Nataliia Fedorchenko, PhD in Law
Kyiv University of Tourism, Economics and Law

A PENALTY AS A WAY TO ENFORCE CONTRACTUAL OBLIGATIONS TO PROVIDE SERVICES

The article studies the characteristics of penalty as the most common way to enforce the obligations to provide services.

Condition of the economy of any country, stability and efficiency of civil turnover are directly dependent on the conscientiousness and diligence of participants in civil turnover and on the proper fulfillment of contractual obligations. A specific feature of modern civil turnover became the low level of contractual discipline, a significant increase in the number of non-fulfilled or improperly fulfilled obligations. This, in turn, stipulated the urgent need to improve the protection of the interests of participants in civil turnover and exacerbated the problem of ensuring the proper fulfillment of obligations.

In our legal system, the main task to enforce the fulfillment of contracts on the provision of services is seen as creating ways to encourage a debtor to a personal fulfillment of a contract and only in case of impossibility of personal fulfillment - to the creation for a creditor additional indemnity in the event of non- fulfillment or improper fulfillment of a contract. In addition, it should be noted that the current civil law does not limit parties of a treaty in deciding how to enforce the obligations, as well as the simultaneous use of all or some of the to enforce the fulfillment of contracts.

One of the main functions inherent to a penalty as a method of enforcement of contractual obligations in general and for the provision of services in particular, is stimulating (ensuring) function. Stimulatory character of a penalty may be directed to different areas of interest of a creditor depending on the type of obligations and direct duties of a debtor. Thus, the penalty may be provided pursuant to the debtor obligation in kind. This occurs, for example, by establishing fines and penalties in case of delay in delivery of services; in case of damage during transport, etc. That is, we can say that in a contractual obligation to provide services, the objective is to forfeit material incentives for a debtor to the proper fulfillment of their main duties: activities related to the provision of services. However, it should be noted that this stimulatory effect mainly peculiar to a penalty established in the long-term legal relationships (storage, bank credit facilities, etc.).

So, as you can see from the above construction contract-mandatory penalty is a specific structure of Soviet law that is stipulated with a planned system of economic management. In this case, the contractual penalty is mandatory in fact turned into a legitimate penalty due to the existence of centralized economic planning. If a party refuses to sign a contract, a court recognized the existence of certain rights and obligations under the plan document. In our opinion, in the present conditions of a market economy any reason to distinguish such a penalty in the service agreement was lost, because it is unsuitable for modern domestic law.

Thus, at the conclusion of contracts for the provision of services parties have the opportunity to pre-determine how to enforce the obligations that will stimulate the proper fulfillment of contract terms. In our opinion, a penalty is the most common, universal way to enforce the obligations to provide services, and this seems an advantage over other ways to enforce the obligations.

The unreasonableness of narrowing of penalty by defining it exclusively in cash was grounded. Attention is focused on the need to expand the scope of contractual penalties, since the possibility of using contractual penalty gives contractors greater guarantees to ensure proper fulfillment of the service contract.

Key words: contracts for services, types to enforce an obligation, penalty, penalization, types of penalties, violation of contractual obligation.

Condition of economy of any country, stability and efficiency of civil turnover are directly dependent on the conscientiousness and diligence of participants in civil turnover and on the proper fulfillment of contractual obligations. A specific feature of modern civil turnover became the low level of contractual discipline, a significant increase in the number of non-fulfilled or improperly fulfilled obligations. This, in turn, stipulated the urgent need to improve the protection of the interests of participants in civil turnover and exacerbated the problem of ensuring the proper fulfillment of obligations.

In order to protect the interests of creditors and prevent or reduce the size of negative legal consequences of a possible non-fulfillment or improper fulfillment of an obligation by a debtor the institution to enforce the obligations is used. This special legal institution took its place in civil legislation (Chapter 49 of the Civil Code of Ukraine), which provides special ways to enforce obligations, which are penalty, pledge, retention, surety, guarantee, earnest, as well as other methods defined by law or contract.

Despite the importance and applicability of the ways to enforce obligations they are not fully regulated by legislation, stir controversy in practice and bring forth to ambiguity of interpretation. Despite the fact that the ways to enforce proper fulfillment of contractual obligations are applied in accordance with current legislation, the clear understanding of the nature and principles of the application of specific measures to enforce proper fulfillment of contractual obligations, including the provision of services becomes particularly actual today.

Thus, the Civil Code of 1922 did not contain a general division concerning ways to enforce obligations. Civil Code of the Ukrainian SSR in 1963 included the Art. 178 "Enforcement of obligations", which was perceived as general and gave the definition of the enforcement of obligations and an exhaustive list of its types (penalty, pledge, surety, earnest and guarantee). Despite the fact that the list was exhaustive, the parties of a contract to provide services had no opportunity to choose other ways to enforce the obligations. But the legislator of the Civil Code of Ukraine adheres to a fundamentally new approach to the definition of ways to enforce obligations which lies in the fact that both the law and the contract may provide different ways of enforcement than established in Part 1 of Art. 546 of the Civil Code of Ukraine.

Note that in contemporary legal literature there are similar ideas about the inadvisability to fix general provisions on the enforcement of obligations at the legislative level. Moreover, V. Popandopoulos criticized the feasibility to combine the relevant legal institutions in one chapter on the grounds that the enforcement of obligation as a separate institution does not exist[1]. Other scientists argue that a solid doctrine about the enforcement of obligation has not yet been created in the domestic civil law, although there is a great need for such teaching[2].

The ways to enforce proper fulfillment of contractual obligations to provide services is characterized by such features: a) the predictability by legal and/or contractual norms; 2) the dependence on the mechanism and nature of obligations to provide services; 3) the directivity on the enforcement of existing service obligations; 4) the conditionality with realities of economic and social nature, with a large probability of non-fulfillment or improper fulfillment of contractual conditions on the provision of services by a debtor; 5) the encouragement of a debtor for proper fulfillment of obligations due to the possibility of using additional negative consequences in the form of encumbrance of property and inability of use or possession of property, or significant growth of the cost on obligations or possible losses in future; 6) the synchronization with the peculiarities of certain types of service contracts, or even direct integration to its mechanism.

In our legal system, the main task to enforce the fulfillment of contracts on the provision of services is seen as creating ways to encourage a debtor to a personal fulfillment of a contract and only in case of impossibility of personal fulfillment - to the creation for a creditor additional indemnity in the event of non-fulfillment or improper fulfillment of a contract. In addition, it should be noted that the current civil law does not limit parties of a treaty in deciding how to enforce the obligations, as well as the simultaneous use of all or some of the ways to enforce the fulfillment of contracts.

Thus, in spite of the criticism of the inappropriate fixation of general provisions about the enforcement of obligations at legislative level, the approach of legislator enshrined in Chapter 49 of the Civil Code of Ukraine seems more corresponding; this approach consolidated both general provisions on the enforcement of obligations and special regulations on the use of each of the ways fixed in this chapter.

[1] Попандопуло, В.Ф. (1980). Обязательство и ответственность в гражданском праве. *Вестник Ленинградский университета,* 93.

[2] Пучковская, И.И. (2012). *Относительно разграничения видов обеспечения исполнения обязательства и мер гражданско-правовой ответственности (на примере неустойки).* Киев: Алерта, 125.

As a result, a creditor and a debtor may realize the specific consequences of non-fulfillment or improper fulfillment of contractual obligation.

Speaking about legal nature of a penalty we should note that there are discussions in the doctrine whether to recognize a penalty as a way to enforce the fulfillment of an obligation or as a measure of responsibility, or to recognize the dual legal nature of a penalty. Without focusing our attention on this issue, we'll note that in this paper the most common and acceptable point of view about the dual nature of a penalty in civil law is supported: a penalty is a way to enforce the fulfillment of an obligation and a measure of civil liability at the same time[1]. In our opinion, the abovementioned approach is quite acceptable for an understanding of legal nature of a penalty as a way of enforcement of contractual obligations to provide services, because on the one hand a penalty is included to the legislative measures aimed to stimulate the proper fulfillment of obligations taken on by a debtor to establish additional guarantees for satisfaction of the creditors' interests; and on the other, in the event of breach of contract to provide services a debtor gets an additional obligation to pay a penalty. Thus, according to I. Puchkovskaya, types of enforcement of obligations, of course, encourage a debtor to fulfill his obligation, but its main purpose is to protect a creditor in the event of a breach of the secured obligation by a debtor[2].

One of the main functions inherent to a penalty as a way to enforce a contractual obligation in general and for contract to provide services in particular, is stimulating (ensuring) function. Stimulating nature of a penalty may be directed to different areas of interest of a creditor depending on the type of obligation and direct responsibilities of a debtor[3]. Thus, a penalty may enforce the fulfillment of obligation by a debtor in kind. This occurs, for example, by establishing fines and poena in case of delay in provision of services or in case of damage of cargo during transportation, etc. That is, we may say that in a contractual obligation to provide services, the objective of a penalty is a material motivation of a debtor for proper fulfillment of his main duty: to carry out the activity related to the provision of services. However, it should be noted that this stimulatory effect mainly peculiar to the penalty established in the long-term legal relationships (storage, bank credits, etc.).

Speaking about the peculiarities of a penalty as a way to enforce obligations to provide services it is appropriate to allocate next features: a) a penalty is characterized with accessory (complementary) nature to the main obligation, i.e., a penalty is a supplement to the existing contractual obligation to provide services; b) a penalty is aimed at the prevention of non-fulfillment or improper fulfillment of the service contracts; c) non-fulfillment or improper fulfillment by a debtor of obligations under a contract to provide services appears before the application of penalties, therefore the basis to impose the negative effect at a debtor is a violation of a contractual obligation; d) according to the principle of freedom of a contract, the parties are free to formulate (where possible) the terms about a penalty on their own discretion; d) a recovery of a penalty compensates those losses incurred by a creditor because of a breach of a contract to provide services; e) a penalty as a way to enforce an obligation to provide services unlike the other types of enforcement of obligations has no such sign, as the presence of additional guarantee for fulfillment of obligation.

The doctrine of civil law classifies a penalty on the criterion of sources of emergence for the next types: a) a penalty, which emerges directly from a law (a lawful penalty); b) a penalty, which emerges exclusively from a contract (a contractual penalty); c) a penalty that emerges from a combination of two legal bases: from the prescriptions of a law and a contract (a lawful contractual penalty)[4].

It should be noted that a penalty is considered lawful if the law determines not only the possibility of its recovery, but also direct grounds for application of a penalty and its amount. A penalty which amount is determined in a law, but parties to a contract change (increase) the amount of a penalty is considered by V. Yakushev as a contractual penalty[5]. M. Artemenko believes that the concept of contractual penalty covers the cases, when the necessity to impose a penalty is prescribed by law, and its amount is determined

[1] Брагинский, М.И., Витрянский, В.В. (1997). *Договорное право. Общие положения.* Москва: Статут, 384.
[2] Пучковская, И.И. (2013). *О проблеме признания видов обеспечения исполнения обязательства способами защиты.* Москва: Право, 175.
[3] Константинова, В.С., Максименко, С.Т. (1981). *Правовые вопросы материального стимулирования деятельности предприятий.* Саратов: Изд-во Саратовского университета, 74.
[4] Райхер, В.К. (1958). *Правовые вопросы договорной дисциплины в СССР*. Ленинград: Изд-во Ленингр. ун-та, 121, 122.
[5] Красавчиков, О.А. (1972). *Советское гражданское право*. Москва: Высш. Школа, 402.

by jurisdictional bodies in the case where the parties had disagreements[1]. That is, if the legislator, for example, indicates that a debtor is liable to a creditor by paying a penalty, the amount of which is determined by the terms of a contract, such a penalty can not be considered as lawful, because the parties to a contract to provide services may prescribe otherwise. In this case, if the parties to a contract have not provided the enforcement of their obligation by a penalty, it will not be charged.

The next court case may serve as an example. Judicial board on civil cases of the Supreme Court of Ukraine dismissed the protest of a deputy of Prosecutor General of Ukraine in the case of B.Yu and B.N. to the insurance company "Oranta-Dnepr" to charge a penalty for improper fulfillment of obligation by the defendant under insurance contracts. The Judicial board dismissed the abovementioned protest of a deputy of Prosecutor General of Ukraine, because the insurer shall be liable for late payment of the sum insured (insurance indemnity by paying a penalty, the amount of which was determined by terms of the insurance contract[2]. As follows from the case, the fulfillment of obligation according to insurance contracts of B.Yu and B.N. was not enforced by a penalty, and its amount was not defined in contracts. On these grounds the court quite reasonably rejected the claims set in a protest of a deputy Prosecutor General of Ukraine.

Application of provisions of imperative norms about inclusion of conditions concerning the ways to enforce obligation in a content of a contract to provide services is the evidence of care of legislator about a consumer (customer) as economically weaker party in a contractual relationship; and on the other hand it gives relevant guarantees to a contract party, which is forced to enter into a contract with a natural monopolist (for example, Ukrainian railways).

Considering the totality of legal acts in Ukraine A. Otradnova concludes that today a lawful penalty enforce the following main legal relations: a) legal relations, where one of the subjects is a state or a state enterprise, institution, organization (legal relations emerging in connection with the provision of needs of a state in certain resources and legal relations in which state-owned enterprise is a party providing certain services, transfers property, finances certain works, etc.); b) civil legal relations which participants are legal entities of private law of non-state forms of ownership, except of areas that are subject to a clear and detailed government regulation, assurance and control (transport relations, relations in protection of consumers' rights, credit and settlement relations, communication relations, etc.); c) other civil legal relations not connected with the interests of a state, which inherited the enforcement of obligations with a lawful penalty from the Soviet system of the economy (relations of supply) [3].

It seems that offering the above-mentioned groups of legal relations A. Otradnova supported an attempt of legislator to protect the interests of a state and state-owned enterprises from dishonest contractors. Moreover the enforcement of certain relations to provide services by lawful penalty aimed at normal existence and development of those areas that are under state regulation and control, because, for example, the violations in the provision of passenger services in Kiev cause harm not only to contractors, but to the city as a whole.

We'll note that although current legislation has a limitation with double the NBU discount rate regarding the collection of contractual penalties (poena) in monetary obligations, but the amount of lawful penalty in many cases is quite significant. This is especially true about a penalty, which is set in civil relations with a state and the responsibility bears the contracting public authority. At the same time, the thesis proposed in legal literature about fixation at legislative level a possibility of enforcement with a penalty deserves attention, especially concerning the fulfillment of obligations to provide services from a state, what is important for compliance of the general principle of civil law - the principle of equality of parties[4].

It is commonly known that the amount of a lawful penalty is determined directly in the law that established this penalty. The amount of a lawful penalty may not be random. In certain cases, a legal act established the limit beyond which the liability in the form of penalties does not occur. At the same time, the legislation does not prohibit to resize a lawful penalty in a contractual way (in this case in the service contracts). That is parties of a contract to provide services are entitled to increase or decrease the amount of a penalty prescribed by law.

[1] Артеменко, М.С. (1986). *Роль неустойки в обеспечении исполнения плановых договорных обязательств в новых условиях хозяйствования*. Москва: Минх им. Г. Плеханова, 10.

[2] Ухвала Судової колегії в цивільних справах 1998 (Верховний Суд України). *Офіційний веб-портал Верховної Ради України.* < http://zakon4.rada.gov.ua/laws/show/n0001700-98>.

[3] Отраднова, А.А. (2002). *Неустойка в гражданском праве.* Киев, 84.

[4] Отраднова, А.А. (2002). *Неустойка в гражданском праве.* Киев, 86.

The amount of a penalty may be reduced by court if one of the following conditions exists: a) if the amount of a penalty is much greater than the size of damage; b) other circumstances of significant importance (p. 3 art. 551 of the Civil Code of Ukraine). An example is the lawsuit for the recovery of a penalty for delay in fulfillment of obligation in which a panel of judges of the Supreme Court of Ukraine in the decision of 19 October 2006 pointed on the possibility of reducing the amount of the penalty for delay of fulfillment of the obligation[1].

The contractual penalty is formed on a fundamentally different basis. The question about its inclusion to a contract should be settled by parties themselves. It is the parties and not the legislator who determine the conditions for application of a contractual penalty, its amount for improper fulfillment of an obligation, grounds and reasons to apply. As an exception, in the event of pre-contractual dispute with the consent of the parties, the matter may be referred to a court decision[2].

Among the varieties of contractual penalty O. Ioffe singled out: a) contractual-voluntary penalty, which is formed on the initiative of the participants of obligation and b) contractual-obligatory, which appears in a contract as a result of compliance by the parties of mandatory requirements of the legal norm[3].

The amount of a contractual penalty should be determined according to the amount of penalties that exist in current legislation for the same or similar offenses. Thus, for example, it is not justifiable when the amount of penalty for improper fulfillment of service under a contract is greater than for non-fulfillment of a service as far as non-fulfillment of contractual obligations is a greater violation of contract for services than its improper fulfillment.

From the foregoing it seems appropriate to emphasize that today we have the extension of the scope of a contractual penalty, since the possibility of contractual penalty provides contract parties with greater guarantees to enforce proper fulfillment of a service contract. Thus, in the service contracts parties may specify the possibility to differentiate the use of a penalty for failure to fulfill an obligation. Anticipating the application of a penalty for breach of contractual obligations to provide services parties are able to take into account the specifics of a particular type of service contracts, as well as features of contractual relationships with contractors.

Another type of a contractual penalty, which is widely used in the days of the planned economy, is contractual-obligatory penalty, which appears in the contract as a result of compliance by parties of mandatory requirements of a legal norm. It should be noted that the approaches of those researchers to understand the legal nature of this type of penalty is significantly different. So, if some scientists classified it as a type of contractual penalty[4 5], the others on the contrary underlined the need for separation of a penalty to lawful, contractual and lawful-contractual[6,7].

So, as you may see from the abovementioned the construction of contractual-obligatory penalty is a specific structure of Soviet law, which was stipulated with the planned system of economic management. In this case, a contractual-obligatory penalty in fact turned into a lawful penalty due to the existence of centralized economic planning. If parties refused to sign a contract, the court recognized the existence of certain rights and obligations under the planned document. In our opinion, in present conditions of market economy any reasons to distinguish such type of a penalty in service contracts are useless, because it is unsuitable for modern domestic law.

Thus, in conclusion of contracts to provide services parties have the opportunity to pre-determine how to enforce the obligations that will stimulate the proper fulfillment of contractual terms. In our opinion, the penalty is the most common, universal way to enforce the obligations to provide services and has many advantages in comparison with other ways to enforce the obligations.

[1] Бондаренко, Н. (2007). *Свобода договора в его разумности*. Киев, 17.
[2] Гелевей, А.И. (2003). *Неустойка как вид обеспечения выполнения обязательства.* Киев, 67.
[3] Иоффе, О.С. (1958). *Советское гражданское право.* Ленинград: Изд-во Ленингр. ун-та, 479.
[4] Граве, К.А. (1950). Договорная неустойка в советском праве. Москва: Юргиз, 10.
[5] Сорокина, С.Я. (1989). *Способы обеспечения исполнения гражданско-правовых обязательств между социалистического организациями.* Красноярск, 71.
[6] Райхер, В.К. (1958). *Правовые вопросы договорной дисциплины в СССР.* Ленинград: Изд-во Ленингр. ун-та, 122.
[7] Слесарев, В.П. (1989). *Экономические санкции в советском гражданском праве*. Красноярск: Издательство Красноярского университета, 78.

References

1. Artemenko, M.S. (1986). *Rol' neustojki v obespechenii ispolnenija planovykh dogovornykh objazatel'stv v novykh uslovijakh khozjajstvovanija*. Moskva: Minkh im. G. Plekhanova.
2. Bondarenko, N. (2007). *Svoboda dogovora v ego razumnosti*. Kiev.
3. Braginskij, M.I., Vitrjanskij, V.V. (1997). *Dogovornoe pravo. Obshchie polozhenija*. Moskva: Statut.
4. Gelevej, A.I. (2003). *Neustojka kak vid obespechenija vypolnenija objazatel'stva*. Kiev.
5. Grave, K.A. (1950). *Dogovornaja neustojka v sovetskom prave*. Moskva: Jurgiz.
6. Ioffe, O.S. (1958). *Sovetskoe grazhdanskoe pravo*. Leningrad: Izd-vo Leningr. un-ta.
7. Konstantinova, V.S., Maksimenko, S.T. (1981). *Pravovye voprosy material'nogo stimulirovanija dejatel'nosti predprijatij.* Saratov: Izd-vo Saratovskogo universiteta.
8. Krasavchikov, O.A. (1972). *Sovetskoe grazhdanskoe pravo*. Moskva: Vyssh. Shkola.
9. Otradnova, A.A. (2002). *Neustojka v grazhdanskom prave*. Kiev.
10. Popandopulo, V.F. (1980). Objazatel'stvo i otvetstvennost' v grazhdanskom prave. *Vestnik Leningradskij universiteta.*
11. Puchkovskaja, I.I. (2012). *Otnositel'no razgranichenija vidov obespechenija ispolnenija objazatel'stva i mer grazhdansko-pravovoj otvetstvennosti (na primere neustojki).* Kiev: Alerta.
12. Puchkovskaja, I.I. (2013). *O probleme priznanija vidov obespechenija ispolnenija objazatel'stva sposobami zashchity*. Moskva: Pravo.
13. Rajkher, V.K. (1958). *Pravovye voprosy dogovornoj discipliny v SSSR.* Leningrad: Izd-vo Leningr. un-ta.
14. Slesarev, V.P. (1989). *Ehkonomicheskie sankcii v sovetskom grazhdanskom prave*. Krasnojarsk: Izdatel'stvo Krasnojarskogo universiteta.
15. Sorokina, S.JA. (1989). *Sposoby obespechenija ispolnenija grazhdansko-pravovykh objazatel'stv mezhdu socialisticheskogo organizacijami*. Krasnojarsk.
16. *Ukhvala Sudovoi kolegii v civil'nikh spravakh* 1998 (Verkhovnij Sud Ukraini). *Oficijnij veb-portal Verkhovnoi Radi Ukraini.* <http://zakon4.rada.gov.ua/laws/show/n0001700-98>.