



## THE PENALTY UNDER THE LEASE AGREEMENT

KAMBOUROV & PARTNERS  
ATTORNEYS AT LAW

## CONTRACT PENALTY – GENERAL TERMS

- ***What is a penalty?***

A preliminary negotiated **compensation for non-fulfillment of a contractual obligation** (Art. 92/1 The Obligations and Contracts Act (OCA) /. It serves as a **collateral** for the obligation, as an **indemnity** for damages from guilty non-fulfillment, it is also considered as a sanction for the defaulting party.

- ***What is the advantage?***

The penalty releases the creditor from the need to prove the actual damages. Can be cumulated with a claim for the actual damages if they exceed the penalty.

## AN EXCESSIVE PENALTY (EXORBITANT) PENALTY

- ***Reduction of the excessive penalty***

Art. 92/2 OCA - only a non-commercial party (individual) may request a reduction of the penalty due to excessiveness in relation to the actual damage or to the outstanding part of the obligation. The burden of proof is on the debtor. The court does not follow ex officio.

- ***Reduction prohibition***

It is not possible to reduce an excessive penalty under a commercial transaction between traders - Art. 309 CA /except for cases of partial non-performance; compensation for guilt/

- ***Invalidity of the excessive penalty***

A penalty that is so excessive and unjustified that it leads to the enrichment of one of the parties, is out of the inherent functions of the penalty, violates the principle of justice, contradicts morality and should be considered null and void on the grounds of Art. 26/1/3 OCA / CA No. 1/2010 under case № 1/2009 STC of the Supreme Court of Cassation /. Applied ex officio by the Court.



## EXCESSIVE PENALTY CONSEQUENCES

"The default shall be deemed null and void if the sole purpose for which it is agreed upon goes beyond its inherent collateral, guaranteeing, indemnifying and sanctioning functions. The excessiveness of the penalty does not make it a priori void because of the violation of good manners. "

### Consequences:

- The clause imposing excessive penalty is null and void. If it is **voluntarily paid**, it is subject to **return** as paid under a null contract (regardless of the method of payment). The assessment of compliance of the penalty clause is made at the time of its conclusion and on a case-by-case basis.
- In the case of a **dispute** between traders for the payment of an excessive penalty, the claim for payment is **entirely** rejected.

## GENERAL CRITERIA FOR THE VALIDITY OF A PENALTY

General criteria for a penalty compliance:

- type and amount of the obligation secured by penalty;
- securing the obligation with legal remedies other than penalty - mortgage, pledge, etc.
- the type of penalty and the default for which it is intended;
- ratio between the amount of the penalty and the expected damages from the default, and so on.

No 1/2010 on case № 1/2009 of OSTC of the Supreme Court of Cassation - "The conditions and prerequisites for nullity of the penalty clause derive from its functions as well as from the principle of fairness in the civil and commercial relations. The assessment of the nullity of the penalty due to violation of good morals should be made on a case-by-case basis at the time of the conclusion of the contract and not at a later point."

**PENALTY IN PRE-TERM  
TERMINATION OF THE  
CONTRACT**



A compensatory penalty in pre-term termination of the contract on behalf of the lessee

*A penalty, agreed upon under pre-term termination of a lease by the lessee, defined at the amount of the "lease payments for the period of termination of the contract until the expiry of the term agreed upon therein" is treated as null and void due to a contradiction with morals according to the mandatory decision of the SCC / No. 110 of 21.07.2016 under No. 1226/2015, I /*

*In view of the nature of the considerations - for long-term performance of the lessor / provision of the use of the property / and for periodic performance of the lessee / to pay the lease price /, both the cancelation of the contract and its termination have a future effect, terminated by the expiration of the term. The term ensures how. On the grounds of Article 238 of the OCA, if the lease is without a fixed term, either party may give up the contract by giving notice to the other party one month in advance. Where the lease contract is for a fixed term, the lease relationship is in the interest of the lessee - it protects it from the possibility of the lessor to deprive it of the use of the property in advance either due to termination or due to disposition of its property rights in respect of the property, if owner, taking into account the rule under Art. 237, para. 2 of the OCA, as well as the interest of the lessor - to receive, for a certain period, a lease price against the granted right of use of the leased property. At the same time, there is no regulatory restriction and, within the framework of the contractual freedom granted to them on the grounds of Article 9 of OCA, the parties to a lease contract may include a clause for its unilateral termination before the expiration of the term by will of either party or of one of them.. It is also acceptable for the parties to agree upon a penalty for damages in case of pre-term termination of a temporary lease contract, but only within its inherent collateral, compensational and sanctioning functions, otherwise the clause would be null and void due to violation of good morals, for which the court monitors on its own motion, whereas the assessment is made at the time of conclusion of the contract and not at a later point - point 3 of Interpretative Decision No 1 / 15.06.2010. under interpret. case No 1/2009 of OSTC of SCC. In that assessment, the characteristics of the lease and the type of consideration must be considered first of all: the lessor undertakes to give the lessee the use of one item at a lease price and the lessee to pay it, but only against the provided use. Upon termination of the lease, the lessor does not receive a lease price, but can provide the property to another person therefore realizing the missed profit. On the other hand, if a penalty has been agreed upon in case of pre-term termination of a lease contract by the lessee, to the amount of all the lease payments not paid under the contract until the end of its term, the lessor under the terminated lease will receive a property benefit from the opposing party to the amount that would have been received if the contract was not terminated but without the use of the property. Consequently, the penalty thus agreed upon for pre-term termination goes beyond the above-mentioned functions of the penalty, creates conditions for unjust enrichment of the former lessor and violates the principle of fairness.*



**JUDICIAL REASONS FOR THE INVALIDITY OF  
A PENALTY IN THE AMOUNT OF THE LEASE  
PAYMENTS FOR THE PERIOD OF TERMINATION  
OF THE CONTRACT UNTIL THE EXPIRY OF  
THE TERM STIPULATED IN IT**





A penalty to secure a monetary obligation such as lease installments and consumables:

- Ratio between statutory interest and penalty for unperformed monetary obligation
- Penalty without a limit or without a fixed term
- Validity of a penalty of 1% per day / in compliance with the specific obligation - 8-18 times over the statutory interest is considered void /

**PENALTY FOR NON-  
PERFORMANCE OF  
MONETARY OBLIGATIONS**





## **PENALTY FOR NON- PERFORMANCE OF THE OBLIGATION TO RETURN THE LEASED PROPERTY**

A penalty for non-performance of the obligation to return the property:

Case study: What did the parties agree to? By virtue of the unconditional clause of the lease contract, the performance of the obligation under item 13 of the contract - the return of the leased property shall be effected within five days after the expiry of the agreed term of the contractual relationship between the parties or upon its pre-term termination by any of the parties, is covered by a penalty for non-performance accepted by the co-contractors in a global amount of BGN 10,000 (or the equivalent of the annual lease of the site + 50%).

In a case of incidental control, the SCC did not consider the penalty invalid:

Decision No 227 / 07.09.2010 in relation to No. 409/2009, the Supreme Court of Cassation, CC, II, introduces "the ratio between the total amount of the penalty and the expected damages to the lessor from the non-performance of the obligation to return the leased property, which in view of the type and purpose of the leased property are not measured solely by the value of the lease due and as foreseeable by the co-contractors at the time of conclusion of the lease, they are defined globally, apparently in view of the profits made so far from the turnover of the process object, reduced ability due to the leased property to secure the non-monetary and peculiar nature of the obligation to return, and its enforcement with other legal means, do not give rise to a legal conclusion for an unfair wrongful clause leading to unjust enrichment that is contrary to good morals.

Ratio between the penalty and the compensation (lease price) under Art. 236 OCA:

The negotiation of a penalty for non-performance of the obligation to return the leased property is compatible with the right to compensation for the damages under Art. 236/2 of the OCA, which the lessor suffers from the arbitrary use of the leased property, after termination of the lease contract, by awarding compensation in the amount of the market lease (in fulfillment of the sanction function).

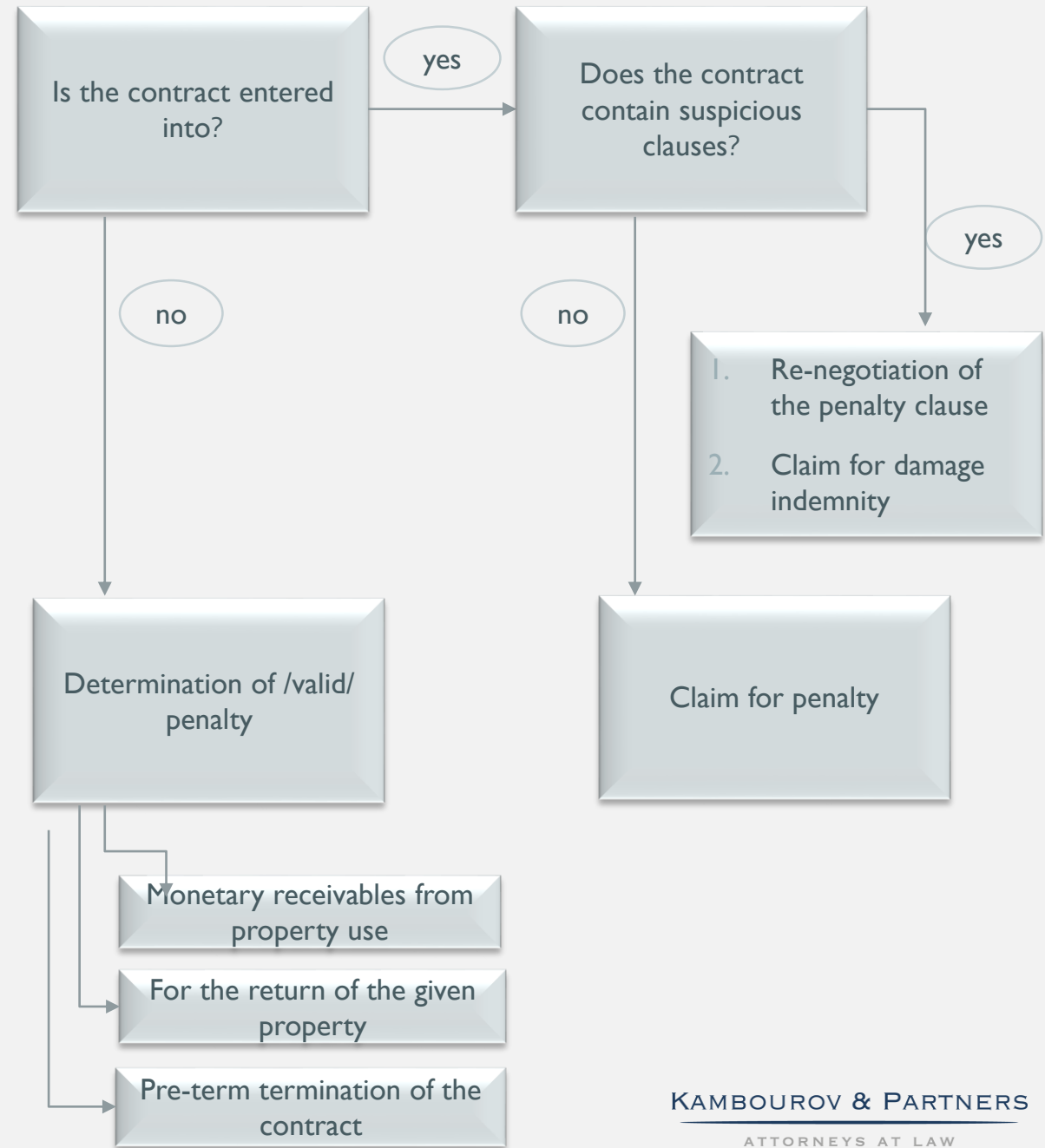
- **Termination** of the lease / special grounds for termination of commercial transactions
- Liability for **failure** due to fault of the lessee/lessor
- "Compensation for guilt"
- Current drawdown of the **deposit** for repayment of unpaid installments / consumables



## PENALTY AND TERMINATION OF THE CONTRACT



# PENALTY MIND MAP





В ЗАКЛЮЧЕНИЕ

- ✓ **There are no standard criteria** for the validity of the penalty
- ✓ The assessment of the penalty is made **at the time of the conclusion** of the contract and in particular
- ✓ Indeed, the **expected damage** from a potential non-performance is a recommended criterion
- ✓ In case of a dispute, it is important for the creditor to provide **evidences** of his or her expectations
- ✓ The excess over the expected should be **reasonable**
- ✓ The consequences of cancellation and termination of the contract are different