

Liquidated Damages under the Law of the United Arab Emirates and its Interpretation by UAE Courts

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Abstract

A common challenge when claiming damages under a commercial contract, and in particular in complex transactions or projects and in respect to specific types of damages such as damages for delay, is the quantification of the damages suffered. These difficulties are frequently addressed by including a liquidated damage clause. Liquidated damage clauses provide that in case of a specific breach of contract a pre-defined amount of compensation shall be paid to the damaged party. Thereby, these clauses serve to simplify damage claims. Liquidated damage clauses, first developed in common law jurisdictions, are frequently used today in the Middle East. Still, Middle Eastern jurisdictions such as the UAE have chosen a more reserved approach to liquidated damage clause.

Article 390 UAE Civil Code governs the validity of agreements on liquidated damages under UAE Law. This clause affords the courts considerable discretion to amend the amount owed under a liquidated damage clause. This appears to challenge the very purpose of a liquidated damage clause. However, Article 390 UAE Civil Code can only be understood when considering the origin and principle sources of the UAE legal system.

Still, the practice of UAE courts in respect to the interpretation of Article 390 UAE Civil Code is ambiguous in some aspects. In particular different UAE courts have taken conflicting positions in respect to the burden of proof regarding the fact of whether the party invoking a liquidated damage clause in fact sustained losses and under which circumstances the compensation agreed upon in a liquidated damage clause is to be adjusted with regard to the actual loss incurred by the party invoking the clause.

This article will outline UAE Law governing agreements on liquidated damages and its interpretation by UAE courts. It seeks to offer a better understanding of the approach to liquidated damages taken not only by the UAE but many Middle Eastern jurisdictions. Furthermore, it will provide an overview of the application of UAE Law governing agreements on liquidated damages by UAE courts.

I. Introduction

While they are a typical instrument in western and common law jurisdictions, the introduction of liquidated damage clauses in Middle Eastern jurisdictions – such as the United Arab Emirates (UAE) – provides some challenges.

Liquidated damages are monetary compensation for loss, detriment or injury to a person or a person's rights or property whose amount the parties designate during the formation of a contract, which shall be paid to the injured party as compensation upon a specific breach (e.g., late performance).¹ Thus, the injured party does not have to quantify the loss it suffered or even prove that it suffered any loss due to the specific breach. The mere fact that the specific breach occurred entitles the injured party to the designated compensation. In principle a liquidated damages clause will be enforced where the amount of liquidated damages is reasonable compensation and not disproportionate to the anticipated damage. Where the liquidated damages are disproportionate, they can, however, be declared a penalty. Such clauses are considered void under most jurisdictions.²

UAE Law imposes restrictions on liquidated damage clauses that go beyond those imposed in other jurisdictions. These restrictions are based in Islamic Law. Pursuant to Article 7 Constitution of the UAE (دستور دولة الإمارات العربية المتحدة) of 1971³ the *shari'a* is the "principle source of legislation in the [UAE]"⁴. However, due to the role of the UAE and Dubai in particular as a commercial centre and the presence of many international law firms with common law background, many contracts drafted in the UAE are influenced by common law principles. This poses two principle challenges: (1) the UAE legal system – and the Civil Code in particular – are heavily influenced by Egyptian law,⁵ which itself has its roots in the continental European Law tradition, and (2) common law principles may conflict with principles of Islamic Law.

Under Islamic Law compensation for damages will only be awarded where (1) such damages can be quantified and (2) substantiated and (3) only in the amount suffered.⁶ A provision that would possibly oblige one party of a contract to compensate the respective other party for damages in an amount that would exceed that of the actual damages suffered, would be considered an uncertainty and thus infringe the principle of *gharar* (الغرر).⁷

1 Hamish Lal: Liquidated Damages, in: *Construction Law Journal* 25 (8/2009), pp. 571–572; Robert Bernhardt: Liquidated Damages or Alternative Performance, in: *Real Property Law Report* 37 (10/2014), p. 47.

2 Cesare Dosi / Michele Moretto: Procurement with Unenforceable Contract Time and the Law of Liquidated Damages, in: *J Law Econ Organ* 31/1 (2015), pp. 160ff.

3 Original Arabic text available at: www.elaws.gov.ae/EnLegislations.aspx (last access 11.04.2015).

4 Translated from the Arabic original by the author.

5 See Raeesa Rawal: Damage Control: Reconciling Deducted Delay Damages and Actual Damages, in: *Construction Law International* 7 (3/2012), p. 42.

6 Herbert J. Liebesny: *The Law of the Near & Middle East, Readings, Cases & Materials*, Albany 1975, p. 221; Alexander Nerz: *Das saudi-arabische Rechtssystem*, Bremen 2014, p. 48.

7 See Wael B. Hallaq: *Shari'a, Theory, Practice, Transformations*, Cambridge 2009, pp. 243–244; Alexander Nerz: *Das saudi-arabische Rechtssystem*, p. 48.

Article 390 United Arab Emirates Civil Code, (قانون المدني، القانون الاتحادي رقم (5) لسنة 1985) (Civil Code), Federal Law No. 5 of 1985⁸ addresses this discrepancy and tries to incorporate agreements on liquidated damages in the UAE as a legal system rooted in the Islamic Law tradition.

As such liquidated damage clauses serve four principle purposes:

- they save time and costs by allowing the injured party to claim damages without having to prove loss;
- by defining the amount to be paid as compensation for a specific breach they make damage claims foreseeable;
- they provide an incentive to comply with the provision of the agreement; and
- by providing certainty in regard to compensation owed they serve to prevent disputes.

Thus, liquidated damage clauses are a useful instrument especially in complex transaction or projects and there is demand in the market to use liquidated damage clauses in the UAE. This demand is addressed by Article 390 Civil Code, which, in principle, allows for agreements on liquidated damages. However, its paragraph two affords the courts the authority to – upon the application of a party to the agreement concerned – in an individual case adjust the amount of compensation owed under a liquidated damage clause to align it with the loss actually sustained by the party invoking the liquidated damage clause.

As will be demonstrated, practice of UAE courts is not consistent as to when judicial intervention to adjust damages sought under a liquidated damage clause is permissible under Article 390(2) Civil Code. There are some decisions that suggest an adjustment is to be made where the damages claimed are exaggerated or excessive in respect to the loss actually sustained. Still, in other cases UAE courts have found that it is sufficient that the damages sought were not equal to the actual losses suffered.

Furthermore, there is some ambiguity as to which party bears the burden of proof required for substantiating the constitutive elements of a claim for compensation under a liquidated damage clause. In particular UAE courts have taken conflicting positions when assigning the burden of proof for substantiating whether the party invoking a liquidated damage clause has in fact sustained loss due to a breach of contract of the party against which the clause is invoked.

II. Article 390 UAE Civil Code

The Civil Code has its roots both in the continental European law tradition and Islamic law. Based on the Egyptian Civil Code, Law No. 131 of 1948 (Egyptian Civil Code) (القانون المدني، القانون رقم (131) لسنة 1948), which itself was profoundly influenced by

8 Original Arabic text available at: www.elaws.gov.ae/EnLegislations.aspx (last access 11.04.2015).

French Law and the French Code Civil in particular,⁹ it was adapted and modified by the UAE to serve as the principle piece of legislation governing civil and commercial matters under UAE Law.¹⁰ However, not in small part due to the strong presence of British and Anglo-American law firms as well as foreign investors commercial law principles that originated in foreign jurisdictions – such as the concept of liquidated damages – have been introduced into the UAE market. An example of how these principles are incorporated in the predominant legal tradition of the UAE is Article 390 Civil Code, which addresses the designation of the amount of compensation owed by agreement. It reads:

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

2) The judge may in all cases, upon the application of either of the parties, adjust such agreement so that the compensation shall be equal to the loss actually suffered. Any agreement to the contrary shall be void.¹¹

Article 390(1) Civil Code recognizing the right of the parties to a contract to define the amount of damages owed. This includes the right of the parties to agree on a specific amount of compensation for a specific breach of contract.¹² Hence, Article 390(1) Civil Code – in principle – recognizes the validity of liquidated damage clauses.

Its second paragraph, however, introduces a corrective element by providing for the possibility of the compensation agreed upon in a liquidated damage clause to be aligned with the loss actually incurred by the party invoking the liquidated damage clause. This corrective element is foreign to the concept of liquidated damages as understood in western and in particular common law jurisdictions. Foreign investors frequently understand it as an undue incursion on their freedom to contract. Still, it appears that the intention of the legislator was not to limit the freedom to contract but rather incorporate the concept of liquidated damages into the UAE legal system and align it with principles of Islamic Law.

Hence, Article 390(2) Civil Code should be understood as regulating the validity of liquidated damage clause with respect to their amount. Such a regulation of liquidated damage clauses in respect to the amount of damages afforded is not entirely foreign to western and common law jurisdiction. Here liquidated damage clauses will be considered penalties where the compensation agreed upon in the clause is disproportionate to the anticipated damage. Such penalties are generally considered

9 Gamal Moursi Badr: *New Egyptian Civil Code and the Unification of the Laws of Arab Countries*, in: *Tulane Law Review* 30, pp. 299f.

10 William M. Ballantyne: *The New Civil Code of the United Arab Emirates: A Further Reassertion of the Shari'a*, in: *Arab Law Quarterly* 1 (3/1986), p. 245.

11 Translated from the Arabic original by the author.

12 Gregor Nikolas Rutow: *Rechtsvergleich über die Zulässigkeit von Haftungsausschlüssen Haftungsbeschränkungen und pauschalitem Schadensersatz in einzelnen arabischen Rechtsordnungen*, Frankfurt am Main 2014, p. 177.

to be invalid and thus unenforceable.¹³ However, the approach taken by UAE Law is, nonetheless, unique. Unlike the approach of western jurisdictions, which declare liquidated damage clauses to be invalid, where the compensation defined therein is excessive, the Article 390(2) Civil Code does not allow for a review and adjustment of the compensation owed under a liquidation clause by the courts with respect to the actual damages suffered. Thus rather than declaring excessive liquidated damage clauses to be invalid, UAE Law provides a corrective mechanism.

1. Validity of Liquidated Damage Clauses

Liquidated damage clauses are valid under UAE Law. Article 390(1) Civil Code does not explicitly address liquidated clauses, but rather limitations of damages in respect to their amount generally. Article 390(1) Civil Code, nonetheless, applies to liquidated damages. Article 390(1) Civil Code generally allows the parties to a contract to agree upon the amount of damages owed. Article 390(1) Civil Code, however, does not demand that such agreement has to be made for each individual case. Hence, the wording of Article 390(1) Civil Code allows for the definition of the amount of compensation owed for a specific breach – thus liquidated damages. Jurisprudence and commentators also support this interpretation.¹⁴

Liquidated damage clauses may, however, conflict with the Islamic Law principle of *gharar*, which prohibits agreements that contain the risk of a person profiting or sustaining loss due to circumstances that are unknown at the time the agreement is made. This conflict is addressed by Article 390(2) Civil Code.

2. Adjustment of Compensation Owed under Liquidated Damage Clauses

Article 390(2) Civil Code affords the courts the authority to, upon application of a party to the relevant dispute, adjust the compensation pre-agreed by the parties based on the actual loss sustained by the party claiming compensation. Since Article 390(2) Civil Code is a mandatory provision, it may not be disposed of by agreement.

This authority of the courts to adjust the compensation previously agreed between the parties in a liquidated damage clause may appear to contradict with the purpose of such liquidated clauses. Liquidated damage clauses serve to simplify damage claims by allowing the party invoking the clause to claim compensation in a pre-defined amount for a specific breach without having to quantify the actual losses sustained. Article 390(2) Civil Code introduces some ambiguity into liquidated damages clauses, since it challenges the definition of the amount of compensation owed. Such an approach to liquidated damages constitutes an incursion on the

13 Cesare Dosi / Michele Moretto: Procurement with Unenforceable Contract Time and the Law of Liquidated Damages, pp. 160ff.

14 See i.e. Gregor Nikolas Rutow: *Rechtsvergleich*, p. 177; Commentary to the UAE Civil Code Issued by the UAE Ministry of Justice, Abu Dhabi 1987, Section §2-0577.

freedom to contract provided for in Article 126 Civil Code. However, Article 390(2) Civil Code has to be considered with regard for the fact that Islamic Law is the principle source of UAE Law.¹⁵

The Islamic Law principle of *ġarar* – frequently translated as ‘uncertainty’ or ‘deceptive uncertainty’ – prohibits the conclusion of agreements that comprise the risk of one party benefiting or sustains losses due to circumstances unknown at the time of conclusion of the agreement.¹⁶ This principle commonly associated with the prohibition of gambling and speculation has implications for liquidated damage clauses.

In a liquidated damage clause the parties commit to a pre-defined amount of compensation due for a future breach of contract. Thus, the amount of compensation is determined before the loss sustained due to such breach being quantifiable. Liquidated damage clauses, therefore, bear the risk that the compensation agreed upon by the parties’ deviates from the loss actually sustained due to the actual breach of contract. Hence, the pre-defined amount may exceed or fall short of the losses actually incurred by the party invoking the liquidated damage clause. Consequently liquidated clauses conflict with the principle of *ġarar*. Pursuant to the principle of *ġarar* an agreement that comprises the risk of one party benefiting or sustaining loss due to unknown circumstances is not permissible.

As the damage caused by a specific breach of contract can usually not be accurately determined when drafting the liquidated damage clause addressing it, the amount of compensation owed under the clause may deviate from the actual loss sustained by a breach of contract. Thus, a party invoking a liquidated damage clause may be entitled to a compensation that exceeds or falls short of the actual loss sustained. Furthermore, the loss actually sustained by a specific breach of contract is unknown at the time the liquidated damage clause is agreed. Hence, the party invoking a liquidated damage clause may benefit or sustain loss from the breach of contract – a circumstance unknown at the time the liquidated damages clause is agreed upon. This constitutes an infringement of the Islamic Law principle of *ġarar*.

Article 390(2) Civil Code addresses this issue. By providing for the possibility to adjust the compensation owed under a liquidated damage clause Article 390(2) Civil Code seeks to unify the concept of liquidated damages as developed in common law with the Islamic Law principles that are the principle source of UAE Law. The principle of *ġarar* prohibits agreements that comprise the risk of a party profiting or sustaining losses due to circumstance unknown at the time the agreement is reached. Therefore, relying on the distinction between liquidated damage and penalty clauses as a corrective element in respect to the amount of compensation

15 See Article 7 Constitution of the UAE of 1971.

16 Mohammad Hashim Kamali: *Islamic Commercial Law: An Analysis of Futures and Options*, Cambridge 2000, p. 151; Wael B. Hallaq: *Shari`a, Theory, Practice, Transformations*, Cambridge 2009, pp. 243f.

owed under a liquidated damage clause is not sufficient to align the concept of liquidated damage clauses with UAE law. The principle of *jarar* demands greater flexibility in respect to the amount of compensation owed under a liquidation clause. Such flexibility is provided by the approach of Article 390(2) Civil Code, which affords the courts the authority to – upon application of a party to the relevant agreement – adjust the compensation owed under a liquidated damage clause to reflect the actual loss sustained.

Provisions similar to Article 390(2) Civil Code are common in Middle Eastern jurisdictions.¹⁷ They can be found, for example, in the civil codes of Egypt,¹⁸ Jordan¹⁹ and Qatar.²⁰ Yet, in contrast to Article 390(2) Civil Code²¹ the relevant provisions of the Egyptian and Qatari civil code do not allow for an adjustment but only a reduction of the compensation agreed by the parties in a liquidated damage clause.²²

3. No Compensation where no Actual Damages Were Incurred

As per the Commentary to the UAE Civil Code issued by the UAE Ministry of Justice (Commentary on the Civil Code) an agreement on liquidated damages may only oblige the party in breach to pay the pre-agreed compensation where loss was in fact incurred.²³ Hence, while a party seeking compensation under a liquidated damage clause does not have to substantiate the actual amount of loss it incurred – unless either of the parties requests the court to adjust the compensation owed pursuant to Article 390(2) Civil Code – the fact that loss was in fact sustained by the party invoking the liquidated damage clause has to be proven.

4. No Retroactive Agreements on Liquidated Damages

Furthermore, the Commentary on the Civil Code provides that Article 390(1) Civil Code does not allow for an agreement regarding compensation for past breaches.²⁴

17 See e.g. Said Hanafi: Contractors Liability under the Civil Codes of Algeria, Egypt, Qatar & the UAE, in: *The International Construction Law Review* 25 (2008), p. 229.

18 See Article 224(2) Egyptian Civil Code.

19 See Article 364(2) Jordanian Civil Code, Law No. 45 of 1976 (القانون المدني، القانون رقم (45) لسنة 1976).

20 See Article 266 Qatari Civil Code, Law No. 22 of 2004 (القانون المدني، القانون رقم (22) لسنة 2004).

21 As well as Article 364(2) Jordanian Civil Code.

22 See Articles 224(2), 225 Egyptian Civil Code and Article 266 Qatari Civil Code.

23 Commentary to the UAE Civil Code issued by the UAE Ministry of Justice, Abu Dhabi 1987, Section §2-0577.

An English translation of the Commentary on the Civil Code is available in: James Whelan: *UAE Civil Code and Ministry of Justice Commentary - 2010*, London 2010. The Commentary on the Civil Code, while not binding for the courts in their interpretation of the Civil Code is held to be “so profuse in its guidance, and held in such respect by the courts of the United Arab Emirates, that it can be said that it is an essential tool for the correct interpretation of the statutory provisions of the [Civil] Code, and that it is often unsafe to rely on the words of the Code alone in determining their meaning and effect.”; quoted as translated in: James Whelan: *UAE Civil Code*, p. 3.

24 See Commentary to the UAE Civil Code issued by the UAE Ministry of Justice, Abu Dhabi 1987, Section §2-0350.

Hence liquidated damages for specific breach may only be agreed on prior to such breach occurring and not retroactively.

III. Liquidated Damage Clauses in the Practice of UAE Courts

1. Validity of Liquidated Damage Clauses

A review of judicial practice of UAE courts shows that UAE courts generally recognize the validity of liquidated damage clauses provided that 1) the party who agreed to pay the liquidated damages is legally responsible for committing a specific breach of contract, 2) the party invoking the liquidated damage clause actually sustained losses and 3) a causative link exists between the specific breach and the damage suffered.²⁵

a) Specific Breach

Liquidated damages may be awarded where the party agreeing to the liquidated damage clause is legally responsible for the specific breach defined in the clause. Specific breach can be any active infringement of or default in performance of the obligations under the relevant contract. A common event of default that triggers compensation under a liquidated damage clause is delay in performance.²⁶ For the party invoking the liquidated damage clause to be entitled to compensation, the party in breach has to be legally responsible for such breach.²⁷ Unless the liability of the party in breach is limited, it will be regarded legally responsible for the specific breach where it, its employees, representatives or agents caused such specific breach intentionally or negligently (Article 282 Civil Code).²⁸

b) Loss Sustained

Compensation under a liquidated damage clause will only be awarded where the party invoking the clause actually sustained losses due to the breach of contract. The UAE Union Supreme Court (المحكمة الاتحادية العليا) (Supreme Court) for instance dismissed a claim brought by the main-contractor against its sub-contractor based on the liquidated damage clause of the sub-contracting agreement whereby the main-contractor sought compensation for delay in completion of the sub-contracted works, because in the opinion of the court the main-contractor did not suffer any losses due to the late performance of the sub-contractor. The client – despite the late performance of the contracted works – did not claim damages from the main-contractor. Therefore, the court found that, since the client did not invoke the liq-

25 See Supreme Court, Case No. 103 of Judicial Year 24, Judgement rendered 21 March 2004; Supreme Court, Case No. 782 of Judicial Year 22, Judgement rendered 7 April 2002. Decisions of UAE courts can be accessed in their Arabic original text under: www.mohamoon-uae.com (last access 11.04.2015).

26 See Supreme Court, Case No. 103 of Judicial Year 24, Judgement rendered 21 March 2004.

27 See Supreme Court, Petition No. 26 of Judicial Year 24, Judgement rendered 1 June 2004.

28 Commentary to the UAE Civil Code issued by the UAE Ministry of Justice, Abu Dhabi 1987, Section §2-0577.

liquidated damage clause under the main-contracting agreement or seek compensation due to late performance from the main-contractor in any other way, the main-contractor had suffered no loss. Accordingly the court refused to award compensation under the liquidated damage clause of the sub-contracting agreement to the main-contractor. The court stated that:

establishing fault on the part of the respondent [the sub-contractor] is not by itself sufficient for awarding liquidated damages. The claimant [the main-contractor] has to actually have sustained loss as a result of this fault.²⁹

c) Causative Link

Damages may only be awarded where the underlying act of the obligated party is causal for the loss suffered by the injured party; thus, a causative link must exist between the two.³⁰ In respect to liquidated damages this means that a causative link has to exist between the specific breach by the party against which the liquidated damage clause is invoked and the losses sustained by the party invoking the clause.

d) Burden of Proof in Respect to the Fact that Loss Occured

Unless where a party to the relevant dispute makes an application to the court to adjust the compensation provided under the liquidation clause, the actual amount of loss incurred does not have to be substantiated. Still, as shown above compensation under a liquidated damage clause will only be awarded where the party invoking the clause actually sustained loss due to the specific breach. As a general rule under UAE Law, pursuant to Article 1(1) Law of Evidence in Civil and Commercial Transactions, Federal Law No. 10 of 1992 (Evidence Law) (قانون الاثبات في المعاملات المدنية والتجارية، قانون اتحادي رقم 10 لسنة 1992),³¹ the burden of proof in respect to a specific fact lies with the party asserting it.

According to the Supreme Court this general principle also applies in respect to proving the elements of a damage claim under a liquidated damage clause. For instance, in a dispute relating to work performed in a construction project the Supreme Court dismissed the sub-contractor's counterclaim brought based on the liquidated damage clause of the sub-contracting agreement against a claim of the main-contractor for compensation for late performance by the sub-contractor due to the fact that the sub-contractor relied only on the fact that the sub-contracting agreement comprised a liquidated damage clause, but failed to establish that it actually suffered any loss due to the specific breach.³²

29 See Supreme Court, Petition No. 26 of Judicial Year 24, Judgement rendered 1 June 2004.

30 Article 283 CC; Commentary to the UAE Civil Code issued by the UAE Ministry of Justice, Abu Dhabi 1987, Section §2-0348 and §2-0352.

31 Original Arabic text available at: www.elaws.gov.ae/EnLegislations.aspx (last access 11.04.2015).

32 Supreme Court, Case No. 103 of Judicial Year 24, Judgement rendered 21 March 2004. The Supreme Court reaffirmed this position in Case No. 412 of 2009, Judgement rendered 27 January 2010.

2. Adjustment of Compensation Owed under Liquidated Damage Clauses

As a matter of practice, UAE courts do exercise the competence to intervene and adjust the amount of compensation agreed upon in a liquidated damage clause afforded to them by Article 390(2) Civil Code where they are requested to do so by a party to the relevant dispute. However, the Abu Dhabi Court of Cassation (محكمة النقض أبو ظبي) and the Dubai Court of Cassation (محكمة النقض دبي) appear to have taken different positions as to when they are authorized to exercise this authority.

a) Discrepancy between Compensation Owed under the Liquidated Damage Clause and Actual Damages Incurred

According to Article 390(2) Civil Code the courts may, upon application of a party to the relevant dispute to do so, adjust the compensation owed under a liquidation clause in an individual case to ensure that such compensation is equal to the actual loss sustained. However, there is some ambiguity as to whether the compensation owed under a liquidated damage clause is to be adjusted wherever there is a discrepancy between the amount specified in the liquidated damage clause and the actual losses sustained or only where the compensation provided for by the liquidated damage clause is excessive compared to the actual losses suffered.

The Dubai Court of Cassation appears to hold that the compensation owed under a liquidated damages clause may be adjusted wherever there is a discrepancy between the compensation agreed upon in the liquidated damage clause and the losses actually suffered by the party invoking it. For instance in a dispute between a main-contractor and its sub-contractor the court found that the amount agreed upon in the liquidated damage clause of the sub-contracting agreement was to be adjusted, because it exceeded the amount the client could claim under the liquidated damage clause of the main-contracting agreement. The court, therefore, ruled that the sub-contractor was obligated to pay to the main-contractor liquidated damages in the amount agreed upon in the main-contracting agreement and not the higher amount agreed upon in the sub-contracting agreement.³³

However, the Abu Dhabi Court of Cassation has taken a different position. The court found that where the parties to a contract agreed on compensation in a liquidated damage clause

[t]here is an assumption that the assessment of compensation agreed corresponds with the loss sustained by the party invoking the liquidated damage clause. The judge has to abide by the agreement of the parties and give effect to it unless the party against which the clause is invoked proves that the agreed compensation is excessive.³⁴

This inconsistency in court practice creates considerable ambiguity for the application of liquidated damage clauses. Arguments can be made for both positions. The inter-

33 Dubai Court of Cassation, Appeal No. 222 of 2005, Judgment rendered 19 June 2006.

34 Abu Dhabi Court of Cassation, Appeal No. 941 of 2009. Translated from the Arabic original by the author.

pretation of Article 390(2) Civil Code offered by the Dubai Court of Cassation appears to adhere more strictly to the wording of the article. Article 390(2) Civil Code provides for an adjustment of the compensation agreed in a liquidated damage clause “so that the compensation shall be equal to the loss actually suffered”.³⁵ The formulation that the compensation shall be equal to the loss actually suffered suggests that an adjustment shall be made wherever there is a discrepancy between the compensation provided for in the liquidated damage clause and the actual loss incurred by the party invoking the clause regardless of how significant this discrepancy is. Furthermore, the position of the Dubai Court of Cassation reflects a stricter interpretation of Islamic Law and the principle of *ġarar* in particular.³⁶

The position of the Abu Dhabi Court of Cassation on the other hand puts a stronger emphasis on the agreement of the parties and their freedom to contract as provided for in Article 126 Civil Code.³⁷

Still, the Commentary on the Civil Code supports both positions. It provides that “compensation must be equivalent to the damage in fact suffered”.³⁸ Since the Dubai Court of Cassation and the Abu Dhabi Court of Cassation are the highest court authorities in their respective emirates, it is to be expected that the lower courts will follow the position taken by their respective Court of Cassation. This would create an imbalance in interpretation of Article 390(2) Civil Code and the application of liquidated damage clause between the two emirates. Furthermore, it remains to be seen which position the courts of the other emirates will follow. The existing ambiguity may be resolved by a decision of the Supreme Court. However, a decision of the Supreme Court on this issue is still outstanding.

b) Burden of Proof in Respect to the Discrepancy between Compensation Owed under the Liquidated Damage Clause and Actual Damages Incurred

Where a party invokes a liquidated damage clause, the party does not have to prove that it suffered loss in the amount of the liquidated damages agreed upon in that clause. The fact that the parties agreed that compensation in a specific amount shall be owed in case of a specific breach constitutes the assumption that the loss actually incurred corresponds with the loss actually suffered by the party invoking the liquidated damage clause. The burden of proof for substantiating that the loss actually sustained deviated from the pre-agreed compensation lies with the party challenging the amount agreed upon in the liquidated damage clause.³⁹

35 Translated from the Arabic original by the author. Emphasis added by the author.

36 See above at II.1.

37 Commentary to the UAE Civil Code issued by the UAE Ministry of Justice, Abu Dhabi 1987, Section §2-0006.

38 Commentary to the UAE Civil Code issued by the UAE Ministry of Justice, Abu Dhabi 1987, Section §2-0577.

39 Supreme Court, Petition No. 370 of Judicial Year 20; Abu Dhabi Court of Cassation, Appeal No. 941 of 2009.

The aforementioned position suggests that the party challenging the compensation determined in the liquidated damage clause is required only to substantiate that the pre-agreed amount is excessive or deviates from the losses actually suffered, rather than proving the actual amount of damages suffered. The reason being that a liquidated damages clause is based on the rebuttable assumption that the amount of the compensation agreed upon reflects the actual loss sustained. It follows that if the party challenging the compensation owed under the liquidated damage clause is able to rebut the presumption, then the court would have to exercise its authority to adjust the compensation to reflect the loss actually sustained by the party invoking the clause. This interpretation is further supported by Article 48(1) Evidence Law, which stipulates that “an assumption specified by law relieves the person whose interest they affirm of any other method of proof. Notwithstanding, these assumptions may be refuted by evidence to the contrary”.⁴⁰ Article 48(1) Evidence Law may be interpreted as providing that refuting an assumption specified by law only requires evidence contradicting the assumption but not evidence proving the specific circumstances of the case at hand.

Following this interpretation of Article 48(1) Evidence Law, it would appear that where a party has successfully rebutted the presumption that the compensation agreed upon in the liquidated damage clause does not correspond with the losses actually incurred by the party invoking the clause, the court would have to investigate the actual damage suffered.

This interpretation is supported by a decision of the Dubai Court of Cassation in which the court overturned a decision of the Dubai Court of Appeal (محكمة الاستئناف دبي). In this case, the respondent alleged that the loss actually suffered by the claimant was considerably lower than the compensation stipulated by the liquidated damage clause. The respondent, therefore, requested the court refer the matter to an expert to identify the losses actually incurred by the claimant. The Dubai Court of Appeal, however, rejected this request and awarded the claimant the compensation provided for in the liquidated damage clause. The Dubai Court of Cassation, however, held that while an agreement on liquidated damages transferred the burden of proof that the losses actually sustained by the party invoking the liquidated damage clause to the party challenging the amount of the compensation provided therein, the court still remained obligated to establish all elements of the damages awarded. The court failing to do so constituted an error of law. Therefore, the Dubai Court of Cassation held that the matter should have been referred to an expert to identify the losses actually incurred by the claimant.⁴¹

40 Translated from the Arabic original by the author.

41 Dubai Court of Cassation, Petitions No. 63 and 99 of 2005, Judgement rendered 26 July 2005.

c) Determination of the Adjustment

The UAE courts are free to exercise their discretion when adjusting the compensation stipulated by a liquidated damage clause in an individual case pursuant to Article 390(2) Civil Code. In Case No. 36 of Judicial year 21 the Supreme Court held, that

[t]he assessment of damage and the evaluation of the underlying circumstances when assessing the compensation due are matters of fact within the sole discretion of the trial court.⁴²

While in its decision the Supreme Court did not specifically address the adjustment of compensation owed under liquidation clauses pursuant to Article 390(2) Civil Code, the courts findings are nonetheless relevant in this respect as they generally address the assessment of damages by the competent courts under UAE Law.

IV. Conclusion

Liquidated damage clauses are a frequently used instrument in contracts under UAE Law today. UAE Law in principle recognizes such provisions as valid. However, as the concept of liquidated damages derives from a foreign legal system, UAE Law governing them had to be adjusted to incorporate liquidated damages in the UAE legal system, specifically, liquidated damages as treated in common law jurisdictions conflict with the Islamic Law principle of *gárar*. Since Islamic Law is the principle source of UAE Law, this conflict had to be addressed. The Civil Code does so by affording the courts the authority to – upon the application of a party to the relevant dispute – adjust the compensation stipulated by a liquidated damage clause in order to align the compensation awarded with the losses actually sustained by the party invoking the liquidated damage clause. This was necessary to make the concept of liquidated damages compliant with Islamic Law. However, this approach to liquidated damages jeopardizes some of the advantages provided by liquidated damage clause; in particular, where the losses actually sustained are difficult to quantify.

Furthermore, the application of UAE Law governing liquidated damage clauses is somewhat ambiguous. Most relevant is the inconsistency between the positions taken by the Dubai Court of Cassation and the Abu Dhabi Court of Cassation in respect to how significant the discrepancy between compensation agreed upon in a liquidated damage clause and actual loss sustained by the party invoking it has to be to warrant adjustment. This inconsistency causes considerable uncertainty in respect to the application of liquidated damage clauses in the UAE and, in particular, between Dubai and Abu Dhabi. Since a decision of the Supreme Court on this issue is outstanding, it is to be expected that the courts of Dubai and Abu Dhabi will follow

42 Translated from the Arabic original by the author. The Supreme Court affirmed this position in Case No. 128 of Judicial Year 25.

their respective Court of Cassation. Furthermore, it remains to be seen which position the courts of the other emirates will take.

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