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## LIQUIDATED DAMAGES UNDER

'CIVIL TRANSACTIONS LAW OR CIVIL CODE – 1444 H.'

Generally speaking, liquidated damages are a sum of money specified in some contracts that are to be paid by one party to another as a compensation for intangible losses suffered by the latter due to breach of contract by the former.

Since many a times damages are difficult to be estimated or computed, parties agree either for a specific amount or a percentage of the contract value to be payable by the defaulting party.

Although liquidated damages are accepted in most of the jurisdictions, the extent to which such damages are allowed depend on provisions in the relevant regulations, the case law, or the discretion of courts. However, it is almost a settled practice that courts differentiate between liquidated damages and penalties. Usually, the courts do not entertain claims for compensation that are either stated as penalties in a contract or they are obvious as penalties for the reason that while liquidated damages are intended to compensate the non-breaching party for actual damages suffered, penalties are meant to punish the breaching party.

In Saudi Arabia too, the stand towards liquidated damages has always been clear and it revolves around the well-enshrined principle of Sharia “There be no

harm; nor cause any harm” and the Civil Transactions Law (Law) reflects the same principle while covering the issues related to compensation and damages. It stipulates explicitly “every wrongful act that causes harm to others shall render the offender liable for damages and the wrongful act resulting in damage will be considered as such and the person committing the act shall be held liable unless there is an evidence to the contrary.”<sup>1</sup>

Before delving into liquidated damages, let us see provisions related to breach of contract and damages in general.



## Breach of Contract

The Law enables a non-defaulting party to demand performance from a defaulting party or terminate the contract besides claiming compensation for damages sustained in both cases. However, the court may decline request for termination of a contract if the breach by a defaulting party is of little importance compared to the underlying obligation.<sup>2</sup>

At the same time, the Law allows parties to agree beforehand that the obligee shall have the right to terminate the contract in case of a breach by the obligor without any need for a court ruling. It goes further in allowing the parties to remove the requirement of notice for terminating the contract by having an explicit agreement covering this issue.<sup>3</sup>



## Effects of Termination



The provision of compensation for damages is based on the principle that in case of termination of a contract, the parties be restored to the position that existed before the conclusion of the contract and if such restitution is impossible, the non-defaulting party shall be entitled to compensation. This principle has well been accommodated in the Law.<sup>4</sup>

The Law also enables a non-defaulting party to delay its own performance in case of delay by the other party.<sup>5</sup>

For instance, if an employer of a construction contract fails to make payments to the contractor, the latter may suspend works or decline to fulfill its obligations, without being liable for delay in completion of works.

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<sup>1</sup>Articles 120 and 121

<sup>2</sup>Article 107

<sup>3</sup>Article 108

<sup>4</sup>Article 111

<sup>5</sup>Article 114



## Degree of Compensation



While dealing with compensation or damages, the crux lies in the degree or the extent to which the courts could ascertain and award damages. The Law provides for compensation to remove the damage in full by restoring the aggrieved party to its possible pre-damage condition and the compensation for the damage caused should be proportional to the loss sustained or the profits lost. However, it adds a degree of responsibility on the aggrieved party in requiring it to make reasonable efforts expected of a prudent person in avoiding the damage.<sup>6</sup>

While there is no specific stipulation covering loss of anticipated profits or anticipated losses, the Law specifically provides for compensation for moral damages that includes mental agony or psychological stress caused to the aggrieved party in view of loss of honor, reputation, or social standing.<sup>7</sup>



## Compensation for Damages

The Law reiterates the principle of making good the damages sustained by any party and extends this principle to situations where the parties have not agreed in advance in such regard or do not have any contract as well as incidents and acts of omission that were not anticipated. Although, generally speaking, the Law requires compensation to be assessed in a monetary form, yet, the court may award a compensation in a fungible form that could restore the situation to the former status. And if the court is unable to make a final assessment of compensation, it may award an initial compensation without prejudice to the right of the aggrieved party to claim reconsideration of the assessed value within a period of time determined by the court.<sup>8</sup>

Notably, the Law stipulates that the claims for compensation arising out of a wrongful act shall not be heard after the lapse of (3) years following the date on which the aggrieved party became aware of both the occurrence of damage and the identity of the person liable for it, and in all cases, claims will not be entertained after lapse of (10) years from the date of occurrence of damage.<sup>9</sup>



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<sup>6</sup>Articles 136 and 137

<sup>7</sup>Article 138

<sup>8</sup>Articles 139, 141

<sup>9</sup>Articles 143



## Damages in Lieu of Performance

The Law covers the issue of obligor's inability to perform any specific obligation including the situation where the specific performance was delayed and became meaningless for the obligee. In these cases, the obligor will be required to compensate the obligee towards damages in lieu of performance. However, damages shall not be awarded in case the obligor proves that the non-performance was due to a cause beyond his reasonable control. Similarly, the obligor shall be obliged to compensate the obligee for damages caused due to delay in performance unless it is proved that the delay was due to a cause beyond the reasonable control of the obligor.

However, if a wrongful act of the obligee contributed to the damage sustained due to non-performance or delayed performance by the obligee, the right to compensation would be extinguished in proportion to the former's contribution to damage.

The Law allows parties to agree in relieving the obligor from damages arising from non-performance or delayed performance of contractual obligations unless the same is the result of a fraud or gross error on his part. However, these exceptions cannot be applied to relieve a person who had committed a wrongful act.<sup>10</sup>



## Liquidated Damages

This component in any contract is always crucial to ensure that the parties will perform their obligations in a timely manner and the party failing to perform its obligations will be liable to compensate the party sustaining damages. While enabling the parties to agree on issues related to liquidated damages in advance in the subject contract or a supplementary agreement, it does not require serving of any notices for the damages becoming due under the contract.<sup>11</sup> However, in the absence of any agreement related to liquidated damages, the damages will become due only after a notice is served upon the obligor.<sup>12</sup>

Notably, the Law stipulates that the liquidated damages will not become due if the obligor proves that the obligee did not sustain any damage. Besides, the courts will have the power to reduce the amount of the agreed liquidated

damages if the obligor establishes that the liquidated damages were overestimated. Conversely, the courts may increase the liquidated damages in proportion to the damage sustained if the aggrieved party proves that the damages have exceeded the agreed liquidated damages as a result of fraud or gross error on part of the obligor. The Law specifically disallows any agreement to supersede or circumvent the provisions related to liquidated damages. If there were to be no agreement in regard of liquidated damages, the courts will assess the same in accordance with the provisions related to compensation for damages, especially in line with the principle of restoring the aggrieved party to its possible or supposed pre-damage condition and damages to be proportionate to the loss sustained and the profits lost, as well as the component of moral damage.<sup>13</sup>

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<sup>10</sup>Articles 170, 1781, 172, 173

<sup>11</sup>Article 178

<sup>12</sup>Article 175

<sup>13</sup>Article 179



## Conclusion

The Law extensively covers issues related to breach of obligations and compensation towards damages sustained by the aggrieved party.

The importance of having a prior agreement on liquidated damages cannot be over-emphasized, as it provides to both parties a clear dimension and protection.

However, it is important to note that the provisions related to liquidated damages should neither be expressed as penalties nor provided in a manner that would seem like penalties when parties enter into a dispute.