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Penalties

*Do we have a free reign to
impose penalties following on
from*

El Makdessi and ParkingEye?

Lesley Anderson QC



Penalties – a free rein?

Scope

- The law on contractual penalty clauses
- The position *pre-El Makdessi*
- The position *post-El Makdessi*
- Implications for contract makers and breakers



Penalties – a free rein?

The Problem

“an ancient, haphazardly constructed edifice which has not weathered well, and which in the opinion of some should simply be demolished, and in the opinion of others should be reconstructed and extended”



Penalties –a free rein?

A brief history:

- Equitable origins in C16th– relief from defeasible bonds
- Relationship with relief from forfeiture
- Primary obligations v secondary obligations
- Adapted by common law end C17th to damages clauses
- Tension between:
 - Holding parties to bargain even when “improvident”;
and
 - Relieving from liability to pay damages wholly out of
proportion to damage



Penalties – a free rein?

Types of situation to which the penalty rule may apply:

- Cases involving a breach of contract
- Circumstances other than breach of contract



Penalties – a free rein?

Types of clause to which the penalty rule may apply:

- Clauses setting out the damages to be paid on breach (typically LAD type clauses)
- Clauses withholding payment on breach
- Clauses requiring the transfer of property on breach
- Clauses requiring payments of non-refundable deposits



Penalties – a free rein?

The classic exposition:

- *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd* [1915] AC 79 per Lord Dunedin at pp.86-88:

(1) use of expression “penalty” or “liquidated damages” not conclusive

(2) Penalty = payment of money stipulated as *in terrorem* v genuine covenanted pre-estimate of damage

(3) Question is one of construction to be judged at date of contract

(4) The following may be helpful or even conclusive....



Penalties – a free rein?

- (a) Penalty if sum stipulated is extravagant and unconscionable in amount in comparison with greatest loss conceivable
- (b) Not a penalty if breach consists only in paying a sum of money and the sum stipulated is greater than sum which ought to have been paid
- (c) Presumption of penalty when single sum is payable on occurrence of one or more of several events, some which may occasion serious and others but trifling damage
- (d) May be genuine pre-estimate of damage even if the circumstances make pre-estimation almost impossible



Penalties – a free rein?

The conjoined appeals:

- *Cavendish Square Holding BV v Talal El Makdessi*
 - Burton J. [2012] EWHC 3582 (Comm) – no penalty
 - In CA: Patten LJ, Tomlinson LJ and Christopher Clarke LJ [2013] EWCA Civ 1539 - penalty
 - Permission from SC
- *ParkingEye Limited v Beavis*
 - HHJ Moloney QC – no penalty
 - In CA: Moore-Bick LJ, Patten LJ and Sir Timothy Lloyd [2015] EWCA Civ 402 – no penalty – permission given to appeal



Penalties – a free rein?

The relevant clauses:

- In *El Makdessi*:
 - Clause 5.1 by which Defaulting Shareholder was deprived of Interim Payment and Final Payment
 - Clause 5.6 by which required Defaulting to sell all shares at an amount equal to Net Asset Value
- In *ParkingEye*:
 - Parking charge of £85 for failing to remove car after 2 hours



Penalties – a free rein?

In the Supreme Court [2015] UKSC 67:

- Lord Neuberger/Lord Sumption and Lord Carnwath
- Lord Mance
- Lord Hodge
- Lord Clarke agreed with reasoning of Neuberger/Sumption, Mance and Hodge (but sided with Hodge on two aspects and Hodge and Mance on another)
- Lord Toulson agreed with Mance and Hodge on general principles or penalties and application in *El Makdessi* but lone dissent on outcome in *ParkingEye* (but on unfair terms ground)



Penalties – a free rein?

- STILL WITH ME?



Penalties – a free rein?

The Supreme Court:

- Rejected judicial abolition of the rule
- Rejected that it should be confined to non-commercial cases
- Rejected extension of rule to non-breach of contract cases
- Rejected that it was confined to payments of money
- Allowed appeal in *El Makdessi*
- Dismissed appeal in *ParkingEye* (save for Lord Toulson)



Penalties – a free rein?

Instead:

- Doctrine only applies to regulate remedies for breach of primary obligations not to the primary obligations themselves
- Test of a penalty lay in the “*unconscionable and extravagant*” formulation
- If genuine pre-estimate of loss will not be a penalty
- Clauses which might otherwise be penal may be properly justified by commercial considerations other than the desire to recover compensation for the breach



Penalties – a free rein?

[32] Neuberger/Mance JJ

- *“The true test is whether the impugned provision is a secondary obligation which imposes a detriment on the contract-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation”*



Penalties – a free rein?

- Some tentative conclusions





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