

HBN
Newsletter

PENALTY CLAUSES IN COMMERCIAL CONTRACTS: MUCH MORE THAN MEETS THE EYE



Curaçao, January 2021

Background

In general, contracts establish rights between two or more persons, on the basis of which one party is obligated to perform (debtor) and the other is entitled to that performance (creditor).

In a contract, either party can be debtor and/or creditor depending on the specific obligation. For instance, a real estate purchase agreement includes mutual obligations for both seller and buyer. On the one hand, the seller is entitled to payment of the purchase price (creditor) and the buyer is obligated to pay (debtor). On the other hand, the buyer is entitled to delivery and transfer of the property (creditor) and the seller is obligated to comply accordingly (debtor).

Commercial contracts are not any different in this regard.

If the debtor fails in the performance of an obligation, the creditor can, among other things, request performance of that obligation or claim compensation.

If compensation is the goal, it takes several steps to reach the point at which compensation is received. After all, if the obligation can still be performed, the debtor must be in default and the creditor must prove the non-performance, the existence and the amount of the damages, and the relation between the cause of the non-performance and the damages.

Sometimes the amount of the damage cannot be determined. If parties go to court, this aspect may lead to lengthy and costly proceedings.

How can the creditor prevent this process as much as possible?

By including proper penalty clauses in commercial contracts in advance.

A penalty clause is a payment or other obligation in case of failure in performance by a contracting party.

Below are five items a creditor must consider when negotiating and drafting penalty clauses. Please note that these items are written from the perspective of the creditor and are a general description of penalty clauses under Curaçao law. The items are not specific advice on strategy in a particular contract or case.

1. Why add penalty clauses to commercial contracts?

A penalty clause provides legal certainty. It releases the creditor of any burden of proof about the existence and the amount of the damages (to be) suffered. The chances of having to litigate about certain aspects of a claim will be smaller. As a result, adding a penalty clause to commercial contracts will ultimately save the creditor and his business time, hassle and money.

2. Do penalty clauses apply to all non-performance of the debtor?

Yes. Non-performance by the debtor may be not performing at all, performing poorly, partial performance, late and/or incomplete performance. However, under Curaçao law, the creditor cannot demand performance of both the penalty clause and the main obligation to which the penalty clause relates (except if the penalty concerns timely performance of the main obligation or if the penalty aims to urge performance of the main obligation).

3. Can the creditor deviate from the law?

Yes. A few options would be that, in the event of non-performance by the debtor:

- the creditor has the choice between claiming a penalty and damages due by law (statutory compensation);
- the creditor can claim both a penalty and statutory compensation;
- a penalty only replaces compensation for loss due to delay. Yet, the creditor may claim both a penalty and alternative compensation;
- penalties may also be claimed in the event of force majeure (non-attributable failure);
- actual costs, such as out-of-court collection costs and costs of litigation (instead of the court-approved scale of

costs), can be claimed by the creditor; and/or

- statutory or contractual interest on the amount of a penalty must be paid.

4. Which circumstances must be considered when negotiating and drafting penalty clauses?

- the (dis)proportion between the amount of the penalty and the actual damage amount;
- the nature of the contract (e.g.: is including this specific penalty clause usual in this specific contract?);
- the content and scope of the penalty clause (e.g.: is the wording of the penalty clause clear? Is there a maximum to the penalty amount?);
- the circumstances under which the penalty clause will be invoked by the creditor (e.g.: the gravity of the violations, the extent to which the debtor is to blame for the violations, the extent to which the debtor will be aware of the breach of the penalty clause etc.);
- the capacity of the parties (e.g.: are parties acting in their business or personal capacities?);
- the circumstances under which the penalty clause has been created (e.g.: did parties negotiate about the content and the amount of the penalty? Did parties discuss the reason behind a

- high penalty amount?);
and/or
- whether one penalty amount is applied to widely varying violations with(out) making distinction between bigger and smaller violations.

5. Are certain topics off limits for the creditor?

Yes. Even if a penalty clause is regulated by contract, the debtor may, however, request the court to reduce a penalty if it is evident that fairness so requires. That option cannot be validly excluded in the contract.



hbn | law & tax

Do you have a contract or specific clause that you would like to have reviewed, drafted, or litigated about? If so, feel free to send an e-mail to:

Nathania Soon
Attorney-at-law
nathania.soon@hbnlawtax.com



Would you like to know more? Follow this link for a comprehensive overview:

https://hbnlawtax.com/app/uploads/2021/01/HBN-Newsflash_Penalty-Clauses-full-version.pdf

Amsterdam

Concertgebouwplein 7
1071 LL Amsterdam
The Netherlands
T. +31 20 303 3020
E. info@hbnlawtax.com

Aruba

Beatrixstraat 38
Oranjestad, Aruba
T. +297 588 6060
E. info@hbnlawtax.com

Bonaire

Bulevar Gob. N. Debrot 20
Kralendijk, Bonaire
Caribbean Netherlands
T. +599 717 6944
E. info@hbnlawtax.com

Curaçao

L.B. Smithplein 3
Willemstad, Curaçao
T. +5999 4343300 (general)
T. +5999 7325400 (tax)
E. info@hbnlawtax.com

Sint Maarten

W.G. Buncamper Road 33
Philipsburg, St. Maarten
T. +1 721 542 2272
E. info@hbnlawtax.com

©2016 HBN Law & Tax | The information provided in this document is for general information purposes only and does not constitute legal or other professional advice. No rights can be derived with respect to its reliability for specific purposes and no warranty is given to its accuracy or completeness.