



**Limitation of Liabilities– Analysing a balanced approach  
to Limiting Liabilities in Construction Contracts**

**تقييد حدود المسؤولية – تحليل طريقة متوازنة للحد من المسؤوليات  
والإلتزامات في عقود المقاولات**

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### **Abstract**

Limitation of Liability clauses involves risk allocation in contract. Beyond the fact that the agreed contract terms apportion the rights and obligations in a contract, the contract and actions of parties are governed by the prevailing law. This governing law is expected to provide adequate statutory and legal controls to regulate specific liability terms in contracts, in addition to offering ample guidance in interpretation of these terms. The dissertation aims to investigate the concept of liabilities, its limitation and the provisions in the legal framework of the UAE; with the intention of assessing adequacy and proficiency of the UAE law in comparison to its economic counter-parts. The study reveals certain lacuna in the UAE law and in order to overcome these issues, approach to achieve equilibrium in liability or risk allocation in contracts is recommended. The research findings advocate need for statutory intervention and reforms to provide players in the construction industry legal protection from unreasonable and unconscionable contract terms.

## تقييد حدود المسؤولية – تحليل طريقة متوازنة للحد من المسؤوليات والإلتزامات في عقود المقاولات

### ملخص

تتضمن البنود التي تحد من المسؤولية في عقود المقاولات تخصيص جزء للمخاطر، فبالإضافة إلى البنود العادية المتفق عليها في العقود التي تحدد الحقوق والواجبات فإن هذه العقود وتصرفات وأفعال الأطراف المتعاقدة عادة ما تكون محكومة بالقوانين السارية، وعليه فإنه من المفروض أن تكون القوانين المعمول بها كافية لتوفير غطاء قانوني ينظم بنود تحمل المسؤولية وتحديد المسؤوليات في تلك العقود، إضافة إلى توفير تشريع كاف لتفسيرها. هذه الرسالة البحثية تسعى إلى البحث في مفهوم المسؤوليات ومحدوديتها، والأحكام والبنود الناظمة لها في إطار قانون دولة الإمارات العربية المتحدة بهدف تقييم مدى كفايتها وفعاليتها بالمقارنة مع نظرائها من القوانين الإقتصادية. الدراسة تكشف النقاب عن وجود فجوة ما في قانون الإمارات ولكي يتم تغطية هذه الفجوة يقترح البحث طريقة لتحقيق التوازن بين المسؤوليات ومخصصات المخاطر في العقود. يخلص البحث إلى إستنتاجات تؤيد الحاجة إلى التدخل القانوني وإجراء بعض التعديلات لحماية الأطراف في صناعة المقاولات ضد البنود غير المقبولة واللاعقلانية.

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### **Keywords**

Breach of Contract - Contractual and Tort based liability – Causation Damages - Decennial – Liability - Due care, skill and diligence - Duty of Care - Duty of Purpose - Exclusion clause - Exclusive Remedy clauses – Foreseeability - Indemnity - Indirect and Consequential damages - Limitation Factors - Limitation of Liability – Limited Liability – Liquidated Damages - Losses – Mitigation - Muqawala – Natural Result - Performance Clause - Professional Duties - Professional Indemnity Insurance - Proportionate Liability – Reasonableness – Reasonable Certainty - Remedies - Strict Liability - Unfair Terms – Unlimited Liability

### **Table of Abbreviations and Definitions**

A/E	Architects and/or Engineers
Code	UAE Civil Transaction Code
DL	Decennial Liability
EPC	Engineering, Procurement and Construction
FIDIC	Fédération Internationale Des Ingénieurs-Conseils
Muqawala	A muqawala is a contract whereby one of the parties thereto undertakes to make a thing or to perform work in consideration of which the other party undertakes to provide
PI	Professional Indemnity
PII	Professional Indemnity Insurance
SoP	Security of Payment
UAE	United Arab Emirates
UCC	Uniform Commercial Code
UCTA	Unfair Contract Terms Act
UTCCR	The Unfair Terms in Consumer Contracts Regulation 1999
UTD	Unfair Terms Directive 1993

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Credit Contracts Act 1981

Das Bürgerliches Gesetzbuch, the “BGB”, Article 307(1)

Fair Trading Act 1986

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Railways and Canal Traffic Act 1854

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The Unfair Contract Terms Act 1977

The Unfair Terms in Consumer Contracts Regulation 1999

UAE Civil Transaction Code, Law # 5 of 1985

Unconscionable Contracts Ordinance 1994 (Cap 458)

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Uniform Commercial Code

# **1. CHAPTER ONE - INTRODUCTION**

## **1.1. Background**

Most bespoke forms of contracts used in the UAE are developed and maintained by client organizations and therefore tend to be less balanced in regards to risk allocation and fairness of terms. With such imbalanced provisions, contractors and architects or consulting engineers (herein after referred to as “A/E”), with little bargaining power, are often subjected to imposition of unreasonable and onerous contract terms, and to unrealistically high or unlimited liability in the event of breach or negligent default.

Acceptance and retention of such high risks can have a detrimental effect on an organisation, the project and eventually the whole industry. Clauses related to Limitation of liability, exclusion and indemnity play a vital role in allocation of risks in a contract. Both parties to a contract should therefore strive for maximum benefit from such clauses as these play a major part in settling issues in times of disputes, non-performance or breach.

When a contract is breached, the non-breaching party has the remedy to avail of damages under the law of contract. The breach may also establish a tort, which makes the injured party eligible for damages under tort. The innocent party may also be entitled to remedies for consequential losses if these losses were foreseeable at the time of contract finalization. However the remedies or damages are subject to limitations agreed under contract or as per the governing law. As it is important for every business to manage potential risk or liabilities that may arise against them, the validity of clauses related to agreed limitations of liability are of high importance in construction contract law.

Under the freedom of contract principle, the parties to a contract are able to increase or limit the extent of liability for breach of contract, claims from third parties or for liabilities under tort, by means of exclusions, limitations of liability and indemnities. However, the general notion of freedom of contract must be unprejudiced that any party who can freely enter into a contract should not be

absolutely free to excuse itself from the commitment to perform<sup>1</sup>. To empower contracting parties and strike a balance, English law has developed a mix of statutory rules and case law which must be taken into account while negotiating and practicing these clauses<sup>2</sup>.

In the UAE, statutory controls similar to those available under the UK law such as The Unfair Contract Terms Act<sup>3</sup> (UCTA), Unfair Terms in Consumer Contracts Regulations<sup>4</sup> etc., are not in place. In the absence of such statutory intervention or case law that can be considered as binding precedents, it sometimes becomes hard to understand what can be considered as a reasonable or legally enforceable limitation of contractual liabilities. Not only the UK, but also many other common law and civil law jurisdictions have brought about legislative measure to control unfair terms or exclusion clauses in commercial construction contracts.

In the UAE, contractual liabilities are often seen as limited, excluded and in some cases as unlimited. The limitation of liabilities has been a highly debated area of construction law. Clauses related to limitation of liability set the rules of the game in a contract. At the same time indemnity clauses are considered another side of the same coin<sup>5</sup>. Indemnity clauses involve risk allocation and indemnification. These clauses can be the most effective risk allocation tools available to contracting firms. These clauses are also considered amongst the most difficult to negotiate with the client organization. Depending on the jurisdiction, limitation of liability clause may be also the most contested once applied<sup>6</sup>.

Justifiably, different jurisdictions take different views on limitation of liabilities whether contractual or under tort. The position under the UAE law can be

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<sup>1</sup> Ashurst LLP, 'Limitation and Exclusion of Liability', April 2009

<sup>2</sup> Ashurst LLP, 'Limitation and Exclusion of Liability', April 2009

<sup>3</sup> The Unfair Contract Terms Act 1977

<sup>4</sup> Unfair Terms in Consumer Contracts Regulations 1999

<sup>5</sup> R H Kroman, Contracting with Suppliers – *A Balanced Approach to Indemnities and Limitations of Liability*, Co-presented by the Association of Corporate Counsel Ontario Chapter and WeirFoulds LLP, 2 June 2011

<sup>6</sup> The Essentials of Negotiating a Limitation of Liability Clause, Crow Friedman Group Newsletter, (January 2011, Vol 6, Issue 1), available at [http://www.crowfriedman.com/pdf/newsletter\\_0111.pdf](http://www.crowfriedman.com/pdf/newsletter_0111.pdf) accessed on 02 February 2014

considered as covered by article 882<sup>7</sup> of UAE Civil Code (Code) which states “Every condition which tends to exempt the contractor or the architect from his or her liability for damages or to minimize such liability shall be void”. However this limitation provision cannot be considered very straightforward as on the other hand, as direct contradiction article 390<sup>8</sup> of the Code allows the contracting parties to fix in advance by mutual agreement the amount of damages, subject to the provisions of the law. With these conflicting positions, it can only be assumed that limits may be applicable for liquidated damages, and do not apply to decennial liability and tortious liability. However no determinations can be made with any degree of certainty without further analysis of the provisions.

## **1.2. Research Overview / Problem**

This dissertation intends to investigate the concept of liabilities a contractor or A/E may be held accountable for after a contract breach or professional negligence. In the absence of clear statutory provisions in the UAE, with regards to what liabilities may be limited or excluded, the question about what types of direct and consequential damages will be recoverable from the breaching party becomes a big question. This precise problem is what this dissertation seeks to explore. To achieve this, different types of losses or damages will be analyzed to understand what damages may be recoverable under different liability terms, as applicable under the UAE law, then generally comparing these with the provisions found under the UK law and other similar jurisdictions. FIDIC being the basis of most contracts used in the UAE, is also referred to, to draw comparisons, for bench-marking purposes.

The dissertation researches legal liabilities formed by formation of a contract. This is limited to contractual and tort liabilities and does not cover criminal aspects, forgery etc.

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<sup>7</sup> UAE Civil Transaction Code, Law # 5 of 1985, Article 882

<sup>8</sup> UAE Civil Transaction Code, Law # 5 of 1985, Article 390

### **1.3. Main Research Questions**

This dissertation seeks to answer following questions, generally comparing these between the UAE law, other jurisdictions and international practices.

#### Main Research Aims / Questions are:

- Investigate the key elements that establish and allocate liability in a contract.
- What is the view of limited liability or unlimited liability, in other words the provisions under the UAE law?
- What are the problems associated with accepting or imposing unlimited liability?
- In light of the research findings, is the limit of liability provisions and other related statutory controls recommended to be incorporated into the UAE law by judicial measures?

### **1.4. Aims And Objectives**

This dissertation aims to understand and identify the basis related to limitation of liabilities and the UAE Law's approach towards unlimited liability in dispute situations. In addition, this study considers statutory controls in place in other jurisdictions in order to determine the short-falls in the UAE law. These analyses are done with the following objectives:

- To analyze the concepts of liability and its limitation in the Construction Industry.
- To investigate how the UAE courts may interpret liability clauses and limit liability.
- To explore the need for statutory intervention and recommend further research.

### **1.5. Significance Of Research**

Many construction contracts in the UAE contain unlimited liability or major exclusion provisions. However, the legality of such provisions appears yet to be explored and research on this topic would be enlightening to professionals in the construction industry. It is important for all contract professionals to understand what liability clauses are compatible with the UAE law. Findings from this research are expected to shed light on the topic and help the professionals in the construction industry include reasonable and valid liability terms in the contract. It is also expected that findings from this study will substantiate the need for further research on this subject and the necessity of establishing much needed statutory controls related to contract terms covering the Limit of Liability, Unfair Terms and Exclusions.

## **1.6. Research Methodology**

The dissertation analyses literature material, journal articles, books, reports and case-law from the UAE and the UK. In addition, professional opinions from Construction Law Experts and Contract Professionals from the UAE's Construction / EPC industry shall be sought by means of an interview questionnaire. The interview questionnaire will not cover the full scope of the research; it will be limited to assessing the practical aspects and prevailing understanding of limitation and liability provisions in the UAE Civil Code. A detailed methodology and reasoning on this survey will be provided in the Chapter 5, under section 5.1

## **1.7. Dissertation Structure**

- a) Chapter one provides an overview of the research. A summary of the background, research problem, research questions, aims and objectives, significance of research and the research methodology are identified.
- b) Chapter two – An overview of Liabilities and their interlink to corresponding contractual elements – this chapter will explain about liabilities, their limitations and other component factors. This includes analysis of types of damages and losses, types of consequential losses,

applicable remedies or damages. This chapter will also research, the interlinking of liability clauses with indemnity and exclusions clauses, and common methods and objectives of limiting liability.

- c) Chapter Three – Limitation Provisions under the UAE law. This chapter will explore legal provisions under the UAE law and about available legal and state controls, generally comparing these with provisions under Common Law principles.
- d) Chapter Four – Pros and Cons of imbalanced liability provisions in Construction Contracts. This chapter will seek to explore problems and risks associated with accepting or imposing unlimited liability in a contract.
- e) Chapter Five – Findings from the research and recommendation for achieving the balanced approach - This chapter will explain the research methodology used for conducting interviews, findings and recommendations from the literature review and the interviews conducted. This chapter will also suggest necessary statutory control if this is deemed as a need for consideration under the UAE law.
- f) Chapter Six – Conclusion - This chapter will conclude all findings, recommend an approach and propose further studies to support statutory controls if the research findings verifies it as necessary.

## **2. CHAPTER TWO - Overview of Legal Liabilities and its interlink with corresponding contractual elements**

It is commonly perceived that limitations of liability seek to reduce or eliminate liability while indemnities seek to increase liability<sup>9</sup>. The scope of this chapter is to explain about liabilities, their limitations and other component factors. This includes analysis of types of damages and losses, types of consequential losses, applicable remedies or damages. However, during the discussion of remedies, specific performance which is considered as the primary remedy in most Civil law nations including the UAE will not be discussed. Only damages amounting to monetary compensation shall be researched.

In addition, interlinking of liability clauses with indemnity and exclusions clauses, common methods and objectives of limiting liability will be examined. The aim of this chapter is not to examine wide-ranging constituents of contract law; rather it will identify and briefly examine the relevant features in a construction contract and illustrate a picture of liability network in a contract set-up.

### **2.1. Concepts of liability, breach and damages**

To understand liability, all other associated factors must be explored. Given below is a concise review of these component factors.

#### **2.1.1. Liability in legal context**

Liability is a very broad term. It can be defined as a “responsibility which is a state of one who is bound in law and justice to do something which may be enforced by action. This liability may arise from contracts either expressed or implied or in consequence of torts committed”<sup>10</sup>.

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<sup>9</sup> R H Kroman, Contracting with Suppliers – *A Balanced Approach to Indemnities and Limitations of Liability*, Co-presented by the Association of Corporate Counsel Ontario Chapter and WeirFoulds LLP, 2 June 2011

<sup>10</sup> As defined in Legal dictionary <http://legal-dictionary.thefreedictionary.com/liability> accessed on 2 December 2013



Echoing Justice Stephen Breyer's words 'words do not explain themselves'<sup>11</sup>; elements of liability have to be further explored since a definition does not sufficiently explain its constituent factors. A series of professional duties or liabilities namely; Contractual, in the tort of negligence and statutory duties<sup>12</sup> are formed on undertaking of a contract. Contractors and A/E duty can arise from an implied provision in contract, in tort or by statutes<sup>13</sup>. Therefore, performance of a contract essentially means carrying out all obligations including those imposed by express and implied terms, oral and written terms, mandatory and supplementary rules and customs; all as stipulated under the contract, law of tort and the statutory regulations.

When a contract is made, in addition to a contractual duty of care, its sibling – concurrent duty of care in tort is also formed<sup>14</sup>. This duty of care is principally an implied or expressed term in the contract. As quoted by Mr Powell<sup>15</sup>, a duty of care is something that:

“a professional person owes to his or her client a duty to exercise reasonable care and skill in the performance of the task required of him or her. The required standard of care is that of that paragon of virtue: an ordinary skilled person of the same discipline<sup>16</sup>”

In certain circumstances, the professional shall be required to apply duty of care in tort to third parties, breach of which can give rise to claim under professional negligence and tort of negligence. The method of determining liability of a professional who failed to exercise required level of skill and duty of care was

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<sup>11</sup> A Searbook, 'Justices Get Candid About The Constitution', 09 October 2011, available at <http://www.npr.org/2011/10/09/141188564/a-matter-of-interpretation-justices-open-up>, accessed on 05 February 2014

<sup>12</sup> Alway Associates, 'Professional Negligence' available at <http://www.alway-associates.co.uk/legal-update/article.asp?id=108>, accessed on 05 November 2013

<sup>13</sup> S Furst, V Ramsey, A Williamson and D Keating, *Keating on Construction Contract* (9<sup>th</sup> electronic edn, Sweet & Maxwell, London, 2012)

<sup>14</sup> J L Powell Q.C, 'Professional Liability & Construction: Risk Retained and Risk Transferred', 01 December 2009

<sup>15</sup> J L Powell Q.C, 'Professional Liability & Construction: Risk Retained and Risk Transferred', 01 December 2009

<sup>16</sup> As held in *Bolam v Friern Hospital Management Committee* [1957] 1 WLR 582

well established under the 1963 Australian case of *Voli v Inglewood Shire Council*<sup>17</sup>, as below:

*“An architect undertaking any work in the way of his profession accepts the ordinary liabilities of any man who follows a skilled calling. He is bound to exercise due care, skill and diligence. He is not required to have an extraordinary degree of skill and diligence. But he must bring to the task that he undertakes the competence and skill that is usual among architects practising their profession. And he must use due care. If he fails in these matters and the person who employed him suffers damage, he is liable to that person. This liability can be said to arise either from a breach of contract or in tort.”*

Having stated this, it has to be emphasized that what standard and skill are to be exercised will certainly differ according to the specific facts and circumstances of each duty and these can be determined by way of interpretation of terms agreed in the contract. The contract will be the starting point for the measurement of all liabilities.

Let’s now examine how a liability is formed under a contract. A contract is an undertaking of a duty, responsibility or an obligation. A duty or responsibility translates into a risk. A risk is considered as a liability. This risk may be transferred or in other words indemnified by insurance. When this responsibility or duty is not fulfilled, it constitutes a breach and a claim of damages arises. This network of liability is demonstrated in Figure 1.

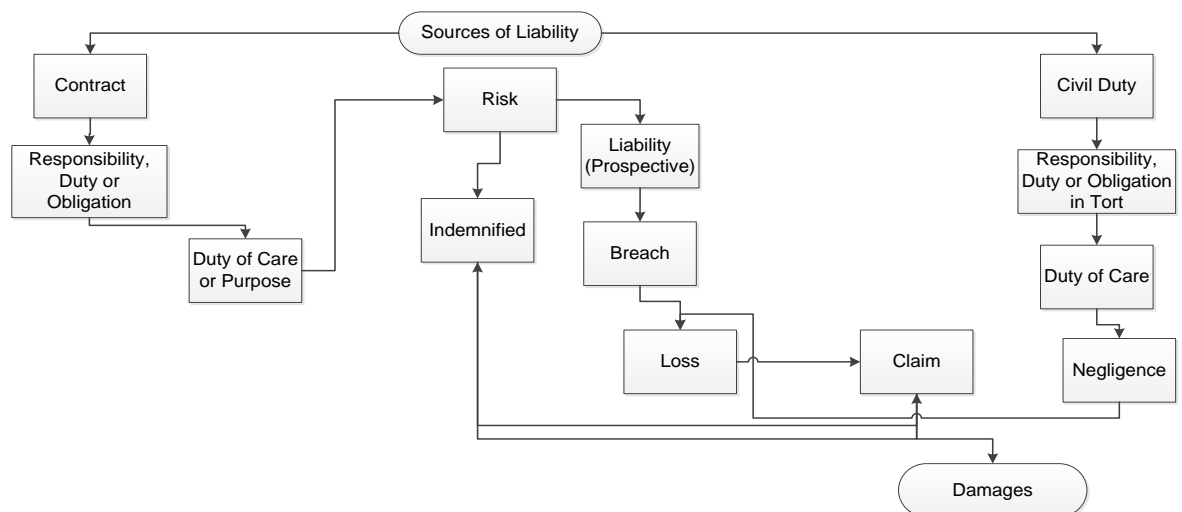


Figure 1 - Network of Liability

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<sup>17</sup> *Voli v Inglewood Shire Council* [1963] HCA 15; (1963) 110 CLR 74

### **2.1.2. Breach of contract, evoking claim for liabilities**

When a party to the contract fails to fulfil any of the contractual obligations, a breach occurs. A breach may be in one of the following forms<sup>18</sup>: Non-performance, Delayed performance, Defective performance and other non-compliance.

- When one party does not perform their contractual obligation, this is referred to as non-performance.
- If delivery of promised services is delayed beyond an acceptable time, this can be considered as a delayed performance. In a contract, when a time is stipulated as a matter of essence, failure to perform within this agreed time frame is considered as a material breach. If the time was not stated to be of essence, it would only constitute a minor breach.
- A complete or partially delivered contract that does not conform to the requirements under contract can be referred to as a defective performance.
- In construction contracts defective performance can be due to, defective construction, defective design or both.
- When a breach of contract is established, the non-breaching party who suffered damages can claim for damages.
- Other non-compliance may not affect the quality of the building. However, parties must not escape liability in cases of non-compliance. Examples, a contractor who does not purchase an insurance policy. A professional is not expected to achieve perfection in every element of his work, but achieve a standard of reasonable skill and care<sup>19</sup>. It must be rare that a complex project is completed without some form of minor unfulfilled contract requirement and therefore note every error in the performance will constitute a breach or negligence.

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<sup>18</sup> Effective Exclusion Clauses, Stevens & Bolton LLP, March 2012

<sup>19</sup> Alway Associates, 'Professional Negligence' available at <http://www.alway-associates.co.uk/legal-update/article.asp?id=108>, accessed on 05 November 2013

In the field of law, the aim of civil law is to provide adequate compensation to the aggrieved party whereas the role of criminal law is to punish the wrongdoers. Thus damages serve as a remedy for breach of contract or negligence in tort. Other common forms of tort such as misrepresentation and fraudulent misrepresentation do not fall under the scope for scrutiny in this research.

### **2.1.3. Damages as the remedy for breach, to recompense liabilities**

Damages are the remedy for breach of contract. Contract remedies give importance to the economic loss triggered by the breach of contract and not on the moral responsibility to carry out the obligations in a contract. The magnitude of compensation is assessed relative to the extent of significance of damages sustained rather than the seriousness of the breach.

In law, damage is the word used for money meant for compensation. This is the case in both common and civil law systems Damages are awarded to compensate a wronged party for loss<sup>20</sup>. The main remedy available at both Civil and Common Law is the award of damages to the injured party.

Damages are meant to preserve three interests of a claimant, namely (1) performance interest, otherwise known as expectation interest, (2) reliance interest and (3) restitution interest<sup>21</sup>. The claimed damages would typically comprise reimbursement for actual loss suffered as a result of the breach and for other gains that the claimant was denied due to the respondent's action that caused the breach. The most important objective of damages in most jurisdictions is to satisfy the performance interest of the claimant by giving an alternative remedy for the 'benefit of bargain' in monetary terms<sup>22,23</sup>, which helps to return the non-breaching party to a situation had the breach not occurred. Damages for tort

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<sup>20</sup> DLA Piper, 'A summary of what direct and indirect losses are', Quick Law 1, Jan 2009

<sup>21</sup> J Y Gotanda, 'Damages in Lieu of Performance because of Breach of Contract', Villanova University of School of Law, Paper 53, 2006

<sup>22</sup> J Y Gotanda, 'Damages in Lieu of Performance because of Breach of Contract', Villanova University of School of Law, Paper 53, 2006

<sup>23</sup> R H Kroman, *Contracting with Suppliers – A Balanced Approach to Indemnities and Limitations of Liability*, Co-presented by the Association of Corporate Counsel Ontario Chapter and WeirFoulds LLP, 2 June 2011

actions are different from contract breach; however some overlap in standards seems to exist<sup>24</sup>. Under tort law, the victim is recompensed for the actual losses suffered, to put him in the same position as if the tort had not been committed<sup>25</sup>.

#### **2.1.3.1. Types of damages and losses resulting from breach**

Losses from a breach of contract are considered to fall under two categories. These are direct and indirect losses. In the same context, damages are also considered as direct and indirect damages. Compensatory Damages can thus be considered to fall under two groups:

- Direct or otherwise known as General Damages;
- Indirect, Consequential, Special or Incidental Damages. Some commentators are seen to differentiate between these types. However I prefer to broadly classify them under one group due to absence of legal classification or definition that is internationally recognized.

The classic case of *Hadley v Baxendale*<sup>26</sup> has been interpreted under numerous subsequent cases and categorised the difference between the two groups as follows:

Direct damage is loss arising naturally, according to the regular progression of matters, directly from the breach of contract and therefore it is foreseeable and recoverable<sup>27</sup>. This type of loss is covered under the first limb of *Hadley v Baxendale*<sup>28</sup>. It does not take into consideration any special circumstance of the claimant.

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<sup>24</sup> R H Kroman, Contracting with Suppliers – *A Balanced Approach to Indemnities and Limitations of Liability*, Co-presented by the Association of Corporate Counsel Ontario Chapter and WeirFoulds LLP, 2 June 2011

<sup>25</sup> J Adriaanse, *Construction Contract Law* (3<sup>rd</sup> edn, Palgrave macmillan, UK, 2010)

<sup>26</sup> *Hadley v Baxendale* (1854) 9 EX 341

<sup>27</sup> Direct or Indirect Loss? Herbert Smith Construction Dispute Avoidance Newsletter, no. 31, Sep 2011

<sup>28</sup> *Hadley v Baxendale* (1854) 9 EX 341

Indirect or consequential damage is “loss that arises from a special circumstance of the case and is recoverable if it may reasonably be supposed to have been in the contemplation of the parties at the time they made the contract, as the probable consequence of the breach. In other words, if the party in breach of contract was aware of the special circumstances of the other party when the contract was entered into, the losses may be recoverable”<sup>29</sup>. This type of loss is covered under the second limb of *Hadley v Baxendale*<sup>30</sup>. This limb was further illustrated in a more modern case of *Victoria Laundry v Newman*<sup>31</sup>. This type is supposed to include all losses faced by the non-breaching party that are attributable to the special circumstances of the non-breaching party that the contracting parties were conscious of during the making of the contract. In short, the liability of the defendant is limited to foreseeable consequences of their breach<sup>32</sup>.

The line between direct and consequential damages seems very fine and damage which is viewed as a direct loss by one court may be regarded by another court as a consequential damages<sup>33</sup>. In general, direct damages shall be most definitely awarded to the injured party but consequential damages are recoverable only if the damages were in contemplation of the parties at the time of entering into the contract<sup>34</sup>. In contrast to this, Mr Knowles<sup>35</sup> explained “Consequential loss does not include those which are normal and usual but comprises losses peculiar to the particular circumstances and not foreseeable”. This is a departure from *Hadley v Baxendale*<sup>36</sup> and it can be easily contested that consequential losses are foreseeable even though not all types may be forecasted.

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<sup>29</sup> Direct or Indirect Loss?, Herbert Smith Construction Dispute Avoidance Newsletter, no. 31, Sep 2011

<sup>30</sup> *Hadley v Baxendale* (1854) 9 EX 341

<sup>31</sup> *Victoria Laundry v Newman* [1949] 2 K.B.. 528

<sup>32</sup> J Uff, *Construction Law* (10<sup>th</sup> Edn, Sweet Maxwell, London, 2009)

<sup>33</sup> R H Kroman, Contracting with Suppliers – *A Balanced Approach to Indemnities and Limitations of Liability*, Co-presented by the Association of Corporate Counsel Ontario Chapter and WeirFoulds LLP, 2 June 2011

<sup>34</sup> R H Kroman, Contracting with Suppliers – *A Balanced Approach to Indemnities and Limitations of Liability*, Co-presented by the Association of Corporate Counsel Ontario Chapter and WeirFoulds LLP, 2 June 2011

<sup>35</sup> R Knowles, *150 Contractual Problems and their solutions* (Blackwell Publishing)

<sup>36</sup> *Hadley v Baxendale* (1854) 9 EX 341

The distinction between the two types was demonstrated also in *McCain Foods v Eco-Tec*<sup>37</sup> which was ruled in reference to cases *Hotel Services Ltd v Hilton International*<sup>38</sup> and *Deepak v ICI*<sup>39</sup>.

In the UAE, the doctrine of stare decisis does not exist and therefore previous cases cannot set precedence or provide adequate guidance in interpretation of a case situation, but can only be used as persuasive measures. Similarly, the damages are accounted for in a case by case approach. In theory, indirect losses, profit loss<sup>40</sup>, opportunity loss and moral damages<sup>41</sup> can be recovered<sup>42</sup>.

### **2.1.3.2. Types of Consequential Damages in construction contracts**

On analysis of different types of consequential losses, three types were found<sup>43</sup>:

- Gains stopped or prevented by the breach, – These include gains from loss of use, loss of profits, lost rent, down or idle time and lost interest. The most common and probably the most expensive example perhaps is lost profits.
- Expenses triggered by the breach – These include expenses caused due to the breach, for example an terminated contractor may incur expenses for bidding on new projects; other examples would be additional labor costs, material escalation cost etc.
- Expenses deemed futile by the breach – These include expenses considered lost as a result of the breach, for example advertising expenditures incurred for a product that could not be launched due to technical issues.

## **2.2. Limitation of liability in a construction contract**

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<sup>37</sup> *McCain Foods GB Limited v Eco-Tec (Europe) Limited* [2011] EWHC 66 (TCC).

<sup>38</sup> *Hotel Services Ltd v Hilton International Ltd* [2000] BLR 235

<sup>39</sup> *Deepak Fertilisers and Petrochemical Corp v ICI Chemicals & Polymers Ltd*[1999] 1 Lloyd's Rep 387

<sup>40</sup> UAE Civil Transaction Code, Law # 5 of 1985, Article 292

<sup>41</sup> UAE Civil Transaction Code, Law # 5 of 1985, Article 293

<sup>42</sup> J Cornish, A Marsden and E Purcell, 'The interpretation of warranties, indemnities and representations in commercial contracts. Governed by the laws of England and Wales, South Africa or the UAE', Latham & Watkins LLP

<sup>43</sup> Limiting Liability under a Contract, Torys, The Technology Group

All legal systems place some forms of limitations on damages awards<sup>44</sup>. A party who wishes to exclude their liability against consequential damages should have such language included in the contract by negotiation. The language used to exclude or limit liability must be clear and unambiguous, to have its intended effect, on scrutiny by the competent law authority. Causation, foreseeability, certainty, fault and avoidability are the most common types<sup>45</sup>. A detailed research on what limitation is in place under the UAE law will be narrated in third chapter.

### **2.2.1. Exclusion clause and its intend**

Contracts use exclusion clauses to exclude, limit or defeat liability for certain types of liabilities or losses. An exclusion clause is considered one of the most contentious boilerplate clauses in practice<sup>46</sup>. These clauses limit liability for breach of contract, different categories of losses, loss of profit, negligence etc. as agreed between the parties. However, the language must be clear and unambiguous and must not be against the public policy. This is the general rule of law. If there is any doubt or ambiguity, the contra proferentem rule will apply<sup>47</sup>. That is, the clause will be interpreted against the party who is relying on the use of it. Uncertainty surrounds the effects of such clauses.

When considering excluding liabilities, the following should be considered:

- Indirect and consequential losses – The scope of such a vaguely defined loss would be unclear to interpreters. If a contract excludes liability for indirect or consequential loss, it would be difficult to determine the exact types of losses intended here. To avoid this uncertainty, the contract should identify the specific types of loss and events for which the liability

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<sup>44</sup> J Y Gotanda, 'Damages in Lieu of Performance because of Breach of Contract', Villanova University of School of Law, Paper 53, 2006

<sup>45</sup> J Y Gotanda, 'Damages in Lieu of Performance because of Breach of Contract', Villanova University of School of Law, Paper 53, 2006

<sup>46</sup> E Mckendrick, Contract Law (5<sup>th</sup> edn, Oxford University Press, Oxford 2012) 405

<sup>47</sup> J Murdoch and W Hughes, *Contraction Contracts Law and Management* (3<sup>rd</sup> edn, Taylor & Francis, New York, 2000)



is sought to be limited or excluded<sup>48</sup>. Consequential loss and its scope can be defined in the contract itself to increase the likelihood that an arbitration panel or court will not entertain cases that are not warranted<sup>49</sup>.

- Excluding liability for negligence – All types of consequences resulting from negligence cannot be limited or excluded. Particular caution must be exercised in this area and only those that are not against public policy or statutes must be excluded, otherwise the clause will not yield intended results. As a standard, in proving negligence the following four elements have to be established. The defendant had a duty to perform relevant services, the defendant breached that duty, the defendant's breach is the cause of the claimed damages and the claimant suffered those damages. If these four elements cannot be established, the claim will ultimately be unsuccessful<sup>50</sup>.

The implication of not excluding liability for a defined consequential loss was best illustrated in *Perini v Greate Bay Hotel*<sup>51</sup>. Perini was appointed as the construction manager undertaking major renovation works for a hotel and casino named Sands. The contract was with Sands for a fee of \$600,000 and did not include a waiver of consequential damages. The project suffered approximately 4 months delay. Through arbitration, Sands was awarded \$14.5m in damages from Perini which was about 24 times the fee. The damages were for Sand's lost profits due to the delay in completion and final hand-over. The New Jersey Court confirmed the shocking arbitration award. Had Perini insisted on a waiver of consequential damages and limited remedies to less severe types in their contract with Sands, they could have avoided such a harsh result<sup>52</sup>.

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<sup>48</sup> A Summersby, A Davis and P Walker, 'A guide to limiting supplier liability in ICT contract with Australian Government agencies' (3<sup>rd</sup> Edition, May 2013)

<sup>49</sup> J L Richey and W D. Wickard, 'Consequential damages in Todays Construction Industry, Effectively avoiding them requires up-front clarity', *Constructioneer*, May 5 2008

<sup>50</sup> D J Hatem, D Hunt and S E Yoakum, 'Professional Liability Insurance concerns for Structural Engineers', *Structure Magazine*, available at <http://www.structuremag.org/article.aspx?articleID=1395> accessed on 20 March 2014

<sup>51</sup> *Perini Corp. v Greate Bay Hotel & Casino, Inc* 29 N.J. 479 (1992)

<sup>52</sup> J L Richey and W D. Wickard, 'Consequential damages in Todays Construction Industry, Effectively avoiding them requires up-front clarity', *Constructioneer*, May 5 2008

### **2.2.2. Indemnity clause in a contract**

An indemnity is an arrangement or agreement where a party (first party) to the contract accepts the risk of loss or damage that the other party (second party) may suffer, whether or not the first party would be responsible for that loss<sup>53</sup>. It is usual practice in a contract, where the contractor or A/E is required to indemnify the employer with a broad range of cover. In a common law state of affairs, these type of broad indemnities are placed to overcome the need to establish liability, causation, foreseeability, reasonableness, meeting limitation periods, loss, mitigation obligation and when breach did not occur<sup>54</sup>. All these ambiguous and onerous indemnity requirements place heavy risks on the contracting party and affects the equilibrium of the contract by imposing uninsurable risks.

The requirement for the contractor or A/E to hold insurance is to ensure that they will have sufficient financial resources to meet the liabilities in the event the risk eventuates<sup>55</sup>.

A typical indemnity clause would require that the Contractor or A/E indemnify and hold the Employer harmless against any and all losses, liabilities, damages, fines, costs, expenses (including legal fees), demands, claims, actions or proceedings which the Employer may suffer or incur in respect of third parties as a result of or in connection with any breach of the contract, negligence or other default of the Contractor or A/E, their sub-contractor, employees, suppliers or agents in connection with the contract, except to the extent that the loss was caused by negligence or wilful default of the Employer.

This indemnity in most of the cases is not provided for in a reciprocal fashion and thus makes only one party responsible for indemnifying the other party in case of loss. These provisions thus bring the contract to a highly imbalanced position.

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<sup>53</sup> A guide to limiting supplier liability in ICT contract with Australian Government agencies (3<sup>rd</sup> Edition, May 2013)

<sup>54</sup> Australian Contract Law, Response to discussion paper, Consult Australia, July 2012

<sup>55</sup> A guide to limiting supplier liability in ICT contract with Australian Government agencies (3<sup>rd</sup> Edition, May 2013)

Even when a total aggregate limit of liability is agreed under the contract, often indemnity provisions are specified as a carve-out.

### **2.2.3. Common methods of limiting or allocating liability in contracts**

The main methods of limiting liability in a contract are<sup>56</sup> :

- By clearly specifying in the contract the maximum limit of the recoverable amount for the breach
- Exclusion of certain type of losses for which the party will not be liable
- By specifying that certain types of remedies are excluded which means only the remedies listed in the contract will be available for damages suffered.
- By agreeing in the contract that the signed agreement constitutes the whole of the contract. Entire Agreement clause provides that the contract contains all rights, obligations, remedies and thereby limit use of other privileges or evidence.

In addition to limit of liability and exemption clauses already explained above, other established and customary means of allocation of risk or limitation of liability in a contract are as follows:

#### **a) Insurance Requirements**

Contracts usually require the Contractors and A/E to provide a number of types of insurance such as Public Liability, Third Party Liability, Workmen's Compensation, Plant and Machinery, Contractors All Risk, Professional Indemnity Insurance (PII) etc. Among these PII is of particular importance and relevant ramifications are explained below.

PII policies also known as Errors and Omissions policies or Professional Liability are meant to recover the losses associated with professional liability. It is meant to protect

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<sup>56</sup> Exclusion and limitation clauses, Out-law.com, August 2011, <http://www.out-law.com/en/topics/projects--construction/construction-claims/exclusion-and-limitation-clauses/> accessed on 01 February 2014

Contractors and A/E from financial loss resulting from negligence or errors and omissions in connection with delivering professional services<sup>57</sup>. Additional indemnity provided typically includes legal and other costs and expenses sustained in the process of defending a claim<sup>58</sup>. This cost could be very high even if the liability did not exist<sup>59</sup>.

There are so many issues and misconceptions entangled with PII policies. For instance, it is misunderstood that a liability for a particular risk is impliedly capped at the limit of the required insurance<sup>60</sup>. However, this shall not be the case depending on the terms of the contract. For a contract with an unlimited liability cap or a higher limit than the required insurances, the employer can seek to recover additional losses from Contractor's or A/E's assets or from other insurance in place<sup>61</sup>. Anyhow, if an allegation of negligence is proved or upheld, the likely damages to be recovered from PII shall be the reasonably foreseeable consequences of the negligent actions.

Another issue often faced is the requirement for unlimited insurance cover under PII. While unlimited insurance is rarely available, the requirement for this is often seen as included in contracts, without conducting any risk assessment to appraise if uncapped insurance is needed. Also broad indemnity provisions undertaken by contractors and A/E to cover losses of employers would not be covered by PII instruments, as PII typically covers only their contractual or civil liability for negligence towards performance of the obligations under the contract. Types of claims not covered under a PII are breach of contract, defective workmanship, fraud, wilful defaults, payment issues etc<sup>62</sup>. Express warranties, guarantee that services will be defect free or fault free, fitness for purpose etc. are additional uninsurable contractual liabilities<sup>63</sup>. Employer's insistence on getting an unlimited PII and broad indemnity cover may all be futile as these may simply fail to be effective.

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<sup>57</sup> I P Samantha, 'Consultants' Liability Insurance An Overview', Clark Wilson

<sup>58</sup> Consultants Key – Professional Indemnity Insurance, Griffiths and Armour

<sup>59</sup> I P Samantha, 'Consultants' Liability Insurance An Overview', Clark Wilson

<sup>60</sup> E Lloyd, 'Insurance in Construction Contracts: A Few Things to Know', available at <http://www.tamimi.com/en/magazine/law-update/section-8/february-6/insurance-in-construction-contracts-a-few-things-to-know.html> accessed on 29 March 2014

<sup>61</sup> E Lloyd, 'Insurance in Construction Contracts: A Few Things to Know', available at <http://www.tamimi.com/en/magazine/law-update/section-8/february-6/insurance-in-construction-contracts-a-few-things-to-know.html> accessed on 29 March 2014

<sup>62</sup> M Copus, 'Understanding Professional Liability Insurance', Hall & Company

<sup>63</sup> The Client's Resource, Intro to Professional Liability Insurance, available at <http://www.schinnerer.com/risk-mgmt/Documents/UnprotectedFiles/Intro-professional-liability.pdf> accessed on 28 March 2014

Decennial Liability being one of the special liabilities the contractors and A/E are subjected to under the UAE law, should consider getting a PII that cover 'legal or civil liability' cover as opposed to 'negligence' cover<sup>64</sup>.

#### b) Performance clauses

This type of clause is meant to impose obligation of performance and also state that a failure to perform will constitute a breach of contract and therefore be liable for damages<sup>65</sup>. A regular performance clause would state that the contractor or A/E shall perform the services as specified in the scope of work.

#### c) Liquidated damages

These provisions are included in the contract to compensate the employer for types of breach such as delay or underperformance. The main benefit of liquidated damages is that they remove the need for quantifying the loss and proving actual loss before such amounts can be recovered. However under local laws, the party being penalized could challenge such liquidated damages levied. Article 390 provides the courts a discretionary power to adjust the pre-agreed level of compensation. It could be the contractor or A/E contesting to reduce the liquidated damages to reflect the actual or the employer seeking to increase the liquidated damages to compensate for losses incurred in full. In both cases, it is the duty of the challenging party to accurately demonstrate, the true extent of suffered loss or harm<sup>66</sup>.

However, the fact is that in the UAE, existence of a liquidated damages provision in a contract does not give the employer an automatic or ultimate right to subtract and retain the pre-agreed amounts without the need for proving it in the future<sup>67</sup>. As reported by Al Tamimi & Co<sup>68</sup>, the UAE courts apply the tripartite test to test and verify liquidated damages. This test checks that a breach is committed by the party who agreed to pay the liquidated damages, the party who invoked the liquidated damages clause suffered actual

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<sup>64</sup> Kamal Hafez Property & Construction, 'Managing the Risk of Decennial Liability', Law Update, 2011, 244, 61

<sup>65</sup> A guide to limiting supplier liability in ICT contract with Australian Government agencies (3<sup>rd</sup> Edition, May 2013)

<sup>66</sup> A Balchin, 'The Middle East, Construction and the Law', Law Update 2013, 256, 9 February 1 2013

<sup>67</sup> A Dimitracopoulos, 'So what have you lost?-Can an employer deduct and keep liquidated damages if a contractor is in delay?', Law Update 2004, 157, 26, Al Tamimi and Company

<sup>68</sup> F Attia, Al Tamimi and Co., 'Liquidated Damages - the bigger picture', Law Update 2012, 247, 2

damages and there is a causative link between the breach and the damage. While this power of the courts can be considered as being meant to bring fairness in penalizing, it is also seen by some as the power of courts to bring uncertainty in already agreed terms.

d) Other contractual mechanisms include<sup>69</sup>:

- Back to back clauses
- Limitation periods
- Warranty clauses - Under this clause one of the parties warrant that they will deliver a certain result and accept liability if this result is not achieved<sup>70</sup>.
- Exclusive Remedies as explained under section 3.4 of third chapter.
- Performance security instruments such as bank bonds & retention monies.

### **2.3. Objectives of Limiting liability in a construction contract**

The practice of exemption clauses or unlimited liability leads to misuse and abuse, particularly in situations where the contracting parties do not have equal economic or bargaining strength. It is seen that the advantages of some types of control outweigh the perceived economic disadvantage due to this limited intervention with the freedom of contract<sup>71</sup>. The reason to limit liability and provide for different risk allocation mechanisms in a contract is to achieve balance in the risk profile in the contract. The ultimate objective of the contracting parties shall be successful delivery of the project without economic constraint and loss for either of them.

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<sup>69</sup> Effective Exclusion Clauses, Stevens & Bolton LLP, March 2012

<sup>70</sup> A guide to limiting supplier liability in ICT contract with Australian Government agencies (3<sup>rd</sup> Edition, May 2013)

<sup>71</sup> The Law Reform Commission of Hong Kong Report on The Control of Exemption Clauses (Topic 13)

### **3. CHAPTER THREE – Limitation Provisions under the UAE Law**

This chapter will research legal provisions under the UAE law and its legal and state controls, generally comparing these with provisions under Common Law. The aim of this comparison is limited to explore the differences in the limitation factors and statutory controls applied under various jurisdictions. The UK law and similar other jurisdictions provide a number of statutory controls to regulate contracting transactions and restrict the use of unreasonable provisions so as to protect the interests of the contracting party who is in a weaker bargaining position.

The UAE is a civil law nation and its primary source of law lies in its statutes. The Code governs all types of contracts including but not limited to construction contracts. Civil Code articles 872 to 896 provide the requirements specific to construction contracts referred to as the muqawala provisions. There are other significant provisions found throughout the code that impacts a muqawala contract, in addition to particular articles that stipulates the tort provisions. Tort law in the UAE is recognized under articles 124 and from 282 to 294 in the Code<sup>72</sup>.

A meagre 25 articles of the Code are not sufficient to cater to the vibrant, young and unparalleled construction industry of the UAE which has seen unprecedented growth that is fuelled by visionary leadership and an entrepreneurial community and therefore this insufficiency can be considered as a lacuna in the law<sup>73</sup>. All situations that cannot be remedied by these articles often require case by case interpretation by the judiciary which relies on the provisions that are embodied in various decrees and ministerial decisions in addition to the Code<sup>74</sup>.

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<sup>72</sup> Law of Tort in the UAE, Al Tamimi and Company

<sup>73</sup> Construction law in UAE a distinct body, available at <http://www.lawteacher.net/contract-law/essays/construction-law-in-uae-a-distinct-body-contract-law-essay.php>, accessed on 02 April 2014

<sup>74</sup> Construction law in UAE a distinct body, available at <http://www.lawteacher.net/contract-law/essays/construction-law-in-uae-a-distinct-body-contract-law-essay.php>, accessed on 02 April 2014

As the contractual liabilities are formed on a consensual basis, and because the UAE recognizes the freedom of contract principle<sup>75</sup>; the parties to a contract may agree on a liability cap and exclude certain types of indemnities or losses. However the Code has imposed certain statutory exceptions to what agreements may be regarded as enforceable under law. Article 31<sup>76</sup> is of particular importance, which states that obligatory provisions of law take superiority over terms in contractual provisions.

There appears to exist widespread uncertainty about how these statutory provisions shall be interpreted in courts or rather how these shall effect a contracting party in case of a dispute leading to litigation. In order to bring some insight into this, some of the legal and statutory requirements in the UAE are examined later in this chapter. First, an analysis of provisions for contractual and tort based liability is provided.

### **3.1. Provisions for contractual and tort based liability and limitation factors**

For liability to arise under the contract, in the UAE, the following must be corroborated<sup>77</sup>.

- A breach of contract by the alleged party
- Loss incurred by the other party
- An underlying link between the breach and the loss

Test for tort based liability in the UAE<sup>78</sup>

- Existence of a duty imposed by law and breach of that duty
- A party suffers certain loss
- Causation between the breach and the loss.

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<sup>75</sup> j c Bueno, *The Projects and Construction Review* (Law Business Research Ltd, London 2011), p 291

<sup>76</sup> UAE Civil Transaction Code, Law # 5 of 1985, Article 31

<sup>77</sup> F Attia, Al Tamimi & Co, 'Can We Really Limit Liability?', Law Update 2012, 254, 3

<sup>78</sup> F Attia, Al Tamimi & Co, 'Can We Really Limit Liability?', Law Update 2012, 254, 3



To assess the above provisions, it is advisable to benchmark with a more established legal system such as the UK, where the principles for liability for a breach of contract is as prominently derived from the landmark decision in *Hadley v Baxendale*<sup>79</sup>. The requirements and limitations of contract damages are<sup>80</sup>:

- Causation – only losses directly caused by the respondent is recoverable
- Foreseeability – Only such losses that were foreseeable as a possible result of the breach of contract will be recoverable
- Mitigation – Only such losses that were not avoidable are recoverable
- Reasonable certainty – Not all losses are recoverable, only those that can be proved with reasonable certainty

To establish a construction claim in tort or liability in negligence under common law, the following requirements must be met<sup>81</sup>:

- the defendant or professional owed a duty of care to the claimant under the contract
- this duty of care was breached
- this breach caused certain damage
- the damage falls within the scope of the duty

The Test in the UAE for tort and contract liability seems to be similar. In comparison to common law the foreseeability and mitigation factors are not apparent in the UAE Code. With reference to natural result<sup>82</sup>, the foreseeability requirement seems set. Nonetheless, mitigation factor as covered under article 290<sup>83</sup> seems applicable only under contributory negligence and not in instances where a contractor or A/E's default is claimed. It is applicable in situations where 'own' act is involved in causing and accruing of damage. Thus the UAE law does not seem to mandate the claimant's duty to avoid accumulating of damages unlike

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<sup>79</sup> *Hadley v Baxendale* (1854) 9 EX 341

<sup>80</sup> S M Waddams, *The Law of Damages* (Canada Law Book, 1991), p 191-192

<sup>81</sup> F O'Farrell Q.C , 'Professional Negligence in the Construction Field', Keating Chambers

<sup>82</sup> UAE Civil Transaction Code, Law # 5 of 1985, Article 292

<sup>83</sup> As provided in Article 290 of UAE Civil Code, the judge shall reduce the level by which an act has to made good or to order that it need not be made good if the person suffering harm participated by his own act in bringing about or aggravating the damage.

the provisions in common law principles. In regards to the causation factor, there seems to exist a fundamental difference between the UAE law and English law. A third party intervention is fatal in that it breaks the chain of causation in the UAE law whereas in English law that does not happen, a causal connection can be established between the breach and harm or loss<sup>84</sup>.

It seems liability under tort cannot be limited as is made clear by article 296<sup>85</sup> which states that any agreement purporting to provide exemption from liability for a harmful act shall be void. It is also pointed out in a Tamimi article<sup>86</sup>: The writer states that “The inability under the UAE law to limit tort based liability is particularly significant....whereas contractual liability does not expose a party to unforeseeable or consequential damages”. This is a highly contentious issue and I would argue that article 878<sup>87</sup> makes the contractor responsible for all damages; consequential damages may be foreseeable and besides the Code under the muqawala provisions does not differentiate between direct and consequential damages. This should mean that all types of tort based liabilities cannot be limited. However it is usual to find contracts in the UAE that limit or cap liabilities.

For example, the FIDIC Red Book<sup>88</sup> which is the most common form of contract under use in the UAE, provides under clause 17.6 that the total liability of the Contractor to the Employer, with the a few exceptions under some other sub-clauses, shall not exceed the sum stated in the Particular Conditions or if a such sum is not stated or agreed, the limit shall be the accepted contract amount. This sub-clause goes on to provide that it does not limit liability in any case of fraud, deliberate default or reckless misconduct by the defaulting party. Thus under the FIDIC Redbook<sup>89</sup>, the overall liability of the contractor, including tort seems

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<sup>84</sup> C Wilby, N Molan, and J Haoula ‘Excluding Consequential Loss – Have You Really Limited Your Loss?’ available at [http://www.velaw.com/resources/pub\\_detail.aspx?id=18978](http://www.velaw.com/resources/pub_detail.aspx?id=18978) accessed on 5 March 2014

<sup>85</sup> UAE Civil Transaction Code, Law # 5 of 1985, Article 296

<sup>86</sup> F Attia, Al Tamimi & Co, ‘Can We Really Limit Liability?’, Law Update 2012, 254, 3

<sup>87</sup> UAE Civil Transaction Code, Law # 5 of 1985, Article 878

<sup>88</sup> FIDIC Condition of Contract for Construction. 1999

<sup>89</sup> FIDIC Condition of Contract for Construction. 1999

limited subject to a few exclusions. It is unclear how far this agreement would be upheld in courts if contested by one of the contracting parties.

Article 390 allows the contracting parties to fix the amount of compensation in advance by agreeing on pre-determined limits specified in the contract or by a subsequent agreement for loss sustained due to a breach<sup>90</sup>. However, the same article also grants the courts a discretionary power to scrutinize and vary the limits agreed in the contract. It provides that if one of the parties makes a claim, the judges may vary such pre-agreed levels in order to make the damages and loss equal and any contract excluding this right shall be void. This is reflecting the Shari'ah principles according to which remedies or compensation shall be equal to the actual loss suffered. Thus agreement on liquidated damages also has no certainty under the existing system.

However, this does not cover the complete picture under UAE law; which imposes further liabilities on the contractors, such as the decennial liability and the no fault provisions.

### **3.2. Decennial Liability**

As per article 880<sup>91</sup>, contractors, A/E and supervising engineers are jointly liable for structural defects or collapse of the work that happens within ten years from the time the works are taken over by the employer. This liability which has roots in French law<sup>92</sup> is known as decennial liability. It is a strict liability under the UAE Law<sup>93</sup>.

Main contractors and architectural or supervising consultant are liable for cost of remedying structural damages that surface within the time period of ten years. When structural integrity of a building is uncertain within ten years of hand-over,

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<sup>90</sup> UAE Civil Transaction Code, Law # 5 of 1985, Article 390(1)

<sup>91</sup> UAE Civil Transaction Code, Law # 5 of 1985, Article 880

<sup>92</sup> Decennial Liability, Professional Liability Update Newsletter, March 2011 available at <http://www.cavignac.com/publications/professional-liability-update-decennial-liability/> accessed on 02 January 2014

<sup>93</sup> UAE Civil Transaction Code, Law # 5 of 1985, Article 880

it is deemed that both the contract and architect are in default, with the exception that the life of the building was meant to be for less than 10 years.

If the contractor did not perform the contract according to the conditions and specifications, the liability for any resultant damage or loss will lie with the contractor, despite the fact that there was no shortcoming<sup>94</sup>. Article 878 provides that “The contractor shall be liable for any loss or damage resulting from his act or work whether arising through his wrongful act or default or not, but he shall not be liable if it arises out of an event which could not have been prevented”. Consequently, default or negligence by a contractor or architect need not exist. The only way the contractor or A/E can escape this liability is proof of force majeure or extraneous circumstances.

It was held in another UAE case that “one of the effects of such a contract is that the contractor guarantees any harm or loss arising out of his act or the thing he has made, whether or not arising through his infringement or shortcoming....There will also be a liability if a defect appears in the building<sup>95</sup>”.

There is lack of clarity as to what constitutes a defect and if the contractor will be liable for all defects for a period of 10 years which is substantially above the usual 1 or 2 years of defects liability period agreed in the contract.

Article 880(2) further provides that such decennial liability cannot be excluded by contract. The obligation to compensate will remain even if it is proved that the cause for defect or failure of the building was due to defective land or despite the fact that the employer had consented to the construction of a faulty building or installation. Thus article 880(2) makes the contractor liable for all types of unforeseeable physical and ground conditions. In summary, for liability to arise no fault is necessary. The contractor and the consultant may be jointly and severally liable.

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<sup>94</sup> Abu Dhabi cassation court case, 125/Judicial Year 1, 2007

<sup>95</sup> Abu Dhabi Court of Cassation, 339/Judicial Year 3 391-JY-3

Article 882 states that agreement the purport of which is to exempt the contractor or the architect from liability or to limit such liability shall be void. Thus it seems in contracts in the UAE, the exposure of consultants or contractors for decennial liability cannot be capped or excluded.

As per article 881, if the role of the architect was only in making the designs or plans, he shall only be liable for any defects in the plans. If the architect also took the role of the resident engineer or supervisory consultant and supervised the construction activities, the consultant will be jointly and severally liable with the contractor, for design and quality of workmanship. This is notwithstanding the fact that designs were defect free but only the workmanship is defective. Here severally liable means it is a duty of purpose. Insurance for decennial liability seems not widely prevalent in the UAE. This is a huge concern with the amount of risk the contractors and consultants are exposed to. The UAE law does not make decennial liability insurance as mandatory. This is notwithstanding the fact that it is mandatory in Egyptian and French law<sup>96</sup> from where UAE law derives<sup>97</sup>. However, cover for decennial liability may be achieved through a PI Insurance that indemnifies civil or legal liability.

Articles 880, 881, 882 and 883<sup>98</sup> thus establish key ultimate principles - Liability related to structural or major defects in a building could be unlimited. The exception to this could be force majeure and faults by third parties and that the burden to prove these external causes falls on the contractor or designer<sup>99</sup>.

There are some fundamental questions the decennial liability provisions raise<sup>100</sup>:

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<sup>96</sup> C Palmer, 'Decennial Liability : A Potential Time Bomb for U.S Design Professionals' available at

[https://www.beazley.com/documents/architects%20and%20engineers/risk%20insights/insight\\_decennial\\_liability.pdf](https://www.beazley.com/documents/architects%20and%20engineers/risk%20insights/insight_decennial_liability.pdf) accessed on 03 February 2014

<sup>97</sup> Kamal Hafez Property & Construction, 'Managing the Risk of Decennial Liability', Law Update, 2011, 244, 61

<sup>98</sup> UAE Civil Transaction Code, Law # 5 of 1985, Article 880 until 883

<sup>99</sup> A Dimitracopoulos, 'Design and Beware - Architect's liability under UAE Law', September, Law Update 2004, 162, 18

<sup>100</sup> M Grimmitt, 'Uncertainty in the Application of UAE Laws, Tales Of The Unexpected: Where Liability Lurks Unseen', Pinsent Masons, available at <http://kluwerconstructionblog.com/2009/11/03/tales-of-the-unexpected-where-liability-lurks-unseen/>, accessed on 4 March 2014

- Does jointly liable mean if one of the liable parties is liquidated, the other party may be liable for the full liability above and beyond their fault?
- When there is proportionate liability, is the liability apportioned on a fault basis between contractor and designer?
- If only one party was at fault, will the other party be relieved of the liability?
- Is there a liability towards other professionals engaged such as the project management consultant or the engineer?

Current legal provisions in the UAE do not offer sufficient clarity about these matters and this ambiguity poses assumed risks to the businesses of construction professionals; who are not able to duly account for these risks.

### **3.3. Duty of Care or Duty of Purpose – What is the position in the UAE?**

The normal standard of works expected from any professional under common law is reasonable skill and care which is a duty of care not a duty of purpose. The courts would not imply that a specific result would be achieved except in a contract where a strict liability or fitness for purpose element was agreed<sup>101</sup>. The contract or law does not impose a strict obligation on the professional<sup>102</sup>. *Bolam v Friern Hospital Management Committee*<sup>103</sup> established this rule.

The rationale behind this approach by English courts is because other doctors and lawyers are not expected to achieve a specific outcome and a similar duty is implied on professional design engineers with regards to achieving a fit for purpose design<sup>104</sup>. The expectation or duty is to meet similar standards of skills and care as any other reasonable professional in the same circumstances. Only in

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<sup>101</sup> J Murdoch and W Hughes, *Construction Contracts Law and Management* (3<sup>rd</sup> edn, Taylor & Francis, New York, 2000), P 168

<sup>102</sup> The scope of designers liability under construction contracts, Construction dispute avoidance newsletter, number 34, December 2011

<sup>103</sup> *Bolam v Friern Hospital Management Committee* [1957] 1 WLR 582

<sup>104</sup> See *George Hawkins v Chrysler (UK) Ltd and Burne Associates* [1988] 38 B.L.R. 36.

package contracts or design and build type contracts, where such an express exclusion is not found the law imposes a fitness for purpose duty<sup>105</sup>. *Greaves & Co Contracts Ltd. v Bynham Meikle and Partners*<sup>106</sup> set this rule. As for liability under pure design contracts, the traditional legal position is that liability arises only where there is negligence not duty of purpose<sup>107</sup>. This was re-affirmed by the Court of Appeal in *Hawkins v Chrysler (UK) Ltd and Burne Associates*<sup>108</sup>.

Professionals experienced in common law jurisdictions will be in for an unpleasant surprise as in the UAE, the situation is totally different<sup>109</sup>. The requirement to achieve a specific result seems to be imposed in all muqawala contracts<sup>110</sup>.

### 3.4. Excluding Consequential loss

A particular definition for Consequential Loss does not exist under the laws of both the UAE and England<sup>111</sup>. Under English law, the consequential loss is perceived as the indirect loss explained under second limb of *Hadley v Baxendale*<sup>112</sup>. However, this rule is not without criticism<sup>113</sup>, as seen in many modern cases such as *Caledonia North Sea Limited v British Telecommunications PLC (Scotland) and Others*<sup>114</sup>. Recently a new concept of “assumption of responsibility” is seen to be preferred over the second limb of *Hadley v Baxendale* as held in *Transfield Shipping Inc v Mercator Shipping*<sup>115, 116</sup>.

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<sup>105</sup> The scope of designers liability under construction contracts, Construction dispute avoidance newsletter, number 34, December 2011

<sup>106</sup> *Greaves & Co Contracts Ltd. v Bynham Meikle and Partners* [1975] 3 All ER 99

<sup>107</sup> J Murdoch and W Hughes, *Contraction Contracts Law and Management* (3<sup>rd</sup> edn, Taylor & Francis, New York, 2000), P 169

<sup>108</sup> *Hawkins v Chrysler (UK) Ltd and Burne Associates* (1986) 38 BLR 36

<sup>109</sup> Limitation on liability in the UAE – beware!, Construction Management Guide

<sup>110</sup> j c Bueno, *The Projects and Construction Review* (Law Business Research Ltd, London 2011) p 291

<sup>111</sup> C Wilby, N Molan, and J Haoula ‘Excluding Consequential Loss – Have You Really Limited Your Loss?’ available at [http://www.velaw.com/resources/pub\\_detail.aspx?id=18978](http://www.velaw.com/resources/pub_detail.aspx?id=18978) accessed on 5 March 2014

<sup>112</sup> *Hadley v Baxendale* (1854) 9 EX 341

<sup>113</sup> J Carnie, ‘Exclusion & Limitation Clauses : Current Developments’, Clendons Barristers & Solicitors, October 2011

<sup>114</sup> *Caledonia North Sea Limited v British Telecommunications Plc (Scotland) and Others* [2002] 1 Lloyd’s Rep

<sup>115</sup> *Transfield Shipping Inc v Mercator Shipping* [2008] 4 All ER 159

In the onset, it may seem that the concept of consequential loss in the UAE is as covered under articles 282 and 283<sup>117</sup>, must be restricted to tort and tortious liability as seems to have been interpreted by some commentators. Following judicial interpretation of the relevant articles<sup>118</sup>, it now appears to generally cover all forms of losses or damages resulting from a contract breach as recognized and covered by the Code<sup>119</sup>. Therefore, all intended exclusions must be clearly worded and expressly stipulated in the contract.

### **3.5. Validity of Exclusive Remedy Clauses**

Exclusive remedies clause is another area where contractors in the UAE seem to place a lot of reliance without realising or evaluating the reliability of terms included. This clause is one among the boilerplate clauses and hence not given much attention by the contractors or employers. One typical such clause limits contracting parties' rights, obligations and liabilities as exhaustive under the terms in the contract. Recourse for liabilities including but not limited to breach, damage, negligence etc. would be limited to express provisions contained in the contract thus making only specific remedies available for breach of obligation.

A contract may require the discharge of numerous obligations and it is not possible to comprehend within the contract, remedies for all types of breach<sup>120</sup>. Therefore, notwithstanding the freedom of contract principle and article that provides that contractual provisions should be given their intention of meaning<sup>121</sup>, rights under mandatory provisions shall most likely be made available to the

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<sup>116</sup> J Carnie, 'Exclusion & Limitation Clauses : Current Developments', Clendons Barristers & Solicitors, October 2011

<sup>117</sup> UAE Civil Transaction Code, Law # 5 of 1985, Articles 282 and 283

<sup>118</sup> UAE Civil Transaction Code, Law # 5 of 1985, Articles 246-2 and 282 to 298

<sup>119</sup> C Wilby, N Molan, and J Haoula 'Excluding Consequential Loss – Have You Really Limited Your Loss?' available at [http://www.velaw.com/resources/pub\\_detail.aspx?id=18978](http://www.velaw.com/resources/pub_detail.aspx?id=18978) accessed on 5 March 2014 citing Fd Sp Ct, app 232/2001, dt 23/10/2001 (23 October 2001); Dubai Sp. Ct, App 401/2000, (11 February 2001) (applying Article 292 to recover damages for a breach of agreement); Dubai Sp Ct, App 149/1995 (awarding the claimant damages for loss of profit); Dubai Sp Ct, App. 511/2002 Civ, (5 April 2003) (applying Articles 290, 292, and 389 to allow the claimant to recover damages for loss of profit)

<sup>120</sup> E Lloyd, Al Tamimi & Co, 'Exclusive Remedies Clauses: UAE Law and the Common Law'

<sup>121</sup> UAE Civil Transaction Code, Law # 5 of 1985, Article 258



aggrieved party<sup>122</sup>. Besides this, other provisions in the Code listed below also place threats to the authority of exclusive remedies clauses which conflicts with binding provision of law<sup>123</sup>.

- Article 106(2) makes unlawful the exercise of a right, if such action would mean harm to other.
- Article 246 also restricts exclusion of provisions of law that apply to contracts.
- Article 309(2) empowers courts to adjust the remedies equal to the loss incurred.
- Article 878 seems to hold the contractor responsible for all losses resulting from his act whether it involves his fault or not except in force majeure situations.

Hence in the UAE the exclusive remedies clauses cannot be considered as a wise option to limit or exclude liability as there is an inherent danger of unlimited exposure to contractors if the clause is proved void. Similarly it is also not considered in the interest of the employers as it brings in uncertainty to available remedies for damages and in case the clause if found reasonable would mean uncovered liability and hidden risk.

While the position in English law is that the exclusive remedies clause may be upheld in courts if found to be reasonable and unambiguous<sup>124</sup> and in general not opposing to the UCTA requirements.

### **3.6. Indemnification in the UAE**

There does not seem to exist any provision in law with regard to unreasonable indemnity, however the courts look for solid proof for claims under an

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<sup>122</sup> UAE Civil Transaction Code, Law # 5 of 1985, Article 31 which provides that mandatory provisions of law may take precedence over terms agreed in contract places uncertainty to the application of Article 258, in the interpretation of an exclusive remedies clause

<sup>123</sup> E Lloyd, Al Tamimi & Co, 'Exclusive Remedies Clauses: UAE Law and the Common Law'

<sup>124</sup> E Lloyd, Al Tamimi & Co, 'Exclusive Remedies Clauses: UAE Law and the Common Law'

indemnity<sup>125</sup>. The compensation granted may be up to the level of all damages suffered including all foreseeable consequential losses such as loss of profit etc<sup>126</sup>.

In cases where the insurer sought to rely on exclusion or limitation of liability or exclusion clauses, it has been held that these shall be reliable only if such language were part of the body of the insurance policy itself by means of which it was easily detectable by the insured<sup>127</sup>. The effect of this is that it can be highly persuasive for following case decisions and to be considered valid such exclusion must be clearly worded and endorsed by the assured<sup>128</sup>. Hence the contractors and A/E have to be very careful with wording in contracts and insurance instruments to ensure that exclusions are clearly spelt out and unreasonable claims will not be withdrawn from their insurance policies.

### **3.7. A check on other jurisdictions**

In order to identify gaps and understand the backwardness of legal controls and statutes in place in the UAE, I have researched and summarized below specific provisions related to controls in place in various other jurisdictions; that affect outcome of unreasonable terms in contracts. The aim is not to draw a comparative analysis but to provide a gap preview with similar economic counterparts.

#### **3.7.1. Control of Unfair terms or liability exemption in other Jurisdictions**

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<sup>125</sup> D Yates, Al Tamimi & Co., 'Technology Contracts: Exercise Care In Choosing A Governing Law', – available at <http://www.tamimi.com/en/magazine/law-update/section-6/november-3/technology-contracts-exercise-care-in-choosing-a-governing-law.html#sthash.m4HfpBc2.W3HDwQ12.dpuf>, accessed on 3 April 2014

<sup>126</sup> UAE Civil Transaction Code, Law # 5 of 1985, Article 292

<sup>127</sup> Dubai Court of Cassation no 27 of 2009 and Dubai Court of Cassation no 298 of 2008

<sup>128</sup> H F Willan, 'The Incorporation and Interpretation of Exclusion Clauses, Conditions Precedent and Warranties in Re/Insurance Policies under UAE Law', February 2013 available at [http://www.hfw.com/downloads/Client%20Brief%20-%20UAE%20law%20\[A4%204pp\]%20February%202013.pdf](http://www.hfw.com/downloads/Client%20Brief%20-%20UAE%20law%20[A4%204pp]%20February%202013.pdf), accessed on 20 March 2014

The UK and most common law nations limit the damages recoverable resultant to a breach in accordance with *Hadley v Baxendale* principles<sup>129</sup>. In addition, there are significant law reforms that have been implemented as well as being considered in common law nations as well as other recognized civil law nations. Furthermore, the doctrine of unconscionability is well established in most common law nations. Unconscionability is generally defined as “taking undue advantage of an inequality in bargaining power”<sup>130</sup>.

### **The United Kingdom**

In England, control of exemption clauses has a long history as can be seen in more specific types of contract. For example, railway and canal companies were prevented from contracting out of liabilities unless it could be proved to be fair and reasonable, by the Railways and Canal Traffic Act of 1854<sup>131</sup>. Their current general law on unfair contract terms is set out in two separate legislative instruments. The Unfair Contract Terms Act (UCTA) stresses exclusion clauses and it is applicable to a wide range of contracts including those between businesses and between businesses and consumers. The Unfair Terms in Consumer Contracts Regulation (UTCCR)<sup>132</sup> was enacted to implement UTD<sup>133</sup> and applies to contracts between businesses and consumers<sup>134</sup>.

For the contract terms to be upheld, any limitation or exclusion of liability for negligence or in contracts, where standard written terms of one of the parties’ is used, these terms shall satisfy the reasonableness test stipulated under UCTA. Section 11(4)<sup>135</sup> provides that where the liability is limited to a specified amount

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<sup>129</sup> Limiting Liability, Herbert Smith, Construction dispute avoidance newsletter, number 39, May 2012

<sup>130</sup> S M Waddams, ‘Unconscionability in Canadian Contract Law’, Loyola Marymount University and Loyola Law School Digital Commons at Loyola Marymount University and Loyola Law School, 7-1-1992

<sup>131</sup> Railways and Canal Traffic Act of 1854

<sup>132</sup> Unfair Terms in Consumer Contracts Regulation 1999 (UTCCR), SI 1999 No 2083

<sup>133</sup> Unfair Terms Directive 1993

<sup>134</sup> Unfair Terms in Consumer Contracts: Advice to the Department for Business, Innovation and Skills, The Law commission and Scottish Law Commission, March 2013 available at [http://lawcommission.justice.gov.uk/docs/unfair\\_terms\\_in\\_consumer\\_contracts\\_advice.pdf](http://lawcommission.justice.gov.uk/docs/unfair_terms_in_consumer_contracts_advice.pdf) accessed on 15 March 2014

<sup>135</sup> The Unfair Contract Terms Act 1977, Section 11(4) (a) and (b)

of money, “the resources which he could expect to be available to him for the purpose of meeting the liability; and how far it was open to him to cover himself by insurance”. It is to be noted that the party relying on the limitation clause has the burden of proving reasonableness<sup>136</sup>. *Ampleforth v Turner & Townsend*<sup>137</sup> was an interesting case where the liability clause did not pass the reasonable test. The contract limited the liability to £1million or the fees paid whichever was less, while the PI insurance required was £10million. The court considered that upholding the limitation clause would mean leaving the insurance provision illusory, mindful of the fact that the cost of such insurance would have been passed on to the client<sup>138</sup>.

If a contract term or an attempt to exempt liability falls within the scope of the Act, control is applied in one of two ways - the exclusion or limitation of liability clause may have no effect at all or it will be held effective if found reasonable by the court.

### **Australia**

The Federal Act <sup>139</sup> of 1974 has provisions to specifically deal with unconscionable terms in business contracts. In addition, several states such as New South Wales<sup>140</sup> have in place further legislation to control unfair terms and provide mechanisms to prevent such continued conduct<sup>141</sup>. These statutes provide good understanding about reasonable terms<sup>142</sup>.

### **The USA**

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<sup>136</sup> The Unfair Contract Terms Act 1977, Section 11(5) and 24(4)

<sup>137</sup> *Ampleforth Abbey Trust v Turner & Townsend Project Management Ltd* [2012] EWHC 2137 (TCC)

<sup>138</sup> Professional Indemnity Insurance versus Financial Caps : know your limits, Hill Dickinson, 2012

<sup>139</sup> Federal Act 1974

<sup>140</sup> The Contracts Review Act 1980

<sup>141</sup> Unfair Terms in Contracts, A Joint Consultation Paper, The Law Commission Consultation Paper no 166, The Scottish Law Commission Discussion Paper No 119, London, 2002

<sup>142</sup> The Contracts Review Act 1980, s 4(1), defines unjust as including “unconscionable, harsh or oppressive”.

In USA, unfair terms are controlled through section 2-302 of the UCC<sup>143</sup> the contents of which has been enacted in all states except Louisiana. Courts take a stricter and more rigorous approach to business contracts when compared with consumer contracts and this is not applicable for a particular form of contract<sup>144</sup>. In addition<sup>145</sup> to section 2-302, other sections that protect the interests of businesses are sections 2-316, 2-318 and 2-719<sup>146</sup>.

### **France**

The French Code<sup>147</sup> controls unfair terms in deals between businesses and between non-professionals<sup>148</sup>. Additionally, there have been recent amendments in the French code to introduce new controls in commercial contracts with respect to unfair terms<sup>149</sup>. With these new provisions, the court can rule the terms unfair if there is essential inequity in the rights and obligations of the parties and in proven cases both punitive measures and civil liability can be established<sup>150</sup>.

### **Hong Kong**

In accordance with the recommendation of the Law Commission<sup>151</sup>, Hong Kong's Control of Exemption Clauses Ordinance<sup>152</sup> was enacted in 1989. The Law Commission made a commendable study on the required reforms and their recommendation was to follow a model similar to UCTA. The Ordinance has

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<sup>143</sup> Uniform Commercial Code, section 2-302

<sup>144</sup> Unfair Terms in Contracts, A Joint Consultation Paper, The Law Commission Consultation Paper no 166, The Scottish Law Commission Discussion Paper No 119, London, 2002

<sup>145</sup> The Law Reform Commission of Hong Kong Report on The Control of Exemption Clauses (Topic 13)

<sup>146</sup> Uniform Commercial Code, Section 2-302 – Unconscionable Contract or Clause, Section 2-316 – Exclusion or Modification of Warranties, Section 2-719 – Contractual Modification or Limitation of Remedy

<sup>147</sup> Code de la consommation, Article L 132-1(1)

<sup>148</sup> Unfair Terms in Consumer Contracts: a new approach?, The Law Commission and Scottish Law Commission, 25 July 2012

<sup>149</sup> Code de commerce, Art L 442-6 al. I(2) as inserted by Loi no 2008-776 of 4 August 2008 and amended by Loi no 2010-874 of 27 July 2009, article 14(V)

<sup>150</sup> Unfair Terms in Consumer Contracts: a new approach?, The Law Commission and Scottish Law Commission, 25 July 2012

<sup>151</sup> The Law Reform Commission of Hong Kong Report on The Control of Exemption Clauses (Topic 13)

<sup>152</sup> Control of Exemption Clauses Ordinance 1989 (Cap 7)

provisions to control exemption clauses, provides for a reasonableness test for indemnity, the exclusion of negligence liability, and consequential losses etc. This ordinance can be considered as one of the best and most suited control instruments to regulate modern business transactions. Unconscionable Contracts Ordinance<sup>153</sup> provides further controls to regulate transactions in business to consumer contracts.

### **Germany and the Netherlands**

The Civil Code<sup>154</sup> provides protection from unfair terms in Germany, which provides provisions to regulate contractual conduct by treating businesses as consumers. It also provides special provisions regarding standard terms. Article 307(1)<sup>155</sup> provides that, in conflict with the good faith requirement, if the contract places one of the parties at unreasonable advantage, the standard terms may be held invalid.

Two types of protection from unfair terms are offered to small businesses in the Netherlands<sup>156</sup>. One which asks for disclosure of standard terms and another that polices the control of the reasonableness of standard terms.

### **Others**

Many other nations such as Canada, Sweden and other countries of the European Union have controls in place to regulate unfair trade terms. The doctrine of unconscionability is well recognized in Canada and there have been legal reforms in different states to control unfair contract terms<sup>157</sup>. In New Zealand businesses

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<sup>153</sup> Unconscionable Contracts Ordinance 1994 (Cap 458)

<sup>154</sup> Das Bürgerliches Gesetzbuch, the “BGB”

<sup>155</sup> Das Bürgerliches Gesetzbuch, the “BGB”, Article 307(1)

<sup>156</sup> Unfair Terms in Contracts, A Joint Consultation Paper, The Law Commission Consultation Paper no 166, The Scottish Law Commission Discussion Paper No 119, London, 2002

<sup>157</sup> S.M. Waddams, Unconscionability in Canadian Contract Law, 14 Loy. L.A. Int'l & Comp. L. Rev. 541 (1992), Available at: <http://digitalcommons.lmu.edu/ilr/vol14/iss3/6>, accessed on 4 April 2014

are offered protection by the Fair Trading Act<sup>158</sup>. In addition, there is legislation to regulate guarantees and credits in contracts<sup>159</sup>.

### **3.7.2. Proportionate Liability**

Under a proportionate liability regime or legislation, the plaintiff would be able to only recover damages from a defendant that is equivalent to the defendant's share in causing the loss<sup>160</sup>. Without legislative support in this regard, the plaintiff would usually be able to recover 100% of the losses from one of the defendants where more than one party is held liable. This type of legislation would protect contractors and A/E to a great extent by making them compensate only for their errors and not others'. Such legislation has been enacted in countries like Australia, USA, Canada, some countries in European Union and has been proposed in the UK<sup>161</sup>.

The situation in the UAE is again very different. The code dictates joint liability; in addition there is a lack of clarity if there is also joint and several liability. The plaintiff can sue one of the parties irrespective of the fact where the fault actually lies.

## **3.8. Interpretation of law by Legal experts and Judiciary**

There are a multitude of challenges to understand how a law will be interpreted in a specific case. The legal system is in its infancy and has a long way to go to attain maturity. Lack of judicial precedent, reduced accessibility to case law etc. pose high risks for businesses to understand and use as persuasive tool in the courts. As a result, clashes regarding the likely interpretation of various conflicting, confusing and ambiguous provisions of law can become common. Each case will need to be raised and resolved on a case by case basis in the

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<sup>158</sup> Fair Trading Act 1986

<sup>159</sup> Consumer Guarantees Act 1993 and Credit Contracts Act 1981

<sup>160</sup> Australian Contract Law, Response to discussion paper, Consult Australia, July 2012

<sup>161</sup> Liability Reforms : Who Pays? Available at [http://www.hkicpa.org.hk/file/media/section5\\_membership/Professional%20Representation/aplus\\_29.pdf](http://www.hkicpa.org.hk/file/media/section5_membership/Professional%20Representation/aplus_29.pdf) accessed on 21 March 2013

absence of access to binding judicial advice. The obvious uncertainty leads to conflicting legal opinion and makes it a huge challenge for contracting parties to understand their full exposure to liability<sup>162</sup>.

Muqawala provisions are currently applied in a similar fashion in a trivial carpentry contract as well as in sophisticated and novel multi-billion dollar construction contracts. This factor along with the lack of body of jurisprudence unlike in the common law world, make it highly imperative to introduce a comprehensive law that caters to the unique and specific requirements of the specialized construction industry<sup>163</sup>.

The following chapter identifies disadvantages related to imbalance in liability allocations in contracts.

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<sup>162</sup> M Grimmitt, 'Uncertainty in the Application of UAE Laws, Tales Of The Unexpected: Where Liability Lurks Unseen', Pinsent Masons, available at <http://kluwerconstructionblog.com/2009/11/03/tales-of-the-unexpected-where-liability-lurks-unseen/>, accessed on 4 March 2014

<sup>163</sup> Construction law in UAE a distinct body, available at <http://www.lawteacher.net/contract-law/essays/construction-law-in-uae-a-distinct-body-contract-law-essay.php>, accessed on 02 April 2014



## **4. CHAPTER FOUR – PROS AND CONS OF IMBALANCED LIABILITY PROVISIONS IN CONSTRUCTION CONTRACTS**

This chapter will seek to list out all problems and risks associated with accepting and imposing unlimited liability in a contract. In addition, it will also provide a synopsis on reasons why liabilities must be limited.

### **4.1. Limited Liabilities**

As a best practice approach, employers should estimate appropriate limits on contractors' and engineers' liability<sup>164</sup>, which should be a reasonable estimate of probable risk under a proposed contract. Evaluating such an appropriate liability limit is one crucial point in ascertaining value for money.

- a) Best value for money – The contractors include risk and insurance cost when estimating the cost of the project and factor the cost into the price offered to the employer. Balanced contractual risk provisions are a prudent way of achieving value for money.
- b) There is no uninsured risk as there is a proper balance in the risk appropriation
- c) Easier and faster negotiation and finalizing of contract deal<sup>165</sup>.
- d) Contractors and A/E are able to price the bid without basing their assumption on vague facts and do not have to guess what risks may eventuate .

### **4.2. Unlimited Liabilities**

- a) Unlimited liabilities have an adverse impact as this is a determining factor for competition; contractors and A/E may refuse to participate in such tenders<sup>166</sup>. Top performing consultants and contractors who are known for providing cost effective and high quality facilities are firm with their risk management standards and often opt out of contracts that are onerous and too risky.

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<sup>164</sup> A guide to limiting supplier liability in ICT contract with Australian Government agencies (3<sup>rd</sup> Edition, May 2013)

<sup>165</sup> Estimating Liability limits for Supply Contracts, Broadleaf Capital International Pty Ltd

<sup>166</sup> Liability and Insurance in Government Contracts, Procurement Guidance Note PGN 03/12, 12 May 2012, Department of Finance and Personnel, Ireland

Consequently, the pool of vendors is reduced thus affecting competitiveness. This together with the high the risk built into the price of services, diminishes the prospects of a competitive procurement model and best project outcomes.

- b) Bad value for money in the case of risks not eventuating and when the client ends up paying these sums under the contract value. The contractors and A/E usually include in their contract price high premiums as cover for higher liability imposed under the contract and for those uninsurable risks may be priced and included as high risk items.
- c) Unrealistically high PI insurance requirements can become a deterrent for small to medium A/E<sup>167</sup> that is locally based, to participate in Government tenders. This means the work ultimately goes to larger and more international A/E. This can restrict experience and the growth of potential talents and innovative firms.
- d) Expert standards and Fitness for purpose requirements are generally an uninsurable risks
- e) To cover unlimited liability undertaken in the contract, the contractors and engineers often take out insurance policies with extensive and expensive coverage. However, the insurance would only pay for damages that they are liable for under the law. Any contractual term that encompasses liability further than the legal position creates an uninsurable risk, which is harmful to both parties of the contract<sup>168</sup>.
- f) Numerous client produced agreements contain aggressive indemnification provisions. Many such provisions are not insurable and when these losses are triggered, it can place firm in an uncovered position<sup>169</sup>, insolvency of the firm and even personal bankruptcy of the directors could be a real possibility in such cases even in a limited liability company<sup>170</sup>.
- g) Contractor's and A/E find it difficult to price a no cap provision as the risks involved are not quantifiable.
- h) An exhibition poor risk management and procurement vision of the Employer.

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<sup>167</sup> Liability and Insurance in Government Contracts, Procurement Guidance Note PGN 03/12, 12 May 2012, Department of Finance and Personnel, Ireland

<sup>168</sup> Australian Contract Law, Response to discussion paper, Consult Australia, July 2012

<sup>169</sup> M Copus, 'Understanding Professional Liability Insurance', Hall & Company

<sup>170</sup> Consultants Key – Professional Indemnity Insurance, Griffiths and Armour

- i) Effects on industry and the contractors, in the case of accrual of liability beyond ones capacity. There is paramount risk in accepting liabilities for consequential losses that are not clearly spelt out in the contract. It is impossible to quantify these risks in advance and therefore cannot get adequate insurance coverage.
- j) Another thing to keep in mind is the background of PI insurance, in the re-insurance industry which is usually from the common law world. All players in the contract have to be mindful of this fact and ensure the needs from the Civil law nations are adequately covered. Insurance is either not available or extremely expensive and for Decennial liability, this is a huge concern.
- k) UAE does not provide a SoP or a statutory adjudication; in this case it becomes very hard for contractors or A/E to pursue issues related to non-payment or delayed payment. This together with a high level of imposed liabilities becomes a tough situation.
- l) The client favoured position of Civil Code is good for a consumer business contract; however when the contract is between two commercial parties especially where the client is in a better bargaining position, the imposed terms do not seem fair.
- m) By imposing unlimited liability or liability for consequential damages, the contractor may exercise a greater degree of care during the undertaking of the contractual obligations<sup>171</sup>. However, this way of incentivizing the contractor or A/E in fact is not a wise way of ensuring proper care of work.

### **4.3. Why should the liabilities be limited?**

The contractor or designer only makes a one-time net profit from the overall fee, whereas the employer is most likely to produce long term benefits from the completed contract. It is thus only fair to allocate risk on the basis of prospective reward<sup>172</sup>.

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<sup>171</sup> B Manahan, 'Owners should seek a limitation of liability for consequential damages', NJPA Real Estate Journal, November 26, 2004

<sup>172</sup> The Essentials of Negotiating a Limitation of Liability Clause, Crow Friedman Group Newsletter, (January 2011, Vol 6, Issue 1), available at [http://www.crowfriedman.com/pdf/newsletter\\_0111.pdf](http://www.crowfriedman.com/pdf/newsletter_0111.pdf) accessed on 02 February 2014

There have been instances where a court construed the limitation period to 50 years where the design life was meant to be 50 years<sup>173</sup>. This can be considered as an extreme and arbitrary application of legal provision by the judiciary. If the law provides such ambiguous and ductile terms, it becomes hard for operators in the industry to cost projects and maintain business functions.

Under the UAE law, there is no specific requirement for architects or contractors to take out specific insurance policies for liabilities that may arise either from a breach of contract or other civil liability. The law should ideally mandate this to provide maximum protection to Employers and contractors or designers as without this, in the event of a claim the service provider could go out of business from the impact of the claim. On the other hand if the service provider is no longer in business, the employer will end up without coverage. However, it is to be noted that compulsory insurance requirements may have other implications.

Another major drawback on imposing harsh liabilities on the designer may be that they stop taking any innovative measures in the project's life and life cycle cost<sup>174</sup>. This would be an extremely unfortunate situation as this would limit and even curtail the prospects of new ideas and technologies.

Insisting on unlimited liability has a high potential to limit competition as many Contractors and A/E, especially those with best of the experience, may be averse or unable to agree to such high exposure<sup>175</sup>. UAE law automatically provides right to lost profits, it could be substantial if it is not expressly excluded in the contract.

Limited liability can also be seen as a method to achieve sustainable procurement as part of realizing the best value for money by building long term business relationships with Contractors and A/Es<sup>176</sup>. It can also be viewed as a corporate social responsibility for Employers. It becomes even more important when there are areas of law that are in an under developed state.

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<sup>173</sup> Decennial Liability and Decennial Insurance, XL Insurance, 2011

<sup>174</sup> Professional Risk and Responsibility, FIDIC

<sup>175</sup> A Summersby, A Davis and P Walker, 'A guide to limiting supplier liability in ICT contract with Australian Government agencies' (3<sup>rd</sup> Edition, May 2013)

<sup>176</sup> Policy Statement on Limitation of Liability, FIDIC

For example, securities of payment legislations or convenient and accessible dispute resolution mechanisms are not currently mandated by law. In addition, there are other laws such as the bankruptcy law which criminalize business failures. There are calls for law reforms in this area to bring it in line with international practice so that entrepreneurs who fail without criminal intent can continue in business or start-over<sup>177</sup>.

Coupled with these issues, lack of controls in liability allocations provides massive uncertainty for contractors and A/E. Statutory intervention thus becomes crucial to businesses to realize and account for just business risks.

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<sup>177</sup> F Matthew, Stop criminalizing Business failure, The Views, Gulf News (Abu Dhabi, 03 April 2014) 1

## **5. CHAPTER FIVE - Findings from the Research and Recommendation for achieving the balanced approach**

This chapter will explain the research methodology followed in the interview process, findings and recommendations from the literature review and the interviews conducted. Endeavour shall be to cover important aspects to be considered under liability, indemnity and exclusion clauses for a contract to achieve a balanced position. This chapter will also suggest necessary statutory control as this is deemed as a need for consideration under the UAE law.

### **5.1. Research Methodology for Interviews**

As part of the endeavour to draw upon experience and to assess the understanding of professionals practicing in the UAE, an interview questionnaire was formulated. In view of the nature of the research topic and to understand the perception of professional practicing in the UAE, a pure quantitative technique was not considered suitable. Rather a more qualitative approach seemed appropriate to achieve a realistic outcome. However, some quantizing of the qualitative data seemed applicable to compliment the qualitative study and are included in this research

Once this interview strategy was concluded, the first step was to prepare a list of questions. The interview questions were basically drafted to align with the research questions, objectives and my personal assumptions which were then expanded to include topics where ambiguities seemed to exist, as found in ensuing literature review.

Subsequent to finalization of questions, I sought and obtained the Supervisor's endorsement of the interview questionnaire<sup>178</sup>. The interviewees were provided advance information about the topic and the objectives of the research along with the invitation to participate in the survey. Furthermore, the participants were given a choice to opt for confidentiality of their interview responses.

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<sup>178</sup> The interview questionnaire is attached to this dissertation as Appendix A

Due to time constraints and unavailability of interviewees, a direct interview was not seen as a practical technique, instead the plan was to communicate and receive responses via emails. The targeted interviewees were practising professionals engaged with developers, contractors, A/E and advisory consultants. However, the aim was not to analyse the perception of professionals based on their background or their employers, but to examine whether their judgement and opinion corresponded with the literature review findings.

The original intent was to obtain expert opinion from approximately 8 professionals. Owing to the risk of non-responsiveness a total of 22 professionals were invited to participate in the survey. Out of these 22, 17 invitees confirmed interest and willingness to provide their feedback to the interview questions. However, only 9 completed questionnaires were received from these participants. Others remained mostly non-responsive. Some regrets were received citing inability to respond due to the technical nature of questions and lack of particular experience in regards to the issues raised. Subsequently, it was concluded that the analysis would be made on the basis of 9 completed interview responses. This low response rate could also be perceived as limited awareness on the topic among industry professionals.

Among the 9 respondents, only one declared the responses as being non-confidential. Others requested strict confidence. Therefore, it was decided that the identities of none of the respondents would be revealed in the dissertation. The following identity code will be used to represent responses of each interviewee.

**Table 1 – Identity Code of Interviewees**

No	Interviewee	Identity - Code
1	Interviewee 1	Interviewee1
2	Interviewee 2	Interviewee2
3	Interviewee 3	Interviewee3
4	Interviewee 4	Interviewee4

5	Interviewee 5	Interviewee5
6	Interviewee 6	Interviewee6
7	Interviewee 7	Interviewee7
8	Interviewee 8	Interviewee8
9	Interviewee 9	Interviewee9

All the respondents were from either a legal advisory or contracts management role. The years of experience of the professionals ranged from 12 to 27 years. Average years of experience were 21.

## **5.2. Discussion of Interview Responses**

Interview questions and the responses are discussed below in a concise form:

### **5.2.1. View on limiting liability in construction contracts, as a general principle or concept**

This question was posed to appreciate if any of the interviewees considered unlimited liability as being reasonable. None of the interviewees advised to have unlimited liability attached to a contract. 70% opined that the decision should be based on many factors and is subject to the circumstances of each contract.

Interviewee1 commented that it is in both parties' interest that liability be limited in all construction contracts, to the extent permitted by law (noting that in many jurisdictions, liability cannot be limited for circumstances leading to death or personal injury). However, he suggested that certain "carve-outs" on the limit of liability are reasonable – namely for fraud or criminal acts.

Interviewee6 was of the opinion that liability must be limited with the exception of liability in respect of death and personal injury. Interviewee7, who thought the limitation factor should be based on several factors and be subject to the circumstances of each contract, commented that limitation should not be prescribed; where the contract is entered into by two commercial parties they



should be allowed to agree what limitation of liability, if any is appropriate to the particular circumstances.

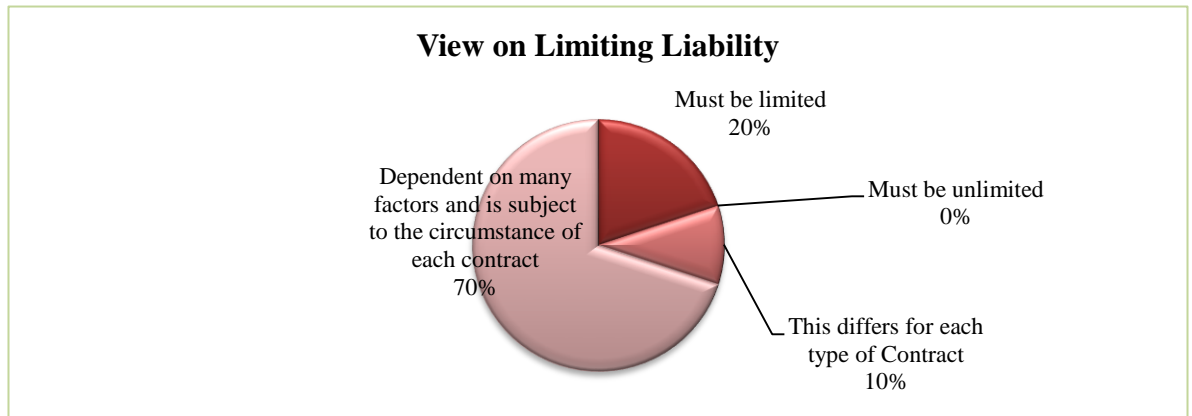


Figure 2 – Professionals' Perception on Limiting Liability

### Discussion

General consensus was 100%, to limit the liability after taking into consideration the specific situation of the contract. In my view, liability must be limited as permitted by law. However if there is a lack of clarity in the law, this becomes a tough call to make. In such a situation, efforts should be made to reasonably assess the risks involved and set an appropriate cap. In all cases, liability should be unlimited for death, injury, fraud and wilful default.

#### 5.2.2. What is perceived as best industry practice to limit liability

Most of the respondents' views were that for both construction and design/build contract, the cap of liability should be the contract price, i.e 100% of the contract price. Interviewee 2 suggested that for very large contracts, a lower percentage of contract prices would be more reasonable. However for design contracts, most of the interviewees suggested that the cap shall be multiples of the contract price depending on the risk profile. Interviewee 1 suggested 3 to 5 times the fees payable.

Interviewee 9 recommended that for all types of contracts, the approach taken in a jurisdiction outside the Middle East, of a genuine pre-estimate of the loss that will be incurred (liquidated and ascertained damages) is the most suitable approach as all parties know their potential liabilities at the outset. He did not suggest linking damages to the contract price as the penalty that may be threatened could be grossly disproportionate to the damages incurred". Most of the interviewees advised that there should be exclusions from the limit: liabilities for death and personal injury, fraud, third party claims for property damage and intellectual property infringement and other matters which cannot be limited under law.

### Discussion

My view is that limits set shall be based on risk assessment. This shall be best prescribed as a total value or in multiples of the contract sum to ensure the cap covered, in cases of substantial variations being executed under the contract. I concede that in very large construction contracts, it may be reasonable to limit the cap to a lower percentage of the contract value if a higher percentage would mean exorbitant risk for the contractor and reduced value for money for the client. For consultancy contracts, limits should be set after considering the risks involved, for a high risk design job the limit on PI insurance may also be considered. However, for the purposes of benchmarking, one time the contract sum for small to medium sized construction contracts and 3-5 multiples of consultancy contract of average risk project should be considered.

#### 5.2.3. Unlimited/uncapped insurance for strict liability obligation and Contractors and A/E dealing with it

Unlimited or uncapped insurance for strict liability obligation and Expert Standards and Decennial liability (DL) insurance seemed rarely available in the UAE. Hence this question<sup>179</sup> was posed to the interviewees. Also another issue

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<sup>179</sup> Question number 5 in the Interview Questionnaire : Is unlimited/uncapped insurance for strict liability obligation & Expert Standards and Decennial liability (DL) insurance available in UAE? How is the risk of DL and the need for unlimited PI Insurance imposed by some Employers, tackled by Contractors and Consultants?

that had to be addressed was how the risk of DL and the need for unlimited PI Insurance imposed by some Employers are tackled by Contractors and A/E.

Most respondents did not think that unlimited insurance was available. Interviewee1 and Interviewee7 believed that the availability of unlimited PI was limited and not at commercially reasonable rates. Interviewee2 thought these would be effectively covered by their PI Insurance policy. Generally, the interviewees were not aware of the availability or existence of DL insurance in the UAE.

Interestingly, with respect to DL, interviewee9 stated that his belief was that most contractors and consultants seemed to ignore the risk so as to include the potential cost in a competitive tender would most likely make their bids uncompetitive. They essentially hoped for the best that the risk will not eventuate. Interviewee7 opined that statutory DL under article 880 only applies in relation to fairly catastrophic failures of the building, which are, fortunately rare. He thought that the primary way in which consultants and contractors get comfortable is that they know that the risk of a claim under article 880 is very unlikely. Interviewee4 commented that in the Middle East Contractors/consultants did not take out any protection for DL. Interview3 said that in his experience PI insurance always had a limit of liability.

### Discussion:

I tend to agree with the point of view that such risks are usually brushed under the carpet by many businesses either unwary of the risks involved or just hoping for luck that risks will not eventuate. Global or project specific PI policies almost always have a set limit. Another issue is that as explained under section 2.2.3, PI insurance does not generally provide indemnity for promise for specific results and liability that is beyond negligence. DL is generally left uninsured or rarely protected by PI insurance. As commented by interviewees, claims on Article 880 have been extremely rare. Nevertheless, if held liable for damages under this article, the claim could be prohibitive. This is a serious issue especially

considering the fact that it is also a no-fault provision and Contractor & A/E should not neglect this risk as this can tear down their businesses.

#### 5.2.4. Applicability of Civil Code provisions to Commercial Construction Contracts

It was seen as argued<sup>180</sup> by some commentators that the UAE Code does not apply to Commercial contracts and shall apply only to Consumer contracts, in particular the muqawala provisions, and that there have been case decisions supporting this argument. There are also many rulings which referred to muqawala provisions as the basis. Therefore, the interviewee's point of view on the applicability of the Code to construction contracts was asked in one of the questions<sup>181</sup>.

The interviewees unanimously agreed that the UAE Code applied to all commercial construction contracts. Interviewee7 commented "If I was acting for a client who is being sued for breach of the Code in relation to a commercial contract I might try to run the argument the Code does not apply, however the client would be advised that this argument is not a strong argument"

#### Discussion

It does not seem that there is any real ambiguity that the Code did not apply to commercial construction contracts. Given that there is an absence of clear legal provision that defines the applicability of the Code to businesses, there is always an inherent risk that a claim may be made on this basis. It is advisable to obtain legal clarity on this matter.

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<sup>180</sup> M Grimmitt, 'Tales Of The Unexpected: Where Liability Lurks Unseen #3', Pinsent Masons, available at <http://kluwerconstructionblog.com/2009/12/14/tales-of-the-unexpected-where-liability-lurks-unseen-3/>, accessed on 7 March 2014

<sup>181</sup> Question number 6 in the Interview Questionnaire : It is argued by some commentators that UAE Civil Code does not apply to Commercial contracts and shall apply only to Consumer contracts, in particular the muqawala provisions. There have been case decisions supporting this argument. There are also many rulings which referred to muqawala provisions as basis. What is your view on applicability of Civil Code to Construction contracts?

#### 5.2.5. Uncertainty in interpretation of Civil Code provisions

One of the most important questions was regarding the uncertainty in interpretation of Code provisions in the absence of clear statutory direction regarding limitation of liability<sup>182</sup>.

The majority of interviewees agreed that there was uncertainty about how the statutory provisions shall be interpreted. One of them commented “I find the various provisions of the Code confusing and whilst they cannot be clarified or refined by precedent, they still have to be interpreted by judges whose opinions may differ on a case by case basis”

Two of the interviewees disagreed with statement with one commenting “most design and/or construction contracts provide for recourse through arbitration and in the cases I have come across both parties seem to accept that the Code provisions apply or at least try to assert them as claims or defences”.

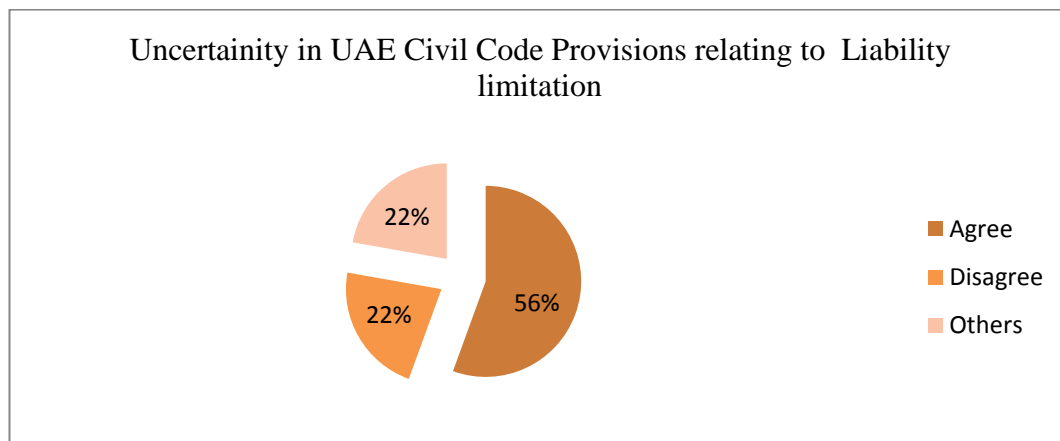


Figure 3 – Perception about uncertainty in Liability Provisions in Muqawala

#### Discussion

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<sup>182</sup> Question number 7 in the Interview Questionnaire : In UAE, it is often seen contractual liabilities as limited, excluded and in some cases as unlimited, through different contract provisions. In absence of clear statutory provisions in UAE, with regards to what liabilities may be limited or excluded, the question about what types of direct and consequential damages may be recoverable from the breaching party becomes a big question. There appears to exist widespread uncertainty about how the Civil Code provisions shall be interpreted in courts or rather how these shall effect a contracting party in case of a dispute leading to litigation. Do you agree with these statements?

It is clear that there is apparent disconnect and ambiguities in the law. Many find the provisions confusing. The fact that there are no legally binding precedents and that the judges have to interpret the articles per case with varying opinions leaves many uncertainties in this front.

#### 5.2.6. Article 383(1) or Strict Liability in Muqawala

In response to question<sup>183</sup> about exercise of care and strict liability provisions in muqawala contracts, 78% of the interviewees thought that the Muqawala provision would become operative as these are mandatory provisions and article 383(1) is only complimentary to muqawala contracts.

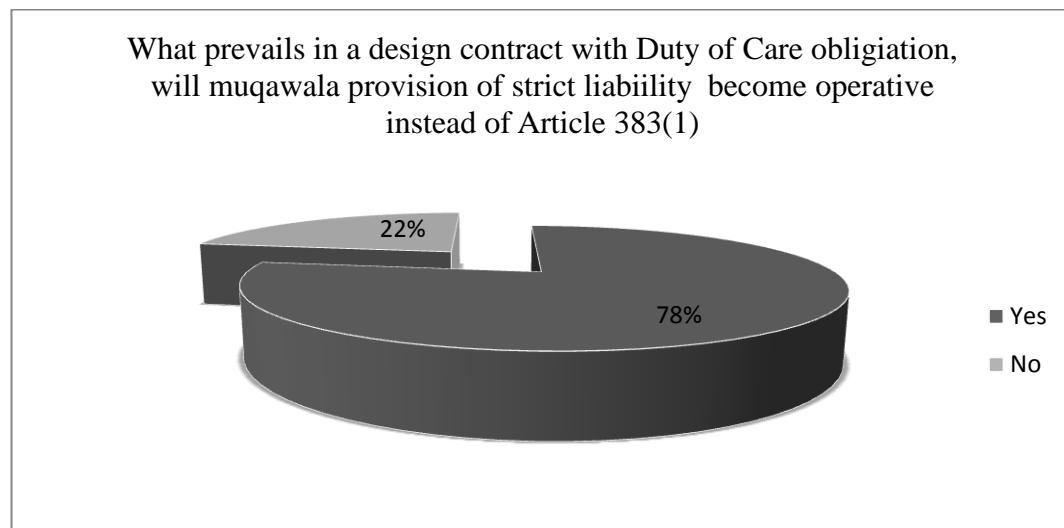


Figure 4 – Article 383(1) versus Strict Liability in Muqawala provisions

#### 5.2.7. Do the new Abu Dhabi contracts introduced by Law No. 21 of 2006 give relief to contractors for the strict liability presumed under the Civil Code?

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<sup>183</sup> Question number 8 in the Interview Questionnaire : Article 383 (1) of UAE Civil Code states “If that which is required of an obligor is the preservation of a thing, or the management thereof, or the exercise of care in the performance of his obligation, he shall have discharged that obligation if, in the performance thereof, he exercises all such care as the reasonable man would exercise, notwithstanding that the intended object is not achieved, unless there is an agreement or a provision of law to the contrary.” UAE law through the Muqawala provisions imposes strict liability obligation on Designers. If the intended result is not achieved in a design contract that stipulates exercise of care as the obligation, do you think that Article 383(1) shall not be applicable and muqawala provision which implies strict liability obligation shall become operative?

This question<sup>184</sup> was asked to understand if these contracts were seen as providing more favourable terms and if this construed lesser liability and offered relief from imposed terms under the Code. Only 20% of the interviewees thought this offered better terms to contractors as shown in figure 5 below. With this response and further to analysis it can be inferred that the new Abu Dhabi contracts are only complimentary to the muqawala provisions and therefore the terms in latter shall prevail.

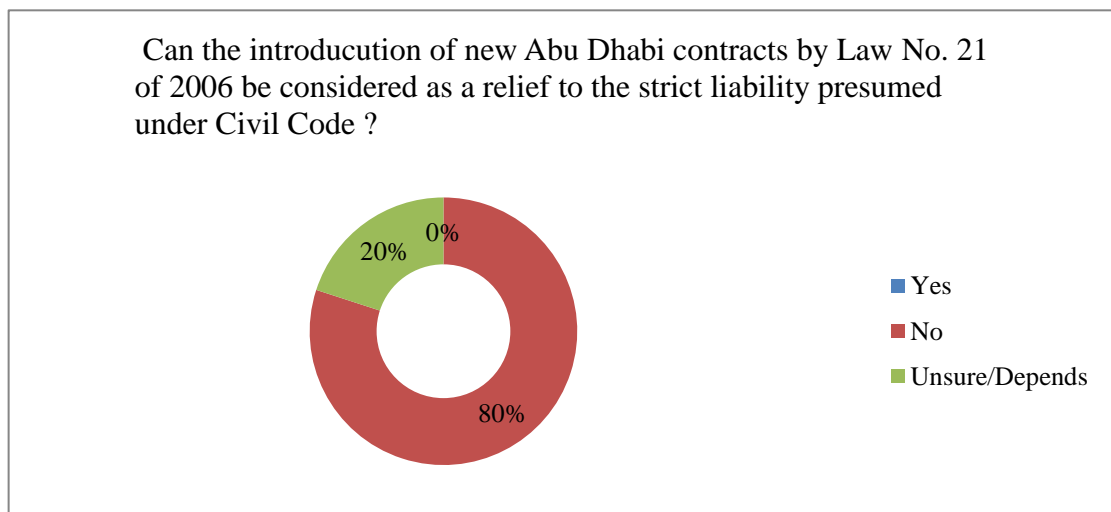


Figure 5 – Is Abu Dhabi Government contract a relief to Strict Liability?

#### 5.2.8. Does new Abu Dhabi contracts offer relief compared to the Muqawala provisions?

67% of the interviewees disagreed with this question<sup>185</sup>, as shown in Figure 6 below. It shows that the law is clear that the muqawala provisions are mandatory and these new forms have not relaxed any terms.

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<sup>184</sup> Question number 9 in the Interview Questionnaire : The new Abu Dhabi contracts were introduced by Law No. 21 of 2006 basis of which is FIDIC 1999, generally considered to provide a better risk apportionment. Does this mean that we can now consider that the mandatory muqawala provisions in Civil Code need not be applied to Construction Contracts undertaken in Abu Dhabi, principally the strict liability obligation? In other words, can this be considered as a relief to the strict liability presumed under Civil Code?

<sup>185</sup> Question number 10 in the Interview Questionnaire : Abu Dhabi Government contract in line with FIDIC 1999 Redbook provides (under article 17.6) that in absence of a limit of liability agreed under the contract, limit of liability shall be the accepted contract amount, for liabilities arising from acts other than fraud, deliberate default and recklessness. If this form of contract is adopted, can the given limitation provision be considered as a relief from more stringent liability imposed on the Contractor under the muqawala provisions?

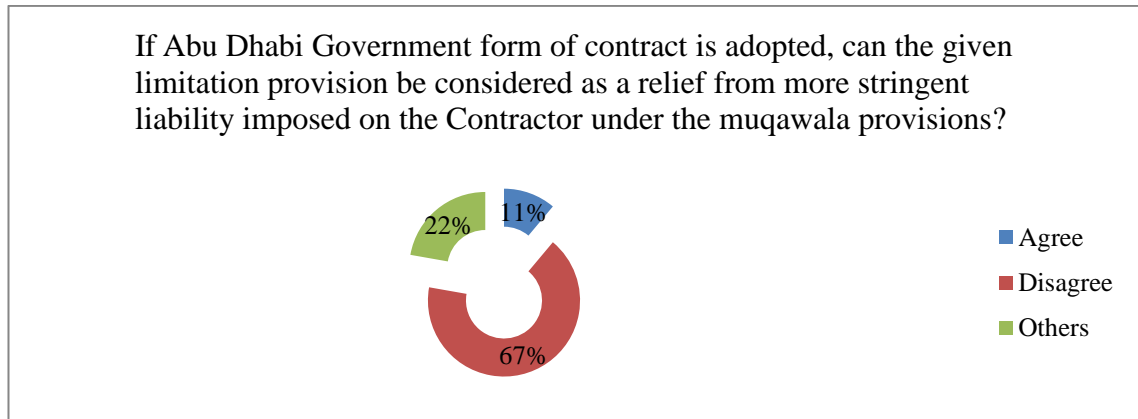


Figure 6 – Limitation provisions in Abu Dhabi Government contract in comparison to Muqawala

#### 5.2.9. Proportionate Liability and Joint Liability in Muqawala provisions

Ambiguity seems to exist in the way article 880(1) allocates liability. To understand interviewees' perception on what this actually meant during application of the article in relevant dispute, these questions<sup>186</sup> were raised.

Most of the interviewees stated in the case of proven proportionate liability, the damage will be apportioned on fault. Interviewee5 stated that liability is joint and several, meaning that the Court can recover from one, both or either. In line with this, Interviewee6 commented that the Employer can decide who to pursue for the loss, designer or contractor. Interviewee2 stated "This is unclear from the wording of the law – it is not clear whether joint and several liability is intended."

#### Discussion

There seems to exist an obvious vagueness in the apportionment of the liability. A proportionate liability regime does not exist in the UAE and therefore, the Employer can choose to pursue without having to bother where the fault lies. It would be up to the rest of the parties in the supply chain to sort out matters

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<sup>186</sup>Question number 11A in the Interview Questionnaire: In event of proven proportionate liability, does the liability get apportioned on the fault basis between contractor and designer or among others in the supply chain who may be liable for the loss? and Question number 11B in the Interview Questionnaire : Does jointly liable mean if one of the liable parties is liquidated, the other party may be liable for the full liability above and beyond their fault?



between themselves. While such an advantage to the Employer is highly desirable in a Consumer contract that cannot be said about a commercial set-up. The law should provide equal privilege to commercial parties.

#### 5.2.10. Unlimited liability as standard Organization terms and policy

Client organizations usually impose virtually non-negotiable standard contract terms. The liability terms are not usually re-visited to assess suitability to contract situations. The interviewee's were asked this question<sup>187</sup>, to validate my understanding that clients actually understood that unrealistic liabilities were not fair, but demanded these as part of their organizational requirements.

Interviewee1 commented that in his experience, the Employer Representative is typically unable to grant a limit of liability if it is in contravention of the organisational or governmental policy. Instead, most Employers defer to their legal department's stance on the matter. Interviewee9 agreed with the question and stated that, issues of liability and risk allocation appeared to be institutionalised. The typical attitude in this part of the world has predominantly been to place all risk no matter how onerous on to the contractor, thereby ensuring the client only pays the original tender price (should he not vary the works). This attitude was beginning to change with law 21 of 2006<sup>188</sup> and more partnering type agreements, but with the world financial crisis, attitudes reverted directly back to the previous culture.

Interviewee2 and Interviewee7 did not agree with the question. Interviewee2 stated that generally employers in the UAE have a very aggressive approach to risk allocation including unlimited liability. For more enlightened clients, doing major projects with established international contractors, a more commercial and modern approach is taken. Interviewee7 stated that he did not think that unlimited liability is unfair. Employer's representatives try to do the best job

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<sup>187</sup> Question number 12 in the Interview Questionnaire : Is it reasonable to consider that the Employer Representatives (the personnel of Client/Employer) understand the issues and concede that unlimited liability is unfair and unreasonable, but they implement these as they are required to follow Organisational or Governmental Policies?

<sup>188</sup> Abu Dhabi Law No. (21) of 2006 on Construction Contracts and Agreements in the field of Civil Contracting

possible for their employer and yes, often that involves following organisational policies, but more often it involves them simply trying to get the best deal for their employer on each aspect of the deal. In relation to caps on liability, that often means getting an unlimited liability or as high a cap as possible.

### Discussion

It can be considered employer representatives follow the established procedures or try to get the best deal for their employer. However, the most important factor that is overlooked is whether this deal was the best value for money and also if the other party was best placed to control or cover the risks involved. It may perhaps turn out that this was not the case and the employer end up with uninsured risk. All employer representatives must endeavour to get best deal for their employer, nonetheless this must be after a thorough analysis of each case to avoid unpleasant future events. Employers shall also endeavour to understand the difference in pricing by inviting alternative bids based on balanced risk provisions.

#### 5.2.11. Are smaller firms less risk averse?

Throughout my professional career, I have observed that the hesitation to sign upon unlimited liability is seen from the point of view of the large international organization. Smaller local firms accept such terms without any obvious objection. Therefore this question<sup>189</sup> was raised to the interviewees.

All interviewees agreed that smaller firms were more willing to accept higher risks. However not everyone agreed that this was due to a less informed point of view. Interviewee1 stated that smaller firms have a limited asset backing and thus tend to be far more likely to accept excess risk, as if they are bankrupted by one claim, the firm enters liquidation and is thereby largely protected against the “mega-liabilities” that are taken on by larger firms with a more substantial asset

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<sup>189</sup>Question number 13 in the Interview Questionnaire : Is it usually seen that the low to medium sized firms have a tendency to accept more risk when compared to larger international firms with established standards of risk tolerance? Is this because in the smaller firms, the legal department is not well established and that the decision makers are not well informed about the probable consequences of the risks undertaken in a contract that is favourable to the Employer?

backing. Larger firms also typically have very robust procedures in place to protect their employees and shareholders – taking on undue risk will typically breach corporate governance standards in larger firms. Interviewee4 had a similar view and noted that probably because they do not appreciate the risk as they have less to lose if things go wrong and sometimes it is the only way they can win work.

Similar to the opinion of Interviewee1, Interviewee7 commented that there is an element of some smaller firms not perhaps being as sophisticated as larger firms and therefore perhaps not appreciating the risks. However, another factor is that in smaller firms, owner managers not only agree the risk but actively manage the design and construction process and therefore manage the risk in a way which is not possible in larger firms where there is a large division of responsibility between different parts of the firm and the owners have little direct interface with either the negotiation of the contracts or the delivery of the work. All of these divisions in large firms mean that large firms put in place policies and procedures which stop them from accepting certain terms and conditions.

Interviewee9 agreed that smaller firms may be less informed but also that the smaller firms are generally local companies who have faced the risk over markets for a longer time and possibly know how better to manage their clients. Interviewee6 and Interviewee7 thought that they were willing to take on higher risks for sake of business.

### Discussion

From these points of view and my personal experience, I would conclude that smaller firms have an issue of lack of awareness, with limited exception. Whether it is an international economic crisis or a mis-calculated business venture, it is a reality that it is tougher for small businesses to survive such set-

backs when compared to larger businesses<sup>190</sup>. Therefore, it is highly recommended that small businesses take adequate risk analysis measures to assess what they are stepping into in such contracts. I would also agree with the point of view that small local businesses may be familiar with their client set-up. It is probably true that the clients generally are not claim oriented and they usually prefer an amicable way of settling issues which mostly works out to the advantage of the small business.

#### 5.2.12. Support for introduction of legislative measure to curtail use of harsh contract terms

It was seen during the literature review that statutory reforms would bring clarity in contracting, the interviewees were asked about<sup>191</sup> the desirability of such legal measures. 56% of the interviewees recommended incorporation of such controls by the state while 22% suggested that this should be introduced only in consumer contracts. Interviewee7 suggested that in commercial contracts, the parties should be left free to contract. He added that if the consultant or contractor does not like the risk allocation under the proposed contract, and is unable to manage that risk etc, then they should not sign the contract; as nobody forces a contractor or consultant to take any particular piece of work.

Interviewee1 who was in favour of the introduction of controls, commented that unfair liability terms unfortunately do occur in contracts and in cases where Employers insist upon them, the more reputable firms will often withdraw from bidding processes, resulting in less qualified (but less risk averse) companies being awarded contracts. There is a perception that firms who do not push back against unfair or unrealistic contract obligations and instead just “hope for the

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<sup>190</sup> M Davis, ‘The Impact Of Recession On Businesses’, February 26, 2009 available at <http://www.investopedia.com/articles/economics/08/recession-affecting-business.asp> accessed on 06 April 2014

<sup>191</sup> Question number 14 in the Interview Questionnaire : In light of your experience in UAE, would you recommend introduction of legislative measures to prohibit unfair liability terms in a contract, to save the contracting parties from consequences of harsh or unconscionable express terms, including terms like unlimited liability, exclusion of liability for breach of primary obligations etc?

best” are occasionally awarded contracts on the grounds that they are viewed by Employers as being “easier to deal with”.

### Discussion

I agree with this point of view, no matter what statutory regulations are brought about, there will always be attempt from ‘the more powerful’ to force biased contract terms. However, the issue is about providing certainty in the conclusion of effect of harsh or unconscionable contract terms. Therefore, statutory controls are desirable. It is true that the contractors or A/E are not forced to undertake work under certain terms, but that may be the only way they can win work and have the business running. Or as explained above, it could be due to a lack of appreciation of risks being undertaken. Of course, we can take lessons from the larger and older economies of the developed world and implement these in our economy. It cannot be suggested that the controls were placed by those jurisdictions without any justified reasons. There have been extensive scholarly studies and reports by each such nation before these were implemented.

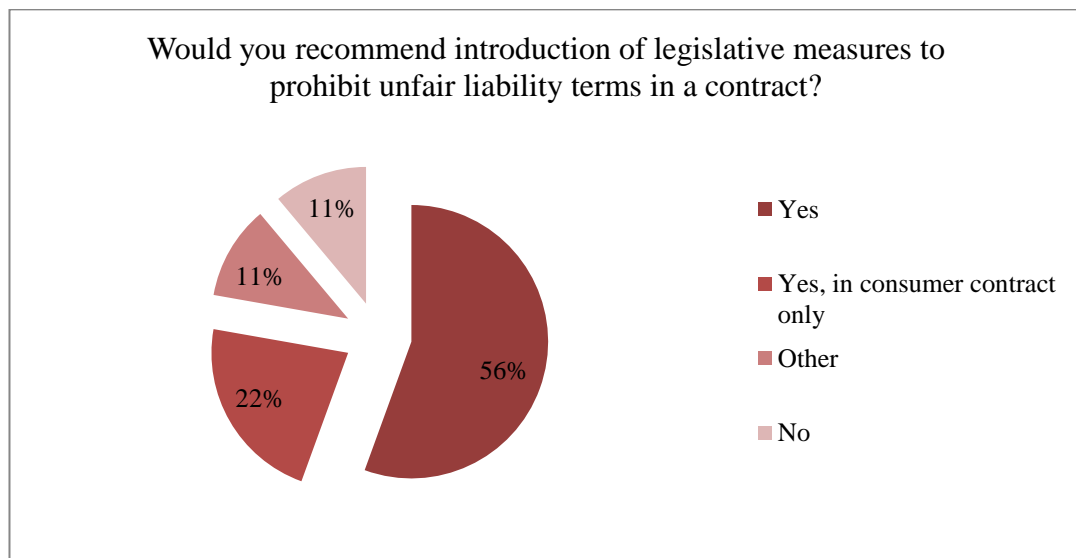


Figure 7 – Support for introducing Legislative measures

#### 5.2.13. Areas that need statutory attention

During the literature review, I noted certain areas of legal subjects which could be considered as needing some statutory attention. Even though the scope of this

research is not to identify the kind of reform required, I thought it would be in the best interests of this study to understand if interviewees also thought these areas should be studied and needed legal clarity. Recommended provisions and number of endorsement received from the interviewees is tabulated below in Table 2. The four areas that are considered to as needing much attention are Proportionate Liability, Reasonable of Contract Terms, Negligence and Duty of Care and Claimant's Duty to mitigate loss.

<b>Recommended Provisions</b>	<b>Total % of recommendation from Interviewees</b>
<b>Unfair Terms prohibition</b>	33
<b>Reasonableness of Terms</b>	44
<b>Negligence and Duty of Care</b>	44
<b>Proportionate liability</b>	56
<b>Types of Recoverable Losses</b>	33
<b>Indemnity and Hold Harmless Provisions</b>	22
<b>Whether Decennial liability is applicable to Supervision firms and other Consultants involved in the project?</b>	33
<b>Mandatory Decennial liability provisions including joint liability provision</b>	22
<b>Ability to limit tort based liability (excluding fraud, gross breach and negligence)</b>	33
<b>Removal of no-fault liability provisions from Muqawala articles</b>	22
<b>Duty to mitigate loss (Claimant's duty)</b>	44
<b>Introduce mandatory insurance requirements for Decennial Liability, Professional Indemnity etc.</b>	33
<b>Security of Payment</b>	33
<b>Vicarious Liability / Liability for Sub-contracted</b>	0

<b>work</b>	
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Table 2 – Provisions that need statutory attention

### 5.3. How can the liability be limited?

Ideally, liability should be limited as a sum of money which is a best estimate of the likelihood of losses or risks. This limit should be commensurate with service value, risk of failure and statutory & cultural operating environment<sup>192</sup>.

One method would be to agree an absolute cap on damages and thereby avoid engaging in subjective and uncertain methods of exclusion of some categories of losses<sup>193</sup>. Contracts should clearly state items or categories of loss where no limit would apply such as death, injury, fraud, breach of IP rights and confidentiality. Ensure the contract conditions clearly indicate liability provision without ambiguity or conflicts.

All contract parties must be aware of the different levels of insurance covered under varying operative clauses within the PI insurance policies. A cover for negligence or errors or omission operative clause provides less cover than an insurance instrument that provides cover for civil or legal liability basis<sup>194</sup>. Similarly, all relevant parties shall be mindful for complete coverage obtained under other insurance and the formalities involved to invoke a claim.

The insured parties shall review their coverage with the brokers regularly to make sure they are adequately covered at all times<sup>195</sup>. Ensure that good contracting practices are followed and only authorized personnel sign the contract. Prudent contractors and A/E shall ensure that their PI limit is in excess above by a

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<sup>192</sup> Policy Statement on Limitation of Liability, FIDIC

<sup>193</sup> Excluding Consequential Damages is a Bad Idea, Adams on Contract Drafting available at [www.adamsdrafting.com/excluding-consequential-damages-is-a-bad-idea/](http://www.adamsdrafting.com/excluding-consequential-damages-is-a-bad-idea/) accessed on 11 December 2013

<sup>194</sup> Consultants Key – Professional Indemnity Insurance, Griffiths and Armour

<sup>195</sup> D J Hatem, D Hunt and S E Yoakum, 'Professional Liability Insurance concerns for Structural Engineers', Structure Magazine, available at <http://www.structuremag.org/article.aspx?articleID=1395> accessed on 20 March 2014

reasonable margin above their combined contract commitments<sup>196</sup>. Contractors and A/E should develop organization wide check-list to help with risk assessment so that each contract personnel can use this as guidance when the contract document is formulated.

Another matter would be not to limit the liability to the fees paid. It may lead to bad results<sup>197</sup> as proved in *Kansas Department of Labor v Bearing Pointpoint*<sup>198</sup>. In their contract, the liability was limited to fees paid. The allegation was raised early on the contract period and there was no payment made. The court held that the provision was not ambiguous and no damages could be claimed.

By taking these measures, Contractors and A/E can try their best to limit their exposure. However, to ensure all measures taken become productive, there has to be adequate support from the State level by means of introducing relevant statutory controls in order to provide access to reasonable contract terms and to curb abuse or manipulation of the weaker contracting party. There should be a study done across various Emirates with developers using different liability provisions to research and establish the different pricing trends so as to examine the effects of unlimited liability provisions. Further research could be initiated to study and recommend ambits of required reform, specifically related to topics listed in Table 2, above.

Even though there is uncertainty in the effects of liability terms agreed under the contracts in the UAE, it is always advisable to stipulate clear and unambiguous terms in the contracts as judges are often reluctant to vary such contractual terms<sup>199</sup>. In addition, the contracting parties themselves should try to ascertain whether the terms agreed/forced are reasonable. They should discuss and

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<sup>196</sup> A Guidance Note to Conditions of Contract for Consultancy Services , ACENZ, June 2005

<sup>197</sup> R Pennington, 'Indemnification, Limitation of Liability and (Un)intended Consequences' available at <http://americancityandcounty.com/contracts/indemnification-limitation-liability-and-unintended-consequences>, accessed on 01 April 2014

<sup>198</sup> *Kansas Department of Labor v Bearing Pointpoint, Inc*, No. 05-4087-JAR

<sup>199</sup> A Dimitracopoulos, 'But I thought we agreed...-Can a contractor's limit of liability be broken?', Law Update 2004, 155, 25, Al Tamimi and Company



specifically agree all such terms to ensure one of the parties cannot easily challenge these contract terms in court<sup>200</sup>.

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<sup>200</sup> Managing liability through Financial Caps, Construction Industry Council, Liability Briefing, Scottish edition, October 2008

## **6. CHAPTER SIX – Conclusion**

### **6.1. Conclusion**

Employers command unlimited liability as it seems to offer ‘all in one’ answer to allocate contractual risks. However, this is an absolute fabricated idea contrary to facts, in reality.

Employers must limit liability of contractors and A/E’s based on proper risk assessment as a fair measure and to obtain best value for their money. Freedom of contract is an essential element for a thriving economy but this principle can be abused in the absence of regulations, hence the State has to implement proper controls to ensure the weaker contracting party is not taken undue advantage.

The economy of the UAE has been developing at a staggering pace. However, multitude of issues popped up during the economic recession. The economy is picking up; but there are apprehensions about the current legal set-up of the country. Significant legal reforms are suggested in many areas of business to provide comfort to entrepreneurial talents. It can be inferred that other economies which have adapted appropriate controls have had very good reason for doing so and UAE should conduct studies as to what may apply best to its economy.

The construction industry being the most vibrant and important, to take the UAE to the goal of becoming a dominant economic force, has to be given adequate attention. The 25 articles of the Civil Code, to govern the ever booming construction industry do not do justice to this industry. In the absence of statutory regulation to ensure security of payment and convenient dispute resolution mechanisms, the limitation of liability in contracts becomes a protracted problem. Unfair terms in commercial construction contract have to be controlled to ensure that businesses do not fall. This becomes even more important in a legal system according to which bankruptcy is a criminal offense. Current provisions do not provide much clarity on liability allocation issues.

## 6.2. Recommended Approach

To summarize, the study recommends the following measures by contracting parties and the State in order to achieve equilibrium in the contracting set-up.

- All contracting parties should take active approach to limit or cap liability to a sum of money based on risk allocation, to attain best value for money.
- Exclusion of indirect and consequential losses must be worded clearly to avoid any ambiguity.
- All terms agreed must be evaluated to ensure if these conform to the reasonableness test and public policy.
- Liability shall be stipulated as unlimited for death, injury, fraud and other reasonable elements.
- The risk accepted by firms should be manageable, reasonable and justifiable and not above their insurance coverage.
- The employer shall be mindful of providing ample opportunities to small and medium sized contractors and A/E and avoid demanding unreasonably high indemnity requirements which may not be feasible for such firms to procure.

The UAE must enact comprehensive law to support the Construction industry and thereby provide certainty to the outcome of agreed terms. Judiciary and State should take keen interest in this domain. The provisions in the UAE Code seem to adequately protect a consumer; however it is seriously biased towards the employer in business contracts. A detailed study has to be launched to understand the extent of reform required in the UAE. To accurately establish liability, it is advisable that the UAE law adapts reasonableness test and limitations factors of foreseeability and claimant's duty to mitigate.

From my study, I conclude that the UAE law does not give adequate guidance and clarity on the following liability matters and therefore allocation of liability and its balance is completely reliant on proper governance by the contracting parties. Future research in below topics would be highly beneficial to ascertain the degree

of necessity of incorporating these concepts into the construction law, in order to provide transparency.

- a) Proportionate Liability
- b) Prohibition of Unfair Terms
- c) Reasonableness of Terms
- d) Negligence and Duty of Care
- e) Types of Recoverable Losses
- f) Indemnity and Hold Harmless Provisions
- g) Ability to limit tort based liability(excluding fraud, gross breach and negligence)
- h) Clarity on Decennial Liability Provisions including clarity on Joint and Several liability
- i) Security of Payment
- j) Duty to mitigate loss (Claimant's duty)
- k) Clarity or relaxation of no-fault liability provisions from Muqawala articles
- l) Study prospects or necessity for mandatory insurance provisions

Subsequent to this, a study has to be conducted also on the best model of incorporating these provisions into the law. One such study could be whether a legislative reform or a Policy Statement would suffice. Also the models applied in various other nations shall be studied to compare and understand what could work best under the UAE legal system and economy.

Based on the research I have carried out for this dissertation, I recommend statutory intervention and reforms in the field of construction contract law to provide contracting parties legal protection from unreasonable and unconscionable contract terms. The reform should take into account all fundamental issues identified above and ensure that key researches are conducted by specialized authorities. Until such time that adequate statutory protection is accessible, the contracting parties must be vigilant and ensure the agreed contract terms are just and enforceable.

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## **Word Count**

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## **Appendix A – Interview Questionnaire**