

Abu Dhabi Court of Cassation Judgment on Liquidated Damages Clauses after Termination

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It is an established principle of UAE Courts of Cassation that the termination of any contract means that the primary obligation (i.e. the obligation to execute the contract) also terminates and consequently any other obligations set out in the said contract, including the Liquidated Damages clause (the "LD") and/or the penalty clause, shall terminate and cannot be applied anymore. Accordingly, the legal basis for claiming compensation, if any, will be based on tortious liability and not contractual liability.

In Abu Dhabi Court of Cassation Commercial Appeal 790 of 2013 (dated 22 October 2014), the Abu Dhabi Court of Cassation developed this established principle further, as it held that termination does not always prevent the court from applying a liquidated damages clause or a penalty clause. The Cassation Court highlighted that as long as the liquidated damages clause or penalty clause is an independent clause which the parties have agreed will survive termination, it will be effective after the termination of the contract.

Al Tamimi & Company successfully represented the claimant in this case before the Abu Dhabi Court of Cassation.

The facts of the case

The claimant entered into a development agreement with the defendant, whereby the claimant agreed to grant rights to the defendant to enable the latter to develop a plot of land by constructing a tower and thereafter to use, enjoy and deal with the tower and pay the premium in accordance with the terms of the contract.

The defendant paid instalments amounting to 50% of the premium but failed to pay the remaining instalments.

After terminating the defendant on notice, the claimant filed a case before the Abu Dhabi Court of First Instance seeking (i) approval of its right to terminate the contract (ii) compensation amounting to AED 64,048,522 representing its loss of profit sustained due to the defendant's failure to execute the contract.

The Abu Dhabi Courts' findings

The First Instance Court issued a judgment approving the claimant's termination of the contract and awarding compensation of AED 31,285,656 (as per the evaluation of the court appointed experts).

Al Tamimi & Co was appointed to represent the claimant before the Court of Appeal. On appeal the claimant argued that the contract includes a liquidated damages clause which stipulates that in case of termination of the contract due to the defendant's breach, the claimant will be entitled to

have all the due instalments up to the date of termination. Therefore, the claimant requested from the Appeal Court an order for compensation amounting to AED 55,972,800 instead of AED 31,285,656.

The Court of Appeal rejected this argument and highlighted that the court was not allowed to apply liquidated damages clauses after the termination of a contract.

The claimant filed an appeal to the Court of Cassation. The claimant argued that the Court of Appeal had failed to notice that the parties had agreed in the contract that the liquidated damages clause would stand and be effective after termination, and that it did not simply apply during the execution of the contract. Accordingly, the judicial principle that the Appeal Court relied on did not apply.

The Court of Cassation accepted this argument by the claimant, holding that:

- Although there is a judicial principle which holds that the termination of any contract means that the contract and all its clauses (including the LD or penalty clause) terminates, this is only applicable if the LD clause or penalty clause represents a penalty for any failure to perform the contractual mutual obligations during the execution of the contract.
- However, if the LD clause or penalty clause provides that it will survive and be effective after termination of the contract as a penalty for said termination, rather than being a penalty that is due upon any failure on performing the mutual contractual obligations during the execution of the contract, then such a clause is to be considered as a separate and independent agreement even though it is stipulated in the terminated contract.
- Therefore, the judicial principle that the Appeal Court referred to and relied on is not applicable in the subject case and accordingly the LD clause or the penalty clause is to be applied.

The importance of the judgment

The judgment is important for a number of reasons.

On a practical level, it firmly clarifies, for the first time in UAE, that LD clauses and penalty clauses are classified into two types according to the text of the clause.

The first type are those that are to be applied when one party has failed to perform a contractual obligation during the execution of the contract. Such a clause falls down upon the termination of the contract and cannot be applied anymore as it is considered as a secondary obligation that follows the primary obligation (i.e. the execution of the contract).

An example of this first type of clause is the LD clause set out in the 1999 FIDIC Red book at clause 8.7^[1]. This provides that:

“If the Contractor fails to comply with Sub-Clause 8.2 [Time for Completion], the Contractor shall subject to notice under Sub-Clause 2.5 [Employer’s Claims] pay delay damages to the Employer for this default. These delay damages shall be the sum stated in the Contract Data.”

The abovementioned LD clause constitutes a penalty on the contractor in case the latter breaches its contractual obligation to complete the project on the agreed date and the aforementioned penalty is effective during the execution of the contract. Accordingly, if the employer terminated the contract, this LD clause (clause 8.7) will not be valid anymore and cannot be applied as it falls down after the primary obligation of the contractor (i.e. to execute the contract) ceases upon the termination of the contract.

The second type of LD clause or penalty clause are those that consist of an independent agreement between the parties regarding the due compensation or penalty that will be due after the

termination of the contract. Accordingly, in this type of clause the LD clause or the penalty clause represents the due compensation as a penalty for terminating the contract and not a measure that will be applied during the execution of the contract in case a breach of a contractual obligation.

Before this Cassation judgment, the UAE Courts would not apply LD clauses and penalty clauses after the termination of the contract and were awarding compensation, if any, based on tort liability, which means that the claimant had to prove the actual damages sustained. Accordingly the compensation awarded was equivalent to the value of the damages suffered.

After this judgment, the Court has clarified that a claimant can request that the other party pay the amount of the LD clause or the penalty clause, if any, after terminating the contract, if the clause can be shown to be an independent agreement granting damages in the even the contract is terminated.