

## Regulation of the penalty clause in the Civil Code of the Republic of Moldova

Veronica GISCA<sup>1</sup>

Arina COSTIN<sup>2</sup>

<sup>1</sup>PhD, associate professor, Academy of Economic Studies of Moldova, gisca.veronica@ase.md,

ORCID : 0000-0002-0781-1995

<sup>2</sup>Undergraduate, Academy of Economic Studies of Moldova, arina.costin@ase.md,

ORCID: 0000-0003-3203-6836

**Abstract:** The penalty clause is an important mechanism in civil contracts to protect the rights and interests of the contracting parties if one of them fails to fulfil its obligations. In the Republic of Moldova, this provision is regulated by the Civil Code, which sets out the conditions and limits under which a penalty clause may be included in civil contracts.

When a contract is concluded, it is uncertain whether one partner or the other will fulfil their contractual obligations properly. Sometimes a contracting party may not be able to perform its obligations, sometimes it may, in bad faith, try to delay performance as long as possible. For diligent creditors, the legislator has regulated several ways in which it is possible to guarantee the performance of obligations. By guaranteeing obligations, we mean all the legal means, i.e. the rights and actions recognised directly by law or arising from the agreement of the parties to the obligation, the exercise of which ensures the enforcement of the claim.

A penalty clause is a contractual provision whereby the parties assess the loss in advance, stipulating that the debtor must pay the creditor a sum of money or other property in the event of non-performance of the obligation.

The purpose of this article is to analyse the regulations on the penalty clause in the Civil Code of the Republic of Moldova, to highlight its importance in civil contracts and to examine the conditions under which it can be applied, as well as its limitations and legal effects.

It will go on to provide details on the concept of a penalty clause, how it can be included in contracts, its limitations and legal effects in the Republic of Moldova, as well as examples of situations in which the penalty clause can be used to protect the interests of the contracting parties.

**Keywords:** creditor, debtor, penalty clause, civil contracts, non-performance, legal effects.

### INTRODUCTION

In fact, the penalty clause represents an advantage for the creditor, avoiding the judicial assessment of damages, the creditor not being obliged to prove the existence and extent of the damage or even to receive the penalties without any damage suffered. In order to obtain payment of the penalty clause, he only has to prove the fact of non-performance, improper or late performance (Pop, 2015).

The penalty clause is a contractual provision whereby the parties agree to bear certain consequences in the event of failure to comply with the obligations assumed by the contract. This clause is intended to discourage the parties from breaching the provisions of the contract by giving them a financial or other incentive to comply with their commitments.

In Moldovan civil law, a penalty clause is a form of contractual liability that can be included in a contract, and its purpose is to protect the interests of the parties to the contract and to encourage the performance of contractual obligations. The penalty clause can be included in any type of civil contract, such as sale-purchase contracts, rental contracts or service contracts.

If one of the parties fails to comply with its contractual obligations, the penalty clause can be activated and a range of sanctions, such as the payment of damages or the enforced performance of contractual obligations, can be imposed on the offending party.

It is important to note that the amount of the penalty clause must be proportionate to the value of the contractual obligation in order to avoid excessive penalties which may be considered abusive. The penalty clause must also be formulated in a clear and precise manner so as to avoid any room for interpretation or confusion.

## BASIC CONTENT

The Civil Code of the Republic of Moldova defines the penalty clause in Art. 947 para. 1, providing: The penalty clause is a contractual provision by which the parties evaluate the damage in advance, stipulating that the debtor, in case of non-performance of the obligation, shall remit to the creditor a sum of money or other property (penalty). It follows from the legal text that the object of the obligation whose non-performance triggers the application of the penalty clause may be any obligation to give, to do or not to do.

Dimitrie Alexandresco defines a penalty clause as an ancillary agreement whereby the parties determine in advance the equivalent of the damage suffered by the creditor as a result of non-performance, late performance or improper performance of the obligation by the debtor. [Dimitrie Alexandresco]

The accessory nature of the penalty clause is explained by the dependence of the penalty clause on the obligation arising from the main contract. The penalty clause in isolation will be non-existent; it cannot be imagined outside a contractual context, outside a pre-existing obligatory relationship. The penalty clause is - as has been argued in French doctrine - "a contract within a contract", according to Professor G. Paisant, or "a unilateral accessory and conditional contract, distinct from the contract containing the debtor's main undertaking" [G. Paisant], according to D. Mazeaud, and the authority of the principle of *accessorium sequitur principale* must therefore be recognised. [D. Mazeaud] It should be emphasised that the phrase "contract within a contract" must not be misleading. The penalty clause may indeed be stipulated in the main contract, just as there is nothing to prevent its insertion in a separate document. From a formal point of view, the penalty clause is not subject to any particular solemnity.

The penalty clause has the following legal characteristics:

- it is an ancillary agreement;
- it has practical value because it fixes in advance the amount of damages;
- it is binding between the parties, like any contract;
- it is payable only when all the conditions for the award of damages are met.

Being of a contractual nature, the penalty clause is intended to determine in advance the amount of the damage to be suffered by the creditor, so that the court is not called upon to determine it itself by its own assessment, but only to establish whether or not performance has been effected in accordance with the terms of the contract. This means that the court cannot require the creditor of the obligation, who invokes the penalty clause, to prove the damage suffered.

In practice, the courts have held that "the penalties stipulated by the parties in the loan agreement have the character of a penalty clause, established for late performance of the obligation to repay the sum borrowed.

According to Article 948 of the Civil Code of the Republic of Moldova, the form of the penalty clause is drawn up in authentic form if the law requires authentic form for the legal act to which the clause applies. In other cases, the penalty clause shall be drawn up in writing, under penalty of absolute nullity.

The form of the penalty clause may be freely agreed between the parties, subject to compliance with the legal provisions on the conditions of validity of contracts and contractual clauses. The penalty clause must be clear and precise so that it can be applied without difficulty and is not open to interpretation.

For a penalty clause to be valid, it must fulfil the following conditions:

- it must be set out in writing;
- it must be proportionate to the seriousness of the breach of the obligation;
- it must be provided for in the contract or in the contract supplement.

If the penalty clause is considered unfair or disproportionate, it can be challenged in court. In such cases, the court may decide to reduce the amount of the penalty clause or to annul it in its entirety.

The right to claim other damages is provided for in Article 949 of the Civil Code of the Republic of Moldova and consists in the possibility for the injured party to claim, in addition to the amount provided for in the penalty clause, other damages if the damage suffered exceeds the amount provided for in the penalty clause or if the penalty clause is considered ineffective.

Thus, if one party fails to fulfil its contractual obligations, the other party may claim the amount provided for in the penalty clause in addition to any other damages or expenses incurred. Such other damages may be

awarded according to the actual loss suffered and may include legal costs or financial losses suffered as a result of the non-performance of contractual obligations.

In the Civil Code of the Republic of Moldova, Art. 949, the right to claim other damages is stipulated:

(1) If the penalty is stipulated for the case when the debtor does not perform the obligation, the creditor may demand both the performance of the obligation and the payment of the penalty. Both the performance of the obligation and the payment of the penalty may not be demanded if the penalty has been stipulated by way of compensation in lieu of performance and not merely as a means of guaranteeing the performance of the obligation.

(2) The creditor has the right to claim compensation for the loss not covered by the penalty (inclusive penalty clause). In cases provided for by law or contract, the creditor may claim either damages or a penalty (alternative penalty clause), may claim compensation for the loss over and above the penalty (punitive penalty clause) or may claim only a penalty (exclusive penalty clause).

(3) If the creditor has received the performance, he may only demand payment of the penalty if he has expressly reserved this right when receiving the performance.

The penalty clause in the case of an indivisible obligation refers to the situation where several persons are obliged to perform an obligation jointly and severally. In this situation, the penalty clause may be provided for in the contract to ensure performance of indivisible obligations and to compensate for any damage caused by non-performance.

Thus, if one of the persons bound fails to perform the indivisible obligation, the other persons may claim payment of the amount provided for by the penalty clause, in addition to other damages or expenses incurred. It is important to note that in the case of indivisible obligations, each of the debtors is liable for the whole obligation and not just part of it. It is also important to bear in mind that the penalty clause may be considered invalid in the case of indivisible obligations in certain situations. If the penalty clause is considered excessive or unjustified, the court may decide to reduce it or remove it completely from the contract.

In conclusion, the penalty clause in the case of indivisible obligations can be an effective way of ensuring performance and compensating for any damage caused by non-performance.

According to the Civil Code of the Republic of Moldova, art. 950, the penalty clause in case of indivisible obligation implies: "If an indivisible obligation is guaranteed by a penalty clause and its non-performance is due to the fault of a debtor, the penalty may be demanded either in full from the guilty debtor or from each co-debtor for his part. In the latter case, each co-debtor has a right of action against the one who caused the penalty to accrue."

In the case of divisible obligations, the penalty clause may be provided for in the contract to ensure performance of the obligations and to compensate for any damage caused by non-performance. A divisible obligation is an obligation that can be divided into several parts or fractions so that it can be performed in part or in full by the debtor.

Thus, if the debtor fails to perform the divisible obligation, the creditor may claim payment of the amount provided for in the penalty clause, in addition to any other damages or costs incurred. It is important to note that the amount fixed by the penalty clause must be proportionate to the damage caused and not excessive.

It is important to bear in mind that, in the case of divisible obligations, the debtor may be required to perform part or all of his obligation. Thus, if the debtor has fulfilled only part of his obligation, the creditor may require payment of the penalty clause according to the amount of the unfulfilled obligation.

According to the Annotated Civil Code art. 951 the penalty clause in case of divisible obligation is:

(1) If a divisible obligation is secured by a penalty clause, the penalty is also divisible and accrues only against the co-debtor who has not performed the obligation and only for the part of the obligation to which he is bound.

(2) Paragraph (1) shall not apply to joint and several obligations. Nor shall they apply if the penalty clause was stipulated to prevent partial payment and one of the co-debtors has prevented full performance of the obligation. In this case, the co-debtor is liable for the entire penalty and the others for their share of the obligation. In the latter case, each co-debtor has a right of action against the one who caused the penalty to accrue.

According to Article 952 of the Civil Code, a statutory penalty clause is a contractual clause that sets a sum of money that the parties must pay if one of them breaches the terms of the contract. This amount is called a penalty and is designed to discourage breach of contract.

Under Romanian law, the statutory penalty clause is regulated by the Civil Code and can be included in contracts under the following conditions:

- the penalty clause must be proportionate to the value of the main obligation set out in the contract;
- the penalty clause must be expressly mentioned in the contract;
- the penalty clause cannot be used to compensate for actual damages suffered by the injured party.

If the penalty clause is found to be unlawful or unfair, it can be annulled or reduced by the court.

The statutory penalty clause states that "The penalty established by law cannot be excluded or reduced in advance by agreement of the parties."

Article 953, Reduction of Penalty in the Civil Code of the Republic of Moldova outlines that:

(1) In exceptional cases, taking into account all the circumstances, the court may order, at the request of the debtor, a disproportionately high reduction of the penalty. In reducing the penalty, account shall be taken not only of the pecuniary interests but also of other interests of the creditor protected by law.

(2) A reduction of the penalty shall not be allowed where the penalty has been extinguished by voluntary enforcement.

(3) No reduction of the penalty for late performance of the pecuniary obligation shall be allowed if the rate of the penalty is equal to or lower than the statutory rate applicable under Article 942.

(4) Any clause derogating from the provisions of this Article to the detriment of the debtor shall be null and void.

If a penalty clause is considered unlawful or unfair, the court may decide to cancel it or reduce the penalty to a more reasonable amount.

According to the Romanian Civil Code, the court may reduce the penalty in the following cases:

- if the amount of the penalty is excessive or disproportionate to the damage suffered by the injured party;
- if the party who breached the contract tried to remedy the breach before being sued;
- whether the breaching party had reasonable grounds for the breach;
- whether the penalty was paid in part or in full by the party in breach of contract.

It is important to note that the reduction of the penalty does not mean that the breaching party will no longer have to pay any penalty. It will have to pay a smaller amount, proportionate to the amount of the principal obligation under the contract.

**Functions of the penalty clause.** In contractual relations, the parties have the possibility, either in the contract or by a separate agreement made after the conclusion of the contract but before the damage occurs, to determine the amount of damages due by the debtor as a result of non-performance of the contractual obligations. At the same time, if a penalty clause is inserted in contracts, the injured party is spared lengthy, costly and uncertain legal proceedings. This avoids a lawsuit between the contracting parties to determine the compensation due for the damage caused to the creditor by the non-performance of contractual obligations.

The creditor benefiting from the penalty clause is relieved of the obligation to prove the damage suffered as a result of the wilful non-performance of the principal obligation. This clause gives the creditor the choice between enforcement in kind of the principal obligation and enforcement of the penalty clause. The option is at the creditor's discretion and not at the debtor's discretion. The parties are therefore relieved of any evidence as to the existence and extent of the damage and, by implication, the amount of damages owed by the debtor. The creditor only has to prove the fact of non-performance, defective performance or late performance of the contractual obligation assumed by the debtor.

The functions of the penalty clause have been discussed in the literature and in practice. There is no uniform view as to their number. However, we agree with the view that the main functions of the penalty clause are as follows: the function of guaranteeing the debtor's performance; the function of mobilising the debtor to perform his contractual obligations; the function of sanctioning; the function of remedying.

*The function of guaranteeing the performance of obligations by the debtor.* This function, although not regulated by law, arises from the practical reasons why this type of clause is inserted in contracts. The insertion of a penalty clause makes it a legal means of putting pressure on the debtor.

The guarantee function of the penalty clause is based on the idea that, by stipulating it in the contract, the creditor is in fact seeking performance of the principal obligation. The purpose of the penalty clause remains only subsidiary. The term 'security' must be understood in the broadest sense, including all legal means available to the creditor to enforce the debtor's obligations. Thus, the creditor, by stipulating the penalty clause, has the guarantee that he will receive what is due to him from his debtor.

The penalty clause is one of the so-called "security interests in rem", the purpose of which is to induce one of the parties to perform in kind, properly and on time a particular obligation for which that security has been stipulated; in this case the penalty clause has been stipulated. At the same time, it should be made clear that this is not a guarantee in the strict sense of the term, which is of such a nature as to break the rule of equality of creditors.

The stipulation of the penalty clause ensures compliance with the obligations assumed in the contracts, encouraging the debtor to perform them properly and in good faith. This "warning" puts material and moral pressure on the debtor to avoid the application of the penalty clause. The guarantee function is effective only to the extent that the amount of the penalty is appropriately set at an amount at least equal to the damages the debtor would be obliged to pay in the absence of the penalty clause. [Florin Luduşan]

*The debtor's mobilisation function in the performance of contractual obligations.* By its drastic nature, the penalty clause is a means of mobilising the debtor to correct contractual conduct, in order not to expose himself to the negative consequences arising from the implementation of this clause. The penalty clause becomes mobilising for the debtor when, in the event of non-performance of the obligations at the time or in the place agreed, the creditor requires the debtor to perform both the principal obligation and the penalties. This function of the penalty clause is particularly evident where the amount of the penalty is greater than the amount of the damage caused to the creditor by the non-performance, improper performance or late performance of the obligation to which the debtor has agreed. The function of mobilising the debtor in the performance of contractual obligations or the incentive function of the penalty clause may take the form of progressive penalties for late performance. [Florin Luduşan]

*The sanctioning function of the penalty clause.* The penalty clause penalises the unlawful non-performance of obligations by the debtor. Thus, the penalty clause is a private contractual penalty. According to this function, the penalty clause is due irrespective of the existence and extent of the damage caused to the creditor. The penalty clause fulfils a punitive function in particular where the amount of the penalty is greater than the amount of the damages, as it is possible that the damage is not present, in which case the payment of the penalty serves to punish the mere fact of non-performance of the obligation and appears as a real civil fine - from a means of prevention it becomes a means of repression, a sanction. The debtor is obliged to pay the sum of money or the value of the assets specified in the clause, even when this is greater than the value of the damage actually suffered by the creditor. [Florin Luduşan]

*The compensatory, valuation and reparation function.* The reparatory function (also called the compensatory function) is the most important function according to most legal doctrine in our country. The purpose of the penalty clause is to make good the damage suffered by the creditor as a result of the debtor's non-performance, defective performance or late performance of the contractual obligations. [Florin Luduşan]

**Legal characteristics of the penalty clause.** From the legal provisions, we can deduce the following defining legal characteristics of the penalty clause:

a) it is a contractual clause;

The penalty clause is a contractual clause contained in the contract between the parties or separate from it. Obviously, the law cannot lay down penalty clauses. It can, however, lay down legal penalties applicable in the event of non-performance of obligations expressly specified in the law. The statutory penalty limits the freedom of the parties to fix the size of the penalty, so that the penalty set by law cannot be excluded or reduced in advance by agreement of the parties, but can be increased by a penalty clause.

b) is accessory;

Since it applies in the event of non-performance of a contractual obligation, the penalty clause is ancillary to the contract from which the obligation arises. According to the principle of ancillarity, the penalty clause will follow the legal situation of the contract in which it is contained (principal accessory). Nullity, assignment or extinction of the contract will have the same legal consequence for the penalty clause. Not vice versa. The nullity of the penalty clause will not entail the nullity of the contract in which it is contained.

As regards the accessory nature of the penalty clause, it should be noted that there is an independence between the agreement in which it was stipulated and the possible invalidity of the penalty clause, but also a dependence of the penalty clause on the validity of the main agreement. This is also confirmed by Art. 1540 para. (1) of the Romanian Civil Code, which states that "The invalidity of the main obligation entails the invalidity of the penalty clause. The nullity of the penalty clause does not entail the nullity of the main obligation". By way of exception, the extinction of obligations by termination or rescission does not lead to the extinction of the effects of the penalty clause provided for non-performance.

c) is solemn;

The penalty clause must be in writing, and this requirement is imposed by the law *ad validitatem* even if the secured contract is also valid in oral form. If the penalty clause guarantees a contract for which the law requires authentic form, then the penalty clause, in the light of its ancillary nature, must also be in authentic form.

The solemnity of the penalty clause is required primarily in order to capture the debtor's clearly expressed willingness to assume payment of the penalty, which may sometimes be higher than the actual loss. Secondly, the written form provides certainty as to what the actual size of the penalty is and for which specific assumptions the penalty will be paid.

We can therefore conclude that the interpretation of a penalty clause will be governed by the principle of transparency, in the sense that its text must be clearly formulated and penalties will be imposed only for the assumptions specified in the clause and will not be extended to the types of non-performance not specified in it.

**Operation of the penalty clause.** As regards the operation of the penalty clause, it becomes enforceable when the conditions of the debtor's contractual liability are fulfilled.

The question of the possibility of combining penalties with performance in kind was addressed by the legislator in Article 1539 of the Romanian Civil Code. According to this article "The creditor may not demand both the performance in kind of the principal obligation and the payment of the penalty, unless the penalty has been stipulated for failure to perform the obligations at the time or place fixed. In the latter case, the creditor may claim both performance of the principal obligation and the penalty unless he waives this right or accepts, without reservation, performance of the obligation".

The following solutions follow from the aforementioned Article:

1. The penalty clause may not be aggregated with performance in kind or with compensatory damages where it has been provided for non-performance;
2. The penalty clause may be cumulated with enforcement in kind when it was provided for non-performance of obligations;
3. Where the clause was provided for non-performance, it may not be aggregated with compensatory damages, but may be aggregated with default damages if there is also delay in performance.

The final issue to be considered in the context of the penalty clause is its operation. There are two special cases of operation of the penalty clause. In the case of a principal obligation which is indivisible but not joint and several, if non-performance is due to the fault of one of the debtors, the creditor is entitled to claim the entire penalty from the debtor responsible for non-performance or to claim partial payment of the penalty from each debtor indivisible, but only for its part. If the principal obligation is divisible, then the penalty is also divisible and will be borne by the co-debtor guilty of non-performance and only in respect of his share. In the case of an indivisible obligation, the penalty may be claimed from the entirety of the culpable debtor, who has a right of recourse against the other debtors.

By way of exception, the rule of severability of the penalty clause in the case of a divisible principal obligation does not apply where the function of the penalty clause was precisely to prevent partial payment and one of

the debtors has prevented performance of the obligation in full. In this situation, the entire penalty may be claimed from the culpable debtor.

## CONCLUSION

The penalty clause is a contractual provision whereby the parties agree that in the event of non-performance of contractual obligations, the party in breach of the contract shall pay a sum of money by way of penalty. This amount does not represent the actual damages suffered by the party who has suffered the loss, but is a fixed amount, provided for in advance by the parties, which is intended to discourage breach of contract.

There are different views on the usefulness of the penalty clause in contracts. On the one hand, some argue that the penalty clause can be useful in situations where it is difficult to determine the actual damages suffered by the injured party and can be a means of deterring breach of contract. On the other hand, others consider that the penalty clause may be excessive and may be an unjustified sanction which can be used by one party to intimidate or put pressure on the other party.

It is important to note that the penalty clause is only legal if it is explicitly stated in the contract and is proportionate to the damage suffered. Otherwise, it can be considered unfair and can be annulled by the court.

In conclusion, the penalty clause may be useful in certain situations, but it must be used with caution and must be proportionate to the damage suffered. It is important to set out the contractual provisions clearly and avoid any ambiguity or uncertainty that could lead to misinterpretation.

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