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THE LEGAL REGIME OF THE PENALTY CLAUSE AS A WAY OF OBTAINING PERFORMANCE IN KIND OF A CIVIL OBLIGATION

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Abstract: *Currently in the New Civil Code, which has incorporated provisions from the old Civil Code and the old Commercial Code, Article 1536 states that in the case of obligations other than those for the payment of a sum of money, late performance always entitles the debtor to damages equal to statutory interest, calculated from the date on which the debtor is in default on the money equivalent of the obligation, unless a penalty clause has been stipulated or the creditor can prove greater damage caused by the delay in performance. Therefore, according to common law, for late performance of the contract or for non-performance of contractual obligations, if penalties for late performance have been stipulated in the contract, it means that liability for that breach has been definitively settled and damages can no longer be claimed, since it is considered that the penalty clause stipulated in the contract has determined in advance the damages that the debtor will pay.*

Keywords: *penalty clause, anticipatory damage, non-performance of obligation, compensatory damages, principal obligation.*

INTRODUCTION

The penalty clause is characterised as that contractual provision by which the parties estimate the damage in advance, indicating that the debtor, in case of non-performance of the obligation, will bear the consequence of remitting to the creditor a sum of money or other property.

Similar definitions can be found in most civil laws of continental countries.

Thus, according to Article 1226 of the French Civil Code, a penalty clause is one by which a person, in order to ensure the performance of an agreement, undertakes to pay something in case of non-performance.

The Swiss Code of Obligations conceives the penalty clause as a stipulation concerning the sanction (penalty) established for non-performance or imperfect performance of the contract which the creditor may demand in lieu of performance, unless otherwise agreed.

According to the Italian Civil Code, a penalty clause is a clause agreeing that, in the event of non-performance or late performance, one of the contracting parties is bound to a certain performance.

The Russian Civil Code does not define a penalty clause as such, but a penalty, which is a sum of money, fixed by law or by contract, which the debtor owes to the creditor in the event of non-performance or improper performance of the obligation, in

particular in the event of late performance. It follows from the definitions of the penalty clause set out above that, as a rule, it is contractual in nature, respectively it is established by agreement between the parties - the contractual penalty clause. The laws of some countries (e.g. the Civil Code of the Republic of Moldova, the Civil Code of the Russian Federation) provide that the payment of the penalty may be ordered by law - the statutory penalty clause. It should be noted that the penalty established by law (if the lex causae is the law of the Republic of Moldova) cannot be excluded or reduced in advance by agreement of the parties (Nicolae, 2015:39).

1. ***The notion of a penalty clause compared to other legal systems***

The penalty clause applies only if the main obligation of the contract is not performed, which may take the form of total or partial non-performance, improper performance or late performance; non-performance may also be both improper and late. It should be noted that only non-performance of the obligation is specified, which is why it should be borne in mind that the institution of non-performance includes any breach of obligations, including improper or late performance.

Therefore, the penalty clause fulfils both the function of compensatory damages (damages due for the prejudice caused to the creditor by the total or partial non-performance or improper performance of the obligations by the debtor) and default damages (damages due for the prejudice caused to the creditor by the debtor's delay in performing the obligation).

The object of the penalty clause is usually a fixed or determinable sum of money called a penalty. It may be fixed either globally or as a percentage of the value of the subject-matter of the contract to which it relates. The penalty clause may be provided in a fixed amount or in the form of a share of the value of the obligation secured by the penalty clause or of the part not performed.

If the penalty clause is contractual, it must meet the conditions of validity required by law for any contract (civil legal act): capacity of the parties, consent, object and cause.

As regards the formal requirements, it should be stressed that the penalty clause always has to be in writing, even if the main obligation for which it was stipulated does not. Under some legislation, failure to comply with the written form of the penalty clause is punishable by nullity. Although only in some countries (Republic of Moldova, Russian Federation) are the written form requirements expressly laid down by law, arbitration practice and doctrine in various countries have consistently shown that the penalty clause must be expressly provided for in the contract (in writing) and is never implied (Uliescu, 2012:44).

As an expression of the principle of freedom of contract, the penalty clause is of particular practical importance, since it avoids difficulties in the judicial assessment of the damage, since the creditor is not obliged to prove the existence and extent of the damage, and in order to obtain payment of the amount laid down in the penalty clause it is satisfactory for the creditor to prove the factual circumstance of non-performance, improper or late performance of the obligation.

The monetary amount stipulated in the penalty clause shall be due instead of the damages which may be awarded by a court in the event of non-performance or improper and, in particular, late performance of the obligation. At the same time, it has been pointed out in the literature that penalty clauses may also present certain dangers when they are imposed by the stronger party to the contract (Mangu, 2020:102).

Thus, it has been found that in consumer contracts, although these clauses are not unlawful as such, they can be recognised as unfair, for example when there is no reciprocity in their application by the parties.

In the context of counteracting the negative effects that can be caused by penal guidelines in adhesion contracts, we note that standard contract terms are void:

- on the global assessment of the user's entitlement to damages or compensation for diminution in value, if in regulated cases the global value exceeds the damages or diminution in value which would have been expected under normal circumstances, or if his contractual partner is not allowed to prove that no damages or diminution in value have occurred or that they are substantially less than the global value;

- whereby the user is promised payment of a penalty if the obligation is not performed or is performed late, if he delays payment or if his contracting partner terminates the contract.

Several opinions have been expressed in the literature on the legal nature of the penalty clause: - most French and Romanian authors qualify the penalty clause as a means of early assessment of the damage suffered by the creditor as a result of the debtor's non-performance of the obligation. - the penalty clause is a means of guaranteeing the performance of the obligation, which is available to the creditor. The emphasis on the guarantee function of the penalty clause is particularly evident in Russian law and doctrine, and this institution is based on Chapter 23 of the Russian Civil Code, entitled "Securing the performance of obligations";

- the penalty clause is a means of assessing in advance the damages to which non-performance gives rise, but it is also a means of guaranteeing the performance of obligations, so it has a dual nature. As far as we are concerned, the penalty clause is a multifunctional institution.

The main functions of the penalty clause are: guarantee function, evaluation function, compensation function, sanction function and incentive function (Veres, 2020:55).

The penalty clause fulfils the ***function of a guarantee***, as regards the performance of the principal obligation, in that the prospect of the consequences of non-performance of the contractual obligation impels the debtor to the actual performance of the contract. The guarantee function is particularly relevant where the amount of the penalty is appropriately fixed at an amount which is at least equal to the damages which the debtor would be obliged to pay in the absence of a penalty clause.The penalty clause also has an ***evaluation function.*** As noted above, it is emphasised in the literature that the penalty clause appears as a procedure for prior conventional assessment of the damage that may

be caused to the creditor by non-performance of the obligation and, respectively, of the extent of the compensation in the form of damages that the debtor owes to the creditor.

The penalty clause also has ***a compensatory (remedial) function***, as it is intended to compensate for the damage suffered by the creditor through the debtor's failure to fulfil contractual obligations.

The penalty clause also has ***a sanctioning function***, which results from the fact that the penalty is payable regardless of the extent of the damage, and may exceed its limits even in the absence of any damage. It is also possible for the parties to agree on a penalty clause which is higher than the damage for the purposes of compensation. In this context, the penalty clause can also be seen as a form of contractual civil liability, as a "pecuniary penalty".

The penalty clause also has an ***incentive function*** for the debtor to behave properly. By making the payment of the penalty an inevitable consequence of the breach of contractual obligations, the penalty clause demonstrates its mobilising role in encouraging the parties to actually perform their contracts. It is an incentive for the timely and proper performance of contractual obligations.

2. Legal nature of the penalty clause

2.1. Accessory nature

The penalty clause is of an ancillary nature, so that the validity of the main obligation determines an essential condition for the very existence of the penalty clause. In this respect, Article 1540 of the Civil Code provides that a penalty clause may only guarantee a valid claim. The nullity or extinction of the principal obligation also affects the penalty clause according to the rule *accesorium sequitur principalem* (Pop et al., 2020:230).

Thus, if the object of the principal obligation is extinguished by force majeure or fortuitous event, the debtor's obligation to perform the performance stipulated in the penalty clause will also be extinguished. The ancillary nature of the penalty clause also derives from its purpose: the purpose of the clause is to enforce the main obligation and not to collect penalties. It should be noted that the nullity of the penalty clause does not entail the nullity of the principal obligation.

The debtor cannot choose between performance in kind and payment of the amount provided for in the penalty clause, the purpose of the penalty clause being to determine the extent of the compensation and not to create an opportunity for the debtor to discharge the principal obligation by another performance - payment of the penalty. This choice is available only to the creditor and only if the principal obligation which has become due has not been performed in kind by the debtor (Pop et al., 2020:256).

The unsecured creditor is actually the creditor with a penalty clause who competes with the other creditors without having any right of preference over the other unsecured creditors of the same debtor.

2.2. Cumulation of penalties with enforcement

As regards the cumulation of penalties with performance, the rule established by most legislation is that a penalty clause may be cumulated with performance in kind only when it establishes a penalty for late payment. As regards a penalty clause establishing compensatory penalties, the rule established in the legislation of many countries is that such a clause may not be aggregated with the performance in kind of the principal obligation (Piperea, 2019:34).

These rules have been enshrined, in particular, in Article 1539 of the Civil Code, which provides that "The creditor may not demand both the performance in kind of the principal obligation and the payment of the penalty, unless the penalty for non-performance at the time or place fixed. In the latter case, the creditor may demand both the performance of the principal obligation and the penalty, unless he waives this right or accepts, without reservation, the performance of the obligation".

There are certain exceptions to the general rule that the penalty payment clause cannot be combined with the enforcement of the principal obligation, both in some national laws and in uniform law instruments. Thus, Article 160 of the Swiss Code of Obligations provides for the creditor's right to demand both performance of the contract and payment of penalties if the contract has not been performed at the agreed time or place (Almasan, 2018:54).

The rule enshrined in our legislation is that the creditor cannot demand both performance and payment of the penalty clause at the same time, except where penalties are also stipulated for improper or late performance of the obligation. If he has received performance, the creditor can demand payment of the penalty only if he has expressly reserved this right when receiving performance. Our civil law therefore widens the scope of cumulation of the penalty clause with the performance of the principal obligation.

The cumulation, under certain conditions, of penalties with performance in kind of the principal obligation is also allowed under other national legal systems, such as those of Germany, Spain, the USA, etc.

In order for the penalty clause to apply, **all the conditions for compensation must be met**. This requirement derives from the fact that the meaning of the penalty clause is the contractual assessment of the damages due to the creditor for non-performance of the contract and that it is, in fact, a form of contractual civil liability, as explained above. In this context, our civil law expressly provides that the debtor is not obliged to pay a penalty if non-performance is not due to his fault.

Therefore, it is required that the non-execution must be the fault of the debtor, attributable to him, and if he proves extraneous cause, he will be exonerated from paying the penalty. It is difficult to conceive of a clause providing for the payment of a penalty in the event of non-performance due to force majeure. Exceptionally, however, such a clause may be interpreted by the parties as also covering non-performance not attributable to the debtor.

Many legislations also require that the debtor has been put in default beforehand, unless he is in default as of right. This formality is not required by the laws of the Scandinavian countries (Denmark, Finland, Norway and Sweden), according to which,

at least in the case of a sale, the penalty clause automatically becomes operative through the effect of the non-performance of the obligation assumed by the debtor (Nicolae, 2015:177).

If the non-performance is partly due to a fortuitous event or if there are other circumstances which exonerate the debtor from liability, such as, for example, the culpable actions of the creditor which contributed to the occurrence of the damage, the court will have to assess the extent to which the debtor is exonerated from liability and, as a result, the penalty will apply only in proportion to the part of the obligation whose non-performance is due to the fault of the debtor.

3. Binding force between the contracting parties

The penalty clause establishes a binding force between the parties to the contract and, as a rule, must be respected by both the parties and the courts, regardless of whether it is equal to, less than or greater than the damage. In a classic formulation, this rule is derived from Article 1541 of the Civil Code, which provides that the penalty may be reduced by the court only where the principal obligation has been partially performed or the penalty is excessive in relation to the damage that could have been foreseen (Almasan, 2018:63).

In this sense, the penalty clause is also characterised by a liability-limiting function, since in principle it sets a maximum level of damages. This function makes the penalty clause similar to the limitation of liability agreement, since in both cases the damages must not exceed the maximum amount agreed by the parties, unless the parties have agreed otherwise in the case of the penalty clause. The fundamental difference is that whereas in the case of the penalty clause the creditor is deemed to be relieved of the obligation to prove the existence and extent of the damage, in the case of the restrictive covenant the creditor is relieved of this obligation.

The above rule is not absolute. In some cases, as we shall see immediately below, the amount of damages provided for in the penalty clause may be adjusted to the amount of the damage actually suffered by the creditor through non-performance of the obligation - either by increase or by reduction.

Under some national laws, the penalty clause is supplemented by damages; if the amount of the loss turns out to be greater than the amount of the penalty provided for in the penalty clause, the creditor is entitled to claim compensation for the loss not covered by the penalty.

According to Article 1539 of the Civil Code, the correlation between the amount of the penalty and the amount of the damage actually suffered by the creditor can be expressed in several ways. As a general rule, the creditor may claim compensation for the damage in the part not covered by the penalty clause (including the penalty clause). In cases provided for by law or contract, the creditor:

- the possibility of claiming damages or penalties (alternative penalty clause);

- the possibility of claiming damages over and above the penalty (punitive damages clause), which means that both the penalty and the full amount of damages are paid in the amount of the damage incurred;

- the possibility of claiming only the penalty (exclusive penalty clause).

Moldovan law also provides for the possibility of judicial review of the size of the penalty. In exceptional cases, taking into account all the circumstances, the court may order a reduction of the disproportionately large penalty clause. When reducing the penalty clause, account must be taken not only of the creditor's financial interests but also of other interests protected by law. At the same time, the law provides that the penalty cannot be reduced if it has already been paid.

It is important to distinguish between the penalty clause, on the one hand, and the alternative obligation on the other, institutions which allow a party to legitimately discharge a contractual obligation by paying a sum of money or forfeiting the money already paid. However, a clause providing that the creditor may retain sums already paid as part of the price may fall within the scope of the regulations on the subject. This can be illustrated by two examples seen below (Istratoaie, 2013:89).

Example I. *A. undertakes to sell a property to B. for 750,000 lei. In order to guarantee the performance of the obligation to pay the price, the buyer (B.) gives the seller (A.) a pledge of 100,000 lei. A. may withhold the earnest money if B. fails to perform the obligation contracted for. Since there is no indemnity fixed in the contract, the amount in question cannot be reduced, even if it is excessive in the circumstances of the case.*

Example II. *A. enters into a car leasing contract with B. The contract provides that in the event of non-payment of a single instalment of the lease the contract will be terminated and the amounts already paid will be retained by the lessor as compensation. Such a clause may be examined from the point of view of the possibility of reducing the amount of the compensation.*

It should be noted that changing the size of penalties in the cases examined above is a faculty, but not an obligation of the court. If the court decides to change the size of the penalty, it must give reasons for its decision, which is not the case when the court refuses to change it. The review of the penalty clause by the court is an exception to the principle of the binding force of the contract in favour of the principle of equity.

The regulations in the common law system differ substantially from those in continental law. The most important difference is that common law legislation refuses, in principle, to recognise the validity of criminal clauses which provide for compensation in excess of the damage sustained.

The first point to be made in this context is that in Anglo-Saxon law there are two concepts: liquidated damages and penalty.

Following from the general principle that legal defences in civil law can only be compensatory but not punitive, in common law, in the event of non-performance of contractual obligations, only amounts which qualify as liquidated damages may be awarded, but not those which qualify as penalties. A clause is regarded as a penalty if it provides for the payment of sums stipulated as a 'threat' (in terorem) to the other party to force it to perform the contract. However, if the clause represents a "genuine attempt by the parties to estimate in advance the damage which will result from non-performance of

the contract", it will be considered liquidated damages, even if the amount stipulated is not exactly equivalent to the damage suffered by the creditor. Whether the clause qualifies as liquidated damages or as a penalty depends on its content, its wording and the circumstances that existed at the time of the conclusion of the contract (and not at the time of non-performance). The fact how the parties have named their clause in the contract - liquidated damages or penalty - is relevant but not decisive.

Clauses formulated in identical terms may be qualified as liquidated damages or as a penalty, depending on the content of the contract and the circumstances in which it was concluded. The court will make the classification in each individual case, assessing to what extent the amount fixed in advance was justified, to what extent the parties, at the time of the conclusion of the contract, could have expected the damage caused by the non-performance of the contract to correspond to the amount fixed in advance. The extent of the loss actually suffered by the creditor is not a determining factor. What is important is the extent to which the amount assessed in advance was justified at the time the contract was concluded.

Common law case law has established certain criteria for assigning clauses to the categories listed. Thus, it has been held that the clause will be considered as a penalty if the amount stipulated is excessive and exorbitant compared to the greatest damage that could result from non-performance. An example of this is the clause in a contract for works, the value of the subject matter of which is £50, which states that the contractor will have to pay a sum of £1 million in the event of non-performance.

A clause in a contract for the payment of a sum of money will be regarded as a penalty if the amount stipulated in advance is greater than the amount due; for example, a clause requiring the debtor to pay £1000 if he fails to pay £50 when due will be regarded as a penalty.

A clause providing for the payment of the same fixed sum in the event of one or more events, some of which may cause serious damage and others - minor damage - is presumed to be a penalty. A clause may be regarded as liquidated damages if the consequences of non-performance of the contract are such that a precise advance assessment of the damage is impossible.

The importance of the distinction between the two categories of clauses is seen in the effects resulting from the qualification of the clause in question. Thus, if the clause is liquidated damages, the creditor may collect the amount stipulated in advance, even if it exceeds the amount of the actual loss suffered. Conversely, if the stipulation is a penalty, the creditor may not claim the amount fixed in advance, but only the amount which he would be entitled to receive if the contract had not contained the penalty clause. In other words, the creditor will have to prove the extent of the loss actually incurred.

It should be noted that the court may declare the penalty clause null and void, but it does not have the power to reduce the amount of damages set by the clause to a reasonable level, as the court may do in continental law states.

It should be noted that in English law, if the clause qualifies as liquidated damages, the creditor will receive the stipulated amount even if he has not suffered any loss. The solution is different in US law. Thus, if no damage has been caused by non-

performance, the court will refuse to award the agreed sum, thus taking into account not only the situation existing at the time the contract was concluded but also that existing at the time of non-performance. Thus, in the common law system, the guarantee function of the penalty clause is less pronounced than in continental law, since the creditor is always required to justify the amount of the sum set out in the contract as an advance assessment of the loss resulting from non-performance of the contract.

CONCLUSIONS

This contractual stipulation is very frequently used and is of great practical use, since it avoids the difficulties of a possible judicial quantification of damages and, in certain cases, the costs of the civil proceedings.Thus, in the event of non-performance of the obligation initially assumed by the debtor, the penalty clause can be used to oblige the debtor in return to perform another service, which does not necessarily have to consist in the payment of a sum of money but may, for example, be an obligation on the debtor to hand over property to the creditor.

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