Summary

I. Scope of the research and the problem tackled

This research is aimed at attempting to objectively identify an optimal system for penalty clauses, whilst preserving the necessity of the penalty clause for legal certainty as well as to offer protection against unreasonable contractual penalties. The penalty clause is usually defined as an agreement whereby the person who falls short of fulfilling his or her contractual duties must perform a determined act (normally in the form of a monetary payment). The penalty clause fulfils two primary functions. Firstly, the assessment of damage function: the penalty clause aims to ascertain the liability of the injured party prior to the damage being caused so that proceedings for the assessment of damages can be avoided. Secondly, the incentive function: the penalty clause provides an incentive for the other party to adequately perform his or her contractual obligations, by making failure financially unattractive. Due to the fact that adequate performance is also more likely to occur by virtue of this financial stimulus, this function of the penalty clause also serves legal certainty. Since the penalty clause assists legal certainty, a penalty clause often arises in international contracts.

Despite these positive effects of the penalty clause, it remains a controversial legal construction because it imposes unreasonable consequences. The danger exists, especially when parties do not contract on an equal footing, that the party who fails to perform will need to pay heavily for his or her failure. On the flipside, a contractual penalty can also be
set at a lower level than the eventual damage caused, such that the obligor is harmed. The question arises whether contractual parties, if one begins from the principle of contractual freedom, can agree to any form of penalty clause, even if one of the parties should be unreasonably harmed as a result. This question is answered differently across Europe. It is true that the practical value of penalty clauses as well as the appended danger is probably recognised across the whole of Europe, but the application of the incentive function of the clause and the ways in which the penalty clause is restricted, fundamentally differ. Due to this variety and with regard to the ever increasing call from academia and the European political scene for a European Civil Code or a European Contract Code, this research has a European intention and dimension: the research is focused on the search for a uniform European rule on the penalty clause.

Three important methods can be distinguished in Europe, each approaching the penalty clause in a different way. Each of these methods will be assessed on the quality of its content in order to see whether it forms an acceptable model for penalty clauses in general.

II. The Dutch/French method

To begin with one can distinguish a Dutch/French method, which is also followed by the Principles of European Contract Law (see Chapter 3). This model recognises the *prima facie* validity of a penalty clause, regardless which of the abovementioned functions it fulfils (incentive or damage assessment). The judge is granted the competency to adjust disproportionately high sums.

Dutch law lays down the validity of both functions of the penalty clause in Article 91, Book 6, Dutch Civil Code. Furthermore, in order to prevent excesses, the judge is also granted in Article 94, Book 6, Dutch Civil Code a reduction and supplementary competency, although reticently, in terms of unreasonably high and low penalties. Only the reduction competency can be regarded as mandatory. The judge may apply the penalty should the obligee (reduction) and obligor (supplementary) request for it respectively. This is tested *ex post* and all circumstances of the case need to be taken into consideration. The reduction criterion ('when the reasonableness obviously requires such action') clarifies the reticent character of the reduction and supplementary competency of the judge. This reticence is a necessary, consequence of the choice for validity of both functions of the penalty clause: a rapid intervention would make the incentive quality of the penalty clause purely illusionary and at the same time bring the legal certainty of the penalty clause into question which the penalty clause in The Netherlands aims to offer. An analysis of Dutch law also brings a number of points to light. Firstly, legal literature is divided concerning the rule that the reduction and supplementary competency of the judge cannot be developed on his or her own motion. Secondly, case law indicates that many have grappled with the question when precisely the reduction should take place. The Dutch Supreme Court has unfortunately made it clear that the aforementioned reticence with respect to lump sum penalties is, in part, lost. Finally, it is unclear to what level a contractual penalty should be supplemented or reduced.

French law also presupposes that both functions of the penalty clauses are valid, although Mazeaud has vehemently criticised this position. He argues that the penalty clause should always fill an incentive function and thus a pure assessment of damages cannot really be regarded as a penalty clause. However, this cannot be regarded as the prevailing opinion. Penalty clauses are fully enforceable as laid down in Article 1152(1) French Civil Code. Article 1152(2) also provides the judge of his or her own motion with a reduction competency, which again may only be used in exceptional circumstances (when the penalty is *manifestement excessive ou dérisoire*). The moment of testing is also *ex post*, all circumstances of the case may be taken into account and the parties are not allowed to exclude the possibility to reduce and supplement the contractual penalty. Reticence in the use of the reduction and supplementary competencies is strictly observed.

The Principles of European Contract Law (herein: PECL) also follow this system and assume (see Article 9:509 PECL concerning 'Agreed Payment for Non-Performance') that penalty clauses are valid in both functions. When the agreed monetary sum is 'grossly excessive' with regard to all circumstances of the case, a penalty must, by virtue of Article 9:509 (2) PECL, be able to be reduced. The PECL rule lacks a possibility to supplement low contractual penalties.

III. The English/Belgian method
The English/Belgian method can be seen as in diametric opposition to the Dutch/French model (see Chapter 4). This method attempts to restrict the unreasonable consequences of a penalty clause by endorsing only one of the two functions of such a penalty clause, namely the assessment of damages function.

The leading case in England on this point is Dunlop, a 1915 House of Lords decision (Dunlop Pneumatic Tyre Company Ltd v. New Garage and Motor Company Ltd [1915] AC 79). This case clarifies that a distinction needs to be made between incentive penalty clauses, which are not enforceable at law, and those clauses which assess the amount of damages, so-called liquidated damages clauses, which are acceptable. It is not altogether clear why English law is so averse to incentive penalty clauses. A possible raison d'être could be that a penalty clause requires a private contractual party to be punished. A private punishment does not belong in the realm of damages, since this field of law only aims at compensating the claimant's damage, whilst a penalty clause forces the respondent to pay a sum higher than the real level of damage caused. As a result, it is concluded that it would not be appropriate to deal with such private punishments within the recognised boundaries of the law of damages owing to the compensatory function of this field of law and the necessary connection punishment has to the State.

In the Dunlop case, Lord Dunedin addressed how penalty clauses and liquidated damages clauses must be distinguished. In fashioning a methodological rule, he stated that a clause is to be regarded as an acceptable liquidated damages clause when it concurs with a 'genuine covenanted pre-estimate of damage' at the moment the contract is concluded (ex ante), while the prohibitive effect remains the essential characteristic of a penalty clause. In situations where the damage is difficult to assess in advance, a number of supplementary criteria are provided, from which it appears that a judge is granted a greater freedom of assessment. Penalty clauses which are determined to be set at an unrealistically low level, are valid in their entirety. English law does not recognise a supplementary competency and a similar penalty clause cannot be considered as an exoneration clause (with limited acceptability).

Strong criticism has been levied in English literature towards the current state of the law with respect to penalty clauses. It has for example been stated that the division between penalty clauses and liquidated damages clauses is altogether unrealistic: the judge needs to turn back time and place him or herself at the moment the contract was concluded and attempt to ascertain what the intention of

the parties was at that moment. This is not only a difficult undertaking but also leads to legal uncertainty. Critics also refer to the practical function of the ? illegal ? penalty clause, since this clause provides, at the very least, a stimulus to satisfy the terms of the contract. For these reasons, some commentators have argued that this standard has to be replaced by a reasonability test. The Scottish Law Commission has concurred with such a plea and has argued for the introduction of an ex post reduction competency.

In spite of the aforementioned criticism, Belgian law has also shared the majority of these hallmarks since the 1970s i.e. only the assessment of damages function is valid and the time at which the contract is concluded serving as the moment of assessment of damages (ex ante). This standard was also confirmed in a 1999 statutory amendment. According to the legislator, the incentive function of the penalty clause should be rejected because the incentive contractual penalty leads to a private inter partes punishment, whereas only the State may punish (an identical reason as that proffered in English doctrine for the unacceptability of penalty clauses). Thus parties may only agree to an amount of money which, at the moment when the contract is concluded (ex ante), conforms with the pre-estimate of the likely damage which can be attributed to the non-performance of the contract (see Article 1226, Belgian Civil Code). A higher agreed amount is not enforceable at law, but is not completely invalid as in England, since the amount must be reduced; by virtue of Article 1231(1), Belgian Civil Code. The judge is provided with a compulsory judicial competency of his or her own motion to 'reduce a punishment which involves the payment of a specified monetary sum should this sum be manifestly above the amount that the parties could determine in order to compensate the non-performance of the contract'. Due to the fact that an incentive penalty clause is invalid according to Belgian law as well as in the accompanying explanatory notes and a reduction of an invalid amount is not legally possible, it is argued that the reduction competency can only be considered as a form of partial nullity. The difference between this system and the sanction imposed in England is thus not desirable. English and Belgian opinions are also comparable in terms of unreasonably low penalty clauses: Belgian law does not recognise a supplementary competency and will also not regard these clauses as an exoneration. Therefore, a similar penalty clause is valid in its entirety.

The new Belgian law contains of a number of uncertainties, for example concerning the degree of the reduction and the contents of the reduction criterion. This has also instigated considerable criticism in Belgian legal literature. Even putting the profound criticism on these technical points to one side, a considerable portion of the commentators regret the choice
of the Belgian legislator to refuse to accept the incentive function of the penalty clause.

IV. The German/Swiss method

The German/Swiss model can be seen as a middle path because it combines properties of the two aforementioned methods. Both functions of the clause are recognised (as in The Netherlands and France) and an \textit{ex post} moderation competency exists, but the incentive penalty clause is dealt with differently than the damage assessment clause. This means that the functions of the penalty clause, similar to the English/Belgian model, need to be distinguished.

It is clear since the German case from the \textit{Bundesgerichtshof} in 1967 (BGH, 6th November 1967, \textit{BGHZ} 49, 84) that an incentive penalty clause (in German a \textit{Vertragsstrafe}) is a different legal construction than a pure damage assessment penalty clause (in German a \textit{Schadenspauschale}). Both functions of the clause are demandable, but a legal regime only exists for the Vertragsstrafe: §339 et seq German Civil Code. These rules are not applicable to the Schadenspauschale. The reason for the distinction between these two variants is unclear, but it seems in no uncertain terms to rest upon an unclear statutory formulation. At the time of enactment, criticism was levied in German literature at the division of both functions of the penalty clause, especially because the parliamentary history provided no explanation for the functional splitting and, in practice, these functions cannot be distinguished. Despite this protest, it was statutorily determined with respect to general conditions that both variants of the penalty clause exist and the \textit{Vertragsstrafe} (§309 nr. 5) should be treated differently from the \textit{Schadenspauschale} (§309 nr. 6).

How should these models be distinguished from each other? In order to assess the answer to this question, one must first consider the aim of the clause. The \textit{Vertragsstrafe} should at any case serve as an incentive in order to force the opposing party to fulfill his or her contractual obligations. The \textit{Schadenspauschale} should however act as a way in which to fix the level of damage. The most important consequence of the qualification of \textit{Vertragsstrafe} is that this falls under the reducing competency of the judge in accordance with §343, German Civil Code. This provisions provides the judge, should the obligor therefore request, the possibility to reduce a \textit{Vertragsstrafe}, when this is \"unverhältnismäßig hoch\". This test is concluded \textit{ex post} and all facts and circumstances which occur up until the moment of the judicial decision may be taken into consideration when determining the reduction. Reticence is taken as the starting position. When the obligor has already paid the \textit{Vertragsstrafe} and thus has not made it clear that he has reserved the right to reduce, then he or she loses his or her right to call on the possibility of reduction. The reduction competency is not applicable to penalty clauses which have been concluded between companies (see §348 of the German Commercial Code). Despite this penalty clauses are also controlled in this situation, especially when they appear in general conditions. German law deals with a \textit{Vertragsstrafe} set at an unreasonably low level in a different manner than Dutch and French law. A supplementary competency does not exist, but §340 II, German Civil Code determines that the agreed amount only sets a minimum level: the creditor is, as always, free to reap more should the damage caused be greater.

\textit{Schadenspauschalen} cannot be reduced on the basis of §343, German Civil Code. It is however imaginable that a judge could treat a high \textit{Schadenspauschale} as a \textit{Vertragsstrafe} and reduce it on this basis, but that is not always possible. Possibilities to restrict unreasonable \textit{Schadenspauschalen} are only contained in the regulation of general conditions (§309 \textit{et seq}, German Civil Code).

Swiss law begins from the same starting point: both variants of the penalty clause are valid and a distinction is made between the incentive \textit{Konventionalstrafe} on the one hand and the pure assessment of damages clause, the \textit{Schadenspauschale} on the other. The \textit{ratio} of this distinction is also clear. A statutory regime only exists for the \textit{Konventionalstrafe}, in Article 160 \textit{et seq}, Swiss Code of Obligations. Article 163, Swiss Code of Obligations contains a reduction competency when the \textit{Konventionalstrafe} is \"übermäßig hoch\". The rule is also here that the \textit{Konventionalstrafe} is enforceable, and the reduction of (high) penalties an exception. This reticence is strictly observed in practice. The reduction competency is not directly applicable to \textit{Schadenspauschalen} in Switzerland either. However commentators have argued for an analogous application because both legal constructions strongly resemble each other and both can, in hindsight, entail unreasonable consequences.

V. Accumulation of remedies
An important question rises as to the accumulation of the penalty clause alongside other remedies available for failure, such as demands for performance, termination or compensation (see Chapter 6). Does this necessarily mean that when calling in a contractual penalty, other remedies can be circumvented? The following articles are here of importance: Article 92, Book 6, Dutch Civil Code; Article 1229, French Civil Code; Article 1228 and 1229, Belgian Civil Code; §§340 and 341, German Civil Code and Articles 160 and 161, Swiss Code of Obligations. No statutory provision exists in England and the PECL is also silent on this issue.

One can identify the following common hallmarks, *grosso modo*, across Europe. In all legal systems, the creditor must from the outset make a choice between a penalty clause and a demand for performance, a contractual penalty in principle replaces the regular compensation and a contractual penalty cannot be accrued with termination of the primary obligation, unless the penalty is directed towards the damage caused by dissolution. Analogous exceptions are however made more-or-less everywhere from these general statements. Firstly, the majority of legal systems, apart from England and The Netherlands, provide for a specific rule for penalty clauses which is solely directed towards a delayed performance (as well as with respect to performance in an incorrect place in Switzerland, and in Germany for every form of incomplete non-performance. The contractual penalty can be added to the demand to perform and replacement compensation. Dutch and English law achieve the same result, but without a specific rule.

Secondly, each system assumes implicitly or explicitly that a contractual penalty can be added to another remedy, when both remedies are directed towards diverse interests. Therefore, a penalty clause may be added to a statutory demand for compensation should they be directed towards loss of different kinds. German law recognises this as *Interessenidentität*. A number of differences also exist between the legal systems, for example with respect to the pure penalty clause which can be called in next to all remedies (that is only unacceptable in England and Belgium).

**VI. Special rules**

Special rules are used in almost all of the legal systems researched in relation to penalty clauses in general conditions and consumer credit (see Chapter 7). The general condition rule with respect to consumers in England (the English Unfair Terms in Consumer Contracts Regulations) and Belgium (the *Handelspraktijkenwet*) are more-or-less synonymous with the general regime: penalty clauses in consumer contracts are also unable to perform an *ex ante* "punishing" function. Also in German law, the basic point of view with regard to penalty clauses in general conditions (§309 et seq, German Civil Code) is more-or-less the same as in the general regime (§339 et seq, German Civil Code): a distinction is maintained in the general conditions regulation between the incentive and the assessment of damages function of the clause. However, the implementation varies, especially due to its fragmentation. Swiss law lacks a special general condition regulation. France and The Netherlands stand out with respect to general conditions (Article 123 et seq, French *Code de la consommation* and Article 231, Book 6, Dutch Civil Code respectively) in comparison with the general regime. Departing from the rules laid down in Article 91, Book 6, Dutch Civil Code and Article 1226 et seq, French Civil Code an *ex ante* test is introduced and the reduction sanction is replaced by the invalidity of the litigious clause. It is uncertain how this relates to the reduction competency.

Every legal system has special rules for consumer credit and has therefore adopted a rule which limits the enforceability of penalty clauses. Many simply cap the interest which may be imposed in cases of late payment. The decline of periods which have already been paid is also repeatedly restrained. The thought behind these rules is identical: it is exactly in these sorts of cases that the consumer ought to be protected, especially when the contract comprises a particularly onerous penalty clause.

**VII. Comparable clauses**

From this research (see Chapter 8) is also appears that all legal systems use other clauses which purport to have a comparable effect as the penalty clause? they aim to sanction an incentive to perform should failure occur and/or aim to
assess the level of damages? but fall stricto senso outside the definition of a penalty clause. A number of legal constructions are used with success, especially in England, thus managing to evade the strong law on penalties. In this way, a number of legal methods of ending contractual obligations (and not involving failure) are enforceable e.g. a deposit which is paid at the moment the contract is concluded and is retained in the event of failure; a cancellation clause that comes into force should failure be likely in the near future, is not regarded as a penalty clause since the monetary sum does not need to be paid because of non-performance.

In all other researched systems (France, Germany and the PECL) the treatment of a deposit and the termination competency also create problems. With an eye on the functional equality of the penalty clause, legal commentators in almost all the jurisdictions researched argue for an analogous application of this regime with respect to penalty clauses. A pure cancellation clause on the other hand, which affords the debtor an extra right to end the agreement, is not regarded as a penalty clause. It is also generally recognised that an alternative or facultative obligation is not to be regarded as a penalty clause, although in Germany and Switzerland a variant of the facultative obligation, an 'independent' penalty clause, is regarded as analogous to a penalty clause.

VIII. Conclusions

Function and reduction competency

The conclusions to the research are as follows (see Chapter 9).

The ways in which the contents of the penalty clause are determined and the value which is attributed in this connection to the function of the penalty clause, form one of the biggest differences between the European systems researched in this study. Besides the acceptable character of the clause, differences also arise in terms of the reference date of the various control techniques (ex ante vs. ex post), the necessity to split the incentive and assessment of damages functions, and the nature of the sanction imposed on an excessive penalty clause (invalidity of the whole penalty clause vs. reduction of the agreed amount). The English/Belgian model differs the most from the other European legal systems because it is the only model which rejects the incentive penalty clause, sanctioned with the invalidity of the clause and the maintenance of an ex ante reference date. The other two systems of analysis choose another route with respect to these three points: both functions of the clause are valid, although a restraining reduction competency with an ex post reference date is imposed. In seeing a need to distinguish between both functions

of the penalty clause, the German/Swiss method follows the path of the English/Belgian model, and as such can thus be described as a middle path. The theoretical differences between the three methods translate into difference results. What is the best way in which to deal with penalty clauses?

One must first answer the question whether a special protection mechanism is needed with respect to unreasonable penalty clauses. In my opinion, this is needed for three reasons. Firstly, the penalty clause lends itself to misuse by a stronger contractual party. Secondly, parties are not always fully aware of the purpose of the clause since it only comes into play as a secondary obligation should there be undesirable performance. Thirdly and finally, the consequences of the clause can be unexpected because the parties affect a provision for the future, whilst the future damage is usually unpredictable. Owing to the interference of the penalty clause on the important right to compensation, this unexpected reach can have considerable effects and can impose an onerous obligation to pay on a obligee, who is quite possibly already the weaker party. The general contractual protection mechanisms (lack of consent, good morals) do not offer enough guarantee against these dangers and a specific controlling technique against penalty clauses is therefore necessary. All the systems researched subscribe to this standpoint. The ensuing question is therefore what protection method should be followed.

The English/Belgian protection technique, whereby the incentive character of the penalty clause is invalid, should not be followed for two reasons. Firstly, the incentive quality of the clause should not be rejected, but instead should be regarded as an asset to contract law because it stimulates performance and thus strengthens a fundamental starting point of contract law? the premise that parties usually do what they promised to do. The penalty clause is nothing more than a form of self-regulation or legal enforcement of contractual agreements, which promotes efficiency in the legal market and thus decreased the need for judicial proceedings. The normal contractual mechanisms are often unsatisfactory in order to stimulate performance in a similar way, because they usually only become active once non-performance has already taken place. The English/Belgian concern that the incentive function of the penalty clause needs to be rejected because it would be a private inter partes punishment, is incorrect. The penalty clause intends primarily not to punish the other party
for immoral behaviour, but instead intends to stimulate performance. Since the penalty clause is agreed upon by the parties themselves and is not imposed by a public state organ, the qualification as 'punishment' is incorrect and accordingly the connection often made to criminal law is unsubstantiated. A second concern with respect to the English/Belgian method is that this model forces the court to ascertain the intentions of the clause at the time the contract was concluded. This is often impossible. The clause almost never expressly states which intention was included, whilst at the same time the parties often have double motives: they agree upon an amount not only to replace any damage caused but also to incite the other party to fulfil his or her obligations. The ascertainment of the true intentions at the time the contract was concluded is therefore not real and leads to legal uncertainty. This leads to the conclusion that both the incentive and the damage assessment functions of the penalty clause must be accepted and that the English/Belgian model should be rejected.

Another protection method against excesses is however needed. Personally, my preference is towards legally enforceable reduction competency as offered by the Dutch/French model. This competency must be effective as towards both functions of the penalty clause, so that the aforementioned problems in terms of definitional determination can be prevented. Penalty clauses in commercial transactions should also be subject to such a reduction competency.

The reduction competency must be exercised with reticence, a necessary consequence of the recognition of both functions of the penalty clause and thus ensures that the threat to legal certainty is brought within acceptable proportions. The previously mentioned benefit that the penalty clause offers to legal certainty should not be undermined by the creation of too much uncertainty in the form of broad *ex post* investigation into the clause itself. In this way, the principle of contractual freedom is best protected; parties may agree to any form of penalty clause, irrespective of the level or function, although afterwards only one possibility exists to readjust the amount of the penalty.

Bearing in mind the variety of rationales with respect to the necessity of a special regime for penalty clauses, the most important criteria in determining the assessment reduction need to be: the actual damage caused (including lump sum penalties, partial failure and the party’s own fault), the manner in which the penalty clause was concluded and the factors related to misuse. The fact that the penalty clause fills a useful function or the fact that the debtor intentionally failed to fulfil his or her contractual obligations, are contra-indicators for the exercise of the reduction competency. The starting point of reticence should also be followed with respect to the level of the reduction. This means that a pure penalty clause should not be automatically reduced to nothing, and an assessment of damages penalty clause should remain at a level above that of the damage caused.

There are no good reasons for a complicated distinction between the assessment of damages function and the incentive function in terms of the reduction competency, such is the case in Germany and Switzerland. It is argued that both forms of the penalty clause should be applicable to the same reduction competency. The incentive and damages assessment clauses are essentially the same legal construction (they oblige payment of a monetary sum in the event of an uncertain failure) and an assessment of damages penalty clause can just as equally lead to excesses.

In conclusion, the penalty clause should be seen as one legal construction with three faces; whether it purely fixes the damage, or it incites performance, or it is a combination of both. The value of this tri-polar legal construction is to be found in legal certainty, whether that be the urge to perform, or because it makes a legal procedure unnecessary to determine the existence and extent of damage.

**Other questions**

A number of other questions also deserve attention in order to reach a final conclusion. A contractual penalty clause should not be set at an unreasonably low level, since a similar problem occurs as with unreasonably high penalties. This means that the judge, maintaining a level of reticence, should be endowed with a compulsory supplementary competency should he or she be requested by the creditor.

Furthermore, the special rules in terms of general conditions and consumer credit form a useful addition to this reduction competency because it is exactly in these sorts of contracts where an uneven bargaining power exists in concluding the penalty clause, hence increasing the need for protection. Nonetheless, even here the incentive and assessment of
damages functions of the penalty clause can be valuable. Although extra protection is necessary, the incentive function should not be a priori rejected.

Accumulation of contractual penalties and legal proceedings in the event of failure should in principle not be possible, unless the penalty clause is directed at a delayed performance. The creditor must in principle be able to choose between demanding performance and the penalty clause, whilst the contractual penalty must in principle replace the statutory compensation and the penalty clause should only remain after the termination of the initial agreement insofar as the clause is specifically directed towards the termination. The parties should be able to reject these principles and for example be able to conclude a pure penalty clause, which does not interfere with the right to performance, compensation and termination.

Finally, a penalty clause regime must be explicitly applicable to two interrelated clauses, which accomplish identical aims as the penalty clause (incentive to perform and assessment of damages in the event of failure). The first is the deposit, which contrary to a contractual penalty is already paid at the time the contract is concluded and is lost in the event of failure. Secondly, a cancellation clause should also be considered as a penalty clause. Such a clause which for a fixed amount provides a contractual competency in the event of a threatened failure.

Final conclusion

The system that promotes both functions of the penalty clause and opposes excesses with a reticent use of a judicial reduction and supplementary competency, deserves to be a method which Europe strides towards. The distinction between the incentive and assessment of damages function must be removed, also in terms of reduction competency, due to the problems caused in relation to distinguishing between the two functions and leads to legal constructions to evade the regime of incentive penalty clauses. Furthermore, both the incentive and the assessment of damages function accomplish useful functions in the European legal market.

One can uncover enough support in favour of this method. The recognition of the incentive method of penalty clauses will undoubtedly encounter less resistance than one would expect. One is able to derive this prognosis on the one hand from the forceful criticism in England and Belgium that exists concerning the prohibition of the incentive function, and on the other from the fact that all systems accept incentive mechanisms in contract law. Although any harmonisation is ultimately dependent on the existence of European political willpower, the optimal system defended in this research would provide a genuine basis for the establishment of an potential, future harmonised European rule on penalty clauses.

Referring Principles:

VI.4 - Promise to pay in case of non-performance