

# CLIENT ALERT

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## Liquidated Damages vs. Penalties in Kuwait

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### Introduction

- Liquidated Damages are generally recognized as pre-agreed damages paid by a defaulting party to the non-defaulting party for breach of a contractual term, typically for the consequences of delay in performance of an obligation.
- Penalties are terms in a contract that are penal in nature, resulting in non-compliance, whereby the non-defaulting party imposes a payment on the defaulting party for breach of a particular contractual term, such as not meeting the deadline. It is not necessarily linked to any estimate of loss or damage to the non-defaulting party.

### Kuwaiti Practice

- In Kuwait, the approach to liquidated damages is that parties to a contract have the freedom to negotiate terms in advance for damages that will apply in the event of contractual default for certain events. Such liquidated damages are recognized under Decree No.67 of 1980 ("**Kuwait Civil Code**"). The terms 'penalty' and 'liquidated damages' are used interchangeably, and the courts will consider the substance of the term in the contract rather than the name.<sup>1</sup>
- Applying liquidated damages to a contract under Kuwaiti law would require the subject matter of the contract to be anything other than a financial transaction (e.g., loan agreements or similar financing arrangements).<sup>2</sup>
- There is a fundamental limitation to the non-defaulting party's right of claim, where the alleged defaulting party has the right to object by demonstrating that it has not caused the particular

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<sup>1</sup>This concept as it is agreed in several Kuwaiti judgments. Such as: Court of Cassation, Appeal No. 119/1993 (commercial circuit) in a hearing dated 14th December 1994.

<sup>2</sup>Article 302 of the Kuwait Civil Code provides: "*When the object of the contract is not a sum of money, the contracting parties may specify in advance the amount of damages either in the contract or in a subsequent agreement.*"

damages or loss to the non-defaulting party. Additionally, the courts can reduce the amount of claimed damages.<sup>3</sup> This is done in court proceedings by the assessment and report of the court-appointed expert. The court might increase the amount of damages claimed if the plaintiff proves that the defendant has committed fraud or gross negligence.<sup>4</sup>

## International Practice

- Having different governing laws in the contract might cause a different outcome with relation to the amount that the defaulting party may be obliged to pay. Indeed, where international contracting parties are engaged, they may often rely on UK law as a more 'neutral' and internationally recognized law than Kuwaiti law.
- The UK courts are more reluctant to look beyond the express terms of a contract agreed upon between the parties to a contract. Therefore, the courts will generally support any agreed terms unless the level of damages is oppressive. However, the courts will look to see that the amounts have been negotiated, noting that the commercial intentions of the parties are respected.
- Also, by structuring remuneration structures in contracts to provide for service credits and deductions for performance of service elements as primary obligations, the limitations of liquidated damages under applicable laws can be avoided.

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<sup>3</sup>Article 303 of the Kuwait Civil Code further provides: "*Damages agreed upon shall not be due if the debtor establishes that the creditor did not suffer any damage. The court may lessen the amount of damages agreed upon if the debtor establishes that the amount specified was grossly exaggerated or that the obligation has been partially performed. Every agreement to the contrary is void.*", Court of Cassation, Appeal No. 85/100 (commercial circuit) in a hearing dated 15th January 1986.

<sup>4</sup> This is provided for in Article 304 of the Kuwait Civil Code which states "When the prejudice exceeds the amount of damages agreed upon, the creditor cannot claim an increased amount unless he is able to prove that the debtor has committed fraud or gross negligence."