual loss that is suffered. In our experience, it is more common for the argument to be mounted by a contractor to reduce the damages. That said, there are certainly instances where an employer may apply to increase the damages.