

# The Penalty Clause in Jordanian Civil Law

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## Abstract

The penalty clause was introduced as one of the solutions provided by the legislator to regulate the individual legal transactions. Most netting contract contains a penalty clause, particularly contracts that its implementation takes long time, as in the contracts for work and procurement contracts. However, the practice of this legal option is still confused with other legal options and weaknesses in the wording of its terms, transgression and misunderstanding of the scope and limits of the contractual assurance still remains. Therefore, the origin of the subject and the declaration of its true legal context should be examined through this study, which is based on the position of the Jordanian law and its judicial provisions in this regard.

**Keywords:** Penalty clause, concepts, legal system, limits.

## 1. Introduction

The penalty clause is a preventive tool that helps in resolving potential disputes. The use of the penalty clause has expanded in the recent decades. It is, of course, one of the applications of the party autonomy and is in line with the modern mechanisms of the auto regulation of contracts.

On this ground, the role of the penalty clause in modern contractual transactions has increased to be one of the mechanisms that encourage the implementation of the contract and compensate the breach of such implementation.

The penalty clause in the contracts has a hidden but important benefit. It helps in achieving a better balance in the contractual obligations by redistributing the risk ratios even before the debtor has breached or delayed in carrying out his obligation. In this sense the penalty clause is more than just a compensation gate, as its prior adoption in the terms of the contract adds assurance privilege to it. It is a method of guaranteeing the proper implementation of the obligation.

However, the penalty clause has another practical benefit which is avoiding the controversy over the availability of the element of damage to attest the contractual responsibility. The element of damage is realized once the fault element has been established where the implementation of the contract has been breached. The rule in this case is that the debtor is obliged to pay the value of the penalty clause.

On the other hand, the penalty clause changes the references of determining the amount of the damage; it takes the power of valuing the damage from the judge, who often relies on the opinion of the expert, and gives such power to the parties of the contract. The agreement on the value of compensation indicates the validity of the assessment. Of course, parties have an interest in the moderation of the value of the penalty clause. The creditor who wants the highest value and the debtor seeking the lowest one will agree in the light of custom, tradition and experts in the field concerned to reach a point of logical consensus which balances the value of the penalty clause. This compatibility occurs prior to any breach or dispute, where the Parties still remain in a state of consensus and cooperation.

The legal establishment of the penalty clause is within the scope of the Civil law, which its general rules govern the provisions and effects of contracts. Although the French law is the contemporary incubator of the idea of the penalty clause, the Jordanian legislator derived the same idea from the Islamic jurisprudence, though influenced by the wording of the Egyptian legislator.

The problem of the study is the overlap of the legal system of the penalty clause as it is based on the party autonomy, with the interfering supervision of the judges given to them by the law in the form of a sovereign authority. Some Arabic legislations considered that the penalty clause in the contract to be a combination of compensation and punishment.<sup>1</sup> The reason behind this is that the legal system governing the penalty clause gives the judge the power to modify the amount of the penalty clause by increasing and decreasing it according to specific conditions. In Jordan, the Civil Code allows the judge to amend the value of the penalty clause under two conditions: That one of the parties so requests, and to prove to the judge that there is a variation between the values of the compensation prescribed in the penalty clause and the damage that occurred.<sup>2</sup> The Jordanian

1 Abu Laila, T. (2007). Civil Law, contractual Compensation - Comparative Study. *An-Najah National University, faculty of Graduate Studies*, 2.

2 Article 364 of the law: "Parties may determine in advance the value of the assurance by stipulating it in the contract or in a subsequent agreement, subject to the provisions of the law; The Court may, at the request of one of the Parties, amend this agreement to make the assessment equal to the damage. Any agreement to the contrary shall be void".

legislator has kept the penalty clause in the scope of private law people's transactions, and did not give it the meaning of the punishment. In this sense, the Jordanian judge who reassesses the penalty clause does not intervene in the penalty clause based on his discretion or the direct application of the law. He is just responding to the request of one party to restore the balance in the agreement, that's all. In this part, he seeks to regulate the agreement of the parties and does not seek the application of a legal penalty.

The study aims to clarify the concept of the penalty clause and to determine the conditions of its entitlement and its scope of application, and seeks to distinguish it from the legal concepts similar to it, in order to be able finally to clarify the limits of the legal consequences of this type of assurance, in the view of its legal nature. Although the penalty clause is a legal option that is available to the parties of the contract according to the party autonomy, the limits of the judiciary and public order stops the application of party autonomy. And here we will try to prove two things: the Jordanian law has properly drafted the paragraphs of article 364 of the Civil Code, namely, that of the party autonomy and the power of the judge to amend; the Jordanian judicial rulings are consistent with the presumed balance between the two paragraphs, and the contrary view is based on the distinction of the opinions on the scope and extent of the penalty clause and is not based on a defect or contradiction in the legal system of the penalty clause.<sup>1</sup>

### **1. The quiddity of the penalty clause**

Practically, the general rule is that the compensation is judicial, and is assessed by the judge after checking the availability of its conditions and elements. However, the parties may prefer not to leave the assessment of compensation to the judiciary so they agree on the amount of compensation which the creditor is entitled to if the debtor does not fulfill his obligation or delayed in its implementation in advance at the conclusion of the contract. This chapter will be studied in two parts, one devoted to the study of the concept of penalty clause, and the second to distinguish it from the similar concepts.

#### **1.1. The Concept of the penalty clause**

In order to clarify the concept of the penalty clause, it must be defined, as stated by the jurisprudence, and the definition and knowledge of its dimensions must be analyzed, before demonstrating its most important legal characteristics. The penalty clause has a general definition laid down by jurisprudence. The Jordanian law did not define the penalty clause, which is better as the more the legislator avoids defining legal issues, the more flexible the legal text will be in adapting the relevant legal facts. Zuhdi Ykn defined the penalty clause as "the compensation required by the parties in the contract which is valued by them when the obligation is not performed or there was a delay in the performance".<sup>2</sup> In the same context, Anwar Sultan said that "the penalty clause is an agreement in which the parties assess in advance the compensation due to the creditor if the debtor did not perform his obligation or delays in its implementation."<sup>3</sup> The previous definitions tend to be abbreviated. But prior to them Al-Sanhoury has put a detailed definition by saying that "it is a compensation assessed in advance by the parties rather than leaving it to the judges, and the creditor is entitled to it if the debtor fails to perform his obligation in order to compensate the non-performance or the delay."<sup>4</sup>

By comparing the three definitions, we find a uniform content. However, El-Sanhuri's definition emphasizes the important effect of the penalty clause agreement, namely, the substitution of the discretion of the judge in assessing the value of compensation of the penalty clause by the will of the parties. Whereas the definition of Sultan Lateef added to the definition of Ykn a confirmation on the time-frame of the agreement as a prior agreement to any breach in the implementation.<sup>5</sup>

The Court of Cassation defined it by saying that "the penalty clause is the compensation determined in advance in the contract to which one of the parties is entitled if the other party breached his obligation, and if one of the parties breached his obligation and the other party wanted to claim more than the penalty clause specified in the contract. The way to do so is to request the court to increase this penalty clause to what is equivalent to the

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<sup>1</sup> It is important to mention that the penalty clause was established in Jordanian law under the name of "contractual assurance" (article 364 of the Civil Code), whereas the Jordanian judiciary tended to use the term "penalty clause".

<sup>2</sup> Zuhdi, Y. (1967). *The Explanation of the Law of Obligations and Contracts, and comparing it to modern and Islamic laws. Publications of the Modern Library, Sida, Beirut.* C5, I 1, 135.

<sup>3</sup> Sultan, A. *General Theory of Obligation, Provisions of Obligation, University Publications center, Alexandria.* 172.

<sup>4</sup> Al-Sanhoury, A. *op. cit.*, 851.

<sup>5</sup> In the decision of the Court of Cassation No. 3391/2005 of 19 September 2005, Qistas: "We find that Article 360 of the Civil law states that if the specific performance is carried out or if the debtor insisted on refusing, the court shall determine the amount of assurance to be imposed on the debtor, taking into account the damage suffered by the creditor and the intransigence of the debtor. Article 361 provides that he shall be entitled to the compensation only after notifying the debtor unless otherwise provided by the law or the contract. The benefit of these two texts is that the legislator distinguished between two different types of compensation namely: - compensation for non-performance that compels the damage resulting from the debtor's default - and compensation for delay, which compels the damage resulting from the mere delay of the debtor. The compensation for the delay is sometimes combined with the specific performance if the debtor carried out his obligation late and can be combined also with compensation for non-performance if the debtor did not perform his specific obligation.

damage actually occurred according to article 364-2.<sup>1</sup> On the other hand, Abdulrahman Gomaa stated that the penalty clause is so named because the amount of compensation it contains is usually greater than the actual damage occurred to the creditor as a result of the non-performance or the delay by the debtor. The excess amount represents a contractual penalty or fine that encourage the debtor to perform his obligation in an acceptable time and manner.<sup>2</sup> However, Tariq Abu Laila argues that the penalty clause remains in the circle of compensation agreement and does not have the penalty status, based on the fact that the judge's power to modify the agreed compensation value confirms that the penalty clause is related to the value of the damage. Thus we cannot depend on the argument that the compensation exceeds the value of the damage because it is considered fine.<sup>3</sup>

Although the penalty clause is included in the obligations of implementing the contract, it takes the form of compensation, and differs from the original specific performance as it is a subsidiary obligation.<sup>4</sup> We can see this difference in nature between the two obligations by considering the case of the cash payment. If the obligation to pay a monetary amount represents a penalty clause, serving a notice is required before asking the debtor to pay it,<sup>5</sup> in contrast to the optional specific performance which its subject is cash payment that does not require a notice to be served before the usual implementation, and this is what the court of cassation has decided when it stated that "The subject of the case is a claim to pay the amount of a due cash loan, thus it is not required to be preceded by a legal warning. Thus the case shall not be considered premature if it was initiated without notifying the debtor. Claiming the payment of a cash amount does not require serving a notice. The notices laid down in article 355-1 of the Civil law are related to the specific performance that compels the debtor to carry out his obligation in- specific".<sup>6</sup>

In this regard, we have the right to question the feasibility of the penalty clause in the practical application. According to its definition, it is an agreement that impose a penalty on the debtor who does not fulfill his obligation because he is unable or does not want to implement it as agreed. As if he has failed in his original obligation, how is he expected to carry out his subsidiary obligation? The fact is that this does not diminish the value of the penalty clause because it remains a good option for the creditor if the defaulter was acting in good faith. And in the opposite case, if he was acting in bad faith or was careless, the creditor can depend on the penalty clause in order to initiate a case to obtain the value of the penalty clause without waiting for expert opinion.<sup>7</sup>

Another question arises as to the definition of the penalty clause in order to define its scope as a legal concept. Which is whether the penalty clause, in the sense we have provided, allows it to be insured as a personal right of the creditor through the in-kind insurance? In the in-kind insurance the allocation of the money of the debtor or the third parties will be used to insure the right of the creditor to acquire the amount of the compensation in some cases. This is an uncommon practice but it is possible. It offers the creditor a double assurance placing him in a strong position in the event of the insolvency of the debtor, and takes him outside the circle of the apportionment with the rest of the creditors of his debtor. The result is yes, as the definition of the penalty clause means that it is a personal right that can be enforced by an in-kind assurance.<sup>8</sup>

## 1.2. The characteristics of the penalty clause

The penalty clause is a protective mechanism related to the stage of implementing the contract. It is a compensation for breaching the implementation and causing damage, but it is an obligation that existed even before any dispute. As a result, it carries with it the assurance characteristic.<sup>9</sup> Based on the attribute of the insuring and the proof of the obligation by the penalty clause with the possibility of non-payment if the damage is not achieved, we come to the important conclusion that the penalty clause is an obligation related to the original obligation of implementation and is not separate from it. So the creditor may not demand the implementation of the compensation agreement as long as the debtor is able to perform the original obligation. Both the creditor and the debtor can insist on the specific performance.

In conclusion, we can deduce two characteristics for the penalty clause: that it is an agreement and that it is subsidiary: being an agreement means that it is subject to the general provisions of the contract in terms of the consent, the subject and the reason (the elements of the contract). If the compensation agreement was subsequent

<sup>1</sup> The Judgment of the Court of Cassation No.1998\2532 dated 08-07-1999.

<sup>2</sup> Jumah, A. (2010). The brief in the Explanation of the Jordanian Civil Law - Provisions of obligation. *Dar Wael, Amman*. 62.

<sup>3</sup> Abu laila, T. (2007). Civil Law contractual Compensation - Comparative Study, *An-Najah National University, faculty of Graduate Studies*, 15.

<sup>4</sup> The original obligation of specific performance and the optional obligation of compensation shall only be combined in case of a partial breach of the implementation.

<sup>5</sup> Of course, the penalty clause may be replaced by something else such as carrying out an act or abstaining from it, as it is a personal right after all.

<sup>6</sup> The Judgment of the Court of Cassation No.2005\98 dated 10- 05- 2005.

<sup>7</sup> See El-Zarqa, M. (1999). Provisions of Obligation, 76

<sup>8</sup> See Abu Laila, Tariq: op. cit. 15.

<sup>9</sup> Helalsah, A. (2010) Provisions of Obligation, *Dar Wael, Amman*. 62.

to the original contract that is required to be implemented, the general elements of the contract must exist in the first and second contract.<sup>1</sup> This is in accordance with the decision of the Court of Cassation which found that "the purpose of the penalty clause is to ensure the implementation of the obligation, which means that there is an original obligation with which the penalty clause is a subsidiary obligation.<sup>2</sup> If the subsequent agreement is invalid, the original obligation will remain valid and binding on the debtor, but without supporting it with the penalty clause and its advantages. In this case the creditor can only demand the specific performance at first and then demand the judicial compensation if it is impossible to implement the contract.

However if the compensation agreed beforehand is a clause in the original contract in the form of a penalty clause, the invalidity of the clause shall not mean the invalidity of the contract, but the nullification of the contract will invalidate the clause.<sup>3</sup> An example of the invalidity of the penalty clause listed by the jurisprudence is where the parties agree to consider the mortgaged property to be the property of the creditor when the debtor fails to pay the debt in time, and without any prior notice.<sup>4</sup>

In this occasion, it is worth noting that the agreement of the parties to assess the value of the penalty clause is susceptible to the judge's intervention. The Jordanian law allows the parties of the contract to ask the judge to amend their assessment agreement. Their agreement is fixed in its origin, but the amount required for the implementation is uncertain.<sup>5</sup>

In some cases, the penalty clause may be invalidated if the assessment of the amount of compensation was overestimated or if the public policy is violated. This departs the penalty clause from the compensation for the damage resulted from the breach of the implementation, and turns it into a control instrument used on the debtor. For example, if the employer stipulated in the employment contract that the employee shall pay a big compensation if he left the work suddenly. This is confirmed by Article 819 of the Jordanian Civil Code which reads as follows: "*If the parties agree to penalize the employee with the intention of forcing him to stay in work in the case of breaching the duty of non-competition, the clause shall be invalid*". Subsequently, the Court of Cassation confirmed this in its ruling which stated that "if the defendant is obliged, under an employment Contract, upon the termination of his employment by resignation or dismissal for any of the cases set out in Article 28 of the Labor law and for one year from the date of termination of his employment not to discuss the work of the company, its work, participate or cooperate with any person, institution, company or competitor of the company. In case of breaching any of the above, he undertakes to pay compensation to the company equivalent to twelve months' wages on the basis of the value of his last wage. Since the claimant depended in her claim on the employment contract and its annex between the parties, the provisions of the Labor law are applicable to the facts of this case and this provision is contrary to article 4 of the Labor law, which reads as follows:(4)-B (Any clause or agreement, whether concluded before or after this Act, by which any worker waives any of the rights conferred to him by this Law).

The penalty clause is ostensibly similar to some comparable legal concepts, so we must distinguish it from these concepts in terms of concept, purpose and scope. They are, by the way, five basic legal concepts: the conciliation, the threatening fine, the retainer, the optional obligation and the liability limitation clause (exemption clause).

A. The penalty clause and the conciliation: Although the agreement on compensation is included in the original contract, nothing prevents from agreeing on it subsequently after the conclusion of the basic contract, provided that this is done before the breach of the obligation. Otherwise, this last agreement will be a conciliation contract.<sup>6</sup>

B. The penalty clause and the threatening fine: A threatening fine is intended to induce the debtor to carry out his obligation under the threat of paying a sum of money.<sup>7</sup> Of course, nothing prevents from combining the penalty clause and the fine together in a contractual relationship. Thus the application of the fine may be requested from a judge along with the existence of the penalty clause. The fine induces the implementation of the original obligation of the debtor.<sup>8</sup> The threatening fine is different from the penalty clause in several respects; In terms of

<sup>1</sup> See Bilal, S. (2003). Contractual Compensation and the Power of the judge to amend it in the Syrian Civil law and Comparative Law, *The lawyers magazine*. 8. 256.

<sup>2</sup> The Judgment of the Court of Cassation No. 2692\2008 issued on 21-07-2009, Qustas.

<sup>3</sup> Al-Sanhoury, A. op. cit. 86.

<sup>4</sup> Hamdan, H. (1981). In-kind Insurance, *University publishing house, Beirut*. 9.

<sup>5</sup> The Judgment of the Court of Cassation No.3720\2012 dated 09-12-2009: The decision proves that the contract is the law of the parties, and the relationship between its parties shall be governed by the terms and conditions of the contract in accordance with the provisions of Article (87) of the Civil Code. The competent court has the discretion to amend the value of the penalty clause in the contract to suit it with the amount of damage resulted from the breach made by one of the parties of that contract, in accordance with the provisions of Article 364 of the Civil Code.

<sup>6</sup> The Judgment of the Court of Cassation (1993) No. 221\11, *The Bar Association magazine*. 186: Article 647 of the Jordanian Civil Code defines conciliation as "a contract that removes the dispute and stops the litigation between the conciliators through mutual consent". It is an agreement that has special provisions namely the existence of an existing or potential dispute and the waiver of counter-claims.

<sup>7</sup> The Jordanian law does not recognize the system of the threatening fine.

<sup>8</sup> Eid, E. (1995) Encyclopedia of the codes of trials, Evidence and Implementation. Part 19. 151.

the source: the source of the penalty clause is the will of the parties, but the source of the fine is the judge's decision.<sup>1</sup> In terms of purpose: the purpose of the fine is to compel the debtor to implement his obligation, while the purpose of the penalty clause is to compensate the damage resulted from the breaching the implementation.<sup>2</sup> In terms of implementation: the fine is an interim award, while the penalty clause is a final agreement that is eligible when the implementation has been breached and the damage has been achieved.

C. The penalty clause and the retainer: A retainer is an amount of money paid by one of the parties to the other party upon concluding a contract, and it gives the option of waiver to each of the parties unless otherwise agreed. The retainer is different from the penalty clause that the retainer is a sum of money paid at the time of the conclusion of the contract in exchange for the option of waiving the contract, while the penalty clause is an obligation in the contract that takes the form of compensation. The retainer is eligible only once the contract has been rescinded, whereas the penalty clause is only valid if one of the parties is harmed as a result of the breach made by the other contracting party. It is not required for the entitlement of the retainer to serve a notice as it is a charge not a compensation, while the penalty clause requires serving a notice to get the compensation.<sup>3</sup> Moreover, the retainer is a fixed exchange which is fully entitled, even if the waiver did not cause any harm, whereas the amount of penalty clause may be reduced or increased by the judge.

D. The penalty clause and the Optional Obligation: The optional obligation is the obligation in which the debtor has multiple obligations to choose from, and the debtor is discharged if he performed one of them. Article 407 of the Jordanian Civil Code allows the disposition to have multiple subjects, Provided that each subject fulfills all of its conditions. The rule here is that the debtor chooses the subject that he will implement to benefit from the multiplicity of subjects, but it may be the opposite so the parties agree that the option is for the creditor.<sup>4</sup> Optional obligation may be confused with the penalty clause on the ground that the two concepts contain a second obligation and two subjects of the obligation. However, the fact is that the penalty clause does not combine with the specific performance in principle as in the case of optional obligation, whose implementation is in-kind and non-compensatory and is considered an implementation of an original obligation not a subsidiary one, in contrast to the penalty clause.

E. The penalty clause and the liability limitation clause (exemption clauses): Some jurisprudence distinguishes between the penalty clause and the liability limitation clause in the contracts as each of them has a different function. The second is intended to protect the debtor by determining the compensation ceiling in the event of default (without fraud or gross fault, in accordance with the general rules), whereas the penalty clause is mainly intended to pressure the debtor.<sup>5</sup> We can give a practical example of that clause like in the contract of carriage concluded with airlines and postal companies, which puts a limit for their liability for the loss of baggage, parcels and letters. The difference between the penalty clause and the liability limitation clause is clear in the sense that the latter does not allow the creditor to ask the judge to modify the agreement by increasing the compensation amount to match or to equal the damage occurred even if the difference between them varies. But the debtor may request the adjustment of the agreed compensation amount if it proved that the damage is less than the contractual compensation.<sup>6</sup>

## 2. The legal system of the penalty clause

In the beginning, we emphasize the fact that the penalty clause is merely an agreement that determine the due compensation, and it is not the direct cause of the compensation in the event of a breach. The compensation became eligible when three conditions (fault, damage and association of cause) are satisfied. Accordingly, we will analyze the legal system of the penalty clause in two parts: the conditions of its entitlement and the scope of its application.

### 2.1. The penalty clause entitlement conditions

In order to enforce the penalty clause, the conditions of the contractual liability must be reached. The Court of Cassation decided that "the entitlement to the penalty clause in the contract requires what is required for the existence of the contractual responsibility, which its elements have been established in the civil law. They are: the fault of the debtor, the damage caused to the creditor and the causal relationship between the fault, plus the damage and a prior notification.<sup>7</sup> Since the penalty clause is a compensation, serving a notice is a condition for the entitlement as determined by the Court of Cassation.<sup>8</sup> Accordingly, we will examine the conditions of

<sup>1</sup> Al-Hadidi, A (1999). Procedural Aspects of the threatening fine in the Civil and Comparative Law, *Dar El-Nahda El-Arabiya, Cairo*. 30.

<sup>2</sup> Daradkeh, F. (2004). The Penalty clause in the Jordanian Civil Law, Comparative Study. 254.

<sup>3</sup> Sultan, A. (1983). The Specific contracts, Explanation of the Sales and barter contracts. *Dar al-Nahda al-Arabiya, Beirut*. 88.

<sup>4</sup> Al-Far, A. (1997). Provisions of obligation. *Dar Al-Thaqafa Library for Publishing and Distribution, Amman*. 156.

<sup>5</sup> Abu Saud, R. (1998). Provisions of obligation. *University Publications, Alexandria*. 103.

<sup>6</sup> Jabr, B. (2011). Controls of Distinction between the Penalty clause and the Threatening fine and their Role in delaying the Execution of the Contract - Comparative Study. *Middle East University*. 117.

<sup>7</sup> The Judgment of the Court of Cassation No.2002\444 dated 25-06-2002. See article 246 of the Civil law.

<sup>8</sup> The Judgment of the Court of Cassation No.2008\3726 dated 15-6-2008.

liability and the condition of serving a notice.

### 2.1.1 The conditions of liability

We will discuss three conditions: fault, damage, and Causal relationship.

A) The fault: The fault is a deviation in the performance of the debtor while implementing the contract, in a way that assesses his contractual responsibility. And of course, the determination of the contractual responsibility is related to the type of the obligation whether it is an obligation of result or an obligation of conduct. In contractual responsibility the fault is presumed to be made by the debtor if he breached his obligation in any way, and the debtor cannot deny the carrying out of fault unless he proves that the impossibility of performance is caused by a foreign reason. This is stated in Article 448 of the Jordanian Civil Code which reads as follows: "The obligation shall be discharged if the debtor proved that that the impossibility of performance is caused by a foreign reason that he has nothing to do with it." Article 261 of the same law states that "if a person proves that the damage was caused due to a foreign cause which he has nothing to do with it like the force majeure or the act of a third party or the fault of the victim, he is not obliged to pay a compensation unless there is a text or agreement to the contrary ". The foreign cause is any act or accident that is not attributable to the debtor and causes the damage and entails the avoidance of liability.<sup>1</sup> The judge has a discretionary power to decide that.<sup>2</sup> The fault has many types and degrees. It includes intentional fault or what is known by fraud which disables any clause in the contract in order to limit the liability of the debtor, so the Court of Cassation decided that: "Since the plaintiff did not claim the perpetration of fraud or a gross fault by the respondent, the compensation to which he is entitled is the fixed amount of damage and loss actually suffered by the claimant. The basis of the liability required to claim the compensation is the contractual liability."<sup>3</sup> The fault may be unintentional but serious; in this case the fault will amount to an intentional fault. Also the fault may be unintentional and not serious, yet still give rise to the debtor's liability. As a result, the contractual fault is a reason to pay the penalty amount in all its forms.

B) Damage: The creditor will not receive the amount of the penalty clause if there was no harm. So if the debtor breaches his obligation without causing any harm, the debtor will not be liable to pay the compensation. As if the carrier delayed the delivery of the shipment of goods that will be displayed at an annual festival then it turns out that the festival did not take place at all. The judge assesses the damage taking into account the creditor's loss, provided that the damage is a natural result of the breaching of the obligation. In the obligation that derives from the contract the debtor is obliged to compensate the damage that he could have expected at the time of the conclusion of the contract, except for the case of fraud or gross fault where the debtor is liable for the foreseeable damage and the loss of profits as in the tort liability. The Court of Cassation stated that "what the defendant has made and as a result of breaching her contractual obligations, she caused serious damage to the plaintiff and to the goods that the plaintiff deals with and made her lose the gains it was supposed to make if the board was installed according to the terms of the contract."<sup>4</sup> But the damage intended here is limited to the direct damage that can be expected at the time of the conclusion of the contract. It includes the loss suffered by the creditor without the loss of the gain. The damage that leads to compensation is the damage that is actually suffered whether it has already occurred or that it will inevitably occur in the future. Therefore, by returning to the decision of the Court of Cassation mentioned above, the Court decided that " as the plaintiff based his claim on the breach of a contractual obligation made by the respondent, the compensation that should be awarded is the damage that actually occurred if it occurs while its amount is not provided for in law or contract as required by article 363 of the Civil law which stated that if the assurance is not determined in the law or in the contract, the court will assess it in proportion with the damage actually occurred, i.e. the compensation to be awarded in such case is the fixed amount of damage and loss actually incurred by the other party and does not include the loss of profits and moral damage ".<sup>5</sup>

C) Causal relationship: Causality is the link between the fault and the damage incurred by the creditor. The creditor must prove that the damage he suffered was an inevitable and a reasonable result of the debtor's default, because it is unreasonable to assume that any damage suffered by the creditor is the result of the debtor's default.<sup>6</sup> The creditor can avoid the responsibility by proving the foreign cause, force majeure or the act of the third party, or the act of the creditor himself. If the debtor proves any of that, he will not be liable for the compensation in this case. In this regard, the Court of Cassation decided that "the injury suffered by the person sent abroad to study due to a traffic accident that has affected his scientific achievement, and as a result he failed to obtain the certificate for which he was sent, does not mean that the scholar has violated any of the conditions

<sup>1</sup> This position contradicts the opinion of the jurisprudent, who considers the debtor responsible for the fault, even with existence of the foreign cause, except in the case of force majeure.

<sup>2</sup> Al-Fadl, M. (1996). General Theory of obligation in the Jordanian Civil Law, Provisions of obligation. C2, *Dar Al-Thaqafa and Distribution, Amman*. 461.

<sup>3</sup> The Judgment of the Court of Cassation No.2005\3534 dated 09-03-2006.

<sup>4</sup> The Judgment of the Court of Cassation No.2008\889 dated 02-06-2008.

<sup>5</sup> *Ibid*.

<sup>6</sup> Sultan, A. op. Cit., 279; Dawas, A. op. cit. 215.

of the mission and therefore he is not obliged to refund the money spent on him."<sup>1</sup>

### **2.1.2 Serving a notice**

The advent of the maturity date of the obligation is not sufficient to order the debtor who has not performed his obligation to pay the penalty clause. At first the creditor must notify him as the penal clause does not exempt from serving a notice, and its existence is not considered an explicit or implicit agreement to exempt the creditor from serving a notice to the debtor.<sup>2</sup> Serving a notice, as stated in the explanatory memorandum of the Jordanian Civil Code, is to alert the debtor that the creditor is not negligent in demanding his right to enforce the contract. Serving the notice allows the debtor to be held liable for delaying the implementation of his obligation from the date on which the notice was served.

The Jordanian Civil law did not specify a specific form for the notice. However, the explanatory memorandum pointed out that "a notice can be served through the notary, and it can be served by registered mail or by any other method that achieves the intended purpose". The parties may agree in advance that the debtor shall be considered notified once the obligation reaches its maturity date, without any further action. This agreement is required according to article 361 of the Civil law. The Court of Cassation stated that "with respect to the validity of serving of a judicial notice, serving a notice is required for the validity of the penalty clause unless the contract includes an agreement that exempt from serving a notice."<sup>3</sup>

In order for the notice to be effective, it must be done at the maturity date or after it, but it should not be before it, because in this case it will be ineffective. The creditor can grant the debtor a period of time to implement the obligation in the notice served to the latter by the creditor without affecting the value of the notice, because once the granted period ends, the debtor becomes notified. The law stipulates that the creditor must serve a notice to the debtor in order to be able to demand him to pay the penalty. But the law exempts the creditor from serving a notice in certain cases and considered that by the deadline a sufficient notice that the obligation should be implemented is served to the debtor, otherwise he will be liable for the compensation. Article 362 of the Jordanian Civil law provided for such cases by stating that it is not necessary to serve a notice to the debtor if the implementation of the obligation becomes impossible or ineffective by the acts of the debtor, or if the subject of the obligation is a compensation resulted from an unlawful act, or if the subject of the obligation is returning something that was stolen or he unlawfully received and was aware of, or if the debtor declares in writing that he does not want to fulfill his obligation.

## **2.2 Limiting the penalty clause**

We have explained how the Jordanian civil law allowed contractors to agree in advance on determining the amount of the penalty clause at the time of concluding the contract. This means that the penalty clause in its origin does not conflict with public policy. However, this did not prevent the legislator from restricting this right by giving the judge the authority to amend the amount of Compensation by increasing and decreasing it in the cases where the amount of the compensation is disproportionate to the actual damage. Accordingly we must examine this requirement in two sections: limiting the penalty clause through the judge's power to amend the penalty clause and the public policy.

### **2.2.1 The power of the judge to amend the penalty clause**

The rule is that the penalty clause is binding on the parties, and the judge is obliged to order the debtor who breached his obligation to pay the agreed amount without increasing or decreasing it, regardless of the amount of damage suffered by the creditor, because the contract is the law of the parties. Despite this principle, most of the laws governing the penalty clause empower the judge to amend this agreement. However, these laws differ in the extent to which the judiciary is granted this power. This authority reached its widest scope in Article 364-2 of the Jordanian Civil law, which empowered the judge to amend the penalty clause by Increasing or decreasing it, to make the value of the penalty clause equivalent to the damage as what governs this power is the amount of damage actually occurred.

Regarding the reduction, the Jordanian legislator did not mention the cases where the judge can decrease the amount of the penalty clause, but the reality throws out two cases:

The first case: if the agreed penalty clause is overestimated, the judge should exercise his authority to decrease it cautiously and in an exceptional manner. It is the debtor burden to prove that the assessment of the compensation has been excessive to a large extent. If the debtor proves that, the judge will reduce the compensation to be equivalent to the damage, under the supervision of the Higher Court.<sup>4</sup>

As long as the Jordanian legislator, as mentioned above, did not specify the cases in which the judge may reduce the value of the penalty clause, the debtor may in any case ask the court to reduce the value of the penalty

<sup>1</sup> The Judgment of the Court of Cassation No.96\2674, *The Bar Association magazine*. N.7-8.2000. 2324.

<sup>2</sup> Nassif, E. (1991). The Penalty clause in the Comparative Law and the Leasing Contract. *Financial Navigation*. 133.

<sup>3</sup> The Judgment of the Court of Cassation. No. 2009\2842 dated 09-02-2010.

<sup>4</sup> Abu Orabi, G. (1998). The Power of the Judge to amend the penalty clause in the Jordanian Civil Law - Comparative Study. *Shariaa and Law Studies*. Group 25. 51.

clause in order be equal to the damage that actually occurred. This is clear from the text of Article 364 of the Civil Code which reads as follows: "In all cases, the Court may, at the request of one of the parties, amend this Agreement in a way that would make the assessment equal to the damage."<sup>1</sup>

The second case is the case where the obligation is partially implemented, as the law provides for the possibility of reducing the contractual compensation in the case of the partial implementation, because the partial implementation in its nature calls to review the amount of the due compensation. Of course, this assumes that the creditor accepted the partial implementation that he had the right to refuse; therefore he cannot demand the full penalty clause as long as he has benefited from the partial implementation and the penalty. The Court of Cassation confirmed this by stating that "the contractor shall compensate the land owner for the damage, estimated by the expert, due to the delay in handing over the building on the date agreed upon in the agreement between them, which includes the date of delivery and the obligation of the contractor to pay a fixed amount as a penalty clause for each day on which the delivery is delayed."<sup>2</sup> In fact although article 364-2 of the Civil Code grants the judge broad authority in reducing the value of the penalty clause, the judge's power is not absolute, but has its rules which are the rules governing the judicial compensation. It is therefore assumed that the party who demanded the amendment of the penalty clause will provide legal evidence proving what he claims. For example, the debtor must provide the evidence proving that the value of the penalty clause is much greater than the damage that is caused. And if he is unable to do so, the court will not amend the clause and the debtor will be obliged to pay the penalty clause specified in the contract.<sup>3</sup> However, we believe that the Jordanian legislator gave the judge broad authority to amend the value of the penalty clause, without specifying the cases in which it is permissible. In this context, we wonder about the usefulness of the penalty clause based on the will of the parties. If the judge can intervene with a great power to amend their voluntary agreement,<sup>4</sup> does not this abolish the actual value of article 364 of the Jordanian Civil Code? As for the theoretical justification, this contradicts with what Muhammad Wahid al-Din Swar said criticizing the position of the Jordanian legislator, saying that it was more effective for the Jordanian legislature not to give the judge this high discretionary power.<sup>5</sup> In our opinion, the judge's broad discretionary power does not contradict with the text of article 364 of the Civil Code because the judge exercises his authority as an exception and not as a general rule. The value of the penalty clause shall be amended only at the request of one of the contractors, and shall not be amended until the significant variation between the value of the penalty clause and the damage is proven. This is logical and fair as it is established that any contractual practice is subject to the limitations of the law, as in the case of an abusive clause or even earlier in the supervision on the legality of the elements of the contract of (consent, subject and reason). This is the context in which the power of the judge to amend a compensation agreement comes to light. It is essentially a subsidiary obligation related to the occurrence and magnitude of the damage, which means that the occurrence of the damage is the condition that gives rise to the obligation as the amount of damage specifies the amount of compensation. As a result, there is no contradiction between giving the judge a discretionary power and the will of the individuals. On the practical side, the penalty clause benefits the creditor by exempting him from the burden of proof because it switches it to the debtor who will have to claim that the damage has not occurred or that the agreed compensation is overestimated.

In another direction, the text of Article 364 may be criticized on the grounds that it is not sufficiently flexible because it does not impose an appropriate compensation but requires the compensation to be equivalent to the damage. The Court of Cassation clarified that "the compensation is assessed on the basis of the damage, and the assessment is a matter of fact in which the competent courts can hear, but specifying the legal elements constituting the injury is included in the assessment of the compensation and is considered a legal matter that falls under the supervision of the Court of Cassation". The court decided that "compensating a material damage requires proving the amount of damage, and the issuance of an award that obliges the debtor to pay a compensation that is equal to the damage suffered by the injured person."<sup>6</sup> Talking of equivalent compensation is, in our opinion, closer to fairness than proportionality, and in any case must be proved.

### **2.2.2 The limitation of the public policy on the application of the penalty clause**

The public policy restricts the agreement of wills on the penalty clause in several occasions, which we will review as follows:

A) The linkage between the compensation and the damage: The Jordanian legislator required the occurrence of the damage and considered it as a main element for the entitlement of the compensation in accordance with article 364-2. This means that if the debtor fails or delays in implementing his obligation that is associated with a penalty clause, and no damage is suffered by the creditor as a result, the penalty clause will not be paid because

<sup>1</sup> The Judgment of the Court of Cassation (1984). No. 83\560, *The Bar Association magazine*. 1097.

<sup>2</sup> The Judgment of the Court of Cassation (1984). No. 59\502, *The Bar Association magazine*. 1097.

<sup>3</sup> The Judgment of the Court of Cassation (1984). No. 871\391. *The Bar Association magazine*. 1097.

<sup>4</sup> See Abu Orabi, Ghazi, op. Cit., p. 60

<sup>5</sup> Swar, M. The Power of the Judge in amending the contracts. *Magazine of the Jordanian Bar Association*. No.1-3, 1992, p.136.

<sup>6</sup> The Judgment of the Court of Cassation (2002). No. 2002\138.



the paying condition is not satisfied. This is a matter of the public policy which the parties cannot agree on the contrary. If the parties agree on the value of the penalty clause even if the creditor did not suffer any damage, the debtor will have to recourse to the court claiming that the damage has not occurred in order to evade the payment of the penalty.

B) Exemption from liability: Agreements that exempt or decrease the liability, in the case where the debtor commits a fraud or a gross fault, is considered null and void as it is clear from the text of Article 358-2, which states that "In any event, the debtor remains liable for fraud and gross fault". Accordingly the contractual compensation that its value is so modest carries the meaning of the exemption from that responsibility, thus it will be considered null and void because it is related to the public policy.<sup>1</sup>

C) Exceeding the limit of interest: The Jordanian legislator considers that the overestimation of the value of the penalty clause in order to avoid mandatory legal rules to be invalid, as in the case of the legal and contractual benefits, as the Jordanian legislator has set a maximum interest rate of 9%, and thus the contracting parties cannot exceed it by agreeing on a compensation that is greater than that percentage, as this matter is related to the public policy.

D) The power of the judge to amend the Penalty clause: As we have seen, the Jordanian legislator has given the judges the power to intervene to amend the penalty clause by increasing and decreasing it if one of the parties so requests, to make the compensation equal to the amount of damage. This is considered to be related to the public policy so any agreement to the contrary shall be null and void. "

## Conclusion

The study deals with the penalty clause in contracts in the light of the provisions of the Jordanian law, especially Article 364 of the civil law.<sup>2</sup> The penalty clause is a prior agreement on the assessment of the due compensation when a breach is made by one of the parties of the contract. It is an agreement that operates on the basis of party autonomy, and it is a method that insures the implementation of the agreements. It has two parts: A protective part that guarantees the right of the creditor and a remedial part that ensures compensating him. The penalty clause supports the binding nature of the contract, thus increasing the chances of its implementation and minimizing the effects of the dispute resulting from the breaching the implementation. It is concluded from the above that the provisions of the penalty clause are an organized income agreement and are governed by the provisions of the law, in particular the public policy. The penalty clause is a subsidiary obligation that accompanies an original obligation. Thus its existence and non-existence depends on the existence and non-existence of the original obligation. Thus if the original obligation becomes invalid, the penalty clause will be invalid, but the opposite is not true, as the invalidity of the penalty clause will not lead to the nullification of the contract. The conditions of entitlement of the penalty clause must be satisfied. They are the same conditions of the judicial compensation. The judge may, at the request of one of the parties and not on his own initiative, amend the value of the penalty clause to be equivalent to the damage in four cases: If the debtor proves that the assurance was overestimated, or that the original obligation was partially fulfilled, or if the creditor proves that the assurance was negligible, or if the debtor committed a fraud or a gross fault. The penalty clause exempts the creditor from proving the element of damage that is presumed to be available, thus that damage becomes presumed merely for breaching the implementation. The creditor does not have to prove it thus the debtor must prove that the creditor has not suffered any damage as a result of a breach which means that the penalty clause impairs the general rule of proof. The Court of Cassation stated that "the existence of a penalty clause presupposes the occurrence of the damage according to the agreement of the parties. thus If the obligated claims that the damage is less than what has been estimated under the penalty clause, the burden of proof will be on him because he is proving what is contrary to apparent state in the penalty clause.<sup>3</sup> The penalty clause means *prima facie* that the estimated damage is assessed correctly. Thus the creditor is exempted in the event of overestimation and the debtor is exempted in the case where the assessment is undervalued. In spite of what we have stated in this study, the Jordanian judge attributes the value of the penalty clause to the state of equality with the damage, and not to the state of proportionality that allows some increase in the estimation of the compensation. However, by returning to the cases where the parties of the contract are allowed to oppose the penalty clause before the judge, we found that they are related to an exaggeration in the assessment of the compensation, whether by an increase or a decrease. These cases do not allow a party to ask the judge to amend

<sup>1</sup> One opinion said that the inadmissibility of agreeing on the exemption of the debtor from any liability arising from the non-performance of his contractual obligation, except as a result of his fraud or gross fault, does not prevent the debtor from claiming that he is not liable for fraud or gross fault made by the individuals he has used in the implementation of the Obligation. Any condition that exempts from the liability arising from the wrongful act shall be null and void, see [https://www.facebook.com/permalink.php?id=263525070346969&story\\_fbid=575363972496409](https://www.facebook.com/permalink.php?id=263525070346969&story_fbid=575363972496409)

<sup>2</sup> Article 364 "1- The parties may specify in advance the value of the assurance by stipulating it in the contract or in a subsequent agreement, subject to the provisions of the law. / 2. In any case, the Court may, at the request of one of the parties, amend this Agreement so as to make the assessment equal to the damage, and any agreement to the contrary shall be null and void".

<sup>3</sup> The Judgment of the Court of Cassation (2000) No.2000\1999.

his agreement with the other party who is acting in good faith where there is only a simple difference between the contractual compensation and the damage. This means that the Jordanian legislator, who allowed the judge in Article 2/364 to reconstitute the amount of the compensation to the state of equality between the compensation and the damage, only allows this option if there is a big variation between the damage and the compensation.

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