Damages for delays: Global rules do not always apply

As the familiar language of international contracts unites parties across the globe, Antonios Dimitracopoulos, Partner and Head of Construction Law Department of Bin Shabib & Associates (BSA) LLP, re-examines its force and effect locally

Very often I feel that clients may be lulled into a sense of false security when they tell me that they have budgeted for any delay damages that may be imposed upon them: the contract specifies the daily amount and in any event there is a cap on it of usually no more than 10% of the contract value. They would try to avoid any delays of course or at least avoid responsibility for them, but at the end of the day as long as they have factored that 10% into their figures, the worse case scenario, they feel, has been forecasted and budgeted for.

Generally speaking this perception would probably be right: contracts do almost always include a liquidated damages clause, and the parties agree that a predetermined daily amount would be subtracted from the contractor's monthly invoices if, in the opinion of the employer, the contractor has been late, subject always to a maximum total cap of a percentage of the contract (usually 10% but I have seen 5% or less in very large contracts). There are some variations of this arrangement relating mainly to the desire some employers have to pocket that daily amount whether they have actually been affected by the delay or not.

I have seen attempts seeking to set out the parties' true intentions by using words along the lines of "…without the employer having to prove actual loss" or "…regardless of whether the employer has incurred any loss".

In short, parties sign off the deal and in the mind of the contractor the good news would hopefully be that he will never have to pay a penny more than 10% of the contract value no matter how late the project is. In the mind of the employer, the good news seems to be that if there is any delay, which he can arguably allege is the fault of the contractor, he can enjoy an automatic discount on the original contract price.

But UAE law, like most codified legal systems, always has some nicely tucked away article that could surprise the unwary contractor or employer given the right set of circumstances.

For a start, in local law the concept is generally upheld that damages actually incurred by an employer cannot be lower in quantum than the liquidated damages deducted. Allowing the employer to deduct a predetermined amount in the event of delay regardless of whether such delay has actually affected him to the extent of the amount deducted would arguably be tantamount to undue enrichment and as such would be subject to scrutiny by the contractor's lawyers who would be asked to put the employer to strict proof of not only who the culprit for the delay was, but also of whether that delay actually made a financial and measurable difference to the employer.

In practice, the employer has the initial privilege of simply activating the liquidated damages clause and reducing the amount he considers payable under the contractor's invoices by the agreed daily amount. This places the contractor in a defensive position as he would have to go through the whole process of filing his claim with the consultant and if — the amount justifies it — referring the issue to arbitration. In that scenario, the employer may find that, although he has stated that deduction would take place regardless of any loss incurred, he would be subjected to prove that not only was the delay attributable to the contractor but that, even if it were, this delay has caused him quantifiable actual and, if not expressly excluded, consequential loss. In most cases this would be a difficult hurdle to overcome for the employer, as any evidence adduced, pointing to loss of income for example, would in all likelihood be circumstantial. This could mean that the financial pressure initially applied to the contractor by the employer's application of liquidated damages, might in the end prove to be a pyrrhic victory. Any amounts withheld and not applied to provable loss may have to be returned to the contractor.

For the employer, the message to be borne in mind is that a liquidated damages clause is not an irrevocable right for deductions to be made.

He would ultimately need to prove that he has actually incurred a loss along the lines the parties had initially contemplated would actually be incurred, in the event of a contractor-attributable delay.

However, all is not rosy for the contractor either. The maximum exposure that he had initially factored in could, under UAE Law be exceeded if the delay is substantial and if it resulted in losses being incurred by the employer that are not only quantifiable but also well in excess of what were originally envisaged as likely.

I have come across prudent contractors that often question in advance the validity of their anticipated contractual arrangements. Particularly those that are more worldly-wise and have experienced different treatment of a liquidated damages clause across the globe, often ask whether they can rest assured that when the contract says 10% maximum for delay damages, this is always going to be the case.

The fact is that UAE Law does allow Courts to exercise their discretion on the facts of the claim put before them: if they deem it right, they can break the limit of delay damages. In doing so, they may apply a higher one that may be closer to any significant damages proved to have been sustained by the employer.

The greater the disparity, between the employer's damages and the contractual cap agreed, the more probable it would be that Courts may, if requested to do so by the employer, apply the discretion afforded to them by law.

Whilst this judicial discretion is rarely applied in practice, the legal provision opening the door for the Courts to do so is there. Like any other mandatory law provisions, it will act like a mine, waiting to be stepped upon by those oblivious to the fact that all construction contracts, no matter how "standard", are subject to the overriding laws of each jurisdiction.

At least with regard to liquidated damages, which can mean different things in various countries, it may be wise for both the employer and the contractor to be clear on their intentions. They could set out in the contract a list of the specific and foreseeable instances that may lead to a tangible loss for the employer and which the liquidated damages clause is in each case meant to address.

On the bright side, the landscape of the local construction industry is in the process of being shaped by parties molding their intentions into better thought out contracts. It is encouraging to see clients becoming increasingly aware of the risks in treating international contracts, like the FIDIC-based variety so popular in the UAE, as a universal and infallible language transcending cultures, laws and practices.