

Contractual penalties in employment contracts ineffective for good

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Within each and every legal relationship, the situation may arise in which the parties do not fulfill their obligations, this leading to them (for instance) being liable for compensation.

When it comes to the liability of the employee to the employer, many employers want to impose contractual penalties in the case of certain breaches of duty. This practice had been controversial for a long time in legal opinions and case law, but since 12th July 2019 it has been excluded following a decision by the Supreme Court¹.

Nature of the contractual penalty

If a person culpably causes damage to another person, he or she must (in principle) compensate for it by creating a situation for that other person as if the damage had never been done. The aggrieved party must prove the value of the damage to be compensated.

According to civil law, parties can (in advance) define the value of the damage that would be caused in the contract, irrespective of the actual damaging event. In this case, there is no obligation for the aggrieved party to prove the value of the damage. If the other requirements for damage compensation are fulfilled, he or she can directly request payment of the contractual penalty.

This obviously makes the contractual penalty comfortable and attractive – especially if proving damage would be difficult since it cannot be directly measured.

Also in labour law relationships, the use of contractual penalties could be advantageous, since there are cases in which the determination of the actual damage caused is extremely laborious. If, for instance, an employee does not observe a confidentiality obligation, his fiduciary duty or a non-competition obligation, the employer must carry out time-consuming verification to determine the damage caused.

On the other hand, the contractual penalty has some deterrent effect. If the employee knows the financial risk that comes with a breach of duty, it is more likely that he will refrain from committing it, rather than the obligation being stipulated in the contract with no exact sanction for its breach. The contractual penalty can therefore be seen from the perspective of the employer as a protection against the employee's failure to fulfill his or her obligations.

In some legal systems, e.g. in Germany, the contractual penalty is often encountered in practice.

Distinctive features of Romanian labour law

¹High Court of Cassation and Justice (*Înalta Curte de Casație și Justiție*), Decision No. 19 of 12.05.2019, Official Journal 573 of 12.07.2019

Romanian labour law contains some distinctive features in this context. Among other things, the Labour Code indicates that

1. the employee is liable, according to the civil law, for material damages related to work that he caused to his employer culpably²;
2. the employer can determine and assess the value of the damage caused by the employer and can request compensation for the damage as mutually agreed by the parties (only) if the damage does not exceed 5 legal minimum salaries (i.e. currently 10,400 RON)³
3. the employee may not waive his or her legally recognised rights. Any other agreement is null and void⁴
4. the employer always bears the burden of proof⁵ in labour procedures.

If the requirements stated at no. 2 are not met, the employer will need, in principle, an enforcement order for the compensation for damages⁶.

The decision

The Supreme Court has recorded the following in its decision:

- In principle, labour law states that the existence of damage must be certain and at the time of the assessment, its magnitude must be measurable. This provides an accurate damage verification.
- This verification is carried out (mainly) by the courts.
- Art. 253 paragraph 3 and 4 of the Labour Code only allows an extrajudicial determination in special cases; this is not permitted in advance, but must take place on a case-by-case basis.
- The burden of proof rule in labour law is infringed by a contractual penalty.
- From the court's perspective, a contractual penalty represents inadmissible pressure.

Based on Art. 38 (*see above*) a rule providing a contractual penalty is, therefore, null and void.

² Art. 254 paragraph 1

³ Art. 254 paragraph 3 and 4. If the damage amounts to this value, the employer can establish the damage determination and assessment and, in agreement with the employee, he can establish the compensation within a minimum of 30 days following the decision.

⁴ Art. 38

⁵ Art. 272

⁶ In practice, there are also situations in which employees pay compensation, by choice, in even higher amounts.

Conclusion

What had previously been only a predominant opinion is now confirmed by the Supreme Court. Employers may not implement any contractual penalty against employees.

Although it may be painful for them, the decision is mandatory.

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