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## **Baker & McKenzie Habib Al Mulla**



### The Legal 500



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## **Damages and contracts in the UAE**

In light of the recent economic developments in the gulf region and more specifically in the UAE, many disputes have stemmed out of contracts. To be in a position to claim damages under contracts (amongst other remedies offered by the UAE legal system) the claimant or the defendant should be more familiar with the contractual liability concept, the types of damages recognised under UAE law, the elements of contractual damages under UAE law and, in particular, the conditions required for contractual damages under UAE law.

## **Contractual Liability under UAE Law**

Article 124 of the UAE Civil Transactions Law No 5 of 1985 (the Civil Code) states that:

‘Personal obligations or rights shall arise out of dispositions, legal events and the law, and the sources of obligations shall be as follows:

1. contracts;
2. unilateral acts;
3. acts causing harm;
4. acts conferring a benefit; and
5. the law.’

The first of these sources refers to contracts and is the subject of this article.

In the presence of a contract, any liability arising from breaches to the contract falls within the scope of applicability of the contractual liability.

The Dubai Court of Cassation explains that:

‘There is contractual liability in the presence of three factors; a fault which occurs when one of the contracting parties does not carry out the obligations stipulated in the contract or if there is delay in performing the same; a proven damage; and the presence of causation between the fault and the damages.’<sup>1</sup>

Accordingly, there should be a fault or breach committed by a contracting party, and the other contracting party should have sustained and suffered proven damages as a direct result of such fault or breach.

In addition, the Dubai Court of Cassation states that:

‘When one of these elements elapses the liability elapses as well.’

And:

‘The creditor should establish the debtor’s fault in not performing his contractual obligations and the damages.’

This latter decision is in line with the provisions of article 113 of the Civil Code that sets out:

‘It is the responsibility of the claimant to prove his claim and that of the respondent to refute it.’

To put it simply, a claimant should establish the respondent’s breaches to the contract, and the damages they sustained and suffered as a result of such breaches. A tripod should therefore be erected: a breach, damages and causation.<sup>2</sup>

## **Type of Damages under UAE law**

UAE law recognises the concepts of direct damages, loss of profits, loss of opportunity, consequential

damages, interests and moral damages. It also accepts limitation of liability clauses and penalty clauses.

First, the explanatory note of the Civil Code provides that compensation should be for the direct damages expected by the parties at the time they entered into the contract.<sup>3</sup> Therefore, where compensation is not pre-agreed contractually then it shall be assessed by the court for it to be commensurate with the actual damage sustained.

Accordingly, the quantum of damages, if any, shall be fixed by the courts. This is in line with article 389 of the Civil Code, which provides the following:

'If the amount of compensation is not fixed by law or by the contract, the judge shall assess it in an amount equivalent to the damage in fact suffered at the time of the occurrence thereof.'

Secondly, UAE law recognises consequential damages as well. However, it confines this concept to the tortious liability and excludes it from the scope of application of the contractual liability.

Thirdly, the Dubai Court of Cassation recognises the loss of profits in the course of a contractual liability. Lost profits are normally provided for by article 292 of the Civil Code (even though this article concerns tortious liability) and by the explanatory note of article 389 of the Civil Code. However, for the court to award lost profits, the occurrence of the damage should be certain in the future. Courts will not award compensation for the hypothetical or probable damages.<sup>4</sup> Speculative damages are not accepted. The debtor should show that it is certain that they would have got benefits if the contract had been performed. In addition, the Dubai Court of Cassation recognises the compensation of loss of opportunity (forming a part of or assimilated to the loss of profit) as a result of the termination of a contract, holding that:

'If the opportunity is hypothetical, however, the loss of such opportunity is an occurrence that should be compensated.'

Fourthly, as for moral damages, article 293(1) of the Civil Code provides for the following:

'The right to have damage made good shall include moral damage, and an infringement of the liberty, dignity, honour, reputation, social standing or financial condition of another shall be regarded as being moral damage.'

Although this article relates to tortious liability, case precedents recognise the compensation for moral damages in the course of contractual liability as well.

Fifthly, the Dubai Court of Cassation has repeatedly confirmed the principle of the limitation of liability, save for gross negligence, intentional harm or fraud.<sup>5</sup>

Finally, article 390 of the Civil Code erects the principle of penalty clause under UAE law. However, as stated in this article, the judge can interfere to commensurate the compensation to the actual damages sustained, but this interference of the judge should be triggered 'on the application of either of the parties'. Thus, the parties have the discretion to make application of article 390(2) or not and the judge cannot intervene *ex officio*. The UAE case precedent upholds that the judge should adhere to article 390 of the Civil Code and should apply it if the assessment of the compensation agreed on by the parties is consistent with the damage sustained by the creditor, unless the debtor proves that the compensation agreed on is excessive or that the creditor did not sustain any damage.<sup>6</sup>

The foregoing brings into the issue of whether or not parties to a contract may agree to other sorts of

damages apart from those provided for pursuant to the UAE law. Sometimes specific provisions contained within the contract may not be enforceable under UAE law if they derive from concepts that are not recognised under such legislation.

By way of example, the concept of punitive damages and exemplary damages is not enforceable as it is not recognised by UAE law. Notions of international law cannot be used where UAE law is silent or incomplete and *lacunae* are not to be remedied by international law. In fact, the UAE legal system provides a complete code and, accordingly, parties should not borrow concepts from an alien legal system.

Article 1 of the Civil Code provides the following:

'The legislative provisions shall apply to all matters dealt with by those provisions in the letter and in spirit. There shall be no innovative reasoning (*ijtihad*) in the case of provisions of definitive import. If the judge finds no provision in this law, he has to pass judgment according to the Islamic *Sharia*. Provided that he must have regard to the choice of the most appropriate solution from the schools of Imam Malik and Imam Ahmad bin Hanbal, and if none is found there, then from the schools of Imam Al-Sahfi'i and Imam Abu Hanifa as most befits. If the judge does not find the solution there, then he must render judgment in accordance with custom, but provided that the custom is not in conflict with public order or morals, and if a custom is particular to a given emirate, then the judgment will apply to that emirate.'

It is thus not permissible to invoke the provisions of international law to fill the gaps in the UAE applicable law. Instead, a court called on by a contract to apply UAE law should apply - in the descending order of priority shown below - the sources of law set out in article 1 of the Civil Code. These are:

1. the Civil Code;
2. Islamic *Sharia* as per the schools of Imam Malik and/or Imam Ahmad Bin Hanbal;
3. Islamic *Sharia* as per the schools of Imam Al-Shafi'i and/or Imam Abu Hanifa;
4. local custom not conflicting with public order or morals; or
5. general custom not conflicting with public order or morals.

This conservative position has been confirmed by the Dubai Court of Cassation on several occasions.<sup>7</sup>

### **Elements of Contractual**

First, under UAE law and more generally under a civil law system, a claim for contractual damages is one for compensation in money for the fact that the claimant has not received performance for which they contracted. Once the claimant is compensated the damages disappear. Compensation cannot be given twice for the same damages.

Secondly, damages are based on the loss to the claimant and not on gain to the defendant.

Thirdly, the quantum of the compensation is determined in relation to the extent of the seriousness of the damages sustained and not to the seriousness of the breach *per se*.

### **Conditions of the Contractual Damages under UAE law**

## Damages under UAE law

The victim of a breach of contract can only claim contractual damages as detailed at length (see p65, 'Types of damages under UAE law'). To reiterate, incidental and consequential damages are not accepted in contractual liability.

More specifically, the victim of a breach of contract can only claim contractual damages that they incurred directly from the breach of contract. In addition, the contractual damages should have been foreseen by the contracting parties.

First, the victim of a breach of contract can only claim contractual damages that they incurred directly from the breach of contract. For example, a tenant is compelled to vacate the premises because the landlord failed to maintain or repair the premises. The tenant moved to another flat of equal standards but paid a higher price in rent. While moving to the new premises, some of the furniture was damaged and some microbes in the new flat contaminated the tenant. So, the difference between the rents, therefore, is the direct and foreseeable damage. The damages to the furniture are direct but unforeseen and the disease or contagion are indirect damages.

Secondly, the parties at the time of contracting should have foreseen the damages. This condition results from the *pacta sunt servanda* principle. The parties have contracted on what was foreseeable to them and the debtor can only be obliged for what they would have expected, predicted or foreseen (the word *tawaka* in Arabic can be translated to these three verbs) as damages. Additionally, damages should be foreseen in cause and value.

For example, where a post company agreed to deliver a courier and the envelope is lost while couriered, and then it was revealed that the envelope contained gold, a thing that the post company did not foresee at the date of contracting, the post company will be liable for reasonable damages, as the post company has not foreseen the envelope's value. The foreseeability of the cause meant that, at the time of contracting, the debtor could have not supposed that non-performance would have resulted in such damage. The foreseeability of the amount meant that, at the time of contracting, the debtor could suppose that non-performance would have resulted in such damages, but could have not supposed that the damage is of such importance.

Finally, the foreseeability should have occurred at the date of contracting and is assessed in *abstracto* and objectively (a comparison is made to the notion of 'ordinary person'). The damages expected should be the ones that an ordinary person would have predicted if they were to find themselves in the same contractual circumstances, taking into account the possibility of claiming for other categories of contractual damages, such as loss of profits, loss of opportunity and moral damages as detailed on p65, 'Types of damages under UAE law'.

## Notes

1. *Dubai Court of Cassation, petition no 41/2007, 15/04/2007; Dubai Court of Cassation, petition no 37/2004, 18/09/2004.*
2. *This article does not elaborate on the notion of breach under UAE law. However, UAE law does recognise the error and negligence concepts, and differentiates between gross and simple errors. The causal link or causation is one of the elements of the contractual liability. When causation does not exist, no contractual liability exists either and, subsequently, no compensation is awarded. The Dubai Court of Cassation indicated in two rulings that 'causation is presumed to exist unless the debtor proves that damages resulted*

*from force majeure, the creditor's acts or the acts of a third party'. (Dubai Court of Cassation, petition no 41/2007, 15/04/2007; Dubai Court of Cassation, petition no 37/2004, 18/03/2004.)*

3. *The explanatory note is an official commentary of the Civil Code issued by the UAE Ministry of Justice and purported to explain the provisions of the Civil Code. In addition, the Dubai Court of Cassation refers to it in several rulings. In fact, the Court cites the relevant explanation of a legal provision in the main paragraph of the ruling and explicitly refers to the explanatory note (Dubai Court of Cassation, petition no 130/2006, 10/09/2006; Dubai Court of Cassation, petition no 562/2003, 20/03/2004).*
4. *Dubai Court of Cassation petition no 51/2007, 29/04/200; Dubai Court of Cassation, petition no 46/2006, 08/05/2006.*
5. *Dubai Court of Cassation petition no 134 2006, 10/09/2006; Dubai Court of Cassation petition no 195 2003; 22/06/2003; Dubai Court of Cassation no 15 for the year 2002, 09/03/2002.*
6. *For the UAE case precedent see the Federal Supreme Court of Abu Dhabi, petition no 356 for the 23rd year, 19/10/2004; Dubai Court of Cassation, petition no 63 2005, 26/06/2005.*
7. *Dubai Court of Cassation, petition no 1/2005, 25/04/2005; Dubai Court of Cassation, petition no 28/2004, 17/10/2004.*