



DECODING COMPLEXITY.

LIQUIDATED DAMAGES: STICK OR TWIST?

Article 267 of the Oman Civil Code opens the door for parties to challenge pre-agreed rates for liquidated damages and pursue recovery of actual damages, but they should be aware of the practical implications and risks involved.

Iain Clark, Managing Consultant, Middle East, HKA

BASIS OF LIQUIDATED DAMAGES

As most readers will no doubt be aware, construction contracts will generally include a provision for liquidated damages to be paid by the Contractor to the Employer, in the event that the Contractor fails to complete the works by the completion date stated in the contract.

The parties pre-agree a value (often a daily rate) for liquidated damages, which will be applied to periods of delay beyond the completion date. The rationale behind pre-agreeing the value of damages is to provide both parties with a degree of commercial certainty with respect to delays and avoids the difficulty of proving loss.

The widely held view in common law jurisdictions, supported by case law, is that liquidated damages must represent a genuine pre-estimate of the loss made at the time of signing the contract, which will be incurred by the Employer in the event that the obligation attracting the liquidated damages is not achieved. If a breach of this obligation occurs then the amount payable will be calculated based on the liquidated damages provision, and the Employer is not required to prove any or actual loss. If a liquidated damages provision is found to be a penalty clause, this will render the provision void.

This is contrary to the position in the civil law jurisdiction of Oman, and indeed the wider Middle East region, insofar as the inclusion of a penalty clause in relation to liquidated damages is contractually acceptable; the provision need not be based on a genuine pre-estimate of loss.

As a result, the liquidated damages value included within the contract is often randomly generated and devoid of any supporting calculations, irrespective of whether this remotely reflects the actual damages likely to be incurred by the Employer if the works are delayed.

An adjustment to the pre-agreed rate will not necessarily benefit the party who requested the adjustment be made.

For this reason, it is perhaps unsurprising to find that parties to construction contracts in Oman, appear to be growing increasingly dissatisfied with the value of liquidated damages stipulated in their construction contracts, due to a belief they are not representative of the actual damages suffered by the Employer.

Interestingly, this issue is regularly raised by Contractors and Employers alike, with Contractors

often contending that the rate of liquidated damages is too high, whilst Employers contend that it is too low.

OMAN CIVIL CODE – ARTICLE 267

In such scenarios, Oman’s Civil Code, enacted by Sultani Decree 29/2013, appears to offer a potential solution. Article 267 states:

“(1) If the subject matter of obligation is not a sum of money, the contracting parties may determine the amount of compensation in advance by making a provision of same in the contract or in a subsequent agreement.

“(2) In all cases, the court may, upon the application of either of the parties, amend such agreement to make the compensation equal to the damage, and any such agreement to the contrary shall be null and void.”

Article 267(1) clarifies the rights of the parties to pre-agree and expressly state within the contract, damages which will be payable in the event of a subsequent breach of contract. This is a fundamentally different in approach from that under common law, where the courts do not have the ability to reassess the liquidated damages based on the damage incurred.

However, Article 267(2) establishes the Omani Courts (or arbitrators) ability to adjust the pre-agreed damages in proportion to the actual loss incurred as a result of the breach.

Parties are advised to base the rate for liquidated damages on a genuine pre-estimate of loss, which should reduce the likelihood of disputes between the parties, in relation to the aptness of the rate at a later date.

The rights afforded by Article 267 cannot be contracted out of, meaning that either party may apply for an adjustment to the rate of liquidated damages, irrespective of any pre-agreed rates stated in the contract, or any clause in the contract to the effect that the Contractor agrees and accepts that the stated rates for liquidated damages represent true loss, or are reasonable.

Whether or not the request to open up the liquidated damages is approved is at the discretion of the Omani

Courts or arbitrator once the matter is referred by either party.

It is possible that such a request will be rejected on grounds that the parties have voluntarily pre-agreed the rate of liquidated damages to be applied in the event of a breach of contract; or, the Omani Courts or arbitrator may just elect not to exercise its discretion in the matter.

PRACTICAL CONSIDERATIONS & RISKS

Article 267 of Oman’s Civil Code provides parties to a contract in Oman with an opportunity to request an adjustment to the rate for liquidated damages stated in the contract.

However, there are practical considerations and risks which should be afforded due consideration before proceeding further.

An adjustment to the pre-agreed rate will not necessarily benefit the party who requested the adjustment be made.

For example, the Employer may contend that the rate of liquidated damages stated in the contract is too low and apply for an adjustment pursuant to Article 267(2).

However, the Omani Courts or arbitrator may find the actual damages incurred by the Employer to be less than the rate for liquidated damages included in the contract, or possibly that there was no loss and extinguish the liquidated damages in their entirety.

Similarly, a Contractor who contends that the rate of liquidated damages in the contract is too high may find that the Omani Courts or arbitrator deem the actual damages to be higher than the pre-agreed rate in the contract.

The burden of proof of the actual value of damages, and how it varies from the liquidated damages rate stated in the contract, will rest with the party who is seeking the adjustment.

Therefore, the opportunity to request an adjustment to the rate for liquidated damages may prove to be beneficial to the party seeking the adjustment; however, due consideration should be given to the potential risks, and the ability of the claiming party to substantiate any adjustment.

Parties are advised to base the rate for liquidated damages on a genuine pre-estimate of loss, which should reduce the likelihood of disputes between the parties, in relation to the aptness of the rate at a later date.

ABOUT THE AUTHOR



Iain Clark is a Managing Consultant with HKA currently based in Muscat, Oman, with over nine years of experience in providing claim management, claim preparation, commercial and procurement management, project management and quantity surveying services. He has held commercial, procurement and claims management positions with clients, contractors and consultants in Canada, the UK, Oman and Qatar.

This exposure to various roles in a range of locations has enabled Iain to become experienced in the identification and preparation of claims on behalf of contractors, and the preparation of the resultant financial claims for prolongation and disruption, as well as the review and assessment of claims for extension of time and additional payment on behalf of employers.