

Liquidated Damages for Delay in the Middle East: Not Etched in Stone

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ABSTRACT

Liquidated damages in construction contracts represent a fixed-rate mechanism to compensate employers for delays by contractors. Traditionally, common law courts do not interfere with the amount of liquidated damages due. By contrast, the local courts of certain civil law jurisdictions in the Middle East are empowered to adjust those liquidated damages, which raises important questions about how and when those courts will exercise that power and whether international arbitral tribunals will do the same.

1 INTRODUCTION

Liquidated damages for project delays feature regularly in engineering, procurement and construction (EPC) contracts as a means of compensating the employer for losses incurred as a result of delayed completion by the contractor. In their most basic form, liquidated damages consist of an agreed amount payable when the contractual completion date is overrun. In the main, common law courts do not modify the amounts of contractually-agreed liquidated damages unless the sum is considered an excessive penalty (in which case the court will declare it void).

By contrast, several civil law jurisdictions in the Middle East empower their courts to adjust liquidated damages amounts downwards (and, in some jurisdictions, upwards) in certain circumstances. In their approaches to liquidated damages, such jurisdictions fall broadly into two categories.

The first comprises those jurisdictions where the courts are empowered either to disallow liquidated damages on the basis that there was no actual harm or to reduce the amount of liquidated damages if it was ‘grossly’ or ‘greatly’ exaggerated

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in comparison to the loss actually suffered.¹ This category includes Bahrain, Egypt, Iraq, Kuwait and Syria.²

The second category includes those jurisdictions whose courts have the authority to disregard the liquidated damages clause entirely and assess the damages as equal to the actual loss incurred by the project owner.³ This second category encompasses Jordan, Oman and the UAE.

A contractor's ability to challenge its obligation to pay liquidated damages to a project owner in the contractually-agreed amount raises important questions as to how courts treat actual loss, what they consider as grossly exaggerated, and the basis on which they may decide to disregard a liquidated damages clause.

The remainder of this article is in three parts. Section 2 provides an overview of the rationale behind liquidated damages in construction contracts and the typical common law approach to compensation. Section 3 discusses the treatment of liquidated damages clauses under the laws of Egypt, Bahrain, and the UAE.⁴ Section 4 offers concluding remarks.

2 LIQUIDATED DAMAGES FOR DELAY IN CONSTRUCTION CONTRACTS

It would be rare to find a modern EPC contract that does not provide for liquidated damages in the event of a delay in completion.⁵ In general, EPC contracts provide that, in the event of the contractor's failure to complete all or part of the works by the contractually-agreed date, the contractor must pay to the owner a fixed sum that is agreed in advance and paid periodically.⁶

¹ See e.g. Egyptian Civil Code, Article 224(2), trans. Shalakany Law Office (2008); Bahraini Civil Code, Article 226, trans. Kingdom of Bahrain Ministry of Justice and Islamic Affairs, <http://www.moj.gov.bh/en/default0605.html?action=article&ID=1467> (accessed 26 September 2017). The expression used in the original Arabic is إلى درجة كبيرة, which literally means 'to a great extent'.

² See H. Al-Ahwany, تأملات في الشرط الجزائي: دراسة مقارنة [Reflections on the Penalty Clause: A Comparative Study] (2014), p. 4.

³ See e.g. UAE Civil Code, Article 390, trans. J. Whelan, https://lexemiratidotnet.files.wordpress.com/2011/07/uae-civil-code_english-translation_.pdf (accessed 26 September 2017). See also Al-Ahwany, *supra* note 2, pp. 92, 106, 112 and 114. See also Jordanian Civil Code, Article 364 ('The parties to a contract may set in advance the amount of the indemnity by stipulating it in the contract or in a subsequent agreement in accordance with the provisions of law. And the court may, in all instances and upon request by either party, amend this agreement so that the amount equals the harm. Any agreement contrary to this provision shall be void.' (author's translation)).

⁴ A comparative analysis of the two approaches is beyond the scope of this article.

⁵ While liquidated damages are used for other types of breaches – e.g. breaches of performance guarantees, reputational damage, or unauthorized changes of key personnel – these circumstances are beyond the scope of this article, which deals with liquidated damages for delay.

⁶ See e.g. J. Jenkins, *International Construction Arbitration Law* (2d ed., Kluwer Law International 2013), pp. 13–48; Crown Office Chambers, *Emden's Construction Law* (LexisNexis 2011), p. 1.

Most standard forms of construction contract provide for liquidated damages payable upon late completion.⁷ For example, Sub-Clause 8.7 of the 1999 FIDIC Red Book⁸ provides, in part, as follows:

If the Contractor fails to comply with Sub-Clause 8.2 [Time for Completion], the Contractor shall subject to Sub-Clause 2.5 [Employer's Claims] pay delay damages to the Employer for this default. These delay damages shall be the sum stated in the Appendix to Tender, which shall be paid for every day which shall elapse between the relevant Time for Completion and the date stated in the Taking-Over Certificate. However, the total amount due under this Sub-Clause shall not exceed the maximum amount of delay damages (if any) stated in the Appendix to Tender.

The FIDIC Contracts Guide explains that the rationale behind the inclusion of a liquidated damages provision is to compensate the project owner for losses it will suffer as a result of delayed completion by the contractor and that, where the sum of liquidated damages is fixed by the parties, the intention is that the employer does not have to prove that it has in fact incurred any loss.⁹ Stated differently, the commercial purpose is 'to provide certainty and to save the expense of proving loss'.¹⁰

Liquidated damages provisions benefit both employers and contractors.

For employers, they eliminate the burden of having to prove the actual loss suffered on account of the delay, which might otherwise be an expensive and time-consuming exercise.¹¹ Such clauses also allow employers to claim compensation for damages that a court may have difficulty assessing accurately, such as the value of lost profits and lost opportunities.¹²

For contractors, liquidated damages provide greater certainty regarding liability for delay and the level of risk exposure at the time of entering into the contract.¹³ Using a liquidated damages clause also brings greater certainty to the tendering process as it enables tenderers to factor that exposure into

⁷ For a detailed overview of liquidated damages, see e.g. *Hudson's Building and Engineering Contracts* (12th ed. N. Dennys, M. Raeside and R. Clay, Sweet & Maxwell 2010), pp. 886–935. See also B. Eggleston, *Liquidated Damages and Extensions of Time: In Construction Contracts* (3d ed., Wiley-Blackwell 2009), pp. 1–3.

⁸ Conditions of Contract for Construction for Building and Engineering Works Designed by the Employer (FIDIC, 1999).

⁹ *The FIDIC Contracts Guide* (FIDIC 2000), p. 182.

¹⁰ J.W. Carter and E. Peden, 'A Good Faith Perspective on Liquidated Damages' (2007) 23(3) *Journal of Contract Law* 157, p. 157.

¹¹ See e.g. J. Hosie, 'The Ascertainment of Damages for Delay in Construction Contracts: Liquidated and Unliquidated Damages' (1994) 10(3) *Construction Law Journal* 214, pp. 216–17. See also J. Jenkins, *supra* note 6, pp. 13–48.

¹² See e.g. T.J. Trauner, *Construction Delays: Understanding Them Clearly, Analyzing Them Correctly* (2d ed., Butterworth-Heinemann 2009), p. 225; D. Browder, 'Liquidated Damages in Montana' (2006) 67 *Montana Law Review* 361, p. 363.

¹³ See e.g. E. Baker, B. Mellors, S. Chalmers and A. Lavers, *FIDIC Contracts: Law and Practice* (5th ed., Informa 2009), pp. 409–10. See also Hosie, *supra* note 11, p. 216.

their contract price; and employers are thus better able to evaluate tenders that have priced the contingency of a delay.¹⁴ Further, a contractor who has run into culpable delay is able to weigh the cost of paying liquidated damages to the employer against the cost of channeling extra resources into the project to accelerate progress and thereby mitigate the contractor's exposure to liquidated damages.¹⁵

These benefits are not universal, of course, since the judicial treatment of liquidated damages clauses varies across jurisdictions and may be uncertain and unpredictable, as discussed below.

Common law jurisdictions have traditionally distinguished between a liquidated damages clause and a penalty, the latter being considered an unjustifiable means of coercing performance of a contract.¹⁶ Under English law, for example, the position until recently was that, for a liquidated damages provision to be enforceable, the prescribed amount of compensation payable upon breach had to be a genuine pre-estimate of the loss, not a penalty.¹⁷ This long-standing principle has now been re-evaluated in light of the recent decision of the UK Supreme Court in *Cavendish Square Holdings BV v. Tatal El Makdessi*.¹⁸ Specifically, the traditional 'pre-estimate of loss' test has been replaced with a more flexible 'legitimate interest' test, and courts are now mandated to balance the provision against the legitimate interest of the party seeking to enforce it or, alternatively, to consider whether there is a commercial justification for the clause.¹⁹

¹⁴ *Ibid.*

¹⁵ *Ibid.*

¹⁶ See e.g. D. Jones, 'The Penalties Doctrine in International Construction Contracting: Where to from here?' Society of Construction (New Zealand) Lecture, 24 August 2016, pp. 4–7, <http://dougjones.info/content/uploads/2017/07/Penalties-Lecture-New-Zealand-SCL-Final-Website-Version-3.pdf> (accessed 26 September 2017). See also M. Cheung, 'Shylock's Construction Law: The Brave New Life of Liquidated Damages?', paper presented to the Society of Construction Law, 16 May 2016, (2017) 33(3) *Construction Law Journal* 173, pp. 178–80, <https://www.atkinchambers.com/shylocks-construction-law-liquidated-damages-mathias-cheung/> (accessed 26 September 2017); Y. Goh and M. Yip, 'English Reformulation of the Penalty Rule: Relevance in Singapore?' (2017) 29 *Singapore Academy of Law Journal* 257, pp. 257–8, <http://journalonline.academypublishing.org.sg/Journals/Singapore-Academy-of-Law-Journal/Current-Issue/ctl/eFirstSALPDFJournalView/mid/494/ArticleId/1192/Citation/JournalsOnlinePDF> (accessed 26 September 2017).

¹⁷ The key decision distinguishing between liquidated damages and a penalty is the English case of *Dunlop Pneumatic Tyre Co. Ltd v. New Garage and Motor Co. Ltd* [1915] AC 79.

¹⁸ *Cavendish Square Holding BV v. Tatal El Makdessi and ParkingEye Ltd v. Beavis* [2015] UKSC 67, on appeal from [2012] EWCA Civ 3852 Comm, [2013] EWCA Civ 1539 and [2015] EWCA Civ 402 (collectively '*Cavendish*').

¹⁹ In particular, the court reformulated the test as follows: 'what is necessary in each case is to consider, first, whether any (and if so what) legitimate business interest is served and protected by the clause, and second, whether, assuming such an interest to exist, the provision made for the interest is nevertheless in the circumstances extravagant, exorbitant or unconscionable'. See *Cavendish*, *supra* note 18, §§ 152, 225, 291 and 293. See e.g. Jones, *supra* note 16, p. 7. See also Cheung, *supra* note 16, pp. 9–14; N. Andrews, *Arbitration and Contract Law: Common Law Perspectives* (Springer 2016), pp. 310–12.

Civil law jurisdictions, on the other hand, tend to regard penalties as enforceable²⁰ and make little distinction between penalty clauses and liquidated damages clauses.²¹ The treatment of liquidated damage clauses varies in both legislation and case law,²² so it cannot be assumed that liquidated damages will be treated uniformly across the Middle East. Below we look more closely at the application of liquidated damages clauses under the laws of Egypt, Bahrain and the UAE.

3 LIQUIDATED DAMAGES IN THE MIDDLE EAST

Before surveying three countries in the Middle East where courts (and, potentially, arbitral tribunals seized with disputes governed by the laws of those countries) are empowered to adjust contractually-agreed liquidated damages, it is important to make some brief, albeit general, remarks about their legal systems.

Egypt, Bahrain and the UAE are predominantly civil law jurisdictions. Developed in the nineteenth century, and based on a well-established system of codified laws derived from a combination of the Napoleonic Code, Roman law and Islamic Sharia, Egypt's legal system has influenced that of several other countries in the Middle East (including Bahrain and the UAE) and has served as a model for many of those systems and their civil codes.²³

These countries' civil courts (as distinct from their criminal, administrative or constitutional courts) generally comprise a court of first instance, a court of appeal and a court of cassation. Those courts do not formally use judicial precedent, relying instead on codified law, but court of cassation judgments are strongly persuasive for lower courts.²⁴

²⁰ See e.g. Eggleston, *supra* note 7, pp. 3–5. See also Baker et al., *supra* note 13, p. 409; Jenkins, *supra* note 6.

²¹ See R. W. Thomas and M. Wright, *Construction Contract Claims* (4th ed., Palgrave 2016), p. 4. See also Jones, *supra* note 16, p. 11.

²² See Jones, *supra* note 16, p. 11.

²³ For example, Article 2 of the Constitution of Bahrain states: 'Islamic Sharia is a principal source of legislation.' See Report of the Bahrain Independent Commission of Inquiry, 'Chapter III – Relevant Aspects of the Legal System and Description of the Enforcement Structures' (2011), <http://www.moj.gov.bh/govactions/wps/themes/html/BICI/en/pdfs/C3.pdf> (accessed 26 September 2017). See also R. Price and E. Al Tamimi, *United Arab Emirates Court of Cassation Judgments: 1998–2003* (Brill 2004), p. 8; V. Gorgenlender, *A Strategic Analysis of the Construction Industry in the United Arab Emirates: Opportunities and Threats in the Construction Business* (Diplomica 2011), p. 54. For an overview of the Egyptian legal system, see especially K. El Shalakany, 'Legal Aspects of Doing Business in Africa' (2009), pp. 1–5; see also 'Egypt Law – An Overview: Overview of Egypt's Constitution, Penal Code, and Other Laws', <http://egyptjustice.com/egypt-law-an-overview/> (accessed 26 September 2017). For a general overview of the UAE's legal system, see e.g. R. Price and E. Al Tamimi, *United Arab Emirates Court of Cassation Judgments: 1998–2003* (Brill 2004), pp. 7–12. For a brief synopsis, see also G. Blanke and C. Abi Habib Kanakri, 'Arbitration in Dubai: A Basic Primer' in C. Klausegger et al. (eds), *Austrian Yearbook on International Arbitration 2011*, 217, pp. 222–3.

²⁴ See e.g. M. al-Bashir Muhammad al-Amine, *Global Sukūk and Islamic Securitization Market* (Brill 2011), pp. 353–4. For an overview of the UAE court system, see e.g. G. Feiler, 'The Middle East in the New

As described in section 1 above, the courts of the Middle East fall broadly into two categories in their approaches to liquidated damages. In the sections that follow, we consider two countries belonging to the first category (Egypt and Bahrain) and one from the second category (the UAE).

3.1 DISALLOWANCE OR REDUCTION OF LIQUIDATED DAMAGES: EGYPT AND BAHRAIN

Under Egyptian law, liquidated damages are treated as a penalty for delay in the execution of works.²⁵ Article 224 of the Egyptian Civil Code provides as follows:

- (1) Damages fixed by agreement are not due if the debtor proves that the creditor has suffered no harm.
- (2) The Judge may reduce the amount of damages if the debtor proves that the amount fixed was greatly exaggerated or that the original obligation has been partially performed.
- (3) Any agreement contrary to the provisions of the two preceding paragraphs is void.²⁶

There are, therefore, two legal limbs under which a contractor may challenge a project owner's contractual entitlement to liquidated damages:

- The first – and, arguably, more difficult – limb (Article 224(1)) provides that liquidated damages *will not be owed* if the contractor establishes that the employer did not suffer *any* damage.²⁷ For the sake of brevity, this will be called the actual loss limb.
- The second limb (Article 224(2)) provides that liquidated damages *may be reduced* if the contractor establishes that the amount is 'greatly exaggerated'. This will be called the gross exaggeration limb.

The burden of proving either of these limbs falls squarely on the contractor. In considering Article 224, the Egyptian Court of Cassation has held that 'if there is a penalty clause in the contract, damages are presumed unless the debtor proved

Millennium: Economic Development & Business Law', pp. 419–22. For a synopsis of Bahrain's court system, see e.g. Chapter III of Report of the Bahrain Independent Commission of Inquiry, *supra* note 23.

²⁵ See M.A.M. Ismail, 'Globalisation and Liquidated Damages in International Public Works Agreements in Egypt: An Analytical Perspective on the Penalty for Delay Clause in Infrastructure Agreements' (2009) *The International Construction Law Review* 508, pp. 508–10.

²⁶ Trans. Shalakany Law Office (2008).

²⁷ See Ismail (2014), *supra* note 25, p. 24.

the opposite or that stipulated compensation in the contract exceeded the actual loss'.²⁸ In a similar vein, Sanhoury writes:

The existence of the penal clause [liquidated damages clause] means that the contracting parties consider harm to have occurred [following a breach]. Hence, the occurrence of harm would be presumed and the creditor would not be required to prove it. If the debtor claimed that the creditor suffered no harm it would have to demonstrate that claim. Therefore, contrary to the general principles, the burden of proving harm shifts from the creditor to the debtor as a result of the penal clause.²⁹

In other words, the project owner is not required to prove the occurrence of harm.³⁰ If the contractor challenges the liquidated damages, it has the burden of proving that there is no actual loss or that the contractually-agreed amount is grossly exaggerated.³¹

It is also noteworthy that, barring fraud or serious fault, a project owner cannot claim an amount greater than that agreed in the contract. Article 225 of the Egyptian Civil Code states that: 'If the harm exceeds the amount of damages fixed by agreement, the creditor may not claim the additional amount unless he proves that the debtor has committed fraud or gross negligence.'³²

In considering the actual loss limb, courts and commentators have espoused certain principles:

- Fixing liquidated damages in a contract creates a presumption that the non-breaching party will suffer harm as a result of a breach. Accordingly, as referenced above, the burden of proving that there is no actual loss lies with the party challenging the contractually-agreed amount of liquidated damages.³³ A court will therefore not reject a contractually-agreed amount of liquidated damages unless the debtor can prove that the creditor has not incurred actual loss as a result of the debtor's breach.³⁴

²⁸ See Egyptian Court of Cassation, Case No. 415, Judicial Year 46, 13 February 1980 and Case No. 26, Judicial Year 38, 18 December 1973, as cited in M.A.M. Ismail, *Globalization and New International Public Works Agreements in Developing Countries – An Analytical Perspective* (Routledge 2016) and in Ismail (2009), *supra* note 25, pp. 515–16.

²⁹ See A. Al-Sanhoury, *الوسيط في شرح القانون المدني: الجزء الثاني – نظرية الالتزام بوجه عام* [Al-Wasit Commentary on the Civil Code: Vol. II – The General Theory of Obligations] (Dar Al-Shorouk 2010), p. 803 (author's translation).

³⁰ See e.g. A. Tolba, *الجزء الأول: الوسيط في شرح القانون المدني* [Al-Wasit on the Civil Code, Vol. I] (4th ed., Dar Nashr Al-Thaqafa 1986), p. 605, in particular: 'Even if the debtor was able to prove that the [liquidated damages] are grossly exaggerated, the judge need not reduce that amount to an amount that is equal to actual loss, but may grant an amount that exceeds such actual loss in light of the profit that the creditor may have missed and the loss it has suffered.'

³¹ *Ibid.*

³² Trans. Shalakany Law Office (2008).

³³ See e.g. Egyptian Court of Cassation, Case No. 415/JY46, 13 February 1980.

³⁴ See e.g. Egyptian Court of Cassation, Case No. 26/ JY38, 18 December 1973.

- In calculating actual loss, courts will take into account the loss actually suffered by the non-breaching party.³⁵

By way of example, the government entity in charge of urban development in a new Cairo district sued the buyer of a plot of land for violating the zoning and building regulations set out in the contract, which required the buyer not to exceed the maximum height of buildings erected on the plot and the maximum number of units per floor. On account of those violations, the government entity requested that the court order payment of the damages set out in the liquidated damages clause.

The Court of Cassation³⁶ upheld the lower court's decision not to award any liquidated damages to the governmental entity on the grounds that no harm was caused by the plot owner's breach. The Court of Cassation held that the plot owner was able to show that the entity suffered no harm because (i) the violations were remedied within a short period of time; and (ii) the plot owner's neighbours, for whose benefit the height limit was in place, had waived their right to that easement. The Court of Cassation reiterated the rule that the liquidated damages clause falls away if the debtor demonstrates that the creditor suffered no harm as a result of the breach.

Turning to the gross exaggeration limb, courts and leading commentators have offered the following guidance:

- Liquidated damages that exceed actual loss will not automatically result in a reduction by the courts. A court will not reduce an amount of liquidated damages that is not considered to be grossly exaggerated.³⁷
- Even if a contractor is able to establish that the liquidated damages are grossly exaggerated, the court will not necessarily reduce them to an amount equal to actual loss, but may instead grant a higher amount to reflect any profit that the employer may have missed as well as the loss it has suffered.³⁸
- The courts will assess gross exaggeration by considering the general rules for valuation of damages in the context of contractual liability, which, under Egyptian law, are limited to foreseeable harm, unless there is fraud or serious error.³⁹ In particular, the courts will assess the amount of damages

³⁵ See Al-Sanhouri, *supra* note 29, pp. 791–2, § 469.

³⁶ Egyptian Court of Cassation, Petition No. 102/JY34, 14 November 1967.

³⁷ See Al-Sanhouri, *supra* note 29, p. 818.

³⁸ See Tolba, *supra* note 30, p. 605.

³⁹ See Al-Ahwany, *supra* note 2, pp. 111–12.

on the basis of Article 221(1) of the Egyptian Civil Code, which stipulates that damages may be recovered only and to the extent that they are a natural consequence of the breach in question and were foreseeable at the time of entering into the contract.⁴⁰

- Egyptian law does not require the amount of damages to be *equal* to the actual harm suffered by the creditor at the time of its occurrence.⁴¹
- Courts tend to look to the time at which a claim for liquidated damages was made when determining whether they were grossly exaggerated.⁴²

For example, in one case involving the purchase of real estate, the contract provided for liquidated damages in the amount of EGP 1 million payable upon the failure of any party to perform any obligation or upon delay.⁴³ Before the lower courts, the buyer successfully claimed the full amount of liquidated damages from the sellers for delays in handing over the property. The Court of Cassation, however, considered that the Court of Appeal had not given due consideration to, or adequate reasoning regarding, the sellers' defence that they had handed over most of the units, and thus partially performed their obligations, yet were still exposed to liquidated damages amounting to EGP 1 million for a contract worth EGP 2.8 million. The Court of Cassation commented that liquidated damages may be reduced by the courts where it is clear that the amount of damages contractually fixed by the parties is grossly exaggerated compared to the actual losses incurred by the creditor. While the Court of Cassation's judgment suggested that the liquidated damages were grossly exaggerated, it was left for the trial court to make that determination.

Like their Egyptian counterparts, Bahraini courts are empowered to modify the amount of liquidated damages. Article 226 of the Bahraini Civil Code is substantially similar to its Egyptian equivalent and provides as follows:

Damages fixed by agreement are not due, if the debtor establishes that the creditor has not suffered any loss.

⁴⁰ *Ibid.*

⁴¹ *Ibid.*, p. 112.

⁴² According to Sanhouiri, whether liquidated damages are grossly exaggerated can be determined by the courts when a claim is made ('A penal clause [liquidated damages clause] only addresses the valuation of due damages. It is not a cause of damages, but is merely an assessment by the parties of damages in advance of the breach and in accordance with the surrounding considerations and circumstances at the time of their agreement. If it was revealed thereafter that the extent of harm that has occurred was not commensurate with what the parties had assessed in advance of its occurrence, and that their assessment was exaggerated to a far extent, then this is either a mistake in assessment on the part of the contracting parties or a result of pressure on the debtor to accept an unfair clause. In either case, the amount of liquidated damages must be reduced to the extent that is proportionate with the harm.'). A. Al-Sanhouiri, *الجاء الثالث - نظرية الالتزام بوجه عام*, [Al-Wasit Commentary on the Civil Code, Vol. III - The General Theory of Obligations] (Dar Al-Shorouk 2010), pp. 816-17.

⁴³ Egyptian Court of Cassation, Case No. 2444, JY70, 12 June 2001.

The court may reduce the amount of these damages, if the debtor establishes that the amount fixed was grossly exaggerated or that the principal obligation has been partially performed.

An agreement contrary to the provisions of the two preceding paragraphs is void.⁴⁴

Accordingly, a contractor party to a contract governed by Bahraini law may avail itself of both the actual loss and the gross exaggeration limbs. As with the Egyptian Civil Code, the Bahraini Civil Code places the burden of proving either limb squarely on the contractor.⁴⁵

Although there is little case law or commentary that sheds light on the application of either of the above limbs, one case at least is worth summarizing. The employer sought to collect a delay penalty from the contractor at the contractually-agreed rate of BHD 30 per day for its failure to hand over the building by the agreed completion date.⁴⁶ The court of first instance found in the employer's favour and ordered the contractor to pay BHD 1,050 as a delay penalty. Upon appeal by the contractor, the appellate court reduced the delay penalty to BHD 350 because (i) the schedule of payments was unfair to the contractor, and (ii) the delay penalty fixed in the contract was exaggerated considering that the contractor had completed 80% of the works.

The employer challenged the appellate court's judgment before the Court of Cassation. The employer argued that: (a) the appellate court erred when it reduced the delay penalty since the contractor – who is experienced in the construction industry – had agreed to the payment schedule under the contract; (b) there was no evidence on the record that the delay penalty was exaggerated; and (c) the final amount of the delay penalty, as reduced by the appellate court, was not commensurate with the harm the employer had suffered on account of the contractor's failure to hand over the building by the agreed date. The Court of Cassation rejected the employer's challenge, citing Article 226(2) of the Bahraini Civil Code, which permits the reduction of liquidated damages in two instances: (i) if the debtor had performed the original obligation in part, and/or (ii) if the debtor proves that the assessment of liquidated damages was greatly exaggerated. The Court of Cassation held that the lower court's exercise of its discretion to reduce the liquidated damages was valid considering that the contractor had performed 80% of the works and had been paid only 30% of the contract price.

⁴⁴ Kingdom of Bahrain Ministry of Justice and Islamic Affairs, <http://www.moj.gov.bh/en/default0605.html?action=article&ID=1467> (accessed 26 September 2017).

⁴⁵ See e.g. M. Grose, *Construction Law in the United Arab Emirates and the Gulf* (Wiley-Blackwell 2016), p. 140.

⁴⁶ Bahraini Court of Cassation, Petition No. 197/2006, 6 November 2006.

3.2 DISREGARD OF LIQUIDATED DAMAGES CLAUSES: UNITED ARAB EMIRATES

In contrast to their Egyptian and Bahraini counterparts, UAE courts may disregard a liquidated damages clause in its entirety.⁴⁷ This approach is influenced by Islamic jurisprudence, which provides that compensation must be equal to harm.⁴⁸

Article 390(1) of the UAE Civil Code allows parties to agree on a fixed amount of damages in advance for a breach of contract.

The contracting parties may fix 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.⁴⁹

Article 390(2) entitles the courts, at the request of either party, to reassess the amount fixed in the parties' agreement to reflect the actual loss suffered.

The judge may, in all cases, upon the application of either of the parties, vary such agreement so as to make the compensation equal to the harm, and any agreement to the contrary shall be void.⁵⁰

The UAE courts therefore have the authority to determine the amount of compensation payable to the project owner for the contractor's delay, irrespective of the amount of compensation specified in the liquidated damages clause. They may declare the liquidated damages clause void in its entirety and assess the amount of compensation due to the contractor as if the amount fixed in the liquidated damages provision did not exist.⁵¹ Importantly, parties cannot contract out of the courts' authority to make such determinations. In practice, however, the courts rarely exercise their Article 390 powers.⁵²

A number of principles can be drawn from literature and case law:

- Article 390(2) can be relied upon by the contractor in asking for a decrease or by the project owner in asking for an increase. In either scenario, the party seeking the adjustment bears the burden of showing that the actual loss suffered is out of proportion to the liquidated damages prescribed in the contract.⁵³

⁴⁷ See Al-Ahwany, *supra* note 2; Jones, *supra* note 16, p. 13.

⁴⁸ See J. Whelan, *UAE Civil Code and Ministry of Justice Commentary – 2010* (Sweet & Maxwell 2010).

⁴⁹ UAE Civil Code, Article 390(1), trans. J. Whelan, https://lexemiratidotnet.files.wordpress.com/2011/07/uae-civil-code-_english-translation_.pdf (accessed 26 September 2017).

⁵⁰ *Ibid.*

⁵¹ See Al-Ahwany, *supra* note 2, p. 106.

⁵² See R. Rawal, 'Damage Control: Reconciling Deducted Delay Damages and Actual Damages' (2012) 7(3) *Construction Law International* 42.

⁵³ *Ibid.*

- Any amount of damages to be awarded must be equal to actual harm. If the court determines that the project owner is entitled to compensation, the court must award damages in an amount equal to the harm suffered.⁵⁴
- Courts may reduce the amount of liquidated damages that has been contractually fixed by the parties where it is clear that the actual loss incurred by the employer is less than the total amount of liquidated damages agreed.⁵⁵ Equally, courts may increase the amount of liquidated damages upon application by the employer.⁵⁶
- The courts will exercise their full authority when assessing the level of damages and must follow the general rules for valuation of damages in the context of contractual liability, which are limited to foreseeable harm.⁵⁷ This means that the amount of liquidated damages the courts will grant the employer will not cover any additional or consequential loss suffered by the employer between the occurrence of the loss and the issuance of the judgment.⁵⁸
- In practice, courts are reluctant to vary the parties' agreement and appear to exercise their Article 390 powers only in rare circumstances.⁵⁹

The UAE courts have considered Article 390 of the UAE Civil Code in a number of cases.

In one such case,⁶⁰ the subcontractor claimed that liquidated damages for delay were not due because the main contractor did not suffer harm as a result of the subcontractor's failure to perform the subcontract. The Union Supreme Court overturned the lower court's award of liquidated damages to the main contractor, noting that proof of breach is not sufficient to award these damages under Article 390 of the UAE Civil Transactions Law. The court added that an award of liquidated damages may be rejected if the debtor shows that the creditor suffered no harm on account of the breach. Finding that the subcontractor's non-performance was not the cause of the penalties paid by the main contractor to the employer under the main contract, the court held that the main contractor did not suffer the type of harm that would warrant an award of liquidated damages.

⁵⁴ See Al-Ahwany, *supra* note 2, p. 106.

⁵⁵ Dubai Court of Cassation, Judgment No. 138/94, 8 April 1995.

⁵⁶ See e.g. Whelan, *supra* note 48 ('If the damages are due and the same is equal to the loss sustained, then the liquidated damages agreement in question shall be upheld. However, if the due damages are not equal to the loss sustained, the judge shall have the right, upon the request of one of the parties, to increase or decrease the amount of these damages in order to reflect the loss. This is in line with the Shari'ah principles under which compensation shall be equal to actual loss suffered.').

⁵⁷ See Al-Ahwany, *supra* note 2, p. 112.

⁵⁸ *Ibid.*, p. 114.

⁵⁹ See Rawal, *supra* note 52.

⁶⁰ UAE Union Supreme Court, Petition No. 414/JY21 (Civil), 27 March 2001.

In another case,⁶¹ the owner of a billiard hall sought AED 320,000 in liquidated damages from the supplier who had promised to provide twenty snooker tables by a certain date. The contract provided for liquidated damages at the rate of AED 500 per table for every day of delay. Although the supplier was thirty-two days late in delivering the tables, according to the court-appointed expert, the claimant had acknowledged that the monthly revenue generated by the billiard hall ranged between AED 50,000 and AED 52,000. The court of first instance relied on the report to award the claimant only AED 79,680 in damages. The Dubai Court of Appeal then reduced that amount to AED 50,000 at the respondent's request, on the basis that this would render the liquidated damages awarded equal to the actual harm suffered. The Dubai Court of Cassation upheld the reduction of liquidated damages and stated that the judge may, at the request of either party, amend the amount of damages fixed by agreement such that it reflects the harm suffered by the non-breaching party.

4 CONCLUSION

While liquidated damages are enforceable in Egypt, Bahrain and the UAE, the contractually-agreed amount is not etched in stone and parties may invoke the relevant provisions of those countries' civil codes. In each of these countries, and others in the region, the burden of proof in challenging the contractual amount rests squarely on the party seeking the adjustment. Looking beyond the courts, it is the author's experience that international arbitral tribunals may be less likely to adjust contractually-agreed amounts and will consider a range of additional factors, including sanctity of contract, industry practice, party sophistication and possibly the difficulty of establishing loss in construction projects.

⁶¹ Dubai Court of Cassation, Petition No. 494/2003 (Rights), 24 April 2004.