



# **THE EFFECT OF ARTICLE 390(2) OF THE UAE CIVIL CODE ON LIQUIDATED DAMAGES CLAIMS IN THE UAE CONSTRUCTION INDUSTRY**

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Philips v Attorney General of Hong Kong 61 B.L.R. 41 (PC)

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### **Table of Statutes**

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Federal Law No. 18 of 1993, Issuing the Law of Commercial Procedure

Federal Law No.10 of 1992, Issuing the Law of Proof in Civil and Commercial Transactions

### **Table of Rules**

Dubai International Arbitration Centre Rules 2007

Dubai International Financial Centre – London Court of International Arbitration Rules 2008

### **Table of Treaties**

New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958)

Riyadh Arab Agreement for Judicial Cooperation, 6 April 1983 between United Arab Emirates, Jordan, Bahrain, Tunisia, Algeria, Djibouti, Saudi Arabia, Sudan, Syria, Somalia, Iraq, Oman, Palestine, Qatar, Kuwait, Lebanon, Libya, Morocco, Mauritania and Yemen (“Riyadh Treaty”)

**Table of Abbreviations and Definitions**

<i>Article</i>	Article 390(2) of the UAE Civil Code
<i>UAE Civil Code</i>	Federal Law No. 5 of 1985, Issuing the Law of Civil Transactions
<i>DIAC</i>	Dubai International Arbitration Centre
<i>DIAC Rules</i>	Dubai International Arbitration Centre Rules 2007
<i>DIFC-LCIA Rules</i>	Dubai International Financial Centre – London Court of International Arbitration Rules 2008
<i>FIDIC</i>	Federation International des Ingeneurs- Conseils
<i>LD</i>	Liquidated Damages
<i>NYC</i>	Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958)
<i>Riyadh Treaty</i>	Riyadh Arab Agreement for Judicial Cooperation, 6 April 1983 between United Arab Emirates, Jordan, Bahrain, Tunisia, Algeria, Djibouti, Saudi Arabia, Sudan, Syria, Somalia, Iraq, Oman, Palestine, Qatar, Kuwait, Lebanon, Libya, Morocco, Mauritania and Yemen
<i>UAE</i>	United Arab Emirates
<i>UAE Commercial Code</i>	Federal Law No. 18 of 1993, Issuing the Law of Commercial Procedure
<i>UAE Evidence Code</i>	Federal Law No.10 of 1992, Issuing the Law of Proof in Civil and Commercial Transactions

### **ABSTRACT (English)**

Issues relating to liquidated damages strike at the heart of any construction project as they regularly feature in construction disputes and usually involve substantial sums. In the context of the UAE, there is certain disquiet amongst construction players and legal practitioners alike that the UAE Civil Code, in particular Article 390(2), instead of being a beacon of light to illuminate parties' rights, has the reverse effect of muddying their rights and obligations when claiming under a liquidated damages clause. Is this criticism of the Article fair or is it merely the musing and whining of parties disgruntled by the court's exercise of its power pursuant to the Article to do justice in an individual case?

In light of the foregoing, the dissertation seeks to examine the terms of the Article and its impact on claims for recovery of liquidated damages in construction projects in the UAE. In particular, the interplay between the right of parties to freely contract and the court's supervisory jurisdiction to limit this right, which is a power drawn directly under the Article, shall be highlighted and examined. As a corollary, this analysis also highlights the sometimes uneasy relationship between common law principles, which have spilled over and somewhat overflowed into the UAE legal landscape, and the indigenous civil and Shariah law principles which predicate and overarch the Article and Civil Code.

A study of various UAE case law is undertaken including the analysis of the various principles, tests and thresholds applied by local courts when considering and applying the Article in particular cases. It is also intriguing to ascertain how arbitral panels grapple with the Article in UAE arbitrations especially where the tribunal members or disputants emanate from outside UAE. This has an impact on the wider view in relation to the attractiveness of the UAE as a regional arbitration centre or hub. A recent seminal arbitration decision shall be considered.

The upshot to these, as will be demonstrated, is that the Article is alive and well and is almost frequently argued and applied in the courts. Though not free from infirmities, it does go some distance in achieving justice on a case by case basis. It will also be shown that, at least in one arbitration proceeding, the Article remains relevant and vital in adjusting the rights of parties with a view to achieving fairness between them. The dissertation also proposes a new detailed draft provision which may be considered for adoption to improve the understanding and operational efficacy of the present Article itself.

**Word Count: 419**

## **ABSTRACT (ARABIC)**

### **ملخص**

إن المسائل المتصلة بالتعويضات المتفق على قيمتها سلفاً تؤثر بصورة مباشرة على أي مشروع إنشاءات. وفي محيط دولة الامارات العربية المتحدة فإن هناك نوعاً من الفلق يسود أوساط العاملين في قطاع الإنشاءات والممارسين القانونيين على السواء لأن قانون المعاملات المدنية بدولة الإمارات العربية المتحدة وبصفة خاصة المادة رقم 390/ منه، بدلاً من أن يكون بمثابة منارة تضيء للأطراف طريق حقوقهم ، صار يضفي غموضاً على حقوق والتزامات الأطراف التي تقدم أي مطالبة بموجب مادة التعويضات المتفق عليها سلفاً. هل هذا الانتقاد لهذه المادة يعتبر عادلاً بصورة حقيقية أم مجرد إدعاءات وأوهام يسوقها الأطراف معبرين عن سخطهم بسبب ممارسة المحكمة لسلطتها بموجب هذه المادة للفصل في أي دعوى فردية.

وعلى هذا الأساس فإن هذا البحث يهدف لدراسة شروط المادة رقم 390/2 من قانون المعاملات المدنية وتأثيرها على المطالبات بتعويضات متفق على مبالغها في مشاريع الإنشاءات في دولة الإمارات العربية المتحدة. وبصفة خاصة سيتم إلقاء مزيداً من الضوء على التداخل ما بين حق الأطراف في التعاقد بحرية والإختصاص القضائي الإشرافي على تقييد هذا الحق وهي سلطة يتم ممارستها بصورة مباشرة بموجب هذه المادة . وكنتيجة حتمية فإن هذا التحليل يركز أحياناً على تلك العلاقة المضطربة نوعاً ما بين مبادئ القانون العام والتي غطت وغمرت قطاع القانون في دولة الإمارات العربية المتحدة من جهة والمبادئ التقليدية للشريعة والقانون المدني والتي تنسب إليها هذه المادة وقانون المعاملات المدنية من جهة أخرى.

وفي هذا البحث سيتم إجراء تحليل للجوانب المختلفة للقانون في دولة الإمارات العربية المتحدة بما في ذلك تحليل المبادئ والممارسات المختلفة التي يتم إستخدامها من قبل المحاكم المحلية عند تطبيق هذه المادة في دعاوي قضائية معينة. كما يحاول البحث التأكد من كيفية تعامل محاكم التحكيم مع هذه المادة في قضايا التحكيم وبصفة خاصة عندما يكون المحكمون أو المتنازعون من خارج دولة الامارات العربية المتحدة. وهذا الجانب بصفة خاصة يكون لديه تأثير عندما يتم التقييم من قبل المراقبين حول عما إذا كانت دولة الإمارات العربية المتحدة يمكن أن تعتبر مركز تحكيم إقليمي جذاب. ومن خلال هذا الإطار سيتم فحص ودراسة أحدث قرارات التحكيم النموذجية.

والخلاصة التي يتوصل إليها البحث هو أن هذه المادة مفعلة ومتداولة وهناك إقتناع بها إذ أنها مطبقة في المحاكم. وعلى الرغم من أنها لا تخلو من العيوب إلا أنها حققت الكثير في إشاعة العدل إذا تم النظر إليها على أساس حالة بحالة. وكما توضح الدراسة فإنه وعلى الأقل في قضية تحكيم واحدة فإن هذه المادة بقيت حيوية ومثارة في الحفاظ على حقوق الأطراف وتحقيق العدل فيما بين المتنازعين.

ويقترح هذا البحث مسودة شرط مفصل جديد يمكن أن يتم النظر في إقراره من أجل تعزيز فهم وتحسين الفاعلية التشغيلية للمادة الحالية نفسها.

## CHAPTER 1: INTRODUCTION

The present Chapter provides an overview of UAE law in relation to civil and commercial matters and the Article itself. It identifies the research problem and the associated research questions that this study seeks to answer. The research methods applied and the aims and objectives of this study are also presented in this Chapter accompanied by the purview and significance of the research.

### 1.1 Background

Though jurisprudentially young in legal terms, the United Arab Emirates (“UAE”) possesses a compendium or collection of rules and laws which are codified much like in other civil law systems in the world.

One of the more seminal codes in this regard is the Federal Law No. 5 of 1985 (“the Civil Code”) which is the baseplate of the law of UAE.<sup>1</sup> The Civil Code serves as a primary source of legislation for civil and commercial matters to the extent not specifically addressed by other special purpose legislations.<sup>2</sup> As such, the Civil Code regulates contracts including construction agreements where UAE law is the applicable governing law.

Juxtaposed to this, however, is the fact that most of the construction forms<sup>3</sup> utilized in the UAE emanate from outside the country and are heavily influenced by other legal systems including principles of common law. In this regard, Essam Al Tamimi, a prominent UAE legal practitioner, aptly observed,<sup>4</sup>

*“In addition, because of the nature of Dubai in particular as a commercial center and because of the presence of international law firms with “common law” roots, many contracts which have been drafted in the UAE appear to have been influenced by common law principles. This has created difficulties in the application of the law to these contracts by the courts of the UAE since judicial authority does not recognise some of the principles or the practices of the common law system...”*

<sup>1</sup> Marjorie Hall, *Business Laws of the UAE*, vol III (1987 edn, Graham & Trotman Limited 1987) 3.1 ii

<sup>2</sup> Bryan Cave LLP, *Business Laws of the UAE*, vol 1 (2004 edn, Brill Academic Publishers 2004) 8

<sup>3</sup> Examples include the first version of the Federation International des Ingeneurs-Conseils (Fidic) Red Book published in 1987 and the newer version of the Fidic Red Book published in 1999 with amendments

<sup>4</sup> Essam Al Tamimi, *Practical Guide to Litigation and Arbitration in the United Arab Emirates* (1st edn, Kluwer Law International 2003) 5

UAE therefore often witnesses the frontline battle between two fundamental but disparate legal systems where waves of common law principles regularly strike the shores of the indigenous laws of the UAE - often with unpredictable consequences. At the sharp end of this frontline battle is the impact the Civil Code has on claims for liquidated damages ("LD") in a construction project in the UAE.

## 1.2 General Principles

Briefly, the fundamental legal first principle in relation to LD (which is heavily influenced by the common law legal position) is that claims for LD which represent a genuine pre-estimate of damages are recoverable.<sup>5</sup> On the other hand, if the amount of the LD is established to be *in terrorem* or excessive by the courts, it is a penalty and thus is not recoverable.<sup>6</sup> However, case law indicates that the English courts generally appear to be reluctant to descry a penalty clause and are predisposed to upholding contractual terms agreed between parties which fixed the level of damages for breach.<sup>7</sup>

Therefore, for every common law trained legal practitioner, the notion of LD in construction contracts appears unremarkable. *Sans* the unenforceability of the agreement underlying the LD clause or the LD clause itself and save for it being found to be a penalty, it does not lie for a contractor, the party on whom the LD would fall upon, to contend that it should not be imposed or that it should be reduced. In fact in most commonwealth courts, the award of LD where delay is proved is almost assured - it being a purely arithmetical exercise between the number of delay days and the rate of LD per day.<sup>8</sup>

This simplicity is deliberate and serves at least four (4) useful purposes, which are as follows:

### 1.2.1 Administrative convenience

It ensures that the employer or party relying on the LD clause does not have to prove loss. This saves time and costs in proceedings and obviates the need to reopen this issue at least at the initial stage. The

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<sup>5</sup> *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd* [1915] AC 79 CA, 86-88

<sup>6</sup> *Robophone Facilities Ltd v Blank* [1966] 3 All ER 128 (CA), 1446-1447

<sup>7</sup> Hamish Lal, "Liquidated Damages" (2009) 25 Construction Law Journal No 8, 571

<sup>8</sup> *Philips v Attorney General of Hong Kong* 61 B.L.R. 41 (PC), 58-59

party challenging has to then prove to the court why the LD is inapplicable or is a penalty.

### **1.2.2 Protection of the contractor**

The cap on the LD actually also protects the contractor in that he can be apprised of his worst case exposure in the event the full LD sets in and he can then price his work accordingly.

### **1.2.3 Deterrence**

The LD also appears to be a powerful tool which confers upon the employer the security of the contractor's timeous performance on pain of the contractor being liable to deductions which could deplete his margins or in some cases which may cause the contractor loss. For the contractor, this provision either incentivizes him to complete on time or deter him from delaying the project.

### **1.2.4 Certainty and avoids litigation**

Theoretically at least, it has also been stated that LD clauses serve the useful purpose of promoting commercial certainty and litigation by allowing parties to know in advance the financial consequences of breach on their part and hence dissuades the need to litigate in future.<sup>9</sup>

## **1.3 Article 390(2) (“the Article”)**

However, for these common law trained legal players, the application of this notion in the UAE itself may take them by surprise as the UAE courts are conferred with full statutory authority to adjust the LD. This comes in the form of Article 390(2) of the UAE Civil Code. For completeness, Article 390 states that:

*“(1) The contracting parties may fix the amount of compensation in advance by making a provision therefore in the contract or in a subsequent agreement, subject to the provisions of the law.*

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<sup>9</sup> Lal (n 7) 570

*(2)The judge may in all cases, upon the application 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.”*

The Official Commentary on the Civil Code<sup>10</sup> states:

*“Entitlement to compensation is a prerequisite for the application of this Article. If compensation is not payable, then the provisions of this Article do not come into operation. If compensation is due and payable and the amount determined by the parties is compatible with the damage sustained, then well and good. However, if it is more or less, then the judge may reduce or increase the figure upon the request of either party, as it is a jurisprudential requirement that the amount of compensation should be equivalent to the actual damage sustained.”*

## **1.4 Research Problem**

### **1.4.1 Unclear Case law**

As will be demonstrated, UAE case law is not consistent as to when judicial intervention to reduce the LD is permissible. There are some cases espousing the principle that an adjustment is to be made when the LD claimed is exaggerated or excessive in relation to the amount of loss whilst in others it appeared sufficient that the actual loss did not equal the LD. This vagueness has serious repercussions on the smooth operation, and, hence, confidence in the application of the Article.

### **1.4.2 Standard of proof**

It is also unclear what is the legal standard of proof required in practice for the party to discharge his burden pursuant to this Article and whether they are the same for both the party relying on the LD clause and the party challenging the clause. This is critical as it impacts the ability of parties to prepare and present their respective cases and affects, ultimately, their prospects of success.

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<sup>10</sup> James Whelan, *UAE Civil Code and Ministry of Justice Commentary* (Thomson Reuters 2010)

### 1.4.3 Article and Arbitration

It is also instructive to consider whether this rule of law is recognized and accepted in construction-related arbitration proceedings. Real estate and construction cases constitute a major share of arbitration disputes in the UAE<sup>11</sup> most of which come under the governing jurisdiction of UAE law. As LD claims are found *passim* in almost all construction disputes, it would appear that the Article may be influential in the examination and final determination of such claims.

### 1.5 Research Questions

The study seeks to answer the following research questions, namely:-

1. How do we reconcile the impact of the Article in light of the pre-agreed LD?
2. How does the Article operate in practice in the courts?
3. How does the Article feature in the context of arbitrations?

### 1.6 Aims and Objectives

The aim of this study is to ascertain whether and to what extent the Article changes the dimension of party litigation in construction disputes including whether the Article is effective in achieving justice and fairness between litigants.

This aim is fortified by the following objectives:

1. To determine whether the Article impact construction disputes when LD were already agreed pursuant to the principle of freedom of contract?; And
2. To analyze the ambit of the Article and to establish whether it facilitates the judge/arbitrator to ensure that recovery is predicated on actual loss irrespective of prior agreed LD?

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<sup>11</sup> Dubai International Arbitration Centre, "Official Statistics 2011"

## 1.7 Research Methods

To respond to the above questions, it is considered that an examination of the wordings of the Article itself be examined including the official commentaries on the same. Further, there is a steady source of case law on the Article though a scrutiny of their nuances suggests that they do not, at all times, speak with one voice.

As is established practice, arbitration cases and awards are confidential and external parties have no resort to them. It is therefore not immediately plain as to whether, and if so, international arbitrators grapple with the Article and to what extent they do so. To alleviate this evidential and empirical difficulty, an expurgated reference to a major arbitration case in which this author was involved in and where the Article was considered will be made. Though this case may be indicative of how other arbitration tribunals deal with the Article, it is by no means decisive and every arbitration turns on the facts presented to the tribunal in a particular case. However the case still provides an intriguing window as to how international arbitrators contend with the Article.

## 1.8 Significance of Research

The average value of disputes in the construction industry in the Middle East construction industry more than doubled in 2011 rising by 104% to US\$112.5 million compared to US\$56.25 million twelve months earlier<sup>12</sup>. Hence, the effect of the Article may feature prominently in view of the fact that most construction disputes involve LD. This particularly so as the more common forms of contract used in UAE, the FIDIC Red Book 1987 [clause 47.1] and the 1999 edition of the same [clause 8.7] both specifically cater for LD or delay damages respectively.

The research seeks to provide one of the few written English language dissertations and journals on the topic. The significance of the topic cannot be underestimated in view of the fact that the Article dramatically alters the respective pre-agreed positions of both the employer and contractor on LD which in major projects are very considerable amounts.

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<sup>12</sup> EC Harris, *Global Construction Disputes Reports*, 2012

## 1.9 Structure of Dissertation

This dissertation consists of six chapters. The present Chapter provides an overview of UAE law in relation to civil and commercial transactions and the Article itself. It identifies the research problem and the associated research questions that this study seeks to answer. The research methods applied and the aims and objectives of this study are also presented in this Chapter accompanied by the purview and significance of the research.

Chapter 2 provides an analysis of the core provisions of Article 390 and its official commentaries and explanations thereto. The ambit of the Article is also discussed herein.

Chapter 3 analyzes the operation of the Article in practice in the UAE courts. The salient principles laid down in the courts and their application to various cases are examined. Two practical difficulties in its operation and effectiveness are also analyzed.

Chapter 4 shall examine whether the Article has any role to play in construction-related arbitration disputes and the manner in which, if at all, it impacts such disputes. A recent seminal arbitration decision is discussed to provide an indication of the Article's relevance and importance in arbitrations including a consideration of practice points that stem from the decision.

Chapter 5 postulates the merits of the Article. A draft new provision is also postulated for consideration in order to address some of the drawbacks of the Article and to improve its application in formal dispute processes.

Chapter 6 weaves together the sum total of the research outcomes to present the overall findings and recommendations for further research.

## **CHAPTER 2 – THE ARTICLE**

Chapter Two provides an analysis of the core provisions of Article 390 and its official commentaries and explanations thereto. The ambit of the Article is also discussed herein.

### **2.1 Preamble**

At the outset, it ought to be highlighted that the Civil Code, the codified law in which this Article is located, heavily imports Islamic Shariah principles into its provision and comprises Islamic-law based rulings especially with respect to damages.<sup>13</sup>

### **2.2 Article 390**

The wordings of the Article are self-explanatory and are reproduced below:

*(1) The contracting parties may fix the amount of compensation in advance by making a provision therefore in the contract or in a subsequent agreement, subject to the provisions of the law.*

*(2) The judge may in all cases, upon the application 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.*

#### ***Enabling provision***

Article 390(1) is an enabling provision specifically recognizing the validity of pre-agreed liquidated damages provisions between parties.

#### ***Supervisory jurisdiction***

However, Article 390(2) limits the application of such provisions by empowering the judge with discretion to vary the pre-agreed amount of damages in line with the loss suffered.

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<sup>13</sup> W M Ballantyne, "The New Civil Code of the United Arab Emirates: A Further Reassertion of the Shariaa" (1986) 5 Arab Law Quarterly 245

The explanatory notes<sup>14</sup> issued by the UAE Ministry of Justice explained that the Article does not apply to agreements on amount of damages when actual damages have already been incurred or suffered. Therefore, the intent of the Article is to assist the parties to assess damages in advance given that it may be difficult for the parties to assess the amount of actual damages as and when they arise.

### 2.3 Rule of Jurisprudence

Effectively, the rule of law enshrined in the Article is that the court may reduce the compensation that was earlier agreed between the parties. *Ipsa facto*, this not only shifts the relational tectonic plates between the parties but it now behoves on the employer to prove that he suffered the actual loss which builds up to the LD that he is actually claiming. The force behind the Article then is that it is a mandatory provision. Article 31 of the Civil Code states:

*"A mandatory provision [of law] shall take precedence over a duty created by a contractual stipulation"*

### 2.4 Rule of Practice

The Article is not only a basic rule of jurisprudence but a rule of practice. Once a contractor objects to the amount (which he had assented to before), the court is entitled to look at the LD claim and decide whether losses equivalent to the LD were actually suffered and not merely claimed. This is perfectly consonant with its sister provision - Article 292 of the Civil Code. Article 292 states that:

*"In all cases the compensation shall be assessed on the basis of the amount of harm suffered by the victim, together with loss of profit, provided that that is a natural result of the harmful act".*

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<sup>14</sup> Whelan (n 10)

## 2.5 AMBIT OF THE ARTICLE

To effectively apply this Article in a formal dispute process, its ambit and purview must be properly understood.<sup>15</sup> The Article:

- (1) allows for damages to be both decreased or increased in fit and proper cases, as the case may be; and
- (2) only applies for consideration if actual damages are incurred and the obligation to pay has arisen;

but does not apply to:

- (3) post breach agreed compensation;
- (4) when the agreement has lapsed or been terminated; and
- (5) claims under tort.

### 2.5.1 The damages may be decreased or increased

In the regional context, whilst the civil codes of Egypt, Algeria and Qatar, for example, also anticipate a possibility of judicial intervention to restore an imbalance in an agreement, the Article, inspired to a greater extent by the overarching rules of Shariah, is more discrete and specific in conferring the judge the full freedom to adjust the amount of damages under the parties' agreement.<sup>16</sup> This is ascribed to the fact that while the civil codes of Qatar, Egypt and Algeria do not permit their courts to increase the amount of liquidated damages (unless there is fraud or gross negligence), there is judicial discretion for UAE courts to do so.

It has been observed that this judicial power to increase the LD undermines one of the most important advantages of having an LD clause in the first place which is the protection of the contractor against

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<sup>15</sup> This has to be read in conjunction with judicial principles discussed at 3.2 below which supplement the scope and ambit of the Article.

<sup>16</sup> Said Hanafi, "Contractors Liability under the Civil Codes of Algeria, Egypt, Qatar & the UAE", Vol 25, The International Construction Law Review, 2008, 229

unliquidated damages.<sup>17</sup> In such a case, it has been suggested that as a trade-off the contractor should at least be conferred the specific right to equally apply to the court to increase his contract price if he sustained more losses than what was anticipated at the contract signature which may have been caused by factors such as a sudden increase of material cost, labour strikes, etc. This argument proceeds on the basis that if the court is permitted to rectify a wrong or unfair provision in a contract pursuant to the Article, this discretion should be applied as a general rule and not only in relation to damages.<sup>18</sup>

However, the judicial power to impact on parties pre-agreed positions in construction cases is not unusual. It is noteworthy that, even in cases involving apportionments of delay in construction disputes, it is not uncommon for decision makers i.e. judges or arbitrators to exercise the contractual mechanisms themselves and to retrospectively apportion responsibility for a delay.<sup>19</sup>

### **2.5.2 Article only applies if actual damages incurred and obligation to pay has arisen**

The explanatory notes also state that the pre-agreed or pre-ascertained LD provision would only apply if actual damages are incurred. This must be true as LD clauses are ancillary contractual obligations and only apply when the corresponding obligation to pay damages has arisen. Hence, it is suggested that the Article is symbiotic to the LD clause itself. Interestingly, this approach dovetails the English position on this point as illustrated by the recent decision of Henning Berg v Blackburn Rovers [2013] EWHC 1070 (Ch). In Henning Berg, Berg was employed as the club manager for Blackburn Rovers football club. The employment contract provided for a fixed term of three years, which was terminable by Blackburn Rovers for convenience, but subject to the payment of Berg's salary for the remainder of the fixed term. The payment provision was

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<sup>17</sup> James Mullen, "Liquidated damages under UAE and UK law: A Comparison", Fenwick & Elliott Annual Review, 2013-2014 <<http://www.fenwickelliott.com/research-insight/annual-review/2013/liquidated-damages-uae-uk-law-comparison?> accessed on 10 March 2014

<sup>18</sup> Mohd Shafik, "UAE Construction Law: A UK Perspective on Payment and Liabilities" (LLM, University of Salford 2010) 23

<sup>19</sup> Dado Hrustanpasic, "Time Bars and the Prevention Principle: Using fair extensions of time and common-sense causation", (2012) Construction Law Journal, 383 & Bailey, "Concurrency, Causation, Commonsense and Compensation (Part 2)", (2010) 27 International Construction Law Review, 203

described in the contract as a compensation payment and liquidated damages.

Berg's employment was terminated after 6 months. He claimed GBP 2.25 million in salary for the remaining 18 months. Blackburn Rovers refused to pay on the basis that the provision was unenforceable as a penalty.

The court held that the clause was not capable of being a penalty because the payment did not become due as a result of a breach of contract. In this case, Blackburn Rovers was entitled to terminate the contract and the obligation to pay damages did not arise at all.

This English approach is also consonant with the effect of Article 338 of the UAE Civil Code which determines that if an obligation is not fulfilled the party in breach will be entitled to compensate the other party which, to turn this provision on its head, logically means that the LD will not apply unless an obligation for payment of damages has first been established in general.<sup>20</sup>

### **2.5.3 Article does not apply to post-breach agreed compensation**

It is important to bear in mind that the Article is otiose where parties agree to an amount of compensation payable to the injured party *after* the contract provision has been breached. In such a scenario, this agreed amount is not subject to review or adjustment by the courts pursuant to the Article.<sup>21</sup>

### **2.5.4 Article does not apply when agreement is terminated or has lapsed**

Further, upon a rescission, all agreements, obligations and undertakings included in the contract lapse, and when the principal obligations lapse the pre-agreed damages will also lapse. In such a case there is no room to apply the Article.

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<sup>20</sup> Ulf-Gregor Schultz, *Liquidated Damages under the UAE Laws – A Reliable Compensation Mechanism for both the Employer and the Contractor?*, Arab-German Yearbook 2013, Construction & Consulting, 121

<sup>21</sup> Jatinder Garcha, 'UAE: Limitations of Liability in the UAE – Beware! (14 November 2013, Fenwick Elliott LLP)  
<<http://www.mondaq.com/x/272284/Building+Construction/Limitations+On+Liability+In+The+UAE+Beware>> accessed 10 March 2014

### 2.5.5 Article does not apply to claims under tort

As it is a pre-agreed contractual clause, a claim for compensation based on default and liability in tort does not trigger the provisions of the Article.

## 2.6 Conclusion

In view of the importance of this Article, recognition of its intent and ambit is necessary for both employers and contractors so that:

- (a) It may lead to a negotiation of a successful contract for both parties;
- (b) It ensures proper risk evaluation by both contractors and employers and reduces, as far as possible, any unintended consequences; and
- (c) Records and documentary evidence to prove actual losses are retained.

For the contractor, in a case of a possible reduction of the LD, the Article may thereby assist him to pursue/defend his entitlements – an avenue which may not be available to him under western systems.<sup>22</sup>

To the contrary, for the unwary employer, entrapment may be almost complete. The mere arithmetical tabulation of the LD is viewed as a theoretical or paper loss and therefore uncompensable. Whilst at the initial stage the employer may still activate his claims for LD which will place the contractor in a defensive posture as the contractor may have to proceed with the entire rigmarole of filing his claim with the engineer or even to arbitration, this may all ultimately be a pyrrhic victory to the employer in view of the Article and if the employer is unable to prove actual loss.<sup>23</sup> Instead, there must be cogent evidence evinced (usually by way of expert evidence) to prove that the LD claimed was actually lost/incurred. It is not uncommon that there is considerable number of instances where the employer is simply unable to do so. In view of the above and the fact that even claims produced on a “global” basis by contractors are invariably frowned upon by courts or arbitrators<sup>24</sup>, it can be reasonably presumed that it is equally important for the employer defending an LD clause to place forward a

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<sup>22</sup> Raid Abu Manneh, ‘Construction and Engineering, Contracting in the Middle East’, Mayer Brown, (2008) Issue 57 December, 6.

<sup>23</sup> Antonios Dimitracopolous, “Construction Contracting in the Middle East: Regional departures from international practices” (March 2008) Construction Law International, Volume 3 No 1, 7

<sup>24</sup> Vincent Hooker, “Major Oil & Gas Projects – the real risks to EPC contractors and owners” (2010) Construction Law Journal, 123

breakdown of actual loss in order to prevent the downward adjustment of the LD by virtue of the operation of the Article.

## **CHAPTER 3 – THE ARTICLE IN THE COURTS**

Chapter Three analyzes the operation of the Article in practice in the UAE courts. The salient principles laid down in the courts and their application to various cases are examined. Two practical difficulties in its operation and effectiveness are also analyzed.

### **3.1 General**

As a matter of practice, the UAE courts do exercise their discretionary power in accordance with the Article to intervene and vary the agreement of the parties in relation to pre-agreed amounts of LD.

It appears that the party who wishes the judge to exercise his discretionary power would have the burden of establishing why the pre-agreed amount should be varied either downwards or upwards. It is however very rare for the court to actually increase the amount of damages and the vast majority of the cases involved a reduction of a pre-agreed LD to reflect actual loss.<sup>25</sup>

A sampling of various court decisions which reveal the tests, principles and thresholds applied by the local courts in relation to the Article shall be set out hereunder. However, the following caveats apply:

1. Decisions of the highest UAE courts do not possess legal binding authority but, in practice, they are very persuasive and often relied upon by UAE legal advocates in their arguments before the local courts.
2. It is not uncommon to find cases with conflicting nuances because different judges may take different approaches in applying the relevant legal provisions to the particular facts or circumstances of their cases.
3. There may be scope, in a particular instant, to argue that the LD provision in question is not applicable at all because of certain peculiar facts and/or provisions of the contract.

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<sup>25</sup> Raeesa Rawal, "Damage control: reconciling deducted delay damages and actual damages" (October 2012) *Construction Law International*, Volume 7 Issue 3, 42

### 3.2 JUDICIAL PRINCIPLES

As the Civil Code is a body of codified regulations, judicial exposition of the various articles under the Code is important for it provides a guidepost for litigants or users of the Code to comprehend the exact scope and remit of a particular provision of the Code.

In the context of this Article, the following salient judicial principles appear to apply, namely:

- 3.2.1 Compensation must equal actual damage
- 3.2.2 LD clauses are recognized but cannot be excessive
- 3.2.3 Tests for awarding damages must be satisfied
- 3.2.4 Elements of damage must be proven
- 3.2.5 Burden rests with challenging party

#### 3.2.1 Compensation must equal actual damage

The Dubai Court of Cassation in its judgment confirmed:

*“The condition contained in a construction contract, which is subject to private law to the effect of binding the contractor to pay a fixed fee to the employer or the main contractor, regarding each period of time in which the contractor delays performing the agreed work, is a mere agreed compensation (Liquidated Damage), it is established in accordance with Article (390) of the Civil Transactions Law that it is allowed for contracting parties to specify in advance the amount of compensation by including such in their contract or in a subsequent agreement subject to the provisions of the Law, the judge may, in all cases, when requested by any party, amend such agreement to the effect of making the compensation equal to the actual damage, any agreement to the contrary is null and void...”<sup>26</sup>*

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<sup>26</sup> Dubai Court of Cassation in Appeal 222/2005, Judgment issued on 19th June 2006

### **3.2.2 LD clauses are recognized but cannot be excessive**

It is perfectly acceptable for parties to specify in advance the amount of such compensation by providing for it in the contract or in a subsequent agreement. This is in line with Article 2 of the UAE Commercial Code<sup>27</sup> where the parties are entitled to agree on any contractual terms that they deem fit, provided that such terms are not inconsistent with the provisions of law or contrary to public order or public morals.

However, the law imposes exceptions to such freedom; one of them is the concept of re-assessment of delay damages. It is opened to the judge in proper circumstances to reduce the level of the consensual damage if it is demonstrated that the amount of the compensation is seriously excessive.

### **3.2.3 Tests for awarding damages must be satisfied**

The following conditions for awarding damages must be satisfied<sup>28</sup> before the Article may be fully consummated and applied:

- (a) Fault or civil wrongdoing on the part of the party who agreed to pay the pre-agreed LD;
- (b) The party who invokes the pre-agreed LD actually incurred damage; and
- (c) There must be causation between the fault/civil wrongdoing and the damages.

The above conditions are applicable as the inclusion of the LD clause into a contract does not supersede this tripartite test for awarding damages as these are the normal requirements that must be satisfied for recovery of damages in the UAE.<sup>29</sup> Therefore, in the context of an LD claim, in order to establish whether compensation is payable, the court examines the conditions giving rise to it, namely a contractor default, actual damage, and the causal relationship between the default and the damage, which is the criterion for the assessment of

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<sup>27</sup> Federal Law No 18 of 1993, Issuing the Law of Commercial Procedure

<sup>28</sup> Dubai Court of Cassation Petition No. 494/2003, the hearing of 24 April 2004 and Federal Supreme Court Petition No. 344/19 (judicial year), the hearing of 23 January 1999.

<sup>29</sup> Faisal Attia, "Liquidated Damages – The Bigger Picture" (Al Tamimi Law Update, March 2012) <<http://www.tamimi.com/en/magazine/law-update/section-6/march-5/liquidated-damages-the-bigger-picture.html>> accessed on 10 March 2014

compensation payable. No compensation will be payable if any of these three elements are missing.<sup>30</sup> In such a case, the Article is inapplicable.

### **3.2.4 Elements of damage must be proven**

In order for a penalty for delay to be paid, it is not sufficient that only the elements of default have been made out against the respondent under the contract. It is also necessary that the *element* of damage sustained by the claimant should be made out. If the respondent negates the element of damage, then the prescribed penalty will lapse. The trial court is therefore obliged to include in its judgment a statement of the elements constituting damage taken into account under the penalty.<sup>31</sup>

### **3.2.5 Burden rests with challenging party**

The corollary to the Article is also that a provision in a contract for a penalty clause brings damage within the assessment of the contracting parties. However, unlike under normal circumstances, the claimant is not obliged to prove damage as the existence of the LD clause will be conclusive presumption that the damage has taken place. In such a case, the burden will lie on the other party to prove that there has been no damage in respect of which compensation is claimed. There is also a presumption that the LD is commensurate with the harm sustained by the claimant, and the judge must abide by and give effect to that term of the contract, unless the respondent proves that the amount agreed is excessive. In that event it will be opened to the judge to reduce it to a level commensurate with the damage sustained by the claimant.<sup>32</sup>

## **3.3 APPLICATION OF THESE PRINCIPLES**

Applying the above principles in the context of construction contracts, the courts have exercised their discretionary power under the Article in the following instances:

- (a) dismissing a claim for LD brought by a main contractor against its subcontractor for delay in completing the subcontracted works because

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<sup>30</sup> Union Supreme Court 782/Judicial Year 22, 7 April 2002

<sup>31</sup> Union Supreme Court, 103/Judicial Year 24, 21 March 2004

<sup>32</sup> Union Supreme Court, 412/2009, 27 January 2010

the employer did not claim LD from the main contractor (notwithstanding the late delivery of the project). The Court concluded that the main contractor had suffered no loss as such and accordingly it refused to award any LD though it was pre-agreed, the Court stated that:

*"the establishment of the fault on the part of the Respondent [the sub-contractor] is not by itself sufficient for awarding the LD's, unless there is an actual loss sustained by the Claimant [the contractor] as a result of this fault".*<sup>33</sup>

- (b) reducing the full amount of LD claimed by a contractor from its sub-contractor on the basis that the rate of the LD that could be levied by the employer under the main contract was lower than the rate of the LD's under the sub-contract. The Court therefore awarded the contractor LD's as per the rate under the main contract rather than the higher rate under the sub-contract. The Court explained that:

*"the Claimant [the contractor] cannot collect LD's from the Respondent [the sub-contract] which exceeds the LD's payable by the Claimant to the employer, otherwise the claimant would be unjustly enriched at the expense of the Respondent".*<sup>34</sup>

- (c) dismissing a counterclaim based on an LD clause brought against a contractor whom had earlier sued based on unpaid work done. The dismissal of the claim on the LD was due to the fact that the claimant for the LD merely relied on the late penalty clause but was unable to prove that he suffered any damage.<sup>35</sup>
- (d) dismissing a claim brought by the owner of a villa against the contractor for late penalties under a late penalty clause as the owner was unable to prove his loss and because delays were attributable to the owner and his consultant.<sup>36</sup>

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<sup>33</sup> Petition No.26/24, the hearing of 1 June 2004.

<sup>34</sup> Petition No. 222/2005, the hearing of 19 June 2006.

<sup>35</sup> Federal Supreme Court Judgment 103/ Judicial year 24, Civil Appeal No103-24

<sup>36</sup> Federal Supreme Court Judgment 344/Judicial year 19 Civil Appeal No 344-19

Distilling the above principles, the UAE courts essentially recognize:

- (a) parties' right to contract freely and pre-agree a quantum of compensation;
- (b) a claimant's right to rely on the LD clause; and
- (c) the specific power of the judge to override this contractually agreed compensation in appropriate circumstances.

It is apparent that this power to cause an adjustment to the pre-agreed LD is not an unimportant power in the context of construction contracts as these contracts routinely contain LD for contractor culpable delay.<sup>37</sup> It should be borne in mind that, as the Article is a mandatory provision, the parties are not entitled to contract out of this judicial right to set the amount of compensation<sup>38</sup> and any attempt to do so will be null and void. Perhaps, another way to justify the operation of this rule is the fact that consistent with Article 318 Civil Code, the court ensures that it does not make an order that will advance an unjust enrichment. Hence, in view of the court's retrospective power to adjust the LD, UAE law views whatever compensation that was agreed as a mere holding position and a temporary or ephemeral arrangement between the parties in the course of a project.

From a review of the cases, it is laudable that a body of judicial principles on the Article has emerged. They serve as useful blueprints to guide the understanding, operation and effect of the Article. These principles are beneficial for legal practitioners as it places them in a better position to advise contractors or employers who will, in turn, have a keen picture of their respective rights and obligations. This should also augment risk management and risk allocation strategies in construction projects. Admittedly, these judicial first principles and tests succeed to some extent in enervating uncertainty and aiding coherence in the application of the Article.

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<sup>37</sup> Michael Kerr, "Construction and Projects in UAE: Overview, Multijurisdictional Guide 2013/2014" <[www.dentons.com/~media/PDFs/.../United%20Arab%20Emiratespdf.pdf](http://www.dentons.com/~media/PDFs/.../United%20Arab%20Emiratespdf.pdf)> accessed on 10 March 2014

<sup>38</sup> James Robinson, "UAE Contract Law – 5 Points to Remember", Herbert Smith Freehills, September 16 2011 < [www.herbertsmithfreehills.com/~media/HS/T-160911-7.pdf](http://www.herbertsmithfreehills.com/~media/HS/T-160911-7.pdf)> accessed on 10 March 2014

### 3.4 Problems with the Article

However, whilst case law has been indicative of the primary position at law in relation to this Article, two niggling but fundamental doubts remain to be clarified, namely:

- (A) What is the standard of proof required under the Article and are the standards of proof the same for both parties?
- (B) Is a reduction of the LD allowed once it is shown that actual loss is different from the agreed LD amount or a reduction is only possible if the LD is excessive or exaggerated in relation to the actual loss?

#### (A) What is the standard of proof required and are the standards of proof the same for each party?

The general rule on burden of proof is set out in a number of provisions of the UAE Civil Code and UAE Evidence Code<sup>39</sup>. Basically, the rules require the party who asserts to bear the burden of proving its assertion.

In respect of pre-agreed damages however, the Federal Court<sup>40</sup> stated that a party relying on the pre-agreed LD provision need not prove its losses. It is the party who opposes the LD who will have the burden to prove that the damages had not been incurred. The court explained that there is a presumption that the pre-agreed amount of LD would commensurate with the harm suffered, and therefore the judge should uphold the pre-agreed amount unless the other party proves that the pre-agreed amount is excessive.

The effect of the courts' explanation above suggests that the party challenging the pre-agreed amount of LD is only required to persuade the judge that the pre-agreed amount is excessive rather than actually proving what is the actual amount of damages suffered. The reason being is that a pre-agreed LD provision operates on a rebuttable presumption that the pre-agreed amount would reflect the actual loss suffered; it follows that if the challenging party is able to rebut the presumption, then the judge would see fit to exercise its discretionary power to vary the pre-agreed amount to reflect the actual damage or loss.

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<sup>39</sup> The Law of Proof in Civil and Commercial Transaction, Federal Law No.10 of 1992.

<sup>40</sup> Petition No. 370/20, the hearing of 2 May 2000

The above position on rebuttal presumption is supported by Article 48(1) of the Evidence Code which states that:

*“Presumptions specified by the law relieve the person whose interest they affirm of any other method of proof. Notwithstanding, these presumptions may be refuted by evidence to the contrary, provided there is nothing to decree otherwise.”*

Therefore, it would appear that after a party has successfully rebutted the presumption by adducing credible evidence to show that the pre-agreed amount is excessive, the judge would then have a duty to assist the parties to investigate the actual damage suffered, rather than leaving the challenging party with the sole burden or responsibility to prove the actual amount of damage. Arguably, this duty stems from the need to prevent a situation of unjust enrichment which is consistent with Shariah principles.

The view above is supported by a decision of the Dubai Court of Cassation<sup>41</sup>, where it overturned a decision of the Court of Appeal for its failure to address or deal with the elements of damages. In this case, the respondent argued that the claimant suffered no loss and requested the Court to refer the matter to an expert to investigate whether the claimant suffered any losses. The Court of Appeal however rejected this argument and did not refer the matter to an expert. Instead, the Court awarded damages to the claimant on the basis of the LD agreement. In overturning the decision, the Dubai Court of Cassation held that:-

*“the LD’s agreement shall shift the burden of proof from the claimant to the respondent but the court is still obliged in all cases to indicate the element of the damages awarded. The court failed to do so and this is an error of law”.*

The Court of Cassation also held that the lower court should have accepted the respondent’s request for the referral of the matter to an expert to examine whether the claimant suffered any losses, since this request was essential for the respondent to establish its case.

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<sup>41</sup> Petition No. 63/2005 & 99/2005, the hearing of 26 July 2005

Whilst there are obvious merits in the approach of the courts and its attempt to elucidate the burden of proof, these case law do not set out in detail what is the standard of proof (as opposed to the burden of proof) required to successfully invoke this Article and whether the standards of proof are the same for both parties in the judicial exercise. The burden of proof relates to the obligation to prove one's assertion whilst the standard of proof pertains to the level or extent of proof required in a particular case. The Article is silent on how this judicial discretion is to be exercised leaving practitioners to speculate the likely approach of judges.<sup>42</sup> This is an important discussion as the Article itself refers to:

*(2)The judge may in all cases, upon the application of either of the parties, vary such agreement...*

It is thus uncertain what is the standard of proof placed on the party making this *application* to challenge the LD. Purely as a guide, there are generally three (3) standards of proof, namely:

- (a) A prima facie case – light standard
- (b) On a balance of probabilities – medium standard
- (c) Preponderance of evidence – highest standard

In practice, as the cases above illustrate, the burden swings in a pendulum-like manner when the Article is raised as a legal argument. The claimant need only point to the existence of the LD clause. The onus then shifts to the party challenging the LD (the respondent) to then show that the claimant's actual loss is lower than the LD claimed. However, what is the standard of proof that is expected of the challenging party in such a case?

UAE law does not have a concept of a standard of proof and much is left to the court to exercise its discretion. It is expected that the court has to conduct a balancing exercise and to straddle between ensuring that this party does not raise specious objections whilst at the same time not shutting the door on his statutory rights to dispute the LD claim. It should also be recognized that the respondent suffers from an evidential handicap as he invariably does not have

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<sup>42</sup> Nicholas Brown, "Global Diversity in the Enforcement of Liquidated Damages", Solicitors Journal, Sep 2005 <[www.pinsentmasons.com/mediafiles/1220732381.pdf](http://www.pinsentmasons.com/mediafiles/1220732381.pdf)> accessed on 10 March 2014

access to information to prove the other party's actual loss. It may therefore be unjust to require him to discharge his standard of proof based on a preponderance of evidence or even on a balance of probabilities and a burden based on a *prima facie* standard seems more appropriate.

On the other hand the claimant's burden when disputing the challenge cannot be lower than the respondent's. It is the claimant who is seeking payment under the LD clause and should be expected to have full information and documentary evidence to prove his actual loss. *A fortiori*, if the claimant himself is applying to increase the LD.

Hence, whilst it is recognized that the courts have taken pains to articulate how the overall legal burden shifts, it is difficult to discern what is the actual standard of proof expected of parties when discharging these burdens. It is not exceptional to state that different standards of proof have dissimilar ramifications on a party's ability to raise and plead his case and whether he is able to discharge the same in the eyes of the law. Though fine, these margins are fundamental as they lead to different outcomes and may be the difference between the success and failure of a claim or defence.

It is submitted that the difficulty faced in the practical application of the Article is symptomatic of four (4) higher level jurisprudential tensions in play, namely:

- (1) *The principle of freedom to contract and to agree on the LD as against the court's power to essentially replace the pre-agreed LD and rewrite the law of the parties;*
- (2) *The claimant's contractual right that the LD becomes payable as against the respondent's statutory right to challenge the same under the mandatory Article;*
- (3) *The prospective pre-agreed position of parties at the time of contract as opposed to the courts retrospective power to adjust the same; and*
- (4) *The pursuit of system wide certainty and efficiency to cause a systemic consequence<sup>43</sup> as against favouring an individual outcome between immediate contracting parties<sup>44</sup> for a more principled and fairer result<sup>45</sup>.*

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<sup>43</sup> Richard A Posner, *How Judges Think*, (Harvard University Press 2008) 202-203

<sup>44</sup> A.M. Gleeson, "Individualised Justice—The Holy Grail" (1995) 69 Australian Law Journal 421, 431–432

<sup>45</sup> Nicholas Brown, "Industry Standard Terms: another fly in the ointment of contractual intent?", (2013) Construction Law Journal, 259

The upshot to these competing interests coupled with the uncertainties in the operation of the Article is that it places one or even both parties at a distinct disadvantage and may ultimately cause unfairness and potentially lead to unjust and differing outcomes in formal dispute processes.

It is submitted that the above difficulties may be somewhat assuaged in the context of arbitrations in the UAE. While the arbitration rules of the more common arbitration centres in the UAE - the Dubai International Arbitration Centre ("DIAC") and the Dubai International Financial Centre-London Court of International Centre ("DIFC-LCIA") - equally recognize the importance of the arbitrators deciding the parties' dispute in accordance with the governing laws chosen by them, both these rules<sup>46</sup> contemporaneously empower the tribunal to decide on the specific rules of evidence to be applied on any matter in dispute. This would theoretically mean that the tribunals may delineate to both parties the exact parameters for the application of the Article. This transparency and clarity may serve to enhance the prospect of a fairer outcome when this Article is applied.

**(B) Is a reduction of the LD permissible once it is shown that the actual loss is different from the agreed LD amount or a reduction is only possible if the LD is excessive or exaggerated in relation to the actual loss?**

A review of the cases reveal that the courts used words<sup>47</sup> such as "excessive"<sup>48</sup>, "exaggerated"<sup>49</sup>, "unreasonable"<sup>50</sup> or be "commensurate with"<sup>51</sup> interchangeably when highlighting the disparity that has to be demonstrated between the amount of actual loss and the amount of LD claimed.

It is immediately apparent that these words are highly subjective and do not bear the same meaning or even gradation of meaning. Perhaps, one of the reasons for this unwitting obtuseness is the fact that the UAE court system generally possesses a three (3) tier structure with the first two (2) layers (first instance and court of appeal) having three (3) judges each with the final right of appeal being before five (5) judges on the bench in the cassation court. While this may ensure that every case obtains the attention it deserves, it also paves the way for a

<sup>46</sup> Article 27.2 DIAC Rules 2007 & Article 22.1 (f) DIAC-LCIA Rules 2008

<sup>47</sup> Caution must invariably be given to those who rely on English translation in seeking to ascertain what the UAE law is – Hall (n 1) 3.1 iii

<sup>48</sup> Appeal No103-24 (n 35)

<sup>49</sup> Petition No. 63/2005 & 99/2005 (n 41)

<sup>50</sup> Federal Supreme Court Judgment 356, hearing of 19 October 2004 in Civil Appeal 356-23

<sup>51</sup> Appeal 222/2005 (n 26)

multiplicity of different nuances even in majority decisions as effectively eleven (11) judges had the opportunity to comment on the principles of a particular case.

This indiscriminateness in the various words used leaves the door potentially ajar to the counter argument that the discretion afforded by the Article is to be only used in extreme circumstances where a party's actual losses are found to be very significantly higher or lower (and not just different) than the parties pre-agreed level of compensation for breach. In other words, the discretion available to increase or reduce damages under the Article should only be exercised in narrow circumstances when the actual damage sustained is very substantially different from the contractually agreed compensation. This seems to follow from the principle under UAE law that the parties' contract is the law of the parties (i.e., a party must perform its obligations as provided for in the contract). Some support may be drawn from the Abu Dhabi Court of Cassation in Appeal No. 941 of 2009. The court in that case stated that:

*“The effect of Article 390 ... is that a stipulation for a penalty clause renders the assessment of harm a matter for the contracting parties, and the obligee does not have to prove it. Rather, the obligor has the burden of proving that it did not take place. There is a presumption that the assessment of compensation agreed is commensurate with the harm suffered by the obligee, and the judge must abide by that clause and give effect to it unless the obligor proves that the agreed compensation is excessive or that the obligee did not suffer any harm at all.”*

To follow the narrow view of this principle to its logical conclusion, it has been stated that whilst the court has to power to adjust this should only be so upon the application of either of the parties and the judge cannot intervene *ex officio*.<sup>52</sup>

This lack of clarity is unhelpful as it creates controversy as to how much lower the actual loss must be in relation to the LD amount before the court intervenes and reduces the same. Cases where the amounts are starkly different or there is no loss at all are *low hanging fruits in the tree* and easily resolved. However, there are many instances where this is not the case and more difficult facts are

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<sup>52</sup> Habib Al Mulla, “Damages and Contract in the UAE”, *The In House Lawyer* (12 March 2010) <http://www.inhouselawyer.co.uk/index.php/united-arab-emirates/7893-damages-and-contracts-in-the-uae>> accessed on 10 March 2014

presented. As a simple illustration, should the court exercise its discretion under the Article if the LD claimed was 100M AED but the provable actual loss is 90M AED? This difference cannot be said to be “exaggerated” or “excessive”. However, whilst the amounts are not polar extremes, to allow the LD to stand would be tantamount to unjustly enriching the claimant to a not insignificant sum of 10M AED much to the chagrin and prejudice of the respondent.

### **3.5 Conclusion**

The judicial principles laid down in the local courts and the guidance set out in the manner in which the burden of proof shifts in the course of a legal proceeding are meaningful and cast important light on the machinery and operation of the Article in practice.

However, problems remain in terms of how much and to what extent must the level of proof be before a court can be persuaded that the pre agreed LD amount should be replaced by the actual loss. It is also ambiguous as to how far the amounts between the actual loss and the LD must differ before the court is prepared to act under the Article. This latter murkiness, in particular, has the pernicious effect of increasing time and costs as it is to be expected that legal submissions will be made by the claimant that, even if there is a difference in the amounts, this difference is not sufficiently grave for the court to intervene. This reduces the effectiveness of the Article and undermines its avowed statutory intent which is to ensure that compensation is based on damage actually incurred.

## **CHAPTER 4 – THE ARTICLE IN AN ARBITRATION PROCEEDING**

Chapter Four shall examine whether the Article has any role to play in construction-related arbitration disputes and the manner in which, if at all, it impacts such disputes. A recent seminal arbitration decision is discussed to provide an indication of the Article's relevance and importance in arbitrations including a consideration of practice points that stem from the decision.

### **4.1 Introduction**

It is instructive to consider whether the Article, which is autochthonous to UAE, is freely applied in arbitration proceedings in the UAE. In practice, as discussed earlier, how such discretion is exercised in local courts is not always clear and such court precedents can be very hard to decipher or draw any definitive conclusions from.

To potentially exacerbate the situation, the cosmopolitan nature of the UAE means that arbitration proceedings are usually comprised of at least one party from a different jurisdiction and/or chaired by tribunal members who may not originate from UAE or even a civil law jurisdiction.

Discerning the true effect of the Article may be intricate and consequently it is perhaps no surprise that, notwithstanding that they have the discretion to do so by applying the governing law, arbitral tribunals appear more reticent to interfere with the bargain and exercise such discretion than judges in the local courts.<sup>53</sup>

There is also the view<sup>54</sup> that, whilst the governing law should always be deferred to, where there are gaps in a governing law that is underdeveloped, arbitral panels should be receptive to comparative law as well as international legal principles for solutions. Although this view is progressive and arbitration-friendly, if unbridled, the approach runs the risk of over-stepping certain fundamental tenets of UAE law which may be adverse to the enforceability of any eventual award.

<sup>53</sup> Owen Delaney, "When International Standards Meet Local Laws Part 1: Construction Contracts in the UAE and Middle East", (Vinson & Elkins, International Construction Letter, Fall 2011) <<http://www.mondaq.com/x/150738/Contracts+Deeds/When+International+Standards+Meet+Local+Laws+Part+1+Construction+Contracts+In+The+UAE+And+Middle+East>> accessed on 10 March 2014

<sup>54</sup> Christopher R Seppala, "The Development of a Case law in Construction Disputes Relating to Fidic Contracts", (2009) Vol 26 The International Construction Law Review, 114

Perhaps, the better view<sup>55</sup> is for the arbitral panel to instead have resort to judicial principles from regional legal jurisdictions which are more proximate and correlated to UAE jurisprudence as they may be more receptive to the meaning, terms and effect of the Article. The advantage to this approach is also that the UAE is a party to the Riyadh Treaty<sup>56</sup> which ensures reciprocity in the recognitions of judgments including arbitration awards between the signatory countries. This comity of nations between the signatory Arab states would aid the enforceability and enforcement of any judgments which may have encompassed issues relating to the Article.

Regrettably, an exhaustive and comprehensive study is well-nigh impossible as arbitrations are, by their very nature, private and confidential. As a rule of thumb, in the context of arbitration, as long as the governing law of the contract is UAE law, the legal positions set out in Chapters 2 and 3 ought to equally apply to a dispute that is being resolved by an arbitral tribunal as they do in a court of law. Indeed, pursuant to Article 1 of the Civil Code, there is no scope to utilize principles of international law to fill perceived gaps in local law and, if there is no provision in local law, judgment will be passed according to Shariah law and in default according to custom.<sup>57</sup>

## 4.2 Arbitration Decision

However, there is one recent major arbitration decision in Dubai where the Article was discretely raised, considered and applied. For confidentiality reasons, the names of the parties and tribunal members have all not been referenced. Consistent with this, the facts of the case have not been discussed and only the general principles of law analyzed therein will be considered here.

The three-man tribunal in this arbitration consisted of an eminent Queen's Counsel, a senior solicitor specialising in construction and was chaired by one of the world's leading engineers. All three members of the tribunal hailed from the United Kingdom.

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<sup>55</sup> Christopher Ennis and Wolfgang Breyer, "Comparison of treatment of claims for extension of time and compensation under the FIDIC Red Book form according to civil law and common law jurisdictions", (2014) *Construction Law Journal*, 30(1), 3-29, 3

<sup>56</sup> Riyadh Arab Agreement for Judicial Cooperation, 6 April 1983 between United Arab Emirates, Jordan, Bahrain, Tunisia, Algeria, Djibouti, Saudi Arabia, Sudan, Syria, Somalia, Iraq, Oman, Palestine, Qatar, Kuwait, Lebanon, Libya, Morocco, Mauritania and Yemen

<sup>57</sup> Leonora Riesenburt, "United Arab Emirates" (2011) *The Projects and Construction Review*, 292

In deciding whether or not to exercise the discretion given by the Article to amend the amount of LD to reflect the actual damage, the tribunal recognized that it had to make a comparison between the agreed amounts of LD in the contract in that case and any actual loss. The tribunal also acknowledged that the meaning and effect of the Article is uncontroversial. For example, both parties agree that the Article is applicable in the case and that parties to a contract may not contract out of it so that it is a fetter on the parties' freedom of contract, which is a guiding principle of UAE law.

The burden was also not in dispute as it was accepted by both parties that the burden of establishing that the provision in the contract for agreed damages, sought to be displaced before the tribunal, rests upon the party which is seeking to overturn the agreed provision.

As a guide to the exercise of its discretion under the Article, the tribunal had resort to the decision of the Abu Dhabi Court of Cassation in Appeal No. 941 of 2009, namely:-

*"However, this challenge is invalid because of Article 390 of the Civil Code: (1) The contracting parties may fix the amount of compensation in advance by making a provision therefore in the contract or in a subsequent agreement, subject to the provisions of the law; and (2) The Judge may, in all cases, upon the application of either of the parties, vary such agreement so as to make the compensation equal to the harm, and any agreement to the contrary shall be void. The effect of Article 390 as had been held by this court is that a stipulation for a penalty clause renders the assessment of harm a matter for the contracting parties, and the obligee does not have to prove it. Rather, the obligor has the burden of proving that it did not take place. There is a presumption that the assessment of compensation agreed is commensurate with the harm suffered by the obligee, and the judge must abide by that clause and give effect to it, unless the obligor proves that the agreed compensation is excessive or that the obligee did not suffer any harm at all. All of the above is a matter for a finding of fact by the trial court which has complete jurisdiction over the finding and understanding of the facts of the case, and the*

*examination and assessment of the evidence and documents properly submitted before it, and weighing them up, without review in that regard from the court of cassation, provided that its judgment is based on sound grounds sufficient to support it."*

However one issue which the tribunal had to decide upon was whether or not the Article should be given a broad or a narrow interpretation. The party challenging the LD naturally argued for a broad interpretation whereas the party relying on the LD provision argued for a narrow interpretation of the Article in that the jurisdiction could not be invoked unless there was a "very substantial" disparity between the loss actually suffered and the agreed amount of LD. However both parties agreed that the decision whether or not to invoke the discretion given by the Article and then, if so, how to apply that discretion, is a matter for the tribunal of fact.

Applying the principles laid down in the above Abu Dhabi Court of Cassation case, the tribunal held that for the Article to be invoked, the first step is for the challenging party to prove that "the agreed compensation is excessive". The term "excessive" meant to the tribunal as excessive in relation to the harm actually suffered or likely to be suffered. As the party claiming on the LD had claimed an LD of AED133,XXX,XX but the actual proven loss was only AED35,XXX,XX, the tribunal took the view that this difference was excessive and used its powers under the Article to amend the agreed amounts of LD to an amount that reflects the actual loss i.e. to AED35,XXX,XX.

#### **4.3 Key observations**

It is intriguing to note that the tribunal had no hesitation in trying to understand and deal with the Article and to apply it to the facts of the case. The tribunal was robust in trying to ascertain and "get at" what is the actual loss in order to achieve fairness in the proceedings and, more importantly, to adhere to the local law. This is quite remarkable in light of the fact that the tribunal members originated from outside the UAE and *grew up* on the legal diet where, unless it is a penalty, an LD is almost always payable without proof of loss.

In a sense, perhaps it was slightly less difficult for the tribunal to have reduced the LD as the claimed LD amount in the case significantly differed from the actual provable loss. This averted the need for the tribunal to consider whether the figures were sufficiently disparate to justify the tribunal's intervention. Notwithstanding the same, this demonstrated that even in arbitration proceedings the Article has an important bearing on the outcome of parties' claims. In the case, the Article wiped out approximately AED100M from the party claiming under the pre-agreed LD clause.

For domestic arbitrations in UAE, such as the above case, the impact of the Article may thus be more evident. In the context of an international arbitration where issues relating to LD are germane, it would also be similarly imprudent to ignore the significance of the Article. This is particularly so if the governing law is UAE law or one of its Emirates or if enforcement will eventually be sought in the UAE. Pursuant to UAE's ascension to the New York Convention ("NYC") in 2006, the enforcement of an arbitral award containing an LD award may not be straightforward and may run afoul of Clause 2(b) of Article V of the NYC. This Clause states:

*"Article V*

*2. Recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition and enforcement is sought finds that*

*(a)...*

*(b)The recognition or enforcement of the award would be contrary to the public policy of that country."*

Due to the fact that the Article is deeply stepped in the rule of jurisprudence of the UAE and is a mandatory provision, its treatment may be viewed as a matter of public policy.<sup>58</sup> There is thus every prospect that a UAE court may refuse the enforcement or allow a nullification of an award for failure to take into account the Article and which has caused an overcompensation to one party over another thereby violating the principles of Shariah - principles which predicate and

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<sup>58</sup> Counsellor Dr Ahmad, "Globalisation and Liquidated Damages in Egypt" (2009) Vol 26, The International Construction Law Review, 511

overlay the entire scheme and structure of the UAE Civil Code and the laws of UAE.

#### 4.4 Practice Points

In light of the foregoing, as a practice point, it is therefore prudent for a party to carefully draft its pleadings and consider the applicable rules of the arbitration, rules of evidence and any other agreed procedures or guidelines that govern its dispute. This is to ensure that it is able to fully extract and utilize the appropriate procedures and rights of disclosure to ascertain as much evidence relating to any losses suffered directly by its opponent in the event it intends to challenge any pre-agreed amount of LD.

It is also strategic to consider the doctrinal views<sup>59</sup> of arbitrators considered for appointments to ensure that they are familiar with the Article. This is a critical practical consideration as a good selection of arbitrators can improve one's chances of prevailing. Indeed, the selection of a tribunal is the most important decision to be made in any international arbitration.<sup>60</sup> This applies with greater force in the context of our present discussion in view of the peculiarities and challenges posed by the Article.

#### 4.5 Conclusion

As a dispute forum, arbitration is swiftly emerging, if it has not already, as the staple choice for dispute resolution among major corporations involved in large construction projects. As discussed above, even in arbitrations, the Article appears ubiquitous and is inextricably intertwined with any claims for, and assessments of, LD. Statutorily predicated as a mandatory provision, an arbitration panel would do well to acknowledge the Article *lest* the eventual award issued by the tribunal be tainted and, hence, unenforceable for failure to consider a key compulsory provision of UAE law.

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<sup>59</sup> Christopher R Seppala, "Obtaining the Right International Arbitral Tribunal", (2008) Vol 28, The International Construction Law Review, 199

<sup>60</sup> Gerald Asken, "The Tribunal's Appointment", *The Leading Arbitrators' Guide to International Arbitration*, 2004, 31

## **CHAPTER 5 – THE ARTICLE: THE GOOD, THE BAD & THE REFORM**

Chapter Five discusses the merits of the Article. A draft new provision is also proposed for consideration to address some of the drawbacks of the Article and to improve its application in formal dispute processes.

### **5.1 Introduction**

As detailed in Chapter 3, it is indubitable that the Article possesses its fair share of warts. It has even been said, perhaps unfairly, that the UAE legal system ranks low in the spectrum of legal certainty due to the doubt created by this Article as it leaves practitioners to speculate on the likely approach of local judges.<sup>61</sup> It has also been stated that, by virtue of this Article, the enforceability of LD clauses in the UAE poses risks for both developers and contractors.<sup>62</sup>

It ought to however be highlighted that this Article was never postulated nor designed specifically for construction disputes. Indeed, it does not even sit within the section of construction provisions i.e Articles 872 to 896 of the Civil Code. In fact, as has been observed, the influence of Islamic Shariah on the construction provisions is barely visible. The Article merely states the principle of actual harm and reasonable recovery under UAE law. The Article has however been reeled in into the fray of construction disputes as construction contracts are one of the few but major instances wherein parties pre-agree compensation for damages and which, therefore, the Article may be found to be apposite.

### **5.2 Merits of the Article**

For all its perceived deficiencies, to seek a repeal of the Article would be draconian and to ignore its usefulness would be presumptuous. The Article has much to commend itself.

The Article:

- 5.2.1 Places substance over label
- 5.2.2 Saves time and costs
- 5.2.3 Places the burden of proof on the party challenging
- 5.2.4 Possesses safeguards
- 5.2.5 Promotes justice
- 5.2.6 Aids settlement and release

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<sup>61</sup> Brown (n 42)

<sup>62</sup> Attia (n 29)

### 5.2.1 Places substance over label

The Article has the advantage of prioritising actual loss irrespective of whether the clause is termed a penalty clause or an LD clause. This is in tandem with the conceptual thinking in the region as, pre-agreed liquidated damages will, in principle, be enforceable in the Middle East, even when it is expressly labelled as a “penalty”. This is because Middle Eastern laws make no notional distinction between “penalties” and “liquidated damages”.<sup>63</sup> Indeed as has been observed<sup>64</sup>, the terms “penalty” and “LD” are used interchangeably in UAE court hearings. This may not, however, prove too critical in view of the overriding nature of the courts powers under the Article to foreground actual loss.

### 5.2.2 Saves time and costs

It is submitted that the above approach is welcomed as it eliminates the need to *split hairs* between whether a clause amounts to a penalty (irrecoverable) or LD (recoverable) – a distinction which has plagued and scourged many disputes in the common law courts for a century.<sup>65</sup> The common law preoccupation to distinguish between liquidated damages and penalties often causes confusion and creates problems of interpretation.<sup>66</sup>

By treating actual damages as a sacrosanct consideration, the Article places the acid test on the extent of damages sustained and not the category of breach as such.<sup>67</sup> By not treating nomenclatures and labels as overriding considerations and by placing emphasis on actual damage, the Article is more holistic, practical and promotes savings in terms of time and costs and prevents needless legal tussles.

Furthermore, contractors would sometimes try to deploy the prevention principle or the concept of time at large in their effort to thwart the LD imposed by their employers. This issue has been at the forefront of significant judicial and other comment in the United Kingdom and Australia and despite the same this

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<sup>63</sup> Maxwell Winward LLP (undated), “Liquidated damages and Penalties in the Middle East” <<http://www.maxwellwinward.com/pdf/Revised%20LADs%20article%20-%20NL%20version-notvisible.pdf>> accessed on 10 September 2010

<sup>64</sup> Justin Ede, “Liquidated Damages” (Al Tamimi, Law Update, December 2013 – January 2014) <<http://www.tamimi.com/en/magazine/law-update/section-5/january-2/liquidated-damages.html>> accessed on 10 March 2014

<sup>65</sup> *Dunlop* [n 5]

<sup>66</sup> Caslav Pejovic, “Civil law and Common law: Two different paths leading to the same goal” (2001) 32 VUWLR, 826.

<sup>67</sup> *Riesenburg* (n 57) 292

argument is not altogether clear.<sup>68</sup> Perhaps, fortunately, such argument is to a large extent immaterial because, as explained above, UAE law allows the courts to review or vary the amount of liquidated damages to equal the actual loss suffered by a party in any event irrespective of whether there was any act of prevention on the part of the employer.<sup>69</sup> As these arguments are rendered *non sequitur*, parties are deterred from raising them which leads to further savings in terms of time and costs. This also has the positive effect of ensuring that the parties focus their time, attention and resources to the issue of “actual loss” which is the true and live issue in so far as the Article is concerned.

In the similar vein, there is often considerable debate in the common law<sup>70</sup> surrounding how its courts should approach issues relating to apportionment and contributory causation. This examination regularly comprises laborious and costly time and delay analyses as concurrent delay is one of the most complex and controversial aspects of construction dispute resolution.<sup>71</sup> This is somewhat averted in the UAE due to its prioritization and practical emphasis on a party’s actual loss.

### 5.2.3 Places burden of proof on party challenging

Further, although it may vary any pre-agreed compensation, the Article still retains the advantage of placing the opening burden of proof on the contractor rather than the employer. It has been stated that it is practically difficult for the contractor to prove the employer’s actual loss and this Article is therefore rarely invoked by a contractor.<sup>72</sup> This is tactically advantageous to the employer as in a usual case the person seeking payment has to do the initial running to prove his loss.

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<sup>68</sup> Professor Doug Jones, “Can Prevention Be Cured by Time Bars?” (2009) Vol 26, The International Construction Law Review, Pt 1, 74

<sup>69</sup> Eric Teo, “UAE and Chinese Construction Law”, (Al Tamimi Law Update July, 2011) < <http://www.tamimi.com/en/magazine/law-update/section-7/july-2/uae-chinese-construction-law.html>> accessed on 10 March 2014

<sup>70</sup> Dr Franco Mastrandrea, “Concurrent Causation in Construction Claims” (2009) Vol 26 The International Construction Law Review, 104

<sup>71</sup> Matthew Cocklin, “International approaches to the legal analysis of concurrent delay: is there a solution for English law?” (2014) Construction Law Journal, 30(1), 41-56

<sup>72</sup> Erin Miller Rankin, “How the law of liquidated damages can be applied in the local jurisdiction (June 8, 2007) < <http://www.constructionweekonline.com/article-941-how-the-law-of-liquidated-damages-can-be-applied-in-the-local-jurisdiction/#.Ux1ow9hWHIU>> accessed on 10 March 2014

#### 5.2.4 Safeguards in place

There are also safeguards and controls in place in the manner the courts approach the issue. It has been observed<sup>73</sup> that the courts will not use their discretion under the Article if the following apply:

1. Actual damages have clearly been incurred;
2. The party seeking to enforce the contractual provision can demonstrate that the liquidated damages rate was the product of a genuine and reasonable pre-estimate;
3. The liquidated damages rate is not out of line with the norm in similar contracts/projects and in relation to the contract value; and
4. Where the time and cost of proving actual damages with certainty would be substantial.

#### 5.2.5 Promotes justice

More importantly, the Article preserves the court's power to do justice by calculating damages on a case by case basis<sup>74</sup> and ensure that the party seeking damages obtains only precisely what he lost as a measure of damages and not otherwise. This proactive approach has been construed as an "efficiency test" undertaken by the civil law courts which gives these courts an economic superiority in its treatment of LD clauses over courts in the common law.<sup>75</sup>

#### 5.2.6 Aids Settlement and Release

Although both parties have pre-agreed an LD amount, the potential applicability of the Article may discourage unreasonable behaviour<sup>76</sup>, as it will not be lost on the parties, particularly the employer, that it may be the case that he will not be in a position to prove his actual loss or an actual loss proximate to the LD amount wherein the court may exercise its discretion under the Article to reduce the LD to a provable loss amount. This might persuade the employer to avoid litigation

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<sup>73</sup> Raeesa Rawal, "Damage control: Reconciling deducted delay damages and actual damages" (October 2012) *Construction Law International*, Vol 7 Issue 3, 42

<sup>74</sup> Justin Cornish, "The Interpretation of Warranties, indemnities and representations in commercial contracts governed by the laws of England and Wales, South Africa or the United Arab Emirates" (undated, Latham & Watkins) <  
<http://www.lexology.com/library/detail.aspx?g=138d0989-3d61-4526-91fc-e4ca3c77de4e>>  
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<sup>75</sup> Aristides N. Hatzis, "Having the cake and eating it too: efficient penalty clauses in Common and Civil contract law", (2003) *International Review of Law and Economics* 22 381–406, 402

<sup>76</sup> *ibid*, 395

altogether and adopt a more pragmatic and realistic stance which would ultimately encourage a settlement and a release for all parties concerned.<sup>77</sup>

### 5.3 Demerits of the Article

The demerits of the Article revolve around its operational lack of precision, namely:

- (a) It is silent on the standards of proof; and
- (b) It is unclear how far apart the LD and actual loss ought to be before the court steps in.

These have been discussed in detail at Chapter 3.

### 5.4 Proposal for reform

Hence, it is proposed below that a more refined and discrete article be introduced and incorporated specifically within the construction provisions of the Civil Code. This proposed article should be pellucid and plain and set out *inter alia* a party's burden of proof and at what stage it sets in together with the standard of proof he has to meet in every instance.

To remedy the other weakness of the present Article, this new article should also be decisive as to when the LD amount is to be reduced.

Bearing these as guiding principles, the following draft provision below is proposed:

**“Power of Court to vary pre-agreed contractual liquidated damages or penalty<sup>78</sup>”**

- (1) *Where parties under a construction contract or agreement has pre-agreed a payment for liquidated damages or penalty, or a party has in fact made*

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<sup>77</sup> Charles Calleros, “Punitive damages, Liquidated damages, and Clauses Pénales in contract actions: A comparative analysis of the American common law and the French civil code” (2006) Vol 32:1, Brooklyn Journal Of International Law, 117

<sup>78</sup> The dual mention of liquidated damages and penalty is deliberate. This is to eliminate unnecessary and protracted submissions on what is true nature of the clause. Hence, this proposed provision should potentially apply irrespective of whether it is a liquidated damages clause or a penalty clause.

such a payment (whether voluntarily or under a deduction or a set-off<sup>79</sup>), the court may make an order to adjust the pre-agreed liquidated damages or penalty.

(2) *The court may in particular –*

(a) *order that part or all of the pre-agreed liquidated damages or penalty be reduced to the amount of the proven actual loss of the party claiming. Where the court make such an order, the court may consequentially also direct that all or part of any payments already made, whether by way of deduction or set-off, to be repaid<sup>80</sup>;*

(b) *order that part or all of the pre-agreed liquidated damages or penalty be increased to the amount of the actual loss of the party claiming<sup>81</sup>.*

**Conditions to be satisfied**

(3) *The court may make an order under (2)(a) above only if –*

(a) (i) *the party challenging the pre-agreed liquidated damages or penalty clause prima facie<sup>82</sup> demonstrates that the amount agreed under the liquidated damages or penalty clause is lower<sup>83</sup> than the actual loss of the other party; and*

(ii) *the party seeking to rely and enforce the liquidated damages and penalty clause is unable to demonstrate on a balance or*

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<sup>79</sup> This is to cater for recovery where there has been a deduction for penalties in an earlier payment certificate.

<sup>80</sup> This sub provision is to apply when a party is claiming to reduce the LD

<sup>81</sup> This sub provision is to apply when a party is seeking to increase the LD to match his actual loss

<sup>82</sup> I have proposed a lighter standard of proof. This is because the party challenging will usually not know what the other party's actual loss is as it will not have in its possession any information or details of losses actually suffered by the other party.

<sup>83</sup> This is to ensure that this sub-provision may apply so long as the amounts are less than the LD amount. This is to avoid references to 'exaggerated' or 'excessive' which are subjective and which will only invite ambiguity.

probabilities<sup>84</sup> that his actual proven loss is at least equal<sup>85</sup> to the amount agreed under the clause.

(4) The court may make an order under (2)(b) above only if –

(b) (i) the party relying on the pre-agreed liquidated damages or penalty clause demonstrates on a balance or probabilities<sup>86</sup> that his proven actual loss exceeds the amount agreed under the liquidated damages or penalty clause; and

(ii) the other party is unable to prove on a balance of probabilities<sup>87</sup> that that party has not suffered such an actual loss.

(5) At any stage of the specified proceedings the court may, of its own motion, appoint a court-appointed expert to assist the court<sup>88</sup>;

(6) Where a party has access to information which is not reasonably available to another party, the court may direct the party who has access to the information to –

(a) prepare and file a document recording the information; and

(b) serve a copy of that document on the other party or the court-appointed expert<sup>89</sup>.

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<sup>84</sup> This is the normal civil standard, though higher than prima facie, but is reasonable as this party should have in his possession all necessary information to support his position.

<sup>85</sup> It may even be higher in which case he should be allowed the opportunity to apply under sub clause 2(b) to increase his claim.

<sup>86</sup> Similar justification as note 84 above.

<sup>87</sup> It is on a balance of probabilities as by this stage of the proceedings he would have access and sight of the other party's losses and supporting data and in a position to rebut the same.

<sup>88</sup> Most of these matters are technical and/or engineering related and the court may in some instances need to have resort to a court expert to assist the court in its determination

<sup>89</sup> This is a useful power for the court to have to ensure that both parties fulfill their disclosure obligations to maintain fairness and transparency.

(7) *In all circumstances, an order shall only be made if the court is satisfied, having regard to all the circumstances of the case, that it is just to make such an order<sup>90</sup>.*

## 5.5 Conclusion

Admittedly, the Article is afflicted with some major imperfections. However, it does possess propitious qualities which render it pertinent especially in construction disputes and it remains a core empowering provision in allowing the courts to interject and ensure fairness in a particular factual matrix.

The draft article proposed above is not intended to be, nor could it be, an immediate panacea to this area of law. However, it is hoped that it shall at least provide greater clarity and certainty when invoked by parties in a dispute forum.

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<sup>90</sup> This is a key residual power as ultimately the court should only make an order if it is fair to do so. This is to ensure that the hands of the court are not tied and that it retains an unfettered discretion. However, it is to be noted that the UAE courts do not adhere to the traditional common law standard of proof such as the balance of probability test in civil claims or the beyond all reasonable doubt test in criminal matters. The standards proposed above are therefore to be used purely as a guide in the exercise of judicial discretion.

## **CHAPTER 6 – CONCLUSION AND RECOMMENDATIONS**

Chapter Six weaves together the sum total of the research outcomes to present the overall findings and recommendations for further research

As local case law jurisprudence and academic discourse upon this important subject continues to develop and as more arbitration decisions (hopefully) come to light, the body of experience in the operation of the Article will become more profound and any interstices in the Article will be filled in by these decided cases and literature.

Properly understood, the application of this Article is to be welcomed because it makes clear that the court will not allow one party to be overcompensated and is a clarion call that more is required in terms of proof from parties rather than a mere cursory reliance and reference to a pre agreed LD clause.

In one area where there is likely to be a significant difference between the common law and the UAE experience, encouraging signs of transnational uniformity have emerged as evidenced from the major arbitration case discussed above wherein the Article was deferentially considered and applied. This is a boost to UAE in her aim to be a global and regional arbitration centre.

The battle now is to vivify an objective drafting to make the Article more user friendly to construction disputes in the context of LD. This will not only confer clarity in the local context but may incentivize arbitral institutions across the world to specifically consider and, where relevant, apply the Article where UAE law is the governing law. This will ensure that any arbitration award would accord with local customs and practices which will then be conducive to its enforceability in the UAE courts.

The specific examples of the case law analyzed above are merely a synecdoche for the headline statements of principle contained in the Article. Its eventual applicability in a particular case remains heavily hinged on the facts of a particular case and the court's/tribunal's alacrity to do justice in a specific instance. Great care must therefore be taken to ensure that the Article is relevant and that adequate proof exists to demonstrate its relevance either way.

Future research surrounding the Article will focus essentially upon the standard of proof expected and the specific circumstances under which the LD is to be reduced. It is also noteworthy to track whether successive international panel of arbitrators are comfortable to consider and apply the Article in UAE-related arbitrations.

As the debate continues, it is to be hoped that the Article receives continued acceptance and application and, if possible, be fortified by way of a revision to tighten its terms. This will have the effect of enhancing its relevance, utility and operation not only in the local courts but also in arbitration proceedings alike.

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