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Damages clauses, economic losses and compensation – the relationship between contractual damages and damages according to dispositive law

♦ *The relationship between damages clauses and economic or compensation has long been discussed in legal literature. However, there is yet no consensus on these issues, at least not in Sweden. But with three new cases from the Swedish Supreme Court, the problems can be addressed anew. In this article, these cases are analysed in order to explain how we should define a damages clause in order to regulate their relationship to actual damages, and how the cases should be understood in order to clarify the relationship between liquidated damages and compensation. The conclusions are not limited to a Swedish context, but rather relevant for a number of different legal systems. The article has originally been published in Svensk Juristtidning 2022, pp. 156–174 under the title »Avtalsvite, skada och skadestånd«.*[1]

Lecturer in private law, jur. dr David Dryselius – Lund University

1. Introduction

The practice of contracting parties determining in advance the economic consequences of a breach of contract dates back to the Roman age.[2] In Swedish law, these clauses are known as avtalsviten, or damages clauses.[3] They were an integrated part of the Swedish legal system already in the early 1800th century and were mentioned as such by David Nehrman in 1729. They are now found in a variety of contract types, undoubtedly offering certain advantages.[4] Over the past decade, those types of clauses have also been relevant in cases from the Swedish Supreme Court.

However, damages clauses also bring a number of problems, some of which have been discussed in the legal literature since the mid-19th century. Despite being addressed by the Supreme Court, there are still uncertainties related to these clauses, their definition, and the legal effects of including a damages clause in a contract. Those uncertainties are not limited to Sweden, but rather relevant in several legal systems. In this article a few selected issues and recent Supreme Court rulings are integrated into a more cohesive framework, with the purpose that the reader will better understand those clauses.

2. Starting points

2.1 General

The first fundamental issue of this article is whether economic damage or economic loss is a prerequisite for the obligation to pay the amount stipulated in the damages clause. Consider a contract containing the following clause, which is a simple damages clause:

1 If A breaches clause 7, A shall pay 100 to B.

A subsequently breaches this clause 7, and according to the clause, A must pay 100 to B. But what happens if B does not suffer any economic loss due to A's breach? Should A still be required to pay 100 to B? Without the damages clause, where the right to compensation for breach of contract would be governed by default rules, B would bear the burden of proving that she has suffered an economic loss. Without damage, or if B fails to fulfil her burden of proof, the claim for damages will be dismissed. The question is to what extent a damages clause changes this situation—does B have the right to the amount stated in the clause even if she did not suffer any damage? In the case NJA 2018 p. 834 »Vitesundantaget i ansvarsförsäkringen«, the Swedish Supreme Court made several interesting statements, including whether a damages clause is conditional upon damage and what functions such a clause serves.

The second fundamental issue concerns the relationship between the damages clause and compensation according to default rules. Assume that the parties have a damages clause according to (1), but the breach of contract causes B to suffer an economic loss of 200. Without a damages clause, B would be entitled (again she has to fulfil her burden of proof) to compensation for the entire damage, and the question is whether the damages clause affects the application of this rule. This issue has been discussed in legal literature for a long time, but without reaching a consensus. However, two cases from the Supreme Court in the 2010s, NJA 2010 p. 629 »Den försvunna huvudnyckeln«, and NJA 2014 p. 960 »Det Andra Bolaget«, have partially clarified the situation.

2.2 Economic loss as a requirement

According to Swedish law, the legal effects of a contractual provision primarily follow from the interpretation of the provision and,

1 The article is in itself a summary of my dissertation, Dryselius, D. (2019), Avtalsviten: effekter och rättsverkningar [Damages clauses: effects and legal effects]. Much of the literature is in Nordic languages, and many of the writers are or were from the Nordic countries. I have therefore attached a short explanation about those recurring persons which may not be known for the international audience. Moyle, J. B. (1913), The institutes of Justinian, p. 134, Book 3, Chapter 15, Paragraph 7 and Zimmermann, R. (1996), The law of obligations: Roman foundations of the civilian tradition, p. 95 *et seqq.*

2 Moyle, J. B. (1913), The institutes of Justinian, p. 134, Book 3, Chapter 15, Paragraph 7 and Zimmermann, R. (1996), The law of obligations: Roman foundations of the civilian tradition, p. 95 *et seqq.*

3 *Avtal* is Swedish for agreement, and *vite* is Old Norse for injury or punishment. However, the word *avtalsvite* is neutral in the sense that it is not linked to either of the Common law versions of liquidated damages clause or penalty clause, since that distinction between valid and invalid clauses does not exist in Swedish law. I have therefore used damages clauses throughout the text.

4 Nehrman, D. (1729), Inledning til then swenska iurisprudentiam civilem, af naturens lagh och Sweriges rikes äldre och nyare stadgar uthdragen och vpsatt af David Nehrman. Med hans kongl. may:tz nådigsta privilegio [Introduction to the Swedish Civil Law], p. 282. David Nehrman (later knighted to Nehrman Ehrenstråhle, 1695–1769) was one of the first professors in law in Sweden who taught and wrote in Swedish.

secondarily, if interpretation does not yield any content, from supplementation.[5] Whether a clause requires (or does not require) an economic loss is therefore primarily determined through interpretation. If, for example, the wording of the provision indicates that economic loss is a prerequisite for a certain obligation, problems rarely arise. And since this area is traditionally and globally not governed by mandatory norms, the parties are free to decide whether the provision should include a requirement for damage.

An example of such wording is the model clause in the DCFR, which states that the debtor of the damages clause shall pay the amount »irrespective of the actual loss«.[6] This wording gives the clause a clear content on the relevant point, and therefore there is no need for a default rule. But what happens if the provision does not contain such wording? Certainly, the provision can still be interpreted using other data than the wording itself, but if these are also absent, some default rule must be applied to supplement the provision.

In the literature, some authors are clear that a damages clause is not conditional on damage, while others argue that the creditor of the liquidated damages does not need to prove the (full) extent of the damage. The latter group could thus be seen as assuming that there is at least some damage, but that the creditor does not need to demonstrate its exact magnitude.

The early 20th century Swedish legal scholar Tore Almén belongs to the first category. In the first edition of his commentary on the Swedish Sale of Goods Act (*Sw*: köplagen), he writes that »the commitment to a damages clause always gives the buyer the benefit of not having to provide evidence regarding the existence and amount of the damage« and that »the seller cannot, by providing evidence that the buyer has in fact not suffered any damage or that the actual damage is lower than the amount in the damages clause, gain exemption from paying the stipulated amount; this is widely recognized«.[7] The later Knut Rodhe is also clear that there is no requirement for damage. A damages clause should not »be negated by evidence that the damage is less than the amount of liquidated damages« and that »neither can it, as has sometimes been argued, be a general condition for the awarding of liquidated damages that at least some damage has occurred«.[8]

Lars-Erik Taxell wrote in 1972: »The awarding of the amount in the damages clause does not require that the creditor has suffered an economic loss«.[9] Olsen believes that damages clauses, unlike damages according to default rules, »generally do not include a requirement that damage must have occurred,« and the question then arises »whether the requirement for damage according to general rules supplements the clause in court judgments«. After a review of case law, she concludes that »very little suggests that a requirement for actual damage constitutes an independent condition for liability«.[10]

The second group is not as clear, and their statements can be read as implying that there is a requirement to demonstrate the existence of damage, but not its magnitude. For instance, a discussion of damages clauses in 1916 in the proceedings of the Finnish Juridical Society (*Sw*: Juridiska Föreningen i Finland) suggests that »the person who wishes to claim the amount must indeed demonstrate that the condition has occurred upon which the payment according to the agreement is contingent, but does not need to provide evidence of the extent of the interest or damage«.[11] Hakulinen offers a similar argument, stating that the dependency of a damages clause »does not mean that the creditor, when demanding the payment of the amount in the damages clause, must demonstrate the magnitude of the damage caused to him by the breach of contract«.[12]

A common feature in these discussions, regardless of which group they belong to, is that it is not clear how the clause is given its content. As mentioned above, the legal effects of a provision follow from interpretation or supplementation. However, from each authors definition of a damages clause, it is not evident whether damage is a prerequisite. And since the contract content does not follow from an interpretation of the clause, it must follow from supplementation.

Supplementation can be either bound or free.[13] The bound supplementation involves the application of existing default legal norms, while the free supplementation means that the adjudicator—through their discretionary decision-making power—creates a legal norm. From the various statements on damages clauses and economic loss, it is evident that the authors refer to bound supplementation, meaning that the contractual provision is supplemented with an already existing default legal norm. The content of this norm, however, is never made explicit, but it is still possible to draw certain indirect conclusions.

To obtain damages for a breach of contract according to default law, there must be an economic damage or loss of some kind, and the injured party must fulfil its burden of proof regarding the extent of the damage. With a damages clause that does not have damage as a prerequisite, this requirement somehow disappears. Since this does not follow from interpretation, it must follow from default law, which, in the absence of contract content regarding this specific point, supplements the contractual provision. A possible wording of such a default rule is as follows:

5 Ussing, H. (1950), Aftaler paa formuerettens omraade, p. 432 [Contracts in the Field of Property Law] and Adestam, J. (2014), Den dokumentvillkorade garantin, p. 66 [Documentary guarantees].

6 DCFR Book III, article 3:712.

7 Almén, T. (1906), Om köp och byte af lös egendom: kommentar till lagen den 20 juni 1905. Förra delen, Omfattande §§ 1–41 [Swedish Sale of Goods Act. Commentary on the Act of June 20, 1905. Part One, Covering Sec. 1–41], pp. 331 och 336. Tore Almén was a legal scholar at the University of Uppsala and from 1915 until his death a member of the Swedish Supreme Court. During the early decades of the 20th century, he wrote the preparatory works and later commentaries to the previous Swedish Sale of Goods Act (repealed 1991) and The Contracts Act, from 1915 and still used.

8 Rodhe, K. (1956), Obligationsrätt [Law of Obligations], p. 595. Knut Rodhe (1909–1999) was a Swedish legal scholar, focusing mainly on private law and company law.

9 Taxell, L. E. (1972), Avtal och rättsskydd [Contracts and Legal Protection], p. 444. Lars-Erik Taxell (1913–2013) was a Finnish legal scholar and politician, writing both in Finnish and Swedish.

10 Olsen, L. (1986), Ersättningsklausuler: vite och andra avtalade ersättningar vid kontraktsbrott [Damages clauss: Liquidated Damages and other Contractually Agreed Compensation for Breach of Contract], s. 130 *et seq.*

11 Juridiska Föreningens förhandlingar år 1916. (1918), Tidskrift utgiven av Juridiska föreningen i Finland [Proceedings of the Legal Society, Journal Published by the Legal Society of Finland], p. 59.

12 Hakulinen, Y. J. (1962), Obligationsrätt. 1, Allmänna läror [Law of Obligations. 1, General Principles], p. 200.

13 Arvidsson, N. (2010), Aktieägaravtal: särskilt om besluts- och överlåtelsebindningar [Shareholders' agreement], p. 209 *et seq.*

2 If the contract includes a damages clause and the debtor breaches the main obligation of the damages clause, the debtor shall pay the amount stated in the clause regardless of whether the creditor has suffered damage.

The application of this rule is based on the idea that if the damages clause does not contain anything regulating the relationship between the damages amount in the clause and the actual economic damage, the legal norm (2) will apply, meaning that the damages amount of the clause must be paid regardless of whether an economic loss or damage has occurred. This gives the clause content on the unregulated point, and (2) ensures that the payment obligation of the damages clause is not conditional on whether the breach has caused damage.

This reasoning is reflected in statements about damages clauses and damage in the literature. For example, Almén writes that the commitment to liquidated damages »always entails«, Rodhe uses the term »a general condition«, and Olsen mentions »as a rule.« Olsen also refers to general rules to supplement the clause.[14] These formulations must be read as reflecting the content of default law. Clauses that do not regulate a requirement for damage are supplemented and thereby given the content evident from the discussions, with a rule like (2) above.

The problem with these statements is that it is unclear which default rule that provides this content. Supplementing the contract with »ordinary« default law would not work, since the right to compensation under default law according to the positive interest requires damage as a prerequisite, not just in Sweden but in many other Western legal systems. This would imply that the damages clause is supplemented by a different default rule than the one governing compensation according to the positive interest.

In addition to these discussions, there are statements that argue, in contrast to the above, that damage is a prerequisite. This is particularly problematic since one of these statements comes from NJA 2018 p. 834 »Vitesundantaget i ansvarsförsäkringen«. In that case, a contractor had hired a consultant to prepare construction documents. The standard agreement ABK 09 applied between them, and ABT 06 applied between the client and the contractor. According to ABK 09, the consultant is liable for certain damages caused to the client. The consultant's documents contained errors, which caused delays for the contractor. For this, the contractor paid delay damages to the client, and the contractor, in turn, made a claim against the consultant for the damage caused by the errors in the consultant's documents.

The consultant turned to its insurance company. The company denied compensation, citing that the terms stated, »the insurance does not cover fines, penalties, or punitive damages unless it concerns liability for damages which, aside from the designation as fines, penalties, or punitive damages, are covered by this insurance«.[15] The consultant then sued the insurance company, arguing that the damage was covered by the insurance. The district court referred the question to the Swedish Supreme Court, of whether the insurance terms meant that the consultant was not entitled to compensation from the insurance company for the amount paid to the contractor to compensate for the penalty the contractor had paid to the client.

The Supreme Court stated that none of the terms »fines«, »penalty«, or »punitive damages« were defined in the terms, and there was no industry practice, which led the court to assume that the terms have »the meaning that follows from the common understanding of the words and the content of applicable law«.[16] In the next point, the court defined liquidated damages as »a pre-agreed compensation for damage«, followed by a list of different functions that damages clauses can fulfil. This list concludes with the note that a damages clause can relieve the injured party from the obligation to prove individually suffered damage.[17]

The statement that damages clauses are a pre-agreed compensation for damage can only be understood as implying that damages clauses are contingent upon damage. This statement is followed by the court pointing out that »it constitutes a predetermined compensation.« The court also cites fines and punitive damages as examples of »those that do not have or need to have a connection to actual damage.« However, it is unclear how damages clauses relate to these two examples.

With these statements, I mean that the Supreme Court imposes both a requirement for damage – »a pre-agreed compensation for damage« – and makes a distinction between punitive damages and liquidated damages.[18] However, both statements contradict the general understanding in the literature. It is also unclear where the court derived the notion that liquidated damages are a pre-agreed compensation for damage. Had the court instead written »compensation for breach of contract«, this would have been in line with the general understanding. Therefore, due to the deviation from the established view, these statements should be seen as an anomaly in this context.

According to a commentary of the Swedish Sale of Goods Act (written by the same judge who wrote the verdict in the 2018 case, the question of an economic loss as a prerequisite is determined through contract interpretation, but that the starting point is considered to be that there is no requirement for actual damage for the penalty to be enforced. With regard to my opinion, the commentary says that the fact that the function of the penalty is to be a pre-agreed compensation for damage cannot be considered a stance that the right to compensation in the individual case presupposes that damage has occurred and that it is clear that the court did not take a position on whether damage is required for the penalty to be enforced in the individual case.[19]

In light of these ambiguities, I have chosen a different approach. Damages clauses belong to the category of conditional obligations. Besides damages clauses, there are several other conditional obligations, so to differentiate these, I define damages clauses such that their payment obligation is conditional solely upon the breach of its main obligation.[20] If an obligation contains conditions other than the breach of the primary obligation to be triggered, it is therefore not considered a damages clause. By defining damages clauses this way, the default law will never be applied, as the content of the contract is already there from the definition.

14 Almén, Kommentar till köplagen (1906) [Commentary on the Sale of Goods Act], p. 331 och 336, Rodhe, Obligationsrätt [Law of Obligations], p. 595 och Olsen, Ersättningsklausuler [Damages clauses], p. 130 *et seq.*

15 The Swedish text uses "böter, vite or straffskadestånd (punitive damages)", that is a mix on Swedish and English.

16 NJA 2018 p. 834, "Vitesundantaget i ansvarsförsäkringen", para. 12.

17 *Op. cit*. p. 13 with reference to NJA 2010 p. 629, "Den försvunna huvudnyckeln", para. 10–12.

18 Westberg, P. (2020), Konflikt och kontrakt. [Conflict and Contract], p. 160 *et seqq.*

19 Herre, J. and Ramberg, J. (2023), Köplagen: en kommentar (JUNO), 30 september 2023 [Commentary on the Sale of Goods Act], § 67, section 15.2.4 with reference to Dryselius, D. (2022), Avtalsvite, skada och skadestånd. Svensk Juristtidning [Damages Clauses, Loss and Damages], p. 161.

20 Dryselius, D. (2019), Avtalsviten: effekter och rättsverkningar [Damages clauses: effects and legal effects], p. 108.

This means that the following clause does not count as a damages clause:

3 If A breaches clause 7 and the breach causes an economic loss to B, A shall pay 100,000 SEK to B.

Here, the payment obligation of the clause is conditional upon something additional beyond the breach of a specified clause in the contract, and the clause is therefore not considered a damages clause.

However, the requirement for damage does not need to be explicit. Take the following clause as an example:

4 If A breaches clause 7, A shall pay 100,000 SEK to B.

This is identical to clause (1) above. But suppose that clause (4) is, through interpretation—for example, through the common intent of the parties—given the meaning that it is conditional upon damage. In that case, it is not considered a damages clause, even though its wording does not include a requirement for damage.

By defining damages clause this way, a number of the problems I have described above are avoided, without leading to the need to reformulate clauses in contracts to clarify whether or not they are conditional upon damage. Instead, the clause type »damages clause« will function in a similar way to a contract type.[21] By classifying a certain clause as a damages clause, a range of legal effects—which do not follow from the wording of the clause—are created by the fact that the clause belongs to a certain clause type (or rather a set of clauses). If a certain clause is classified as a damages clause, we therefore know that it does not have a requirement for damage, as a damages clause do not contain such a requirement.[22]

2.3 The relationship to default rules of damages

The second issue of the article is the relationship between a damages clause and compensation for the expectation interest (also known as the positive interest or *Erfüllungsinteresse*). This form of compensation is the main rule in Swedish non-mandatory law and many other European legal systems.[23] With two decisions from the Supreme Court, NJA 2010 p. 629 »Den försvunna huvudnyckeln«, and NJA 2014 p. 960 »Det Andra Bolaget«, the question of the relationship between contractual remedies and remedies for breach of contract under dispositive law has been revisited.

The obligation of the party liable to pay for damages according to the damages clause follows from the direct contractual content (hereinafter referred to as *contractual norms*), while compensation for positive interest follows from a dispositive legal norm. The existence of these two forms of compensation is undisputed. However, what governs their mutual relationship has been a subject of discussion in Swedish legal literature since the mid-19th century.[24]

The norm that governs the relationship is referred to as N (assuming here that it exists). According to the principle of contractual commitment, the amount in the damages clause will always be payable. With the same clause as in (1) above, B will always be compensated with 100 from A due to A's breach of contract. What determines any compensation beyond the damages clause is the extent to which the damages clause affects the application of a default legal norm. This influence is governed by the norm N. In other words, N dictates the circumstances under which compensation for expectation interests will *not* be awarded or will be awarded in a limited amount compared to a situation where there are no damages clause in the contract.

Norm N is dispositive, meaning that the parties can agree to waive it. They can do this, for example, by specifying in the damages clause how the amount in the clause relates to compensation according to the default legal norm. An example of such a provision is found in Ch. 5, Sec. 3 of AB 04, which states that if damages have been agreed upon in the contract, the creditor is not entitled to further compensation for the delay. Similarly, the parties may choose to ensure that the damages clause do not affect the total compensation. One such formulation could be that if the injured party can prove that the breach caused damage exceeding the damages clause damages amount, compensation for the actual damage should be awarded.

Let's assume there is an agreement with only one main obligation. If this is breached, compensation is calculated according to the default rule:

5 *non-mandatory legal norm:* compensation according to the positive interest.

If the agreement also includes a damages clause tied to the main obligation, the situation changes. In the event of a breach of this obligation, compensation can now be provided in one or both of the following ways:

6 *contractual norm*: compensation according to the damages clause.

7 *non-mandatory legal norm*: compensation according to the positive interest.

The relationship between (6) and (7) can be described as follows:

8 The damages clause does not affect the right to compensation according to the positive interest.

9 The damages clause does affect the right to compensation according to the positive interest.

Alternative (8) and (9), are clearly incompatible. Which one applies depends on the content of norm N. Suppose the compensation according to the positive interest amounts to 200,000 SEK and the amount in the damages clause to 100,000 SEK. Several combinations of (8) and (9) can in that case be formulated.

The liquidated damages will always be paid, and this is the only legal effect of the damages clause. Thus, a breach of the primary obligation will result in compensation of 100,000 SEK. If the application of norm N results in alternative (8) being applicable, compensation will be paid with 100,000 SEK through the liquidated damages clause and 200,000 SEK through the dispositive legal norm. If, however, alternative (9) applies, compensation will be paid with an amount between 100,000 and 299,999 SEK, depending on the content of norm N.

21 Sw: avtalstyp. See for example Sundberg, J. W. F. (1961), Avtalstyper och typavtal. Svensk Juristtidning [Types of Contracts and Contract Types], p. 12, Arvidsson, Aktieägaravtal [Shareholders' agreements], p. 212 *et seq.* och Dryselius, Avtalsviten, [Damages clauses], p. 225 *et seqq.*

22 Adlercreutz, A. and Gorton, L. (2010), Avtalsrätt II [Contract Law II], p. 49, is another example of this method.

23 Also, the Swedish Sale of Goods Act rests upon compensation according to the positive interest, see for example Kihlman, J., Munukka, J., and Svensson, O. (2017), Köplagen: en kommentar [The Sale of Goods Act, a Commentary], p. 590. och Herre and Ramberg, Kommentaren till köplagen [Commentary on the Sale of Goods Act], § 67, 15.1.1.

24 See for example 1815 års förslag till Handels Balk [The 1815 Proposal for a Commercial Code], kap. 15, 4 § (an early draft of a Swedish Civil Code, which never came into force) and Schrevelius, F. (1857), Lärobok i Sveriges allmänna nu gällande civil-rätt. D. 2, Förmögenhetsrätten [Textbook of Sweden's General Civil Law Currently in Force. Part 2, Law of Property and Obligations], p. 686.

In cases where the application of norm N or a contractual norm result in compensation being limited to the damages clause amount, the damages clause is often referred to as *exclusive*.[25] However, exclusivity is not a legal effect of the damages clause itself, which is why calling it »exclusive« is misleading. Instead, the exclusivity results from the application of a contractual norm or dispositive norm, which, upon the breach of the main obligation linked to the damages clause, excludes the application of the dispositive law's claim to compensation according to the positive interest. However, for practical reasons, I will continue to use »exclusive« or »exclusivity« with this latter meaning.

It is also from this perspective that damages clauses can be related to clauses constituting limited liability. These two types of clauses have long been considered interconnected. For example, in a Swedish preparatory work from the 1970s, it was noted that a low amount in a damages clause in relation to the damage, the damages clause constitutes a type of limitation of liability, comparable to that which occurs through a general limitation of the damages amount.[26] A variant of these is disclaimers, which are a complete limitation of liability regarding a specific remedy, meaning that none of the liability in the non-mandatory norms can be enforced.[27]

This type of clause is based on the premise that contractual parties, according to default legal norms, are responsible for compensating the other party for any damage caused by a breach of contract. The application of this dispositive law can be restricted, for example, through a limited liability or an exemption clause. The legal effect in these cases stems from the contractual norms. Since the amount in a damages clause is, by definition, greater than zero, the damages clause—without considering the remedies provided under dispositive law—results in an increase in liability for the party who breaches the primary obligation.

From this perspective, a limitation of liability is the opposite of a damages clause because a limitation of liability serves no other purpose than to limit (in this case, the liability for damages as prescribed by dispositive law). The effect of a breach of the primary obligation associated with the damages clause may be that liability is limited compared to the liability under dispositive law. However, this limitation is not a result of the damages clause itself. Instead, it is the result of a contractual norm whose legal effect is that the damages clause excludes compensation according to the positive interest. Therefore, a more accurate rephrasing of »may constitute a limitation of liability« would be that if a damages clause, through interpretation, limits the application of dispositive law, it has the same legal effect as the type of contractual norm that gives a limitation of liability its limiting effect.

In the Swedish Supreme Court case NJA 2010 p. 629 »Den försvunna huvudnyckeln«, the question was raised whether what in the case was referred to as a damages clause agreement constitutes a limitation of liability to the amount of the damages.[28] In this case, a subcontractor lost a key that provided access to a large number of apartments. This led the contractor to replace all the locks, which cost approximately 170,000 SEK. At the same time, there was a receipt list between the contractor and the subcontractor, which the Supreme Court considered to be an agreement between the contractor and the subcontractor (who otherwise did not have a contractual relationship). The list included an attachment that stated, among other things, that keys that are not returned to us after notification will be charged at 15,000 SEK. The cost of replacing the locks was covered by the contractor's insurance company, which then sought compensation from the subcontractor who had lost the key. The insurance company demanded compensation for the full amount, while the subcontractor argued that their liability was limited to 15,000 SEK.

In its reasoning, the Supreme Court divided views on the relationship into three categories given that the meaning was not clear from the contract (that is, that the contract could not be interpreted otherwise): (a) the disadvantaged party can choose to claim damages instead of enforcing the damages clause, or (b) the damages clause and its amount exclusively regulate the question of compensation. The Court also addressed the group (c) that does not specify any in-dubio rule (a rule applied when a contract is ambiguous). The conclusion was that despite a comprehensive review of the material, since damages clause can serve various functions and circumstances vary, it cannot be generally stated whether such a clause in dubio constitutes an exclusive regulation of compensation in the event of a breach of contract, and that the clause should instead be interpreted without applying such a guiding rule.[29]

A few years later, in NJA 2014 p. 960 »Det Andra Bolaget«, the Swedish Supreme Court addressed the interpretation of Ch. 7, Sec. 25 of the standard agreement ABT 94. The case involved a contract where the contractor was required to carry out work on a concrete slab. The court considered whether the client had a right to compensation for estimated remedial costs when the contract lacked an explicit provision for such costs.[30]

The Supreme Court first attempted to interpret the contract according to the standard contract interpretation rules established in earlier case law.[31] When this did not provide a clear answer, the

25 See for example Olsen, Ersättningsklausuler [Damages clauses], p. 142 and Bryde Andersen, M. and Lookofsky, J. (2015), Lærebog i obligationsret 1. Ydelsen, beføjelser [Textbook of the Law of Obligations 1. Performance, Rights], p. 429. Also, in “Den försvunna huvudnyckeln”, para. 11 och “Vitesundantaget i ansvarsförsäkringen”, para. 21 the terms “exclusively” and “exclusive,” respectively, are used.

26 SOU 1974:83. Generalklausul i förmögenhetsrätten [General Clause in the Law of Property and Obligations], p. 172.

27 Lundmark, T. (1996), Friskrivningsklausuler: giltighet och räckvidd. Särskilt om friskrivning i kommersiella avtal om köp av lös egendom [Limited Liability Clauses: Validity and Scope. With Particular Reference to Exemptions in Commercial Contracts for the Sale of Movable Property], p. 34 *et seq.*, Håstad, T. (2009), Köprätt och annan kontraktsrätt [Sale of Goods Law and Other Contract Law], p. 125, and Johansson, S. O. (2015), Grov vårdslöshet och avtalsfrihet – var står vi i dag med ansvarsfriskrivningar? Juridisk Tidskrift vid Stockholms universitet [Gross Negligence and Freedom of Contract – Where Do We Stand Today with Liability Exclusions], p. 52 et seq.

28 The case “Den försvunna huvudnyckeln”, para. 7. The case is also analyzed in different perspectives by van der Sluijs, J. (2011), Utgör en vitesklausul en ansvarsbegränsning och i så fall mot vem? Juridisk Tidskrift vid Stockholms universitet [Does a Damages Clause Constitute a Limitation of Liability, and If So, Against Whom?], p. 160 et seqq., and Unnersjö, A. (2021), Regress: begreppet regressrätt och solidarregress [Recourse: The Concept of a Right of Recourse and Recourse in Joint and Several Liability], p. 97 *et seqq.*

29 The case “Den försvunna huvudnyckeln”, para. 13. In the case, the court interpreted the clause, with the result that the compensation was limited to the amount of the contractual penalty.

30 NJA 2014 p. 960, “Det Andra Bolaget”, para. 8.

31 See for example Ingvarson, A. and Utterström, M. (2020), Tolkning av entreprenadavtal [Interpretation of Construction Contracts].

court then considered the issue in light of non-mandatory law.[32] According to this, the client would generally be entitled to compensation for estimated remedial costs.[33] However, the contract did not explicitly provide for such compensation.

The court then concluded:

If the parties to a contract have specified a certain remedy for a contract breach in an agreement does not typically exclude the right to other remedies that may arise from applicable legal rules. For a stipulated remedy to be considered exclusive, it generally needs to be clearly indicated in the contract or supported by other evidence that the regulation is intended to be comprehensive.[34]

Consequently, the court determined that ABT 94 did not preclude the client's right to claim compensation based on legal principles for estimated remedial costs as an alternative remedy when the contractor failed to fulfil their remedial obligation.

At first glance, the 2010 and 2014 decisions may seem contradictory, as the court in the 2010 case suggests that no general rule N exists, while the 2014 case implies that such a rule does exist. This apparent contradiction stems from the fact that the court in both cases was discussing non-mandatory law. But if the court's discussion is viewed solely in terms of interpretation, the contradiction disappears, as it then pertains only to how the specific agreements were interpreted in each case.

If the court's statements are interpreted in the context of non-mandatory law, the two decisions can be summarized as follows, with the 2010 case considered first:

10 Non-mandatory law does not contain a rule regarding the relationship between damages clauses and compensation according to the non-mandatory interest.

11 Non-mandatory law includes a rule concerning the relationship between stipulated remedies and remedies under non-mandatory law.

In the 2010 case, the court based its reasoning on the premise that the meaning does not emerge from the contract.[35] This should be read as the court seeking the content of law without specifying the purpose of the rule. No rule was found, and the court concluded that it could not generally be stated whether a damages clause, in the absence of explicit contractual terms, constitutes an exclusive regulation of compensation for a breach of contract. Thus, the clause must be interpreted without applying such a guiding rule.[36]

In support of the court seeking a legal norm of type N, the terms generally and typically are used. At the same time, the court also discusses a rule of interpretation, which is not the same as a dispositive legal norm. It can be considered that the court was looking for a specific interpretative rule for contractual penalties, which would be analogous to the special interpretative rule for limitations of liability and disclaimers in standard contracts. Such an interpretative rule would be a counterpart to the specific rule for limitations of liability and disclaimers, which states that these clauses should be interpreted restrictively.[37] The court could also be seeking a legal norm to apply to the interpretation of the contract in light of the content of the non-mandatory law.[38] In this case, it would be an indirect statement about the content of the law.

In other words, there might be a difference here between (a) the content of the non-mandatory law and (b) the non-mandatory law used as an interpretative rule.[39] However, this distinction is far-fetched, and the most reasonable interpretation of the case is that the court was looking for a norm of type N—regardless of whether it would be applied directly or serve as background for an interpretation in light of dispositive law—but found that such a norm was lacking.

Similarly, the judgment in the 2014 case can be analysed. It is not clear whether the court is discussing interpretation or supplementation. Some guidance can be found in the term generally, which might suggest that the court is talking about a supplementary rule. However, there is also a possibility that the court is referring to the same type of interpretative rule as in the 2010 case. Another option is that the court is making an empirical observation, namely that contracts usually do not imply that agreed penalties for breach of contract are exclusive.[40]

In the next sentence, the court continues with what is required for a penalty to be exclusive, stating that it generally must be clear from the contract terms or supported by other indications that the regulation is comprehensive. If the court is discussing interpretation, the reasoning could be that there is a specific interpretative rule for agreed penalties for breach of contract, including contractual penalties. However, the reasons for such an interpretative rule are difficult to trace. According to some statements in the literature, standard contracts include a special and restrictive interpretative principle for onerous and unexpected clauses.[41]

Examples of such clauses, which are onerous for one party, are limitations of liability and disclaimers. An exclusive penalty, if the

32 The case “Det Andra Bolaget”, para. 23.

33 “Det Andra Bolaget”, p. 30.

34 “Det Andra Bolaget”, p. 31.

35 “Den försvunna huvudnyckeln”, para. 11.

36 “Den försvunna huvudnyckeln”, p. 12.

37 Se till exempel Adlercreutz and Gorton, Avtalsrätt II [Contract Law II], p. 116, Hellner, J., Hager, R., and Persson, A. H. (2020), Speciell avtalsrätt II: kontraktsrätt. H. 2, Allmänna ämnen [Special Contract Law II: Contract Law. Vol. 2, General Topics], p. 122, Herre and Ramberg, Kommentaren till köplagen, [Commentary on the Sale of Goods Act], 3 §, section 2.4.3, Lehrberg, B. (2020), Avtalstolkning: tolkning av avtal och andra rättshandlingar på förmögenhetsrättens område [Contract Interpretation: Interpretation of Contracts and Other Legal Acts in the Field of Property and Obligations Law], p. 211 *et seq.* and Bernitz, U. (2018), Standardavtalsrätt [Standard Contract Law], p. 113. See also “Den feluppmätta kontorsfastigheten” NJA 2016 p. 237, para. 28, where the court said that disclaimers within the scope of the Sale of Goods Act should be interpreted restrictively and must be clear and explicit to have effect.

38 See for example Lehrberg, Avtalstolkning [Contract Interpretation], p. 195 for such a interpretation method. This is also mentioned in NJA 2013 p. 271, “Skadorna på Läckebys arbeten”, para. 7.

39 See footnote 30 *supra.*

40 According to Tørum, A. B. (2019), Interpretation of commercial contracts, p. 173 any commercial contracts include limitations expressly stating that, for damages in excess of the maximum liquidated damages sum to be awarded, gross negligence must be established.

41 Adlercreutz and Gorton, Avtalsrätt II [Contract Law II], p. 116, Grönfors, K. (2013), Avtalsgrundande rättsfakta [Legal Facts Giving Rise to Contracts], p. 66 *et seq.,* Lehrberg, Avtalstolkning [Contract Interpretation], p. 196 *et seq.*, Bernitz, Standardavtalsrätt [Standard Contract Law], p. 70 et seqq. and 113 and Tørum, Interpretation of commercial contracts, p. 168. See also NJA 2012 p. 597, “Den försenade kraftverksgeneratorn”, para. 18 *et seq.*

damage exceeds the penalty amount, has the same effect on the application of non-mandatory law. However, a contractual penalty cannot also be a disclaimer because the penalty amount must be greater than zero. This implies that the restrictive interpretation contained in the applicable law in this area also applies to contractual penalties if, like limitations of liability, they restrict the application of dispositive law.

If the court in both the 2010 and 2014 cases is discussing the content of the supplementary law, other issues arise. Since contractual penalties belong to the category of agreed penalties for breach of contract and damages according to the positive interest belong to the category of remedies under dispositive law, the court's statements would be contradictory.

This contradiction can be partially resolved by interpreting the judgments in the 2014 case differently. If the case is seen as discussing a non-mandatory main rule, with the legal effect that contractual penalties do not affect the application of dispositive law remedies, there are also two exceptions to the main rule: (i) the contract may be interpreted differently or (ii) there is other support for considering the regulation as comprehensive.

The interpretation of the contract, and thereby giving it a different content than the law, follows from the principle that the parties are bound to their respective contractual obligation. However, regarding (ii), this could be seen as non-mandatory legal rules, meaning that law contains an exception rule stating that agreed penalties for breach of contract can exclude the application of law remedies. Norm N could be an example of such an exception rule, given that it has this content.

Finding support for a norm N with this content is difficult. Other statements in legal sources are lacking. Literature contains some statements related to the principle of contractual obligation. However, the problem is that the principle is one-sided, stating only that contractual norms apply. It does not specify what does not apply because of the application of contractual norms

To achieve this dual effect, it is necessary for the principle of contractual obligation to function similarly to, for example, Sec. 3 of the Sale of Goods Act, which states that if the contract provides otherwise, the provisions of the Act do not apply. Thus, it would also mean that if the contract terms (in this case, through the damages clause) stipulate otherwise, the right to damages according to the positive interest does not apply.

An example of a formulation that can be interpreted as the existence of such a general, dual-functioning principle is the following:

If a valid agreement exists (which is the starting point in the absence of mandatory rules that strip such agreements of their legal effect), it applies, and to the same extent, it overrides the general rules of obligation law. The function of the general rules is therefore primarily supplementary, insofar as the agreement is ambiguous or does not address a particular issue.[42]

The italicized part represents the legal effect of a general principle from which norm N can be derived. A possible content of N would then look as follows:

12 If the debtor breaches the main obligation of the damages clause, the creditor is not entitled to any other financial compensation for the breach than that provided by the clause.

Previous literature provides some examples of how a similar content is formulated. The statements should be read as prescribing a dispositive rule similar to (12).

The first example is from the 1815 Proposal for the Commercial Code. According to its Ch. 15, Sec. 4, The rights-holder may not demand any damages other than the penalty, whether he seeks enforcement of the obligation or abstains from it.[43] Comparing this with the ten-year younger Proposal for a General Civil Code, the principle of contractual obligation and the fact that it concerns non-mandatory rules are also clear. The proposals are identical in the first part, but in the 1826 legislative proposal, the conclusion reads other damages than the penalty, unless otherwise stipulated.[44] This follows from the purpose of the penalty, which is described as one can secure either the fulfilment of the other's obligation or a certain amount of damages, without waiting for an often uncertain assessment of the amount of damage.[45]

Similar statements appear in later literature. Winroth discusses interpretation primarily, stating that the question of whether the penalty is intended to replace general legal rules and take their place must be determined by interpretation based on its content and other known circumstances related to the case. However, in doubtful cases, it is closest to assume that, except for claims for repayment, the damages amount is intended to constitute full compensation without examination of the actual damage and thus bind both parties.[46]

Taxell states that one should generally consider that a damages clause – when not otherwise explicitly or implicitly stated in the agreement – conclusively regulates the compensation issue. Compensation beyond the amount in the clauses is therefore not applicable.[47] Similarly, Olsen writes that a damages clause tied to a breach of contract should, therefore, be considered as exclusively regulating the liability for compensation within its application area.[48] Krüger mentions that, in his opinion, at least with respect to delay penalties, the normal understanding of a penalty clause is that it represents a standardized and thus exclusive form of compensation.[49] A more recent statement is that an exclusive penalty »is consistent with the tendency to consider clauses stipulating liquidated damages as excluding a right to claim damages.«[50]

All these statements should be read as prescribing a norm N with the same content as (12) above. However, they do not have legal authority as sources of law.[51] Instead, we return to the 2010 and 2014 cases, according to which – whether they talk about interpre-

42 Bryde Andersen and Lookofsky, Lærebog i obligationsret 1. Ydelsen, beføjelser [Textbook of the Law of Obligations 1. Performance, Rights], p. 397 (emphasis added).

43 1815 års förslag till Handels Balk [The 1815 Proposal for a Commercial Code], p. 69.

44 1826 års Förslag till Allmän Civillag [The 1826 Proposal for a Commercial Code], p. 148.

45 *Op. cit.* p. 209.

46 Winroth, A. O. och Lamm, K. (1917), Köp av lös egendom: efterlämnat manuskript [Sale of Movable Property: Posthumous Manuscript], p. 121.

47 Taxell, Avtal och rättsskydd [Contracts and Legal Protection], p. 452.

48 Olsen, Ersättningsklausuler [Damages Clauses], p. 143.

49 Krüger, K. (1999), Norsk kjøpsrett [Norwegian Sale of Goods Law], p. 492.

50 Tørum, Interpretation of commercial contracts, p. 173. However, he does not state from where this tendency is derived.

51 See for example Dahlman, C. (2019), Begreppet rättskälla i Juridiska grundbegrepp: en vänbok till David Reidhav [The Concept of a Legal Source in Fundamental Legal Concepts: A Festschrift for David Reidhav], p. 65 *et seqq.,* for a study of legal sources and legal theory according to Swedish law.

tation or supplementation – an exclusive remedy is the most far-fetched interpretation.

The various readings of the legal cases can be summarized as follows. These are based on the 2010 case stating that there is no norm governing the relationship between damages clauses and compensation according to dispositive law, and the 2014 case stating that such a norm exists and does not limit the application of dispositive law. In this case, the following applies:

13 2010: interpretation – 2014: interpretation compatible

14 2010: dispositive law – 2014: interpretation compatible

15 2010: interpretation – 2014: dispositive law incompatible

16 2010: dispositive law – 2014: dispositive law incompatible

The legal effect of interpretation applies only to the specific contract. Thus, there is no contradiction in (13). There is also no contradiction in (14) since the court in the 2010 case referred to the content of applicable law – that it was lacking – while the court in the 2014 case interpreted such content (regardless of which interpretative rule was used).

In (15), however, a contradiction arises if the court was looking for a dispositive norm to interpret the contract accordingly. If no such norm existed and the court in the 2014 case states that such a norm does exist, the statements are incompatible. In (16), it also follows that the two readings are incompatible because one says that the dispositive law does not contain a certain rule, and the other says it does contain a certain rule.

The question is thus which of (13)–(16) applies. In the 2010 case, I mean that the case must be read as the court seeking a non-mandatory norm. This is evident both from a direct reading of the judgments and from the material the court reviewed, which consisted of presentations of material law rather than presentations of various interpretative rules. Even the use of the term *in dubio* rule should be understood as the court referring to the content of the supplementary law, assuming that *in dubio* rule means its conventional meaning, which is a material rule.[52]

When the court refers to interpretation and auxiliary rule, this should be read as the court discussing interpretation but in the sense that it was seeking a dispositive rule to interpret the contract accordingly. The court was thus looking for a non-mandatory material rule but found none. Therefore, options (14) and (16) remain.

For the 2014 case, a similar analysis can be performed. The case title already suggests that it concerns the interpretation of ABT 94. Further guidance is provided by the headings in the judgments. The court explains, among other things, non-mandatory law in the area (para. 26 – 29), followed by the heading The Question of Right to Compensation for Calculated Remedial Costs According to ABT 94 where the previous quotes are found. In the preceding section, the court compares the contract's provisions with those of non-mandatory law, indicating that dispositive law has certain content and questioning if something different applies according to ABT 94.

Subsequently, in para. 31, the court states that an agreed remedy does not exclude the disadvantaged party's right to other remedies that may follow from the applicable legal rules. It is not explicitly stated in the judgments how this legal effect arises. However, the reasonable interpretation is that the court in para. 31 presents a general interpretative rule – in the court's words, order – which also applies to standard contracts. The court then uses the contract's systematics as part of the interpretation, following an interpretative method it has introduced. In the 2014 case, this follows from the fact that the regulation in Ch. 7, Sec. 25 and 26 of ABT 94 does not provide support for the remedial provision being exclusive, but it must also be considered what is prescribed in Ch. 5 under the heading Responsibility.

The court then applies the interpretative rule mentioned in para. 31 to the circumstances of the case, which means that Ch. 5 and 7, Sec. 25 and 26 of ABT 94 are not interpreted so that when a contractor breaches its remedial duty, the only option available to the client is to undertake the remedy themselves. It does not exclude the right to compensation according to tort law principles as an alternative remedy.[53] The court then examines how the outcome relates to the overall legal system, which is also an interpretative method previously explained by the court in the judgments.[54]

Therefore, the conclusion of the 2014 case must be that the legal effect followed from an interpretation of the contract. Thus, option (14) above remains, and the judgments are compatible with each other. This also means that the non-mandatory law does not contain a norm N that regulates the relationship between penalties and damages. But this does not mean that the penalty creditor is entitled to both the penalty and compensation for the entire damage, that is, a total of 300,000 SEK. Instead, as before, the right to compensation covers the entire damage, but since parts of the damage are already covered by the penalty amount, this should be deducted from the compensation according to dispositive law. In the example above, if B can prove a damage of 200,000 SEK, 100,000 SEK will be compensated by the penalty and 100,000 SEK by dispositive law.

The trend in literature during the latter half of the 20th century has been that the amount in the dagames clauses is exclusive. The Supreme Court also points out in the 2010 case that it is common for these clauses in standard contracts to be exclusive. This is the case, for example, according to AB 04 and NL 17, p. 16 and 17. It can therefore be said that it is typical for delay damages clauses to constitute exclusive compensation for delay. However, that damages clauses are exclusive in several standard contracts and that parties often agree that penalties should be exclusive is an empirical question.[55] The content of applicable law is another question, and these need not have the same answer.

It should also be noted that the right to compensation for the entire damage is governed by a dispositive rule. If the parties do not want this to govern their relationship, they are free to agree otherwise (or explicitly agree that it applies). Regardless of the solution chosen by the parties, it is advantageous if the contract is clear on this issue. As Nehrman pointed out already in 1729, a damages clause reduces the scope of a trial, and to minimize the process as much as possible, it is helpful if the relationship between the penalty and damages is clear.[56]

Another way to clarify the relationship between damages clause and damages according to dispositive law would have been to compare the clause's amount with the economic damage. However,

52 Adestam, J. and Arvidsson, N. (2017), Kommentar till lag (1936:81) om skuldebrev, [Commentary on the Promissory Notes Act (1936:81)] Inledning [Introduction], chapter 1.2.2.

53 "Det Andra Bolaget", p. 32.

54 *Op. cit.* p. 22 with reference to "Skadorna på Läckebys arbeten", para. 7.

55 Adestam, J. and Arvidsson, N. (2021), Avtalsbrott och skadestånd — skuldprincipen i svensk avtalsrätt. Svensk Juristtidning [Breach of Contract and Damages — The Fault Principle in Swedish Contract Law], p. 49.

56 Nehrman, Inledning til then swenska iurisprudentiam civilem [Introduction to Swedish Civil Jurisprudence], p. 282.

this would mean that the parties would need to investigate the extent of the damage, which in many cases can take a long time and incur high costs, thus losing a significant advantage of a penalty clause – that it, all else being equal, reduces the extent of a trial due to a breach of contract compared to if the same trial had been governed entirely by dispositive law.

3. Concluding remarks

In this article, I wanted to clarify two problems long associated with damages clauses: whether they imply a requirement for actual economic loss and the relationship between the amount in the damages clause and damages according to dispositive law. Given the unclear legal status regarding whether a damages clause has a requirement for damages, I believe the best way to solve this issue is to define a damages clause so that they exclude a requirement for economic damages. This means that clauses containing a requirement for damages are not considered damages clauses. It also means that a clause that qualifies as a damages clause is supplemented by norms belonging to the damages clause type, precisely because it is a damages clause.

Such a solution would provide greater predictability for the parties, and they would avoid disputes about the extent of the damage (and thus increased litigation costs). If the parties want a different solution, this is entirely possible, as it falls under the scope of contractual freedom. A clause with a requirement for damages is therefore valid but not considered a damages clause.

Regarding the relationship between the damages amount and damages according to dispositive law, it follows from NJA 2010 p. 629 »Den försvunna huvudnyckeln«and NJA 2014 p. 960 »Det Andra Bolaget« that dispositive law does not contain a norm governing the relationship between damages clause and the dispositive law. This means that the creditor can claim compensation both according to the clause and according to dispositive law, as long as the conditions for each type of compensation are met. The amount in the clause will always be payable. However, damages according to dispositive law, that is, compensation according to the positive interest, will also be payable. Damages according to dispositive law should cover the entire loss, which means that the portion of the damage covered by the penalty amount should be deducted. In the above example, if B can prove a loss of 200,000 SEK, 100,000 SEK will be covered by the penalty and 100,000 SEK by non-mandatory law.