



RECENT DEVELOPMENTS ABOUT PENALTIES

—Michael Furmston*

Abstract—This article explores the changes in the law of penalties, which was until recently considered to be settled post the decision in *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd.* However, the decisions in *Andrews v. Australia and New Zealand Banking Group*, and in *Cavendish Square Holding BV v. Talal El Makdessi*, in Australia and the United Kingdom respectively, have created new ripples in this otherwise consistent position of law. In this context, the article explores some basic principles of penalties, discusses the viability and application of the Penalty Doctrine and the manner in which this tangibly affects the drafting of contracts. Further, the common law relief of the Penalty Doctrine is discussed along with the equitable remedy of Relief against Forfeiture, and the manner in which what constitutes ‘relevant factors’ may differ due to the subjectivity and discretion associated with each relief.

I. INTRODUCTION

Until recently the law about penalties appeared basically well settled. The most frequently cited judgment was that of Lord Dunedin in *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd.*,¹ which recently celebrated its century. It is striking therefore to find recent decisions of the High Court of Australia in *Andrews v. Australia and New Zealand Banking Group Ltd.*² and the Supreme Court of the United Kingdom in *Cavendish Square Holding BV v. Talal El Makdessi*,³ indicating a strong desire for change though in opposite directions.

* Emeritus Professor of Law, Singapore Management University, Singapore. Professor of law, Sunway University, Malaysia.

¹ *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co.*, 1915 AC 79 (HL).

² *Andrews v. Australia and New Zealand Banking Group Ltd.*, 2012 HCA 30 (High Court of Australia). This case has been the subject of an elaborately critical attack by no fewer than 5 leading Australian contract lawyers in JW Carter, Wayne Courtney, Elisabeth Peden, Andrew Stewart and GJ Tolhurst in 30 *Journal of Contract Law* 99.

³ *Cavendish Square Holding BV v. Talal El Makdessi*, 2015 UKSC 67.

There are in fact three cases as the Supreme Court considered two quite separate cases, with very different facts. In the High Court, there is a single judgment; in the Supreme Court the seven judges gave five judgments by Lord Neuberger,⁴ Lord Sumption and Lord Carnwath (paras 1-115); Lord Mance (paras 116-214); Lord Hodge (paras 215-290); Lord Clarke (para 291) and Lord Toulson (paras 292-316). It will be seen that there are three very substantial judgments. On the penalty questions, there was agreement in the result, though not completely in the reasoning. Lord Toulson dissented on a separate consumer protection point.

II. HISTORY

Lord Neuberger's judgment contains an outline of the historical development of the penalty rule.⁵ This goes back to the early 16th century when a practice developed of taking bonds (that is promises under seal) defeasible if the promisor carried out a primary obligation. The common law enforced the bond if the primary obligation was not performed even though the bond was for much more than the value of the primary obligation. Equity came to restrain enforcement at common law on terms that the debtor paid damages, interests and costs.⁶

The equitable rule was taken over by the common law. Lord Neuberger referred to Brian Simpson's article in the *Law Quarterly Review*.⁷ In the late 17th century Common Law Courts began to stay proceedings on a Penal Bond to secure a debt, unless a Plaintiff was willing to accept a tender of the money, together with interest and costs. The statutes of 1696 and 1705 extended this process. Lord Neuberger said,⁸

“The law relieved the contract-breaker of the consequences not because the objective could be secured in another way but because the objective was contrary to public policy and should not therefore be given effect at all. The difference in approach to penalties of the courts of equity and the common law courts is in many ways a classic example of the contrast between the flexible if sometimes unpredictable approach of equity and the clear if relatively strict approach of the common law.”

⁴ This was a joint judgment of Lord Neuberger and Lord Sumption with which Lord Carnwath agreed. This means that if there is a question of a majority, this counts as three votes. For brevity I will refer to this as Lord Neuberger's judgment.

⁵ Cavendish at ¶ 4-8.

⁶ See Lord Thurlow LC in *Slovan v. Walter*, (1783) 1 Bro CC 418 at 419 : 28 ER 1213; Lord Macclesfield in *Peachy v. Duke of Somerset*, 1 Strange 447, 453, (1720); *Baggallay LJ Protector Endowment Loan and Annuity Co. v. Grice* (1880) 5 QBD 592 at 595 (CA).

⁷ A.W. Brian Simpson, *The Penal Bond with Conditional Defeasance*, 82 *Law Quarterly Review* 392, 418-419, (1966). (This article was published when Brian Simpson and I were colleagues and indeed living in the same house, a large four storey Victorian North Oxford house).

⁸ Cavendish at ¶ 7

The practical importance of this view is brought out by comparing the rules about penalties with the rules about relief against forfeiture, which are undoubtedly equitable and where there is, therefore, an element of judicial discretion that is the taking into account of relevant factors.⁹

The High Court did not have the benefit of Lord Neuberger's speech, but it is clear that its view of the history is different; this is most clearly stated in ¶ 51 which says,¹⁰

“There remains for consideration the further proposition in *Interstar Wholesale Finance (Pty) Ltd. v. Integral Home Loans (Pty) Ltd.*¹¹ which, rather than acknowledging the concurrent administration in New South Wales (as elsewhere) of law and equity, appears to treat the penalty doctrine as having disappeared from equity by absorption into the common law action of assumpsit. The proposition should be rejected.”

The Court does not refer to Brian Simpson's article, though it is referred to in the footnotes.

It is, of course, well known, particularly to readers of Meagher, Gummow, and Lehane,¹² that some Australian lawyers think that English judges misapprehend the relationship of Common Law and equity. It may be a question whether there is misapprehension or simply disagreement. What is clear is that in the 17th, 18th and 19th centuries development took place wholly in England, and that from the 1800s cases on penalties seem to be litigated in Common Law Courts. It is also, I think, the case that earlier decisions of the High Court about penalties do not appear to differ from the English cases.¹³

III. SHOULD THE PENALTY DOCTRINE BE ABOLISHED?

In all normal circumstances it would not be argued that a rule, which has been applied in countless House of Lords cases, should be rejected by judicial action. But this is precisely what leading counsel for Cavendish did in this case. She argued that the rule should be regarded as “*antiquated, anomalous and unnecessary.*”¹⁴ The Supreme Court agreed that the rule would be very unlikely to be

⁹ See discussion in ¶ 10 and Hoffmann LJ in *Else (1982) Ltd. v. Parkland Holdings Ltd.*, (1994) 1 BCLC 130.

¹⁰ Cavendish at ¶ 51.

¹¹ 2008 NSWCA 310.

¹² Roderick P. Meagher & John D. Heydon and Mark J. Leeming, *MEAGHER, GUMMOW AND LEHANE'S EQUITY: DOCTRINES AND REMEDIES*, (4th ed., 2002). Justice Gummow was a member of the High Court in this case. This Judgment was handed down on 6th September 2012. It must be noted that Justice Gummow's 70th birthday fell on 9th October 2012.

¹³ See *Amex UDC Finance v. Austin*, (1980) 162 CLR 170, (High Court of Australia).

¹⁴ Cavendish at ¶ 36.

developed in its present form if one was starting today, but it did not accept that the correct course was abolition. The reasoning is instructive.¹⁵

The Court was provided with a survey of the position of other common law jurisdictions, including the United States. All of them substantially retained the penalty doctrine. Perhaps more striking, a similar doctrine is to be found in major civil law jurisdictions, which all have provisions (though of course, not identical) giving courts power to control excessively high agreed damages provisions.¹⁶

This is also a position taken by a number of sets of principles designed for a wide spread international use. So the UNIDROIT principles of international commercial contracts provide in Article 7.4.13 as follows;

- “(1) Where the contract provides that a party who does not perform is to pay a specified sum to the aggrieved party for such non-performance, the aggrieved party is entitled to that sum irrespective of its actual harm.
- (2) However, notwithstanding any agreement to the contrary specified sum may be reduced to a reasonable amount where it is grossly excessive in relation to the harm resulting from the non-performance and to other circumstances.”

It may be instructive to cite two of these illustrations:

- “1. A, a former international football player from country X, is recruited for three years to train the players of B, a football team from country Y, at a monthly salary of AUD 10,000. Provision is made for a severance allowance of AUD 200,000 in the event of unjustified dismissal. A is dismissed without any justification after six months. A is entitled to the agreed sum, even though A was immediately recruited by another team at double the salary received from B.
2. A enters into a contract with B for the purchase of machinery which provides for payment in five instalments of EUR 50,000 each. The contract contains a clause allowing immediate termination in the event of non-payment by A of one instalment, and authorises B to keep the sums already paid and to recover future instalments as damages. A fails to pay the third instalment. B keeps the EUR 100,000 already paid and claims, in addition to the return of the machinery, the EUR 150,000 representing the

¹⁵ Cavendish at ¶ 36-39, ¶ 162-167 & ¶ 251-265.

¹⁶ See Guenter H. Treitel, *REMEDIES FOR BREACH OF CONTRACT, A COMPARATIVE ACCOUNT*, (1988).

three outstanding instalments. The Court will reduce the amount since A's non-performance would result in a grossly excessive benefit for B."

Both Law Commissions have considered the penalty rule, the English Law Commission in 1975,¹⁷ and the Scottish Law Commission in 1999.¹⁸ In both cases, the Commissions recommended legislation that would have expanded the scope of the rule.

It is important to note that Lord Hodge's judgment contains substantial discussion of the Scottish position, which is the same as the English position, though Scotland has never had the formal distinction between Common Law and equity.

IV. CAN THE PENALTY RULE BE APPLIED IF THERE IS NO BREACH OF CONTRACT?

This is the central question addressed in *Andrews*. It arose in the context of bank charges for unauthorized overdrafts. This question had been discussed in an English case, which does not appear to have been cited to the High Courts. The general question does not arise on the facts of *Cavendish* but the judgment of the High Court is the subject of extensive comment. It would be sensible to go back to look at the development of English Law. There is a very useful historical account in the Law Commission Working Paper.¹⁹ The Law Commission has more space than the average textbook editor.

At the time of the Law Commission working paper the leading case was *Campbell Discount v. Bridge*²⁰ in which there was a hire purchase contract for a motorcar. The contract contained a clause that provided that if the hirer failed to make a payment, that the owner could retake possession of the car and recover a minimum payment. Such a clause, standard at the time, was clearly capable of being held a penalty. The contract contained another clause, permitting the hirer to terminate the contract and return the car, but with the requirement to make the same minimum payment. After paying the deposit and the first monthly rent Mr. Bridge wrote a letter saying,²¹

“Dear Sir,

Owing to unforeseen personal circumstances I am very sorry
but I will not be able to pay any more payments on the Bedford

¹⁷ *Penalty Clauses and Forfeiture of Monies Paid*, (The English Law Commission, Working Paper no. 61, 1975). (“Law Commission Working Paper”).

¹⁸ Scottish Law Commission, *Report on Penalty Clauses*, (Scot. Law Com. No. 171, 1999).

¹⁹ Law Commission Working Paper at ¶ 17-26.

²⁰ *Bridge v. Campbell Discount Co. Ltd.*, 1962 AC 600 : (1962) 2 WLR 439 (HL). (“Campbell”). See also *Lombank Ltd. v. Kennedy and Whitelaw*, 1961 NI 182.

²¹ *Campbell* at 20.

Dormobile. Will you please let me know when and where I will have to return the car? I am very sorry regarding this but I have no alternative.”

The finance company claimed that this letter was an exercise of the contractual right to terminate and therefore the penalty doctrine was not involved.²²

The Court of Appeal accepted this argument. The House of Lords allowed the appeal. Viscount Simonds agreed with the Court of Appeal that Mr. Bridge’s letter was an exercise of his option to terminate and could not therefore be a penalty. The remaining members of the House thought that the letter should be treated as a breach of contract and therefore the penalty rules were applicable and the minimum payment provision was a penalty.

The House was however fundamentally divided as to what the position would have been if the correct construction of Mr. Bridge’s letter had been an exercise of his right to return the car. Lord Morton agreed with Viscount Simonds that in that case it could not be a penalty. Lord Denning and Devlin disagreed but not for the same reason. Lord Devlin thought that a provision could not be inside, and outside at the penalty area at the same time. He said,

“My Lords, I do not see how an agreement can be genuine for one purpose and a sham for another. If it is a sham, it means that it was never made and does not exist; if it does not exist it must be ignored all together: it cannot be a part of Clause 9 when that clause is applied by virtue of Clause 6 or Clause 8 and not a part of it when it is applied by virtue of Clause 7. There is no agreement to pay a sum irrespective of depreciation, as the price of exercising the options, and I am not prepared to construct one.”

Lord Denning took a substantially wider view,

“Let no one mistake the injustice of this. It means that equity commits itself to this absurd paradox: It will grant relief to a man who breaks his contract but will penalize the man who keeps it. If this be the state of equity today, then it is in sore need of an overhaul so as to restore its first principles. But I am quite satisfied that such is not the state of equity today. This case can be brought within long-established-principles without recourse to any new equity.”

It is perhaps a surprise that the High Court in *Andrews* did not refer to this.

²² *Campbell Discount Co. Ltd. v. Bridge*, (1961) 1 QB 445 : (1961) 2 WLR 596.

The conventional view is that the matter was resolved for English Law by the decision of the House of Lords in *Export Credits Guarantee Deptt. v. Universal Oil Products Co.*²³ but this is a somewhat unsatisfactory decisive case. The facts were so complex that they are not explained in any of the judgments of the High Court, the Court of Appeal or the House of Lords. Broadly, there were a number of complex interlocking agreements relating to the construction of an oil refinery in Newfoundland. There were a large number of promissory notes, which were guaranteed by the Plaintiff and in respect of a good, many of which the guarantee was called up. The Plaintiff sued in respect of these sums but the actions were not against those who had failed to pay. It is certainly the case that the Defendants sought to invoke the penalty doctrine and that Lord Roskill, delivering the only speech in the House of Lords, held that it did not apply, but it is also true that he said that the sum the Plaintiffs sought to recover was the actual loss. There is no serious discussion of the cases.

This question was not before the Supreme Court in *Cavendish*, but both Lord Neuberger²⁴ and Lord Hodge²⁵ affirmed the limitation to cases of breach. It is realistic to regard this as binding in English Law at least for the lower courts. It is perhaps not wholly inconceivable that the Supreme Court could be persuaded, on the right facts, to a different view. The central question is whether a skilful draftsman should be restricted in their ability to side step the rule which is after all one of substance. The argument the other way is that once one has opened this door it is not clear where to stop.

The position in the Court of Appeal is shown by the decision of a strong court, including two future Law Lords²⁶ in *Lombard North Central Plc v. Butterworth*.²⁷ In this case the Plaintiff and the Defendant entered into a contract for the lease of a computer for 5 years. There was an initial payment of 584.05 £ and a further 19 of the same amount, payable every 3 months (making a total of 11681.00 £). Clause 2 (a) of the contract contained a provision that a punctual payment of the instalments was of the essence to the contract. The Defendant had a poor payment history and in due course the Plaintiff retook possession of the computer, sold it for 172.85 £ and sued for the balance of the price, some 6869.97 £. The Court of Appeal was clear that the penalty rule did not apply to this provision and the sum could be recovered. Mustill, LJ. said,²⁸

“This is not a result which I view with much satisfaction partly because the Plaintiffs have achieved by one means a result

²³ *Export Credits Guarantee Deptt. v. Universal Oil Products Co.*, (1983) 1 WLR 399 : (1983) 2 All ER 205 (HL).

²⁴ *Cavendish* at ¶ 42.

²⁵ *Cavendish* at ¶ 241.

²⁶ Lords Mustill and Nicholls.

²⁷ *Lombard North Central Plc v. Butterworth*, 1987 QB 527 : (1987) 2 WLR 7 : (1987) 1 All ER 267. (“*Lombard*”). See *Cf Financings Ltd. v. Baldock*, (1963) 2 QB 104 : (1963) 2 WLR 359 (CA).

²⁸ *Lombard* at ¶ 20-28.

which the law of penalties might have prevented them from reaching by another.”

V. THE OVERDRAFT QUESTION

In *Andrews*, there was an action apparently by some 38,000 account holders in the Federal Court against the Bank. There were apparently similar proceedings against other banks. The action was started in the Victorian District Registry of the Federal Court. Some parts of this litigation, after the decision of the trial judge, were removed directly to the High Court rather than going to the Full Court of the Federal Court, as would be the usual course. Only some parts of the trial judge’s findings were the subject of appeal, essentially whether the provisions for charges by the bank in relation to transactions by the customer, which was not a breach of contract, could be characterized as penalties. The decision of the High Court was that, in some circumstances, such charges could probably be characterized as penalties and the case then went back to the trial judge to be decided again in the light of this.

The question has now nearly completed a second journey through the Australian Courts, though under another name, *Paciocco v. Australian and New Zealand Banking Group Ltd.* There has been extensive discussion of the banks terms, much of it directed at the banks charges for credit card customers who failed to make their minimum payment on time. Gordon, J. held²⁹ that some of the provisions were penal. The Federal Court of Appeal allowed the appeal.³⁰ The High Court gave special leave to appeal and the appeal was heard on 4th and 5th February 2016.³¹

The same question was litigated in England in *Office of Fair Trading v. Abbey National Plc.*³² This was a major challenge by the Office of Fair Trading to a number of practices of banks in operating accounts. Andrew Smith, J. extensively considered the question where the charges might be penalties at first instance, and there was no appeal against his findings on this question.

In his very helpful judgment Andrew Smith, J. sets out the practice of English banks in detail. The terms used by banks are not identical but they are very similar. The normal practice of English banks in recent years has been to make no charge for customers who maintain a credit balance. The review shows that,

²⁹ *Paciocco v. Australia and New Zealand Banking Group Ltd.*, 2014 FCA 35, (High Court of Australia).

³⁰ *Paciocco v. Australian and New Zealand Banking Group Ltd.*, 2015 FCAFC 50, (Federal Court of Australia).

³¹ The most important change is that the High Court of Australia delivered its judgment in the *Paciocco* case on 27 July 2016. The case is reported at [2016] HCA 28.

³² *Office of Fair Trading v. Abbey National Plc*, 2008 EWHC 875 (Comm), (Supreme Court of the United Kingdom). (“Abbey”).

perhaps, about half the customers would have an agreed overdraft and a not insignificant proportion of those without an agreed overdraft would from time to time overdraw. (Perhaps on average about 20%).

Andrew Smith, J. held³³ that if a customer issues an instruction that would overdraw his accounts or exceed his agreed limit he is not breaking his contract but inviting the bank to make the payment. The bank might have conditions making it a breach but the bank conditions considered by him did not. Andrew Smith, J. examined in detail the conditions of each of the relevant banks.³⁴ He was clear that starting from the position that a provision could only be a penalty if it was triggered by breach, none of the provisions were penal. He did not discuss at all the amount of the charges.

VI. THE BASIC PRINCIPLES ABOUT PENALTIES

For most of the last 100 years, the standard authority cited for discussion of whether a contractual provision is for a penalty has been the speech of Lord Dunedin in *Dunlop*.

- “1. Though the parties to a contract who use the words ‘penalty’ or liquidated damages’ may prima facie be supposed to mean what they say, yet the expression used is not conclusive. The Court must find out whether the payment stipulated is in truth a penalty or liquidated damages. This doctrine may be said to be found passim in nearly every case.
2. The essence of a penalty is a payment of money stipulated as in terrorem of the offending party; the essence of liquidated damages is a genuine covenanted pre-estimate of damage (*Clydebank Engg. and Shipbuilding Co. v. Don Jose Ramos Yzquierdo Y Castaneda*³⁵).
3. The question whether a sum stipulated is penalty or liquidated damages is a question of construction to be decided upon the terms and inherent circumstances of each particular contract, judged of as at the time of the making of the contract, not as at the time of the breach (*Commr. of Public Works v. Hills*³⁶ and *Webster v. Bosanquet*³⁷).
4. To assist this task of construction various tests have been suggested, which if applicable to the case under consideration may prove helpful, or even conclusive. Such as:

³³ Abbey at ¶ 64.

³⁴ Abbey at ¶ 295-324.

³⁵ 1905 AC 6 (HL).

³⁶ 1906 AC 368.

³⁷ 1912 AC 394.

- (a) It will be held to be penalty if the sum stipulated for it is extravagant and unconscionable in amount, in comparison with the greatest loss that could conceivably be proved to have followed from the breach. (Illustration given by Lord Halsbury in *Clydebank Case*³⁸).
- (b) It would be held to be a penalty if the breach consists only in not paying a sum of money, and the sum stipulated is a sum greater than the sum which ought to have been paid (*Kemble v. Farren*³⁹). This, though one of the most ancient instances, is truly a corollary to the last test. Whether it had its historical origin in the doctrine of the common law, that when A promised to pay B a sum of money on a certain day and did not do so, B could only recover the sum with, in certain cases, interest but could never recover further damages for non-timeous payment, or whether it was a survival of the time when equity reformed unconscionable bargains merely because they were unconscionable – a subject which much exercised Jessel MR in *Wallis v. Smith*⁴⁰ – is probably more interesting than material.
- (c) There is a presumption (but no more) that it is penalty when ‘a single lump sum is made payable by way of compensation, on the occurrence of one or more or all of several events, some of which may occasion serious and others but trifling damage’ (Lord Watson in *Lord Elphinstone v. Monkland Iron and Coal Co.*⁴¹).

On the other hand:

- (d) It is no obstacle to the sum stipulated, being a genuine pre-estimate of damages, that the consequences of the breach are such as to make precise pre-estimation almost an impossibility. On the contrary, that is just the situation when it is probable that pre-estimated damages were the true bargain between the parties (*Clydebank Case*⁴², Lord Halsbury; *Webster v. Bosanquet*⁴³, Lord Mersey).⁷

This was extensively discussed in *Cavendish*. No one suggested that the decision in the case was wrong or indeed that what Lord Dunedin said was wrong

³⁸ 1905 AC 6 (HL).

³⁹ (1829) 6 Bing 141.

⁴⁰ (1882) 21 Ch D 243 (CA).

⁴¹ (1886) 11 App Cas 332 (HL).

⁴² 1905 AC 6 at p. 11 (HL).

⁴³ 1912 AC 394 at p. 398.

but there was regret that it had been elevated into an *ex cathedra* statement. Lord Neuberger said,⁴⁴

“Lord Dunedin’s speech in *Dunlop* achieved the status of a quasi-statutory code in the subsequent case-law. Some of the many decisions on the validity of damages clauses are little more than a detailed exegesis or application of his four tests with a view to discovering whether the clause in issue can be brought within one or more of them. In our view, this is unfortunate. In the first place, Lord Dunedin proposed his four tests not as rules but only as considerations which might prove helpful or even conclusive “if applicable to the case under consideration.” He did not suggest that there were applicable to every case in which the law of penalties was engaged. Second, as Lord Dunedin himself acknowledged, the essential question was whether the clause impugned was “unconscionable” or “extravagant.” The four tests are a useful tool for deciding whether these expressions can properly be applied to simple damages clauses in standard contracts. But they are not easily applied to more complex cases. To deal with those, it is necessary to consider the rationale of the penalty rule at a more fundamental level. What is it that makes a provision for the consequences of breach “unconscionable”? And by comparison with what is a penalty clause said to be “extravagant”? Third, none of the other three Law Lords expressly agreed with Lord Dunedin’s reasoning and the four tests do not all feature in any of their speeches.”

Lord Neuberger found the speech of Lord Atkinson particularly helpful. Lord Mance⁴⁵ and Lord Hodge⁴⁶ also made cautionary remarks about Lord Dunedin.

The first and third of Lord Dunedin’s propositions are uncontroversial. As for the second, it has long been thought best to avoid references to terror, though the references to extravagance and unconscionability in the Fourth Rule continue to be used. It is not clear whether any of these somewhat emotive labels are appropriate. The central question is whether the contractual figure is a genuine pre-estimate of damage. But what does this mean? It is not the practice to lead evidence as to how the figure was arrived at. The figure is compared with the Courts’ view as to what a reasonable pre-estimate at the time of the contract would have been. It is important to see that this can be a very difficult question.

This was the case in *Dunlop* itself. There was no direct financial loss to *Dunlop* arising from the Defendant’s decision to sell below list price. It is far

⁴⁴ Cavendish at ¶ 22.

⁴⁵ Cavendish at ¶ 137.

⁴⁶ Cavendish at ¶ 221.

from clear what damages Dunlop would have recovered on these facts if there had been no agreed damages clause. This was, of course, why the clause was in the contract.

It is a central finding in the case that Dunlop had a legitimate interest in seeking to control how their products were marketed. (We do not think this way today but it was a reasonable starting point in 1915.) It is not easy to think of any way this could have effectively be done other than what was actually done. Of course they were not really worried about a single isolated breach of the rules, which would, in practice, be very difficult to catch. They were concerned about a retailer, who deliberately set out to break the rules. If someone did this successfully, others would follow and the system would collapse. It was this danger Dunlop was seeking to avert.

Essentially the House of Lords was deciding whether the figure was acceptable. 5 £ was worth a great deal more in 1915 than it is today but their Lordships clearly thought it was not too large a figure. What we do not know is what would have been an unacceptable figure.¹⁰ £? 50 £? 100 £?⁴⁷

Of course there are cases where the loss to the Plaintiff from the Defendant's breach is clear. This is the case with the payment provisions in hire-purchase contracts, which generated much litigation 50 years ago. Here the maximum loss to the owner is clear from the moment of the contract and it is clear that this figure will reduce payment by payment. This means that contractual figures can be identified as wrong and therefore not binding as in Lord Dunedin's 4(b).

There are important groups of cases that fall in between these extremes. An important practical example is clauses providing for delay in construction contracts. Nearly all construction contracts contain provisions for delay in completion, typically at so much a day or week. The clauses are in printed standard forms and the employer and the contractor agree to the figure to be put in the relevant space on the form. Most contracts also contain provisions for extensions of time on certain events.

Although these provisions are virtually universal and although the construction industry is addicted to disputes, arguments about the level of liquidated damages are relatively rare. This is because in most circumstances the provision has advantages for both parties, for the contractor because it effectively limits his liability for delay and for the employer because he can often deduct the liquidated damages from a payment and avoid the costs of a dispute.

⁴⁷ Cavendish at ¶ 22-24, ¶ 135-143, ¶ 219-221 and 245-248.

An instructive case that was litigated is *Alfred McAlpine Capital Projects Ltd. v. Tilebox Ltd.*⁴⁸ In this case there was a building contract for the conversion of a building into a top of the range office building. The contract provided for liquidated damages at the rate of 45,000 £ per week or part thereof. The figure was the subject of detailed negotiations between the contractor, a large and experienced firm, and the employer. An important factor was that it had been estimated that the rental value of the finished building would be of the order of 45,000 £ per week, though the market for renting top of the range office buildings is volatile. McAlpine sought a declaration that the agreed figure was a penalty. At the time of the judgment the building was still incomplete, some two and a half years after the contract completion date.

Jackson, J. said,⁴⁹

“In my view, a pre-estimate of damages does not have to be right in order to be reasonable. There must be a substantial discrepancy between the level of damages stipulated in the contract and the level of damages, which is likely to be suffered before it can be said that the agreed pre-estimate is unreasonable. Although many authorities use or echo the phrase ‘genuine pre-estimate’ the test does not turn upon the genuineness or honesty of the party or parties who made the pre-estimate. The test is primarily an objective one, even though the court has some regard to the thought processes of the parties at the time of contracting.”

He held that the agreed damages clause was valid.

It is clear that there have been a number of changes in relatively recent times. So although payment of money is the most common case, the penalty rule may be applied where the consequence of the breach is a transfer of property.⁵⁰ There have been a number of cases starting with the decision of Colman J in *Lordsvale Finance Plc v. Bank of Zambia*⁵¹ in which a provision in a syndicated loan agreement providing for payment of interest at a higher rate during any period when the borrower was in default was held not to be penal.⁵² Lord Neuberger,⁵³ Lord Mance⁵⁴ and Lord Hodge⁵⁵ approved these decisions. Deposits, which used to be thought of as subject to different rules, may be held to be penalties if larger than the norm.⁵⁶

⁴⁸ *Alfred McAlpine Capital Projects Ltd. v. Tilebox Ltd.*, (2005) 104 Con LR 39, (“Alfred”).

⁴⁹ *Alfred* at ¶ 50.

⁵⁰ *Cavendish* at ¶ 16, ¶ 157 and ¶ 226.

⁵¹ *Lordsvale Finance Plc v. Bank of Zambia*, 1996 QB 752 : (1996) 3 WLR 688.

⁵² *See Cine Bas Filmcilik Ve Yapimcilik v. United International Pictures*, 2004 ICLC 401 at ¶ 13. *See Murray v. Leisureplay Plc*, 2005 IRLR 946 at ¶ 54.

⁵³ *Cavendish* at ¶ 26.

⁵⁴ *See Cavendish* at ¶ 140, 147, 152.

⁵⁵ *Cavendish* at ¶ 222.

⁵⁶ *Workers Trust & Merchant Bank Ltd. v. Dojap Investments Ltd.*, 1993 AC 573 : (1993) 2 WLR 702. *See Cavendish* at ¶ 234-238.

VII. THE RELATIONSHIP BETWEEN THE PENALTY RULE AND RELIEF AGAINST FORFEITURE

In developed English Law, the penalty rule is treated as common law whereas relief against forfeiture continues to be equitable, so that there is a possibility of discretionary taking account of relevant factors. There is substantial discussion of the relationship.⁵⁷ Some, at least, of their Lordships thought that there were cases where consideration of both sets of rules would be appropriate.

An important and difficult case is *Jobson v. Johnson*.⁵⁸ In this case two brothers, agreed to sell 62,566 shares in Southend United Football Club Ltd., which made up 44.43914% of the share capital of the club, to the Defendant. In due course they assigned the contract to the Plaintiff. The contract provided for a purchase price of 40,000 £. The Defendant agreed to pay in addition to the 40,000 a further sum of 311,688 £ in six equal half yearly payments of 51,948 £, the first payment to be made on 12th February 1984.

There was a provision that if the Defendant failed to pay the first instalment, he should return the shares and should be paid 15,000 £, and if he failed to pay any of the later instalments, he should return the shares and be paid 40,000 £. The Defendant paid the 40,000 £ but did not pay the first instalment. There was then a variation agreement under which he was to pay 300,000 £ in instalments. He paid 100,000 £ but did not pay the remaining instalments. The Plaintiff sought the return of the shares. The Defendant argued that the provisions for return of the shares were penal and in addition sought relief against forfeiture. The trial judge struck out the application for relief because of the Defendant's failure to comply with an order to disclose documents relating to his own financial position. There was no appeal against this.

In this case, the contract provided that if the Defendant failed to make a payment he should return the shares. The Court of Appeal held that there was no reason why the penalty rule could not apply to a transfer of property as much as the payment of money. It followed that simply to order reconveyance of the shares would be penal, but simply to leave the Plaintiff to his action for the balance of the price would go too far in the opposite direction.

The majority of the Court of Appeal, Dillon and Nicholls, LJJ., held that the solution was to offer the Plaintiff a choice of an order for sale of the shares and payment of the unpaid instalments and interest out of the proceeds or to make an order for reconveyance of the shares, subject to an inquiry as to their present value and appropriate orders. The Plaintiff could be offered this choice but he would be free to decline both alternatives.

⁵⁷ Cavendish at ¶ 17-18, ¶ 160-161, ¶ 227, ¶ 291, ¶ 294.

⁵⁸ *Jobson v. Johnson*, (1989) 1 WLR 1026 : (1989) 1 All ER 621.

On these facts, but for the Defendants failure to comply with the order for disclosure, the Court would have been very likely to grant relief on the basis that the Defendant should retain the shares so long as he complied with an order to pay the balance of the price and interests and costs. If he failed to make the payments there would have been an order for reconveyance of the shares with consequential financial provisions. We do not know why the Defendant did not make the disclosure and did not appeal but the most plausible reason is that this would have involved revealing information about his financial position, which he wished to keep to himself. There are hints in Kerr, LJ.'s partial dissent that the shares had become substantially more valuable.

Lord Neuberger criticised the final result of the case. He said⁵⁹

“As a result of his default in giving disclosure, he was able to achieve a better result than he would have done if he had given disclosure.”

Lord Hodge agreed.⁶⁰

VIII. *CAVENDISH SQUARE HOLDING BV V. TALAL EL MAKDESSI*

We now turn to the cases considered by the Supreme Court. The facts of the two cases are totally different and neither is easy. In *Cavendish*, the sums involved are very large; the contract took some 6 months to negotiate and well-known London solicitors advised both sides.

Cavendish was a subsidiary of WPP, the World's largest communication services group. Mr. Makdessi was a leading Lebanese businessman with a group of companies, which have become largest advertising and marketing group in the Middle East. There were a large number of companies. The holding company was Team Y & R Holdings Hong Kong Ltd. (Team). There were 1,000 issued shares in Team, of which 126 shares were held by another subsidiary of WPP. The scheme of the contract was that Mr. Makdessi and a colleague would sell 474 shares, so that 60% of the shares would be held by *Cavendish* and 40% by the sellers.

The agreement, dated 28th February 2008, provided for an initial payment of US \$34 million payable on completion of the contract and three further payments, two of which were dependant, in amount, on the profits for 2007-2009 and 2007-2011. The sellers retained 40% of the shares and there were detailed provisions about their continued involvement. It is clear that the very substantial sums

⁵⁹ *Cavendish* at ¶ 84.

⁶⁰ *Cavendish* at ¶ 283.

paid or promised included a large element, perhaps as much as half for goodwill, associated with a continued involvement of the sellers.

The critical provisions in the agreement for the purpose of the case were:

“5.1 If a seller becomes a Defaulting Shareholder [which is defined as including ‘a Seller which is in breach of clause 11.2;] he shall not be entitled to receive the Interim Payment and/ or the Final Payment which would other than for his having become a Defaulting Shareholder have been paid to him and [Cavendish’s] obligations to make such payments shall cease.

5.6 Each Seller hereby grants an option to [Cavendish] pursuant to which, in the event that such Seller becomes a Defaulting Shareholder, [Cavendish] may require such Seller to sell to [Cavendish] all of the shares held by that Seller (the Defaulting Shareholder Shares). [Cavendish] shall buy and such Seller shall sell the Defaulting Shareholder Shares within 30 days of receipt by such Seller of a notice from [Cavendish] exercising such option in consideration for the payment by [Cavendish] to such Seller of the Defaulting Shareholder Option Price [defined as ‘an amount equal to the [NAV] on the date that the relevant Seller becomes a Defaulting Shareholder multiplied by [the percentage which represents the proportion of the total shares the relevant Seller holds].”

It was clear by 2010 that Mr. Makdessi had become a “Defaulting Shareholder” by offering services to competing companies and proceedings were started in late 2010. Mr. Makdessi argued that these clauses were penalties. Burton J held that they were not; The Court of Appeal disagreed but the Supreme Court restored Burton J’s judgment. The decision was unanimous but not completely so as to the reasons.

Lord Neuberger considered that Clause 5.1 was part of the definition of Cavendish’s primary obligation and therefore wholly outside the penalty area.⁶¹ Lord Hodge thought that this was a strong argument but that even if Clause 5.1 was a secondary provision, it was not, in the circumstances, penal.⁶² Lord Clarke⁶³ and Lord Toulson⁶⁴ agreed with Lord Hodge. Lord Mance, though more cautiously, took the same view.⁶⁵

⁶¹ Cavendish at ¶ 73,74,75.

⁶² Cavendish at ¶ 271-278.

⁶³ Cavendish at ¶ 291.

⁶⁴ Cavendish at ¶ 292.

⁶⁵ Cavendish at ¶ 181.

Lord Neuberger also thought that Clause 5.6 was a primary obligation⁶⁶ and Lord Mance agreed.⁶⁷ Lord Hodge⁶⁸ and Lord Clarke⁶⁹ preferred to regard the Clause as secondary, but on the facts not penal. The moral, which most clearly emerges from this, is the importance for the draftsman to formulate key obligations as primary rather than secondary wherever possible.

IX. PARKINGEYE LTD.V. BEAVIS⁷⁰

This was a very different, but also far from easy case. It concerned the control of car parking near to a supermarket. It should perhaps be explained that English supermarkets have come to seek to attract customers with cars by the provision of car parking but that the car park is often attractive to other motors. Companies have emerged, like the Plaintiff in the present case, whose principal function is the management of such parking spaces.

In this case, the Plaintiffs had been engaged to manage a car park in Chelmsford. They put up some 20 signs at the car park that stated clearly that the maximum stay was 2 hours, which would be free, and that afterwards there would be a parking charge of 85 £. Mr. Beavis stayed in the car park on 15th April 2013 for 2 hours, 56 minutes (this was observed by automatic cameras, which filmed all entries and departures and noted the number plate of the car). Mr Beavis received a notice demanding payment of 85 £ within 28 days but offering a reduction to 50 £ if he paid within 14 days. He did not pay and the Plaintiff started the present action. He argued that the sum was a penalty. (He also relied on a 1999 Consumer Protection Regulation. This argument was unsuccessful but we will not examine it here.)

The case was fought on the basis that Mr. Beavis's act in parking his car created a contract, even though if he had left before 2 hours he would not have had to pay.⁷¹ All members of the Supreme Court were agreed that the penalty rule was engaged. Mr. Beavis had contracted to leave within 2 hours and had broken that promise. The 85 £ was payable on that breach. Parking Eye had not suffered 85 £ worth of damage but that was not the test. The Court looked at a range of other charges. The charge for illegal on street parking is not so high except in Central London but this parking has no free hours. Looking at the question broadly, 85 £ was in the circumstances not unreasonable.

⁶⁶ Cavendish at ¶ 82-88.

⁶⁷ Cavendish at ¶ 182,183.

⁶⁸ Cavendish at ¶ 280.

⁶⁹ Cavendish at ¶ 291.

⁷⁰ ParkingEye Ltd. v. Beavis, 2015 UKSC 67.

⁷¹ This view is not totally without difficulties but we will not examine them here.

X. CONCLUSIONS

It is clear that these cases require careful thought in both Australia and England. They should receive careful consideration in other common law jurisdictions. It would not be a surprise if they provoke a number of other decisions, but some of the most important lessons are for the contract draftsman. Even in Australia, it must be better, where possible to write the contract such that the event which triggers the obligation is not a breach of contract. Similarly a provision is unlikely to be struck down as penal if it states a primary obligation.

It is clear that there are cases where one party promises to make a payment if he breaks the contract so that the penalty rule is engaged but where the test is not whether the agreed sum is a reasonable pre-estimate of damage. This was the case in *Dunlop* and now in *Parking Eye*. In both cases there was a legitimate interest to be protected and the agreed sum was not too large.