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**Liquidated Damages under the New UAE Civil Code: Between Contractual Freedom and Judicial Fairness**

By Chatura Randeniya, Nazim Hashim and Elmukashfi Mohamed | 16 June 2026

Liquidated damages have long constituted a fundamental mechanism for allocating contractual risk, particularly in construction and commercial agreements, by allowing parties to predetermine compensation payable in the event of breach. While the concept was recognised under the previous Civil Transactions Act of 1985 (the “**Old Code**”) the New Civil Transactions Act of 2025 (the “**New Code**”) introduces a more structured framework governing judicial intervention in agreed compensation clauses. Unlike the former provision - Article 390- which granted courts unfettered discretionary authority to amend agreed compensation to reflect the actual loss suffered, Article 340 of the New Code adopts a more detailed structure that expressly regulates when and how judicial intervention may occur.

The revised framework seeks to balance contractual freedom with the need to prevent disproportionate or unjust compensation. As consequence, the enforceability of liquidated damages clauses may increasingly depend on considerations of proportionality and fairness, rather than the singular issue of whether the liquidated damages agreed upon reflect the actual loss suffered.

These developments are likely to have significant practical implications for contractors, employers, commercial parties, and legal practitioners, particularly in relation to contractual drafting, evidentiary preparation, dispute management, and litigation strategy.

What Has Changed?

Article 390 of the Old Code permitted contracting parties to agree in advance on the amount of compensation payable upon breach of contract. However, the same provision granted the courts (and arbitrators, where applicable) broad discretionary power to amend the agreed compensation if it did not correspond to the actual loss suffered. Any contractual attempt to exclude the court’s power was considered void. Importantly, the Old Code contained no guidance as to how the court may exercise its power.

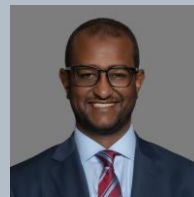
While the New Code continues to recognise the validity of liquidated damages clauses, it introduces a more structured framework for judicial intervention by setting out guidelines for the exercise of the court’s power to adjust the quantum of damages in both upwards and downwards directions, depending on the circumstances of the case.

Pursuant to Articles 340 (2) and 340 (3), a debtor is entitled to seek a reduction of the agreed compensation in the following circumstances:

The Authors

Chatura Randeniya
Partner
crandeniya@afриди-angell.com

Chatura heads the dispute resolution practice at Afridi & Angell. He advises and represents clients in arbitration, DIFC Court litigation, and on-shore litigation. Chatura regularly advises clients in high value civil and commercial disputes, many of which have a cross-border element. He is admitted as Attorney-at-Law of the Supreme Court of Sri Lanka. He is a ranked practitioner by Chambers and Partners and Legal 500. Chatura is a Fellow of the Chartered Institute of Arbitrators (CIArb).



Nazim Hashim
Partner
nhashim@afриди-angell.com

Nazim specialises in UAE litigation and dispute resolution and handles a broad range of civil, commercial, and criminal disputes and is in charge of developing litigation strategies and supervising advocacy in matters before the UAE courts. He advises on employment, property, banking, construction, commercial and corporate disputes. He has been involved in several complex and high-value disputes. Nazim is a member of the Sudanese Bar Association.

- where the agreed liquidated damages are exaggerated or disproportionate to the actual harm suffered;
- where the original obligation has been partially performed; and
- where the creditor, through its own fault, contributed to the damage or aggravated its consequences.

On the other hand, Article 340 (4) grants the creditor the right to seek an increase in the agreed compensation in the following circumstances:

- where the creditor proves that the debtor committed fraud; and
- where the creditor proves that the debtor committed gross fault.

Importantly, Article 340(4) permits the court to determine that no compensation is payable at all where the creditor's own fault has completely absorbed the debtor's fault. This reflects a more nuanced approach to the allocation of contractual responsibility and the assessment of damages.

Under the New Code, the issue of actual loss suffered may come into play where a debtor seeks to argue that the agreed liquidated damages are exaggerated or disproportionate and therefore should be reduced. However, it appears that a creditor may no longer seek an increase in the amount payable as liquidated damages on the grounds that the creditor in fact suffered greater actual loss.

Cassation Courts and the Future Interpretation of Article 340:

The practical application of Article 340 is likely to give rise to several important questions that remain open for interpretation. One of the principal questions is whether the situations expressly mentioned by the legislature regarding the debtor's right to seek reduction of liquidated damages, and the creditors seek an increase in agreed compensation, are exhaustive and restrictive in nature, or whether the courts may extend such intervention by way of analogy or broader equitable considerations.

Equally significant is the question of how the courts will define and distinguish "gross fault" from ordinary fault, particularly given that the new provision expressly permits increasing liquidated damages only in cases involving fraud or gross fault. This also raises the question of how the courts may approach situations where the debtor's conduct constitutes fault, negligence, or breach, but does not reach the threshold of gross fault? Whether ordinary fault alone may justify any form of judicial intervention beyond the agreed compensation remains unclear under the statutory text.

Another key issue is likely to be whether the courts will permit damages in excess of the actual loss suffered by a creditor, if it is able to prove fraud or gross fault by a debtor. It appears unlikely, given that Article 339 (which addresses the position where the parties have not agreed liquidated damages) retains the concept of the judge awarding damages to reflect the actual loss suffered, and as the concept of punitive damages is contrary to Sharia law.



Elmukashfi Mohamed

Associate

emohamed@afриди-angell.com

Elmukashfi has vast experience in commercial litigation and is skilled at resolving disputes amicably and drafting relevant agreements. Prior to joining Afridi & Angell in 2025, Elmukashfi worked at a local firm in Dubai, where he gained experience in drafting, reviewing, and negotiating various commercial agreements.

Practical Takeaways: Dos and Don'ts

Dos

- Do clearly define the triggering events for liquidated damages, including delay, non-performance, or partial breach.
- Do ensure proportionality between the agreed compensation and the anticipated commercial loss, especially if you are the party likely to be claiming liquidated damages, as disproportionality is a ground for downward revision, and not upward revision.
- Do draft precise and unambiguous clauses to avoid disputes concerning interpretation.

Don'ts

- Do not treat liquidated damages as punitive penalties, as the Civil Code recognises compensation rather than punishment.
- Do not ignore evidentiary requirements, especially when seeking upward revision of agreed compensation. ■

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