Penalty Clauses and Associated Doctrines

A Critical Analysis of the Penalty Doctrine and its Possible Application to the Similar Areas of the Law

by

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Abstract

The question of validity of agreed damage clauses has always been a complex one: In common law, a valid and enforceable "genuine pre-estimate of damages", *i.e. liquidated damages*, has been distinguished from an invalid *penalty clause* which provides for a disproportionately large sum of money, compared to the likely actual loss, to be paid upon breach. Furthermore, equity has, in certain circumstances, been prepared to afford certain types of relief to a contract-breaker against forfeiture of his interest in the subject-matter, and/or moneys already paid. This area of the law, however, has always been subject to controversy: the basis of the penalty doctrine, its scope, the practical problems in its application in different areas of the law, the anomalies resulting from the application of the doctrine, and particularly the possible inter-relationship between the penalty doctrine and the rules relating to relieve against forfeiture are among the issues which have attracted academic and judicial discussions. Due to the importance of these contractual provisions, the uncertainties and controversies in this area, and the importance of a thorough examination of major national legal systems to pave the way for achieving uniformity at international level, this study is focused on a critical analysis of the law relating to penalties and associated doctrines in the English legal system, as the basis and origin of the common law.

The thesis is presented in two parts: The first part, chapters 1-5, deals with the issues relating to the penalty doctrine, while the relief afforded against forfeiture is discussed in the second part, chapters 6-9.

Chapter one, the introductory chapter, concentrates on the historical background and the possible justifications of the penalty doctrine. The practical rules to distinguish penalties and liquidated damages are discussed in the second chapter which aims, *inter alia*, at establishing that the intervention of courts should only be limited to a situation where the agreed sum is "*substantially* disproportionate" to the likely actual loss. The relationship between penalty clauses and limitation clauses, and also the issue of the possible application of the penalty doctrine to acceleration clauses are discussed in the third chapter, while the fourth chapter focuses on the anomalies resulting from the well-established rule of the common law which limits the application of the doctrine to a situation where there is a breach of contract between the contracting parties. As one important and controversial area for the application of the penalty doctrine, chapter five concentrates on the application of the penalty doctrine to minimum payment clauses. The practical problems in this regard, the relevance of the basis for termination, and the necessary factors to be taken into account in drafting a minimum payment clause are among the issues considered in this chapter.

Chapter six considers two preliminary issues for the main discussion about equitable relief against forfeiture: the remedies available to a breacher, at common law, to recover his advance payments, including a possible general basis for these remedies, and a historical review of the courts' equitable intervention to afford relief against forfeiture. Relief against forfeiture of the breacher's interest in the subject-matter is considered in the seventh chapter, while chapter eight focuses on the equitable jurisdiction of courts to relieve against forfeiture of advance payments, including both part payments and deposits. Both chapters aim towards illuminating the existence, scope and limits of the jurisdiction, and then concentrate on the possible application of the penalty doctrine when a court exercises its equitable power to relieve against forfeiture. Finally chapter nine discusses the scope and exercise of the statutory jurisdiction of courts to relieve against forfeiture of deposit in contracts for the sale or exchange of an interest in land, after a general consideration of the statutory measures to afford relief against forfeiture.

To My Parents

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Hossein Abedian

Author's Declaration

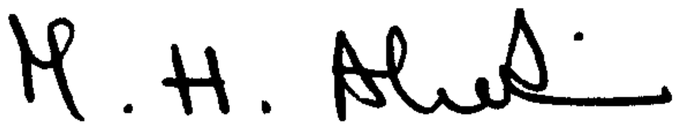
I would hereby declare

that the work contained in this thesis is my own independent work, unless otherwise acknowledged or stated in the footnotes,

that this work has not been previously submitted for any degree or qualification in any university, and

that the views expressed in this thesis are mine, and not of the University of Bristol.

Hossein Abedian



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Introduction

Shylock's bond, as presented by Shakespeare, is an extreme illustration of a penal bond: Antonio borrows three thousand ducats from Shylock for three months. To secure the repayment, he (Antonio) enters into a bond undertaking that in case of non-payment, Shylock shall be entitled to carve:

> "... an equal pound
> Of your (Antonio's) fair flesh, to be cut off and taken
> In what part of your body pleaseth me."[1]

Although Shakespeare represents this bond as a valid contractual stipulation, yet the feeling of a need to do justice, leads him to finish the story by a very strict and literal construction of the contract: Shylock is given the right to have his "pound of flesh", but since there was no mention of blood in the contract, he is required to carve Antonio's breast without any blood coming through:

> "This bond doth give thee here no job of blood,
> the words expressly are a pound of flesh!"[2]

This bond was a sophisticated form of self-pledge to secure performance of a contract in an era when men could not trust each other, and the machinery of the law was weak. At that time, as it will be seen in the next section, there was no serious resistance against use of penal bonds. The parties to a contract also had other incentives to agree upon a bond- or the developed form of it; that is, an agreed damage clause: pre-estimation of future likely damages in advance. The considerable uncertainty in the computation of damages, the difficulty of proving actual loss, and the delay and expenses involved in the judicial process of an action for damages have led the parties to agree upon the likely amount of damages in advance when they enter into the contract. Tindal CJ in 1829 rightly pointed out that there was "nothing illegal or unreasonable in the parties, by their mutual agreement, settling the amount of damages, uncertain in their nature, at any sum upon which they may agree".[3] However, as it may also appear from this passage, English law has, by the equitable power endowed upon Chancellors, differentiated between such

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[1] William Shakespeare, The Merchant of Venice, (Penguin Books, 1994), Act One, Scene Three, lines 146-148, at p. 37

[2] *Ibid.*, Act Four, Scene One, lines 305-306, at p. 92

[3] *Kemble v. Farren* (1829) 6 Bing 141, 130 ER 1234, at pp. 148, 1237 respectively

clauses and terms, agreed upon by the parties, acting in terrorem of the defaulting party[4], which pressurises the promisor into performance and punishes him in case of breach. In general terms, though the latter has been recognized as an unenforceable stipulation, the former remains legally valid.

Nowadays, in most commercial and consumer contracts- even at international level[5]- a clause is allocated to dealing with the pre-assessment of damages. Such clauses, commonly referred to as "agreed damage clauses", can, for example, be seen in most construction contracts, hire-purchase and conditional sale agreements, charterparties, contracts for the sale of land or chattel by instalments, and the like. They are, in general terms, the agreement of the parties about the amount of likely losses which might result from any probable breach of the contract by the promisor. Although in most cases, the subject of the clause is the payment of a certain sum of money to the innocent party, yet it has well been established that the parties' agreement may include certain adverse consequences other than payment of a specific sum of money: they, for instance, may agree that, upon breach, the contract breaker will have to transfer a certain property to the other party[6], or the breach will entitle the innocent party to withhold certain payments due to the promisor[7]; or they may alternatively agree that the promisor will forfeit certain

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[4] See *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd.* [1915] AC 79 per Lord Dunedin at p. 86

[5] An analysis of replies, by twelve different countries, to a questionnaire prepared by the Secretariat of United Nations Commission on International Trade (UNCITRAL) showed that the provisions for the payment of liquidated damages or penalties were *often* inserted in international contracts; they could be seen in a large variety of contracts, among which "supply of goods, manufacture and installation of plant and machinery, construction contracts, joint ventures, and supply of long-term services" were particularly mentioned: see Yearbook of the United Nations Commission on International Trade Law, vol. XII: 1981 (New York: United Nations, 1983), pp. 44-45; *cf.* Beale H., Dugdale T., Contracts Between Businessmen: Planning and the Use of Contractual Remedies (1975) 2 British Journal of Law and Society 45, at p. 55

[6] See, e.g., *Jobson v. Johnson* [1989] 1 All ER 621 (an agreement to transfer shares in a certain football club in the event of breach); see *infra.*, paras. 7.83 *et seq.*

[7] See *Gilbert-Ash v. Modern Engineering (Bristol) Ltd.* [1974] AC 689; see also *Firma C-Trade S.A. v. Newcastle Protection and Indemnity Association (The "Fanti") Socony Mobil Oil Co. Inc. v. West of England Shipowners Mutual Insurance Association Ltd. (The "Padre Island") (No. 2)* [1989] 1 Lloyds LR 239 (providing for the termination of one party's contractual right to be protected and indemnified in respect of his vessel against any claims relating to such vessel "whether already accrued or arising thereafter" in case, *inter alia*, he fails to pay the amounts due to the other party: the effect of the clause was simply disentitling a party to a sum of money which is due to him if he breaches the contract, see particularly per Stuart-Smith LJ at p. 262)

sum of money, like deposits[8] or instalments already paid, in the event of breach. An agreed damage clause may also, in certain circumstances, act as the limitation of the promisor's liability resulting from breach: the parties may agree on an amount which is considerably less than the likely loss which may conceivably flow from breach.[9]

The question of validity of such stipulations has always been a complex one: In general, common law, following equitable intervention of Chancellors to relieve against penalties, has distinguished between a valid and enforceable "genuine pre-estimate of damages"- that is, *liquidated damages*- and an invalid *penalty clause* which provides for a disproportionately large sum of money, compared to the likely actual loss, to be paid upon breach. Furthermore, equity has always been prepared to afford, in certain circumstances, certain types of relief to a contract-breaker against forfeiture of his interest in the subject-matter, or moneys already paid. There are also some statutory measures providing for certain forms of relief against forfeiture.

This area of the law, however, described rightly as the cloudy area of the law, has always been subject to controversy: the basis of the penalty doctrine, its scope, the practical problems in its application in different areas of the law, particularly as to minimum payment and acceleration clauses, the extent to which an agreed damage clause can validly limit the liability of the contract-breaker, the anomalies resulting from the exclusive application of the doctrine when there is a breach of contract, are among the issues which have attracted attention in judicial, as well as academic, discussions. The problems and uncertainty are particularly tense where the issue of the possible equitable intervention of courts to relieve against forfeiture arises: the question of the scope of such an intervention, its limits, and circumstances upon which such an equitable power could be exercised, are by no means clear. Most importantly, despite the close similarity of an agreed damage clause and a forfeiture provision, it is uncertain whether, and how far, the penalty doctrine could be applied when a court exercises its equitable jurisdiction to relieve against forfeiture.

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[8] As it will be seen, deposits are generally forfeitable even without the agreement of the parties to that effect: *infra.*, paras. 6.31, 8.45

[9] See, for example, *Cellulose Acetate Silk Co. Ltd. v. Widnes Foundry (1925) Ltd.* [1933] AC 20, see *infra.*, para. 3.12

Some attempts have also been made to harmonize the law relating to penalties at international level, the most important of which being the attempts made by the United Nations Commission on International Trade (UNCITRAL)[10] which culminated, in 1983, in drafting the "Uniform Rules on Contract Clauses for an Agreed Sum Due upon Failure of Performance"[11]. Although the General Assembly, recognizing the uncertainties in this area of the law due to "disparities in the treatment of such clauses in various legal systems", recommended the implementation of these uniform rules by the States "in the form of either a model law or a convention", it is less clear whether the Uniform Rules have achieved the desired objectives. No convention has been agreed upon by the states on the basis of the Uniform Rules, and in most countries the Rules have not been incorporated in the national law. Another attempt, made by Unidroit, is the insertion of an article dealing with the issue of agreed payment for non-performance in the set of rules entitled "Principles of International Commercial Contracts"[12]. These general principles would be applied where the parties "have agreed that their contract be governed by them".[13] Although this kind of drafting has the advantages of coming into use much earlier than agreeing upon a form of convention or model law, and of being subject to adaptation by the parties to suit their needs, yet it may not be enforced when it conflicts the applicable mandatory national law. The degree of harmony achieved by this form, at least as to penalties, would therefore be very limited.

Two attempts have also been made at European level: In its Resolution 78(3), the Committee of Ministers of the Council of Europe, drafted a certain set of rules "relating

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[10] Other attempts include the "General Conditions of Delivery of Goods between Organizations of the Member Countries of the Council for Mutual Economic Assistance" 1968/1975, amended also in 1979, which contain provisions regulating penalty clauses and liquidated damages. "Benelux Convention relating to Penalty Clause" adopted at Hague on 26 November 1973 should also be mentioned here. Article 1 of this Convention imposes on the contracting states the duty to bring their national legislation into conformity with the uniform set of rules, agreed upon in an annex to the Convention, at the latest by the date of entry into force of the Convention.

[11] For a full report containing the final text of the Rules see Report of the UNCITRAL on the Work of its Sixteenth Session (Vienna, 24 May- 3 June 1983) (A/38/17) (A/CN.9/243), Chapter II [published in the Yearbook of UNCITRAL, vol. XIV: 1983, (New York: United Nations, 1986), pp. 5-12]; see also the Reports of Secretary General: text of draft uniform rules on liquidated damages and penalty clauses (A/CN.9/218) in Yearbook, vol. XIII: 1982, Chapter I, section A, at pp. 27-34; and (A/CN.9/235) in Yearbook, vol. XIV: 1983, Part Two, Chapter I, pp. 27-32

[12] Article 7.4.13, Principles of International Commercial Contracts, Unidroit: Rome, 1994

[13] *Ibid.*, preamble

to penal clauses in civil law"[14], and- recognizing the necessity of having a judicial control over penalty clauses when they are manifestly excessive, and the importance of achieving unity regarding the applicable law- recommended the governments of the member states, *inter alia*, "to take the principles concerning penal clauses in civil law ... into consideration when preparing new legislation on this subject". More recently, the Commission on European Contract Law has been involved in the process of drafting a complete version of "The Principles of European Contract Law"[15]. Article 4.508[16] of these principles deals with the issue of "Agreed Payment for Non-performance", and, with a slight change in wording, is exactly the same as Article 7.4.13 of Unidroit's Principles of International Commercial Contracts. These principles, like Unidroit Principles of International Commercial Contracts, would be applied where "the parties have agreed to incorporate them into their contract or that their contract is to be governed by them".[17] From the point of view of the form these principles will take, they may be subject to the same observation as made above.

It appears that the most important hurdle in achieving unity in this area of the law is the great disparity of different legal systems as to the issue, particularly the manifest difference between the way common law and civil law legal systems handle these contractual clauses[18]: In civil law jurisdictions, an agreed damage clause is generally regarded as a valid stipulation, and unless it is manifestly excessive in comparison with the loss suffered by the innocent party as a result of breach, the judge cannot adjust the amount agreed upon by the parties. In common law world, however, speaking *only* in general terms, the clause is unenforceable if it is grossly disproportionate to the loss which is likely to result from breach at the time when the parties enter into the contract. Any potentially successful attempt to harmonize the law in this regard should, therefore, it seems, start from a detailed analysis of the applicable rules in major families of legal systems to pave the way for formulating a set of rules which provide for compromise

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[14] Adopted on 20 January 1978, at the 281st meeting of the Ministers' Deputies

[15] The first version of these rules has been made available, though the final version is expected to be published in 1997. The whole project, however, has been completed in May 1996.

[16] Article 9.509 in the revised version

[17] Article 1.101(1)

[18] For a comparative account see Treitel G.H., Remedies for Breach of Contract (A Comparative Account), (Oxford: Clarendon Press, 1988), Chap. VII, pp. 208 *et seq*.

solutions which may satisfy, as far as possible, the policies in the law of different legal systems.

Due to the importance of the agreed damage clauses, the uncertainties and controversies existing in the law relating to this area, and the importance of a thorough examination of major national legal systems to pave the way for achieving uniformity in the law applicable to penalty clauses in international trade contracts, this study is aimed towards a critical analysis of the law relating to penalty clauses and associated doctrines in the English legal system, as the basis and origin of the common law. This thesis will thus be committed, as far as the competence of the writer permits, to stating the law, in a clear and well-organized way, in different areas relating to penalty clauses and associated doctrines; singling out the leading cases and examining how far, and how, the relevant authorities could be reconciled; discussing in detail the controversial areas, and pointing out the possible anomalies resulting from the existing law, and suggesting possible solutions. Reference will also be made, where appropriate, to Australian law, as a well-developed common law legal system particularly in relation to penalty doctrine, to present a comparative account of how the subject is treated in these two legal systems.

Although this study covers most controversial areas relating to penalty clauses and associated doctrines, it has, like other studies of this nature, specific limits: In addition to being limited to two major common law legal systems, England and Australia[19], the thesis is limited, except as to the analysis of the statutory relief against forfeiture of deposit in contracts for the sale of land[20], to examining the different forms of relief afforded to a contract-breaker against penalties and forfeiture at common law and in equity. Thus, the statutory measures providing for relief against penalties and forfeitures in certain areas of the law and as to certain contracts, fall outside the ambit of this study.

This thesis will be presented in two parts: The first part will deal with the issues relating to the penalty doctrine, while the relief afforded against forfeiture will be discussed in the second part.

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[19] Occasional reference may also be made to American law, and some international documents.

[20] sec. 49(2), Law of Property Act 1925; see *infra.*, paras. 9.10 *et seq.*

The first part contains five chapters: Chapter one, the introductory chapter, discusses the historical background of the penalty doctrine, and the possible justifications of the doctrine. Both on the basis of the historical review and the different legal and economic justifications provided for the doctrine, it is shown that the intervention of courts in the parties bargain by affording relief against penalties could possibly be justified on the basis of "fairness". The practical rules to distinguish penalties and liquidated damages are discussed in the second chapter which, in addition to considering different rules, aims towards establishing that the courts' intervention should only be limited to a situation where the agreed sum is "out of all proportion" to damages which might conceivably result from breach at the time when the parties enter into the contract. The third chapter considers the relationship between the penalty doctrine and similar contractual provisions. An agreed damage clause which acts as limiting the liability of the contract-breaker, and an acceleration clause are two contractual provisions which are examined in this chapter. The chapter will deal, *inter alia*, with the question of the possible application of the penalty doctrine to these contractual provisions. Chapter four concentrates on the issue of the applicability of the penalty doctrine where there is a breach of contract. The anomalies resulting from this well-established common law rule will be given a detailed consideration here. Finally, as one important and controversial area for the application of the penalty doctrine, termination clauses, in financing transactions like hire-purchase and credit sale agreements, which normally provide for a minimum payment clause will thoroughly be discussed. The practical problems in the application of the penalty doctrine to minimum payment clauses, the relevance of the basis for termination, and the necessary factors to be taken into account in drafting a minimum payment clause are among the issues which are considered in this chapter.

Part Two focuses on the issue of relief afforded to a contract breaker against forfeiture of his interest in the subject-matter, and/or moneys already paid. This part is generally responsible for illuminating the relationship between the penalty doctrine and the rules relating to relief against forfeiture. This part includes four chapters: Chapter six discusses two preliminary issues which are of some importance in a detailed consideration of the rules relating to relief against forfeiture. Since the relief afforded to a contract-breaker against forfeiture of advance payments is mainly equitable, it is appropriate to consider first whether these payments are recoverable in an action at common law. This

issue, and the possible general basis for such a remedy is discussed in the first section of this chapter. The second section presents a brief historical account on the equitable intervention of courts to relieve against forfeiture. Relief against forfeiture of the breacher's interest in the subject-matter is considered in the seventh chapter. This chapter illuminates the existence, scope, and limits of the jurisdiction to relieve against such a forfeiture; and then discusses the circumstances upon which the courts should exercise their equitable power. Chapter eight is responsible for an analysis of the relief afforded against forfeiture of advance payments. The relief against forfeiture of part payments is considered in the first section of this chapter, while the second section discusses the relief against forfeiture of deposits. Both sections will thoroughly consider the scope of the courts' equitable power in these areas, and will focus on the circumstances for the exercise of the jurisdiction. The possibility of the application of the penalty doctrine, when a court exercises its equitable jurisdiction to relieve against forfeiture of advance payments, will be given a detailed analysis. A close analysis of the statutory relief against forfeiture of deposit in contracts for the sale or exchange of an interest in land is the responsibility of the ninth chapter. In this chapter, after a general consideration of the statutory measures to afford relief against forfeiture, the discretionary power of the courts under section 49(2) of the Law of Property Act 1925 to order repayment of deposit to a defaulting purchaser will be examined. The reason for singling out this statutory measure is the possible relation of the penalty doctrine and the equitable rules relating to relief against forfeiture of deposit with the exercise of this statutory power of the courts. The main area of attention in this chapter is the circumstances upon which the courts should exercise their power under the subsection, and the possible inter-relationship between this discretionary power and the equitable jurisdiction to relieve against forfeiture of deposits.

Part One

Penalty Doctrine

Chapter 1

Introductory Chapter

General Remarks

1.01 The intervention of courts to relieve against penalties has a historical origin arising from the relief afforded by the Chancellors against penal bonds. The doctrine has been developed during the course of time, and has well been established in about mid-seventeenth century. Common lawyers, though not unfamiliar with the concept of relief against penalties, have basically adopted the practice of the courts of Chancery in granting relief, and made significant contributions to the development of the doctrine to suit the needs of different eras. Although historically the intervention of courts was justified on the basis of fairness and being equitable, several attempts, by both lawyers and economists, have been made to put forward different justifications for the doctrine. Economists have tried to justify the doctrine from "economic efficiency" perspective, while some others have presented justifications based on human's cognitive defects, or a concern for future freedom. This chapter will focus on these issues: After considering the historical development of the penalty doctrine in the first section, the reasons justifying the intervention of courts to relieve against penalties will, in the second section, be given a rather brief analysis.

1. Historical Background

1.1. Introductory Remarks: Conditional Bond and its Literal Enforcement at Common Law

1.02 The penalty doctrine, in its present form, has historically originated from the Chancellor's intervention to relieve against penal bonds. It was, in medieval times, more convenient and usual, in the common law courts, to sue upon a debt than a covenant[1]: the plaintiff, in such an action, had to produce a sealed instrument in which the defendant had acknowledged himself to be the debtor of the plaintiff. Such an instrument was referred

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[1] Plucknett T.F.T, A Concise History of the Common Law, 5th ed., 1956, p. 634 ; Simpson A.W.B., A History of the Common Law of Contract: The Rise of the Action of Assumpsit, 1975, p. 88 ; Stoljar S.J., A History of Contract at Common Law, 1975, p. 7

to as a "bond", an "obligation" or a "writing obligatory".[2]

1.03 The popularity of the "action of debt" was probably the main reason for the rise of bonds with the condition of "defeasance" endorsed upon it.[3] The obligor executed a bond of a certain sum of money subject to the condition that if he paid a certain sum or performed a certain agreed act by a certain date, the bond would be null and void. In effect, most agreements did normally take the form of one or more conditional bonds. In a contract of loan, for example, the borrower executed a bond in favour of the lender for a larger sum, normally twice the principal sum, subject to a condition of defeasance providing that if the debtor paid the principal up to a certain date, the bond would be of no effect. The subject of the condition of defeasance differed depending on what the main object of the parties' agreement was. In a sophisticated bilateral agreement, for instance, the parties elaborated the detailed terms and conditions of their contract in an indenture under seal, both retaining a part of the indenture. They, then, executed bonds of the same date as the indenture in favour of each other, binding themselves to pay a certain sum of money with the condition that in case of the due performance of their contractual obligations, as provided in the indenture, the bond would be unenforceable.[4] Thus, each party to an agreement was liable because he had executed a bond, not because he had entered to a specific contract.

1.04 The general attitude of the common law courts was to enforce the conditional

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[2] Simpson A.W.B., A History of the Common Law of Contract: The Rise of the Action of Assumpsit, 1975, p. 88; Simpson, The Penal Bond and Conditional Defeasance (1966) 82 LQR 392, at p. 393

[3] It is thought that the device of penal bonds came in with Italian bankers. The instances of the use of these bonds before the end of thirteenth century are rare. See Yale D.E.C., An Essay on Mortgages and Trusts and Allied Topics in Equity (An Introduction to "Lord Nottingham's Chancery Cases, vol. II, 1961"), Sel. Soc., vol. 79, 1, at p. 9 no. 4

[4] An example of such a condition, cited by Simpson, loc. cit., no. 1, p. 91, taken from a bond of 1634, is in the following terms: "The condition of the within written obligation is that if the within bounden Richard Norman his heirs executors administrators and assigns and anye of them truelie and faithfullie hold observe fulfil performe and keepe all and singuler the covenants promises agreements articles clauses and sentences which on the part of the said Richard Norman his heirs ... etc. ought to be held observed fulfilled performed and kept mentioned specified and ordeined in one part of indentures bearing equal date with these presents made between the said Richard Norman of the one part and within named James Younge on the other part according to the true intent purport and meaning of the said indentures that then this present within written obligacon to be voyd and of none effect or else to stand remaine and be in full force power strength and virtue."

bonds according to its terms. Such an attitude was inspired by the general philosophy that it was not the business of courts to remake the parties' bargain: having made their bed, the contracting parties had to lie in it.[5] Further, the bonds were normally regarded as of a compensatory nature, and it was this characteristic which kept them immune from being attacked under the canonist concept of usury[6]. Usurious transactions were clearly regarded illegal in medieval common law. The concept of usury at this time, though it was "in some respects vague, flexible, and uncertain", covered an area in which a creditor was *bound* to get some extra money for the *use of money*.[7] Interest which was stipulated to compensate the creditor for the loss suffered as the result of failure to repay the money on time was not, therefore, regarded as of usurious nature.[8] Penal bonds were considered as in conformity with this concept: the monetary sum provided for in the penal bonds normally served to compensate the creditor for his loss, and was not regarded as a sum paid for the use of the principal money. Moreover, the debtor, by the due payment of the principal or due performance of the promised act, could avoid the creditor from receiving the penal sum. In other words, the creditor was not certain, at the time of the execution of the bond, that he would be able to receive the penal sum provided for in the bond.[9] This may be inferred from an early fourteenth century case[10] in which Passeley's

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[5] Simpson, The Penal Bond and Conditional Defeasance, loc. cit., no. 2, at p. 411

[6] It is sometimes believed that the "early law around this topic [*i.e.* penal bonds] was a constant shifting and evasion of the prohibition of the canon law against usury" and it is, therefore, concluded that this was the reason why this issue did not come into the light until the Reformation. See Yale D.E.C., An Essay on Mortgages and Trusts and Allied Topics in Equity (An Introduction to "Lord Nottingham's Chancery Cases, vol. II, 1961"), Sel. Soc., vol. 79, 1, at p. 9

[7] Simpson A.W.B., A History of the Common Law of Contract: The Rise of the Action of Assumpsit, 1975, p. 114

[8] This included both *damnum emergens* (compensation for consequential loss excluding loss of potential profit) and *lucrum cessans* (compensation for loss of profit). See Simpson, loc. cit., no. 1, p. 114

[9] That is why the common law courts, accepting this canonist theory of usury, used the test whether it was contemplated by the parties that the debtor should be able to discharge himself by payment at the due date, or whether it was their intention that in any event the creditor would be able to receive a sum extra to the principal. Yale cites two cases from the King's Bench in 1591 and the Common Bench in 1598 which clearly illustrate this attitude: In the former, the *Burton's case* (5 Co. Rep. 69a), it was held that "... if it had been agreed between the grantor and the grantee, that notwithstanding such power of redemption, that the 100 *l.* Should not be paid at the day, and that the clause of redemption was inserted to make an evasion out of the Statute, then it had been an usurious bargain and contract within the said statute". In the latter case, it was clearly stated that it was the intent of the parties which makes an agreement as of usurious nature. See Yale D.E.C., An Essay on Mortgages and Trusts and Allied Topics in Equity (An Introduction to "Lord Nottingham's Chancery Cases, vol. II, 1961"), Sel. Soc., vol. 79, 1, at pp. 11-12

[10] *Scott v. Beracre* III., (1313-14) Eyre of Kent, 6&7 Edward II vol. II, Sel. Soc., vol. 27 (Year Book

argument against the validity of penal bonds was rejected by Staunton J. Passeley emphasised on the usurious nature of penal bonds in the following terms:

> "This action of debt is based upon a penalty and savours of usury, of which the law will not permit you to have recovery. For example, if I say that I hold myself bound to you to pay you ten pounds upon such a day, and that if I do not pay them to you upon that day I am then bound to you in forty pounds. And if I fail to pay the ten pounds upon the appointed day the law will not allow you to recover, by way of usury, the forty pounds."

Staunton J. observed:

> "Penalty and usury are only irrecoverable when they grow out of the sum in which the obligee is primarily bound, but what is claimed here is claimed as a debt arising out of covenant..."[11]

1.05 The rule concerning the literal enforcement of penal bonds was a tough law and worked hardly and harshly, especially in case of bonds to secure the performance of complex and sophisticated contracts. For, in case of any default in performance, though trivial, the whole penalty could be sued for. The story of Sir Thomas More's attempted reconciliation with the judges in the reign of Henry VIII, narrated by Lord Mansfield in *Wyllie v. Wilkes*[12], can well illustrate the harshness of this rule:

> "... he [the Chancellor, Sir Thomas More] summoned them to a conference concerning the granting relief at law, after the forfeiture of bonds, upon payment of principal, interest and costs; and when they said they could not relieve against the penalty he swore by the body of God he would grant an injunction."[13]

1.2. The Advent and Evolution of the Doctrine before the Mid-Seventeenth Century

1.2.1. A Trace of the Intervention at Common Law in the Fourteenth Century

1.06 Although towards the middle of the fourteenth century, because of the inflexibility

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Series, vol. VII), p. 26, at p. 27

[11] See also another case in 1352 (Y.B. Mich. 27 Edw. III, M.f. 17, pl. 9) where a debt of 9 marks was secured by a bond of 17 marks. Skipwith argued that this sounded usury but the court, rejecting the argument, gave judgment for both the 17 marks and an extra 6 marks as damages. (cited by Simpson, loc. cit., no. 1, p. 115)

[12] (1780) 2 Douglas 519, 99 ER 331. Lord Mansfield describing the Act of the 4th and 5th of Queen Anne as "an Act made to remove the absurdity which Sir Thomas More unsuccessfully attempted to persuade the judges to remedy in the reign of Henry VIII" referred to this story.

[13] *Ibid.*, at p. 523 and p. 333 respectively

of the common law and the failure of its courts to apply moral standards in cases[14] and general increase in rigidity and formalism[15], the Chancellor had established his own court to deal with the applications for relief addressed to him, there, apparently, could be found no case, in this century, in which relief against penalties had been given.[16] Some trace of intervention, however, on general equitable grounds, could be detected in the common law courts[17]: A man had bound himself to pay a hundred marks in case of his failure to tender a certain writing by a certain date. He was unable to deny that he had failed to tender it on the stipulated day, but he excused that he was in the East on that time and had left the writing with his wife for delivery. Declaring his readiness to submit the document, he claimed that there had been no damage suffered by the plaintiff as the result of his failure. Bereford J. observed:

> "... this is not, properly speaking, a debt; it is a penalty; and with what equity (look you!) can you demand this penalty? ... What equity it would be to award you the debt when the writing is tendered and you cannot show that you have suffered damage by the detention! So, will you receive the writing?"[18]

And when Passeley refuses to receive the document unless there is a judgment of the court, the learned judge points out:

> "Were you to remain asking for our judgment, you would not come by your debt these seven years, for a judgment of the law is not to be given in that sort of way."[19]

Though the court did not apparently give any clear judgment against the plaintiff[20], it is

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[14] See Newman R A, Equity and Law: A Comparative Study, 1961, pp. 22-23, 30

[15] See Yale D.E.C., An Essay on Mortgages and Trusts and Allied Topics in Equity (An Introduction to "Lord Nottingham's Chancery Cases, vol. II, 1961"), Sel. Soc., vol. 79, 1, at p. 11

[16] See Plucknett T.F.T, A Concise History of the Common Law, 5th ed., 1956, p. 634

[17] It is believed that many rules which are now recognised as the distinctive of Chancery have made their first appearance in the common law courts. See Hazeltine, The Early History of English Equity, (in Essays in Legal History, editor: Vinogradoff), pp. 261-285. This cautious policy towards penalties in the early fourteenth century may be because of the probability of the contravention of the penal bonds with the church's prohibition of usury, though it is, on the basis of the arguments which have been relied upon in cases, very unlikely.

[18] *Unfraville v. Lonstede* (1308-9) Y.B. Edward II, Sel Soc, vol. 19 (Year Book Series, vol. II), p. 58, at p. 59

[19] *Ibid.*

[20] The court only told the plaintiff that he had to wait seven years before he could receive a judgment according to the bond. Some commentators believe that the court granted relief in this case "in the name of equity", though it took "the clumsy form of an indefinite postponement of that judgment which is dictated by the rigour of the law." Maitland, Introduction to Y.B. Edward II, Sel. Soc., vol. 19, p. xiii

nonetheless clear that the notion of the non-enforceability of penalties and limiting the plaintiff to damages actually suffered has not been strange to a common lawyer. The case, of course, is apparently a unique one[21], and the practice of the common law courts becomes harder and harder towards the middle of the fourteenth century, emphasising the literal enforcement of the penal bonds, examples of which have already been given.[22]

1.2.2. Limited Relief Against Penal Bonds in the Chancery in the Fifteenth and Sixteenth Centuries

1.07 It was not until the early fifteenth century that the Chancellor started to grant relief in cases where, though there was an actual payment, no formal acquittance or release had been taken, nor there was cancellation of the deed.[23] St. German in *Doctor and Student,* speaking of a situation where "a man that is bounde in an oblygacyon to pay certain moneys paye the money: but he taketh no acquytaunce or yf he take one & it happenyth hym to lese it", refers to this equitable jurisdiction in the following terms:

> "... yf suche defaute happen in any persone/ whereby he is without remedye at the common lawe: yet he maye be holpen in equity by a sub pena..."[24]

Further, in this century the Chancellor, from time to time, came to intervene in cases of extreme hardship and oppression.[25] Turner cites three cases from Edward IV's reign where relief against forfeiture of bonds has been granted, but concludes that in all these cases the relief has probably been based on the general ground of fraud.[26] It does

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[21] See Plucknett T.F.T, A Concise History of the Common Law, 5th ed., 1956, p. 677

[22] *Supra.*, cases cited in notes 10, 11

[23] See 9 Edw. IV, f. 25, pl. 34; 7 Hen. VII, f. 10, pl. 2 (cited by Simpson, loc. cit., no. 1, p. 118, no. 3)

[24] St. German's Doctor and Student, edited by: Plucknett T.F.T & Barton J.L. (Sel. Soc., vol. 91, 1974), First Dialogue, ch. XII, pp. 77-79

[25] See Simpson A.W.B., A History of the Common Law of Contract: The Rise of the Action of Assumpsit, 1975, p. 118 (citing *Bodenham v. Halle*, Sel. Soc. vol. 10, p. 137); Potter says that petitions have been found praying for relief about the middle of the fifteenth century if the money be paid at a later date: Potter H., An Introduction to the History of Equity and Its Courts, 1931, p. 99; Yale believes that though it is not possible to trace in clear outline the jurisdiction later developed as the penalty doctrine in the sixteenth century and earlier, "the principles supporting the jurisdiction go back a great distance". Yale D.E.C., An Essay on Mortgages and Trusts and Allied Topics in Equity (An Introduction to "Lord Nottingham's Chancery Cases, vol. II, 1961"), Sel. Soc., vol. 79, 1, p. 9

[26] In the first of these cases (I Cal. XLV), the bond had been fraudulently obtained. The other two were originally quoted by Sir George Cary (Cary, I, 2, 23): In one of them, the bond "was joint and several, and the obligee extended the time to one debtor, and then sued the other at law", and in the other, the bond had been paid but no formal acquittance had been taken. See Turner R.W., The Equity of Redemption, 1931, p. 24

therefore appear that, in spite of the Chancellor's intervention in certain cases of accident or fraud, no general jurisdiction to relieve against penal bonds can be detected in this century. However, these interventions may be considered as a general basis upon which the Chancellor grounded his jurisdiction of relief against penalties and forfeitures in later centuries.

1.08 Numerous cases of bills for relief could be found in the Calendars of Proceedings in Chancery in the reign of Elizabeth I, though few of them have appeared in reports.[27] This shows the common practice of the Chancellor's intervention to relieve against penal bonds in the sixteenth century.[28] Though this common intervention might have been practised before the reign of Elizabeth, no reason supporting this proposition could be evinced; for, as pointed out by Turner[29], there is little knowledge of the case law of the Chancery Courts during this interval.

1.2.3. Extension of the Relief by the Beginning of the Seventeenth Century

1.09 The position with regard to relief against penalties and forfeitures, by the beginning of the seventeenth century, has been summarised by Sir George Cary (on the basis of notes taken by William Lambard who became a Master in Chancery in 1592) and cited by Simpson[30] who saw no reason to doubt the substantial accuracy of his work. Cary states:

> "If a man be bound in a penalty to pay money at a day or place, by obligation, and intending to pay the same, is robbed by the way; or hath intreated by some other respite at the hands of the obligee, or cometh short of the place by any misfortune; and so failing of the payment, doth nevertheless provide and tender the money in short time after; in these, and many such like cases, the Chancery will compel the obligee to take his principal, with some reasonable consideration of his damages, (*quantum expediat*) for if this was not, men would do that by covenant which they now do by bond."[31]

He, then, adds, pointing out a further ground for relief::

> "If the obligee have received the most part of the money, payable upon the

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[27] Turner R.W., The Equity of Redemption, 1931, p. 24

[28] See Plucknett T.F.T, A Concise History of the Common Law, 5th ed., 1956, p. 608; Simpson A.W.B., A History of the Common Law of Contract: The Rise of the Action of Assumpsit, 1975, p. 118

[29] Turner R.W., The Equity of Redemption, 1931, p. 24

[30] Simpson A.W.B., A History of the Common Law of Contract: The Rise of the Action of Assumpsit, 1975, p. 119; see also Turner R.W., The Equity of Redemption, 1931, p. 25

[31] Cary 1 (cited by Simpson, loc. cit., no. 1, p. 119)

> obligation at the peremptory time and place, and will nevertheless extend the whole forfeiture immediately, refusing soone after the default, to accept, of the residue tendered unto him, the obligor may find aid in Chancery."[32]

This shows the established practice of the Courts of Chancery to grant relief, but as it appears from the passages quoted above, the Chancellor exercised his jurisdiction only in special circumstances where, as a result of accident, misfortune, fraud or trivial breach, the exaction of bond would result in hardship and oppression. There is still no hint showing the general exercise of the jurisdiction to relive against penal bonds simply on the ground that they were penalties.[33]

1.3. The Position After the Mid-Seventeenth Century

1.3.1. The Established Jurisdiction to Relieve Against Penalties

1.10 Towards the middle of the seventeenth century, the scope of the jurisdiction to relieve against penalties and forfeitures was extended.[34] The Chancellor gradually started to turn his attention from cases of accident apt for relief where compensation had been made to cases where compensation could be made.[35] The tendency to extend the jurisdiction in this period can clearly be inferred from a letter written by Norburie in 1621 to Lord Keeper Williams in which he states that Lord Ellesmere, who became Chancellor in 1596 and was succeeded by Sir Francis Bacon in 1617, "would not relieve any that forfeited a bond, unless it were in cases of extremity, or that he could make appear that by some accidental means he was occasioned thereunto ... . Whereas of late much lenity has been used to all debtors, so that many, after four or five years suit and charges in this court, were glad to go away with their principal without costs or damages".[36] The word

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[32] Cary 2 (cited by Simpson, *ibid.*)

[33] See Simpson A.W.B., A History of the Common Law of Contract: The Rise of the Action of Assumpsit, 1975, p. 119; Turner R.W., The Equity of Redemption, 1931, pp. 25-26; Yale D.E.C., An Essay on Mortgages and Trusts and Allied Topics in Equity (An Introduction to "Lord Nottingham's Chancery Cases, vol. II, 1961"), Sel. Soc., vol. 79, 1, p. 13; Holdsworth W., History of English Law, edited by: Goodhart A.L. & Hanbury H.G., 7th ed., vol. 1, 1956 (Reprinted 1966), pp. 457-458

[34] See Turner R.W., The Equity of Redemption, 1931, pp. 26-27, 31-32; Simpson A.W.B., A History of the Common Law of Contract: The Rise of the Action of Assumpsit, 1975, pp. 119-120; Yale D.E.C., An Essay on Mortgages and Trusts and Allied Topics in Equity (An Introduction to "Lord Nottingham's Chancery Cases, vol. II, 1961"), Sel. Soc., vol. 79, 1, p. 15

[35] Yale, loc. cit., no. 1, p. 15

[36] Hargrave's Law Tracts, 431 (cited by Turner R.W., The Equity of Redemption, 1931, p. 31)

"lenity" in the letter suggests that Sir Francis Bacon had extremely extended the relief afforded to debtors against exaction of penal bonds. It has been suggested that this "lenity" was "perhaps the ordering of a stay of execution at common law where the debtor seemed likely to pay money within a short time of the contractual date."[37]

1.11 After the Restoration, the jurisdiction to relieve against penal bonds became well established. The Chancellor relieved against penal money bonds on the payment of the principal, interest and costs. Relief against penal performance bonds [*i.e.* a bond executed to secure the performance of a certain covenant] was also granted upon the payment of damages and costs.[38] For the purpose of determining the amount of damages, in case of bonds to secure performance of covenants, the case would be remitted to a Master of the Court or the Sheriff's jury to assess damages on *quantum damnificatus*.[39] Many cases can clearly illustrate this established jurisdiction of the Chancery Courts to relieve against penalties: In *Hall v. Higham*[40], for example, as to a bill for relief against the penalty of a bond it was ordered that the plaintiff had to "pay interest and costs, which [would] extend unto the Defendant's costs at Law as well as in Chancery", and thus, the plaintiff was relieved against the penal bond upon payment of interest and costs.

In *Wilson v. Barton*[41] there was a bill for relief against penalty of a bond to secure performance of a certain act. Although it was insisted on behalf of the defendant that, because of the plaintiff's wilful breach, no relief could be granted in this case, an injunction against penalty was granted by the Master of Rolls, and a trial to ascertain the amount of damages was directed.[42]

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[37] Simpson A.W.B., A History of the Common Law of Contract: The Rise of the Action of Assumpsit, 1975, p. 120

[38] See Yale D.E.C., An Essay on Mortgages and Trusts and Allied Topics in Equity (An Introduction to "Lord Nottingham's Chancery Cases, vol. II, 1961"), Sel. Soc., vol. 79, 1, pp. 15, 20; Simpson A.W.B., A History of the Common Law of Contract: The Rise of the Action of Assumpsit, 1975, p. 120

[39] "It is a common case to give relief against the penalty of such bonds to perform covenants, etc., and to send it to a trial at law to ascertain the damages in a *quantum damnificatus*." quoted by Yale, loc. cit., no. 3, p. 15, from 1 Eq. Cas. Ab. 91

[40] (1663) 3 Ch. Rep. 3, 21 ER 711

[41] (1671-72) Nelson 148, 21 ER 812

[42] See also *Hodkin v. Blackman & al.* (1674-75) 2 Ch. Rep. 103, 21 ER 628; *Duvall v. Terry* (1694) Shower P. C. 15, 1 ER 11 (relief against penalty of a bond of 140 *l.* to be exacted in case of default in payment of 72 *l.* on the condition that the principal, interest and costs had to be paid by a certain date); *Friend v. Burgh* (1679) Rep. Temp. Finch 437, 23 ER 238 (an order for the refund of the penalty already

1.12 By the extensive practice of the Chancery Courts in relieving against penalties, there was a decline in the use of bonds to secure performance of covenants, for the bonds could not any more be regarded as a better security than the covenant itself. This can clearly be inferred from the words of Heneage Finch, first Earl of Nottingham, in his *Prolegomena*[43] where he, describing the practice of the Chancery Courts to award an injunction against penal bond, says:

> "... equity will not suffer any advantage to be taken of this bond beyond the true damnification, and therefore usually awards an injunction till a trial at law be had either upon an action of Covenant or upon a special issue *quantum damnificatus*. So that a penal bond to secure the performance of covenants is not much better security than a mere covenant, as equity now orders the matter."

Though the development of the jurisdiction to relieve against penal bonds led to a decline in the use of these bonds towards the close of the seventeenth century, it did nonetheless become a basis for a well-established equitable doctrine, empowering the courts to relieve against penalties and forfeitures. The twelfth maxim of equity stated by Richard Francis in 1728 could neatly illustrate this doctrine:

> "Equity suffers not advantage to be taken of a penalty or forfeiture, where compensation can be made."[44]

1.3.2. The Basis for the Relief

1.13 The very first basis for the equitable intervention of the Chancellor was probably that it was inequitable to exact penalties when the defendant could fully be compensated by the payment of principal, interest and costs.[45] Conscience, in a wide sense meaning the desire of the Chancery to do justice when the common law worked hardship, was one of the basic principles upon which the Chancellor grounded his equitable jurisdiction.[46] The

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paid less principal, interest and costs). There are some cases of the same period in which relief has been refused. This is most probably due to special circumstances of each particular case: see, e.g., *Wake v. Calley* (1661-62) 1 Ch. Rep. 201, 21 ER 550, where, emphasizing that the plaintiff had to pay principal, interest and costs, the payment of £1600 penalty of a bond in lieu of the principal, interest and costs was ordered. The order, however, was by the consent of the parties. See also *Dixon v. Read* (1668-69) 2 Ch. Rep. 21, 21 ER 604; *Crisp v Bluck* (1673-74) 2 Ch. Rep. 88, 21 ER 624

[43] Lord Nottingham's "Manual of Chancery Practice" and "Prolegomena of Chancery and Equity", Edited by Yale D.E.C. (Cambridge, 1965), chapter xx, para. 5, at p. 275; see also Simpson, The Penal Bond and Conditional Defeasance, loc. cit., no. 2, at p. 415

[44] Ed. princ. 1728 ; cited by Simpson, loc. cit., no. 1, p. 121

[45] Simpson A.W.B., A History of the Common Law of Contract: The Rise of the Action of Assumpsit, 1975, pp. 120-121

[46] See Turner R.W., The Equity of Redemption, 1931, p. 35; Holdsworth W, History of English Law, 7th

first cases of relief against penal bonds were also probably cases of conscience: the harshness and hardship resulted from the exaction of penalties led the Chancellor to lend his aid to defaulting obligors where compensation was possible. Holdsworth's observations can clearly illustrate this:

> "At bottom it [*i.e.*, the relief] rests upon the idea that it is not fair that a person should use his legal rights to take advantage of another's misfortune, and still less that he should scheme to get legal rights with this object in view".[47]

1.14 The other concept which helped the Chancellor to extend and develop his jurisdiction to grant relief against penalties and forfeitures was the recognition of the fact that a bond was to be regarded as a security for a principal obligation to pay a certain sum of money or perform a certain act.[48] With this conception in mind, the obligor paying the principal, interest and costs (or damages and costs in case of bonds to secure performance of a covenant), it was regarded as inequitable that the obligee should take an unfair advantage of his legal rights which, in certain cases, might have also been acquired with the object of taking advantage of the need of the obligor compelling him to agree to a penal bond or a forfeiture provision.

1.3.3. A Trace of the Concept of "Genuine Pre-estimate of Damages"

1.15 A trace of the concepts of "genuine per-estimate of damages" or being merely "*in terrorem*" may be detected in several Chancery cases decided in this century. It has been suggested[49] that the vagaries of the procedure at law on the basis of *quantum damnificatus* was probably the reason why the Chancellor gave effect to stipulated

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ed., vol. 5, p. 293

[47] Holdsworth, History of English Law, 7th ed., vol. 5, p. 330

[48] See *Emanuel College v. Evans* (1625) 1 Ch. Rep. 18, 21 ER 494, where the Court "conceived the said Lease being but a *security*, and that Money paid, the said Lease had been void". (emphasis added) It has convincingly been argued that the concept of bonds being a security had long ago been recognised by the Common law, though its role in the development of the equitable doctrine of relief against penalties and forfeitures could not be denied. (See Turner, pp.37-39) It was after Restoration that this concept was widely used, the chief of which being by Lord Nottingham in *Thornbrough v. Baker* (1676) 3 Swans. 628, 36 ER 1000, where it was decided that "the interest of the mortgagee was personalty and hence descended to his executors instead of to his heirs". From Lord Nottingham's time onwards, the concept has certainly been a leading principle of the Court of Chancery. See Turner R.W., The Equity of Redemption, 1931, pp. 38-39

[49] See Harpum C, Equitable Relief: Penalties and Forfeitures (1989) 48 CLJ 370, at p. 371

damages, and distinguished them from penalties. In *Tall v. Ryland*[50], the plaintiff was sued on a bond of £20 given to the defendant, after some differences between the parties, on the condition that the plaintiff should behave civilly and like a good neighbour. The ground for the action was that as a result of the plaintiff's bad and unacceptable behaviour, the defendant had lost a customer. The bill was for relief against the penalty of the bond, alleging that damages were neither considerable nor valuable. The Lord Chancellor was reported as deciding that "as this was, the penalty being but £20, he did not think fit to put the Defendant to answer, for the costs of suit here and at Law would exceed the Penalty". The demurrer was, therefore, allowed. His lordship, however, declared that "*this was not to be a Precedent in the Case of a Bond of £100 or the like*"[51]. This may well imply that the Lord Keeper refused the relief on the ground, *inter alia*, that the amount agreed by the parties was a modest and reasonable, and not an excessive and extravagant, sum. Had the parties agreed on a penalty of £100 or the like it would have seemed extremely unlikely for his lordship to refuse the relief.

1.16 In *Small v. Lord Fitzwilliams*[52], £400 was retained by the defendant to secure the release of the dower by A's wife to A in two years time. After the expiry of this time and before release, the wife died, and the defendant retained the sum absolutely. The bill was for the recovery of £400 on the ground that it was penal in nature to secure against the dower. Lord Chancellor agreed with the contention that "this was not in the nature of a penalty, but ... *the measure of the satisfaction for the contingent incumbrance of dower*..."[53], and the relief was accordingly refused. The decision may clearly show the trend towards the view that an agreed sum being a reasonable pre-estimate of actual probable damages which might result from breach should be unobjectionable.

1.17 In *Blake v. East India Co.*[54], the plaintiff, the agent of the defendant company,

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[50] (1670) 1 Chan. Cas. 183, 22 ER 753

[51] Emphasis added

[52] (1699) Prec. Ch. 102, 24 ER 49

[53] Emphasis added

[54] (1674) Chan. Cas. 198, 22 ER 909, A more detailed account of the case can be found in Lord Nottingham's Chancery Cases, vol. 1 (Sel. Soc., vol. 73), case 105 at pp. 59-61

covenanting not to trade in certain commodities, undertook to pay "several Rates for every Pound ... so traded in contrary to the covenant". The plaintiff traded in certain prohibited commodities for himself to his own use. The company brought an action in debt claiming £26,000 as a penalty. A bill by the plaintiff to be relieved against the penalty was dismissed, "though it was objected that this covenant was a greater Penalty than a Bond of double the value". The Lord Keeper was quoted as saying:

> "A Lease is made rendering Rent, and if a Meadow be plowed to pay £5 *per* Acre, is this relievable? I see not how the company can subsist unless such Trade be restricted. Dismiss the Bill."

In his lordship's view, such a term could not be considered as a penalty, for it "might be incurred and yet the offender be a gainer by it too"[55]. Although the term "in terrorem" was not employed here, yet the decision may imply that a contractual term by which the defendant, though having to pay a sum of money referred to as a penalty, may also be a gainer, cannot be regarded penal in nature[56], for it cannot be considered as acting "in terrorem" of the defaulting party.

1.3.4. A Trend Towards the Rule of Compensation

1.18 Lord Nottingham's chancellorship witnessed a clear trend in equity towards the rule of compensation with regard to granting relief against penalties and forfeitures. It was in his time that certain limits for the application of the jurisdiction were introduced and too liberal measure of equitable relief was avoided. Yale describes the situation in the following terms:

> "Lord Nottingham seems to have appreciated the dangers of too liberal a measure of equitable relief, threatening as it did the very right of the parties to assess and provide for in advance possible liabilities for breach of contract. ... Agreements deliberately entered into ought to be kept, but, on the other hand, it is inequitable that one party shall take an unfair advantage of another. Both these considerations go to the making of the rules of equity in cases of forfeitures and penalties."[57]

His famous maxim that the Chancellor mends no man's bargain can to some extent illustrate his general approach towards the equitable intervention to grant relief against penalties and forfeitures. "He was", in the words of Yale, "often prepared to keep a party

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[55] Nottingham's Chancery Cases, vol. 1 (ss, vol. 73), Case 105, at p. 60

[56] See also *East India Co. v. Mainston* (1676) 2 Chan. Cas. 218, 22 ER 918

[57] Yale D.E.C., An Essay on Mortgages and Trusts and Allied Topics in Equity (An Introduction to "Lord Nottingham's Chancery Cases, vol. II, 1961"), Sel. Soc., vol. 79, 1, at p. 19

to his bargain in circumstances of no little hardship. Generally he was not prepared to allow relief because of a mistake unless that mistake were induced by fraud or some species of deception."[58]

1.19 The test which was applied by the Lord Chancellor was to consider whether the term in question was in the nature of a security; if it were, then the case would be considered as a proper one for compensation, and upon the compensation being made, the obligor would be relieved against forfeiture. In *Puleston v. Puleston*[59], his lordship stated:

> "... conditions are of two sorts, either they are such as if they are broken are capable of equivalent recompense, and then the breach is always relieved in equity, as conditions for the payment of money or the like, or such conditions as are not capable of any compensation, and then the breach is never relieved ..."[60]

Thus, where compensation was not possible, no relief would be given against penalty or forfeiture.[61] This can also be illustrated by the judgment of Lord Macclesfield in the

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[58] *Ibid.*

[59] (1677) Rep. Temp. Finch, 312 ; 23 ER 171, Nottingham's Chancery Cases, vol. 1 (sel. soc., vol. 73), case 428 at p. 295

[60] Nottingham's Chancery cases, vol. 1, at p. 296 ; see the application of this principle in *Wheeler v. Whithall* (1676) 2 Freeman 9, 22 ER 1023, where the Lord Chancellor held: "this condition being for payment of money, although in strictness of law the estate were forfeited by the non-payment of the money ... but as it were a mortgage or security for money, and the daughters being paid the said money and damages, they were at no damage; and so ... Andrew [the plaintiff] paying the same should have the land." at p. 11 and p. 1023 respectively; see also *Rose v. Rose* (1756) Amb. 331, 27 ER 222, at pp. 332, 223 respectively; *Northcote v. Duke* (1765) Amb. 511, 27 ER 330 where Lord Nottingham observed: "I take the rule to be, that in all cases where a person has broke a condition, and forfeited a penalty, Equity will relieve, if there can be a compensation." at pp. 513-514, 331 respectively; *Eaton v. Lyon* (1798) 3 Ves. Jun. 690, 30 ER 1223, per Sir R P Arden M.R. at pp. 692-693, 1224 respectively.

[61] See, e.g., *Tall v. Ryland* (1670) 1 Chan. Cas. 183, 22 ER 753, the facts of which have already been given (see *supra.* text relating to note 50). In this case, the defendant was reported as arguing: "... the Bond was to preserve Amity and neighbourly friendship, for the breach of which the Plaintiff did submit to pay that penalty, and there can be no trial had to measure the Damage for breach of the condition, other than the parties have submitted to." This may, it appears, be one of the reasons why the relief was refused. Further, as to *Blake v. East India Co.* (1674) 2 Chan. Cas. 198, 22 ER 909 (*supra.*, text relating to note 54), it has been pointed out that "no reason is given in the book why the bill was dismissed. But it may be observed that no compensation could be made, for it was impossible to ascertain what damage might arise to the company by such trading, by the encouragement it would give to other people." see Francis's Maxims of Equity, XII, 52 (cited by Yale D.E.C., An Essay on Mortgages and Trusts and Allied Topics in Equity (An Introduction to "Lord Nottingham's Chancery Cases, vol. II, 1961"), Sel. Soc., vol. 79, 1, no. 1 at p. 17). See also Simpson A.W.B., A History of the Common Law of Contract: The Rise of the Action of Assumpsit, 1975, at p. 121; Yale, loc. cit., at p. 25

leading case of *Peachy v. Duke of Somerset*[62] where he said:

> "It is recompense that gives this court a handle to grant relief ..."

1.3.5. Adoption of the Jurisdiction by the Common Law Courts

1.20 The established equitable jurisdiction to relieve against the exaction of penal money bonds was adopted by the Common Law Courts by the mid 1670s.[63] Lord Nottingham in his *Prolegomena*[64] describes the situation in the following terms:

> "... in all suits on bonds it's now become the course of the Court, that, if the defendant will pay the principal and interest and charges, the plaintiff shall be obliged to accept it till plea pleaded, else the defendant shall have a perpetual imparlance[65], and all this to prevent a suit in Chancery, which otherwise would give the same relief."[66]

1.21 The position was regularised by the close of the seventeenth and early eighteenth centuries by the enactment of the Statutes of 1696-97[67] and 1705[68]: under the first statute, the plaintiff suing on a bond to secure performance of a certain covenant was permitted to assign as many breaches as he wished, and then it was the duty of the jury to assess damages for theses defaults. The judgment could be entered for the whole penal sum, but the plaintiff was restricted to the recovery of merely his damages and costs. The judgment as to the balance secured him against any further breach. The latter statute empowered the court to discharge an obligor upon the payment of the principal, interest and costs which was due under a penal money bond.[69] The defendant was also entitled to plead payment in bar of an action on a bond, where, in spite of the actual payment, there

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[62] Eq. Cas. Abr. 228, 22 ER 193 ; cited by Yale, loc. cit., at p. 28

[63] See Turner R.W., The Equity of Redemption, 1931, p. 33; Simpson A.W.B., A History of the Common Law of Contract: The Rise of the Action of Assumpsit, 1975, p. 122

[64] Lord Nottingham's "Manual of Chancery Practice" and "Prolegomena of Chancery and Equity", edited by: Yale D.E.C., 1965, chap. v, para. 11, at p. 203

[65] A licence to imparl (*i.e.* to talk the matter over) which stayed the proceeding. (see Simpson, loc. cit., note 2 at p. 122)

[66] Turner believes that the Common Law Courts had already exercised this jurisdiction under James I (1406-1437) by refusing to enforce the penal money bonds which had become impossible of performance through no fault of the obligor. In his view, therefore, these courts were developing their jurisdiction in the same way as the Courts of Chancery had done but "they took half a century longer to reach the same destination". see Turner R.W., The Equity of Redemption, 1931, p. 33

[67] 8 & 9 Will. III, c. 11, s. 8

[68] 4 & 5 Anne, c. 16, s. 12, 13

[69] s. 13

was no formal acquittance by deed.[70] The effect of these statutes was, however, only to regularise the situation which had already been achieved by the Common Law Courts by adopting the procedure of the Courts of Chancery in granting relief.[71] It should, however, be noted that even after the enactment of these statutes, the defendant, who was unable to tender the principal, interest and costs while the action was tried, had to seek equitable relief in the Chancery Courts.[72]

1.3.6. Further Development of the Doctrine: Towards the Recognition of Settled Rules to Distinguish Liquidated Damages from Penalties

1.3.6.1. In Equity

1.22 By the last quarter of the eighteenth century, equity had introduced certain settled rules to distinguish liquidated damages from penalties. By this time, relief against penalties which were collateral to performance contracts was granted as of course: In *Sloman v. Walter*[73], for instance, as to a bond entered into by the plaintiff in the penalty of £500 to secure to him the use of a room in a certain coffee-house, Lord Chancellor Thurlow held:

> "The rule, that where a penalty is inserted merely to secure the enjoyment of a collateral object, the enjoyment of the object is considered as the principal intent of the deed, and the penalty only as accessional, and, therefore, only to secure the damage really incurred, is too strongly established in equity to be shaken."[74]

It was accordingly held that, the bond being unenforceable, nothing but the actual damages could be recovered.[75]

1.23 The practice of the Courts of Chancery, in distinguishing liquidated damages from penalties, was to put much emphasis on the true intent of the parties in order to "really

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[70] s. 12

[71] See Simpson, loc. cit., no. 1, p. 122

[72] Simpson, *ibid.*

[73] (1783) 1 Brown Chan. Cas. 418, 28 ER 1213

[74] *Ibid.*, at pp. 419, 1214 respectively

[75] See also *Hardy v. Martin* (1783) 1 Cox 26, 29 ER 1046 where in an action on a bond in the penalty of £600 to secure the defendant's promise not to sell any brandy within five miles of a certain place, upon the payment of actual loss, the plaintiff was restrained by the Court of Chancery from taking out execution for penalty.

and substantially" perform covenants[76]. Nonetheless, the description of the stipulated sum by the parties and the form in which the penal provision was agreed by the parties were of great importance in determining whether the agreed sum was a penalty. This could well be illustrated by the following extract from the Court's decision in *Lowe v. Peers*[77]:

> "They [Courts of Equity] will relieve against a penalty, upon a compensation: but where the covenant is "to pay a particular liquidated sum", a court of Equity can not make a new covenant for a man, nor is there any room for compensation or relief. As in lease containing a covenant against plowing up meadow; if the covenant be "not to plow" and there be a penalty; a court of Equity will relieve against penalty, or will go further than that (to preserve the substance of the agreement:) but if it is worded- "to pay £5 an acre for every acre plowed up;" there is no alternative, no room for any relief against it; no compensation, it is the substance of the agreement."[78]

1.3.6.2. In the Common Law Courts

1.24 The practice of the Common Law Courts in granting relief against penalties led to the advent of the principle that a penalty is not enforceable. Thus, the law courts, following the Chancery, began to evolve rules to distinguish between liquidated damages and penalties. *Astley v. Weldon*[79] and *Kemble v. Farren*[80] were two instances where the court, applying the Statute of William 1696-97, exercised its power to relieve against penalty: Both cases concerned theatrical performance contracts where the parties had agreed that, in case of a breach of any of several undertakings, the contract-breaker would have to pay a large amount to the other. In the former case, the agreed sum was

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[76] In the words of Sir Arden M.R. in *Eaton v. Lyon* (1798) 3 Ves. Jun. 690, 30 ER 1223, "At Law a covenant must be strictly and literally performed: in Equity it must be really and substantially performed according to the true intent and meaning of the parties, so far as the circumstances will admit..." at pp. 692, 1224 respectively

[77] (1768) 4 Burr. 2225, 98 ER 160

[78] *Ibid.*, at pp. 162, 2228-29, see also *Ponsonby v. Adams* (1770) 2 Brown. Parl. Cas. 431, 1 ER 1044 (A covenant for the rise of the rent from £125 to £150 in case of the tenant's failure to reside in the leased estate. The £25 additional rent was regarded as stipulated damages); *Rolfe v. Peterson* (1772) 2 Brown. Parl. Cas. 436, 1 ER 1048 (A covenant to pay £5 per annum for every acre converted into tillage. The increased rent was not considered as a penalty, but as a "liquidated satisfaction fixed and agreed upon by the parties"; *Fletcher v. Dyche* (1787) 2 Term Rep. 32, 100 ER 18 (A covenant to pay and forfeit a sum of £10 for every week in case of failure to perform certain work in a certain time was considered as liquidated damages)

[79] (1801) 2 Bos. & Pul 346, 126 ER 1318

[80] (1829) 6 Bingham 141, 130 ER 1234

not given any description, but in *Kemble v. Farren* it was agreed to be paid as "liquidated and ascertained damages, and not a penalty or penal sum, or in the nature thereof". In the plaintiff's action to recover the agreed sum, upon the performer's breach, the sum was recognised as a penalty, and actual damages were only held to be recoverable. Chambre J. in *Astley v. Weldon*[81] observed:

> "The jurisdiction of Courts of Equity in relieving on penalties is of very high antiquity. The legislature had now adopted this practice and affords the same benefit to Defendants in action at law."

In both cases, the court applied the presumption that a single sum provided to be paid upon different contingencies, one of which is the non-payment of a smaller sum, should be taken as intended to act as a penalty.

1.25 *Kemble v. Farren* marks an important turning point in the history of penalties in the early nineteenth century: Despite the usual and continuous practice of courts in giving effect to the description given by the parties to the agreed sum[82], Tindal CJ refused to endorse the declaration by the parties that the agreed sum was a liquidated and ascertained damages, and, construing the contract, determined the true nature of the clause as a penalty. It was in this century that the doctrine gradually became associated with the sums agreed to be paid upon breaches of contract. A tendency towards the view that the mere magnitude of the sum agreed to be paid does not turn its nature to a penalty can be detected in several cases decided in this century, among which the observations of Chief Justice Coleridge in *Reynolds v. Bridge*[83] deserve to be quoted here:

> "In *Astley v. Weldon* Lord Eldon distinctly laid down that the mere magnitude of the sum named could not prevent it from being liquidated damages. ... The principle seems to be that if you find a covenant the breach of which will occasion a damage, not uncertain, but such as is capable of being ascertained, as where there is a particular sum to be paid which is *much less* than the sum named as payable upon the breach, there

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[81] (1801) 2 Bos. & Pul 346, 126 ER 1318, at pp. 354, 1323 respectively

[82] Only six years before that, Park J in *Reilly v. Jones* (1823) 1 Bing. 303, 30 ER 122 had observed: "No case has been adduced, in which, after the parties have themselves employed the expression liquidated damages, the court has holden the plaintiff should not recover, on breach of the agreement, the sum named as stipulated damages." at pp. 306, 123 respectively. And the judgment of Burrough J was much stronger on this point: "There is no case which has decided that the Defendant shall not pay the whole sum, where the expression liquidated damages has been employed to designate the nature of the payment."; see also *Barton v. Glover* (1815) Holt, N.P.C. 43, 171 ER 154; *Farrant v. Olmius* (1820) 3 B. & Ald. 692, 106 ER 814; *Crisdee v. Bolton* (1827) 3 Carr. & P. 240, 172 ER 403

[83] (1856) 6 El. & Bl. 528; 119 ER 961

> it is held that the last named sum is specified by way of penalty because a Court of Equity would limit the amount to be actually paid."[84]

Jessel M.R. clearly inclined to this view in his illuminating judgment in *Wallis v. Smith*[85]. In his view, the performance of contracts entered into by "adults- persons not under disability, and at arm's length", according to the intention of the parties is of great importance: the Courts of Law, in his words, "should not overrule any clearly expressed intention on the ground that Judges know the business of the people better than the people know it themselves."[86]

1.3.7. The Judicature System

1.26 Until 1873, Law and Equity were two co-existing systems with certain recognised jurisdictions.[87] The enactment of the Judicature Act, however, led to the unification of administration, though the different principles originating in Law and Equity continued to remain as legal or equitable.[88] Although the penalty doctrine had already been recognised

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[84] *Ibid.*, at pp. 540-541, 966 respectively (emphasis added); In *Astley v. Weldon* (1801) 2 Bos. & Pul 346, 126 ER 1318 Lord Eldon had held: "A principle has been said to have been stated in several cases, the adoption of which one cannot but lament, namely, that if the sum would be very enormous and excessive considered as liquidated damages it shall be taken to be a penalty, though agreed to be paid in the form of contract." at pp. 351, 1321 respectively

[85] (1882) 21 Ch.D. 243, at pp. 263-266

[86] *Ibid.*, at p. 266

[87] It is believed that "equity is the appendix that the Chancery was composing for the saving of the Common Law, and is not an independent system of law". (Sir Frank Kitto, Foreword to the First Edition of Meagher, Gummow and Lehane, Equity: Doctrines and Remedies , (Butterworths, 3rd ed., 1992), p. vi); Viscount Simonds in an Essay objects to this description of Equity stating that such a description cannot adequately reflect the contribution made, and the substantive law brought into existence, by the Chancellor. (see The Character of England, edited by Barker (Oxford, 1947), p. 112, at pp. 117, 124; also referred to in Sir Frank Kitto's Foreword, *ibid.*) The description, though it has been regarded as an accurate historical explanation of Equity, considering the developments of equitable doctrines, has been referred to as "an utterly misleading statement of equity's place in the scheme of things today". (see the illuminating article of Sir Anthony Mason, The Place of Equity and Equitable Remedies in the Contemporary Common Law World (1994) 110 LQR 238)

[88] This seems to be the prevailing view both in England and Australia [see, e.g., *Salt v. Cooper* (1880) 16 Ch.D. 544, at p. 549 where Jessel M.R. observed: "It is stated very plainly that the main object of the Act was to assimilate the transaction of Equity business and Common Law business by different courts of judicature. It has been sometimes inaccurately called "the fusion of Law and Equity"; but it was not any fusion, or anything of that kind; it was the vesting in one tribunal the administration of Law and Equity in every cause, action, or dispute which should come before the tribunal."; see also Goode R., Commercial Law, 2nd ed., (Penguin Books, 1995), p. 117; Jackson D. C., Principles of Property Law, (Australia: The Law Book Company Limited, 1967), p. 62; Megarry R., Thompson M. P., Megarry's Manual of the Law of Real Property, 7th ed., (London: Sweet & Maxwell, 1993), pp. 55 et seq.], though the observations of Lord Diplock in *United Scientific Holdings Ltd. v. Burnley Borough Council* [1978] AC 904 suggests to the contrary: In his Lordship's opinion, "[t]he innate conservatism of English lawyers have made them slow to recognise that by the Supreme Court of Judicature Act 1873 the two

by the Courts of Law, the Judicature system, nonetheless, strengthened the principle. There was, therefore, no need, in an action to recover a penalty, to invoke the Chancery's equitable jurisdiction in a separate set of proceedings, because any possible relief could be granted by the court in a single action. By s. 25 of the Act, however, in case of any conflict between Law and Equity, the equitable rules prevailed.

1.27 The development of the doctrine in the nineteenth century was clearly reflected in the leading decisions of the House of Lords in *Clydebank Engineering And Shipbuilding Co. Ltd. v. Don Jose Ramos Yzquierdo Y Castaneda*[89] and *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd.*[90] cases. Both cases recognised and endorsed the concept that an agreed sum to be paid upon breach amounted to a penalty where it was "extravagant", "unconscionable" or "exorbitant" in comparison with the damages which might conceivably result from breach.[91] The leading judgment of Lord Dunedin in the latter case, which is still to be considered as the most important authority with regard to the doctrine, expounded certain rules and guidelines to distinguish liquidated damages from penalties.[92] Though the concept of "being *extravagantly* large in order to be a penalty" was later ignored by some more recent decisions[93], nonetheless, as we shall

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systems of substantive and adjectival law formerly administered by courts of law and Courts of Chancery ... were fused" (at p. 925), and "to speak of the rules of equity as being part of the law of England in 1977 is about as meaningful as to speak similarly of the Statutes of Uses or of Quia Emptores" (at p. 924). These observations have been regarded as representing "the low water-mark of modern English jurisprudence" [Meagher, Gummow and Lehane, Equity: Doctrines and Remedies, Preface to the Second Edition, (Butterworths, 1984), p. xi], and have sharply been criticised by Sir Anthony Mason who refers to the possibility that Lord Diplock's intention was only to convey the fact that the Judicature Act should not be regarded as prohibiting "the continuing development by judicial decision of the substantive principles of common law and equity". (Mason A. (1994) 110 LQR 238, at p. 240) In his view, Law and Equity should be seen as two distinct systems in origin, which have been administered by one Court, borrowing from each other, in the course of the development of the law as a whole, certain concepts and doctrines. (*Ibid.*, at p. 242 citing with approval the comments of Somers J. in *Elders Pastoral Ltd. v. Bank of New Zealand* [1989] 2 N.Z.L.R. 180, at p. 193) This has resulted in the convergence of equity and common law, and they, in the words of His Honour, "will continue to converge so that the differences in origin of particular principles should become of decreasing importance". (*Ibid.*, at p. 258)

[89] (1905) AC 6

[90] (1915) AC 79

[91] See *Clydebank Engineering* (1905) AC 6, at p. 10 per Lord Halsbury LC; *Dunlop v. New Garage* (1915) AC 79, at p. 87 per Lord Dunedin

[92] These rules will be fully discussed later: *infra.*, chapter 2, section 4: paras. 2.24 *et seq.*

[93] See, e.g., *Cooden Engineering Co. Ltd. v. Stanford* [1953] 1 QB 86

see[94], a move towards the return to this concept has forcefully been started.

1.4. Conclusion

1.28 This historical review of the doctrine reveals, *inter alia*, that

I. Though the concept of relief was not strange to a common lawyer, the doctrine of relief against penalties was first established in equity in mid-seventeenth century. The doctrine was, then, adopted by the Common Law, and was reaffirmed by the Statutes of 1696-97 and 1705.

II. The relief in equity would only be granted upon full compensation being made. Therefore, there would be no relief where compensation was not possible. The amount of damages was assessed in an action at law, either by an action of covenant or upon the issue of *quantum damnificatus.*

III. The basis for the intervention was the clash between the bargain principle and the compensatory principle[95] on the one hand, and the recognition of the true nature of a penalty as being a security on the other: it was regarded as inequitable to exact the penalty where it was possible to compensate the promisee for the loss he had actually suffered. It was not, in fact, in the eyes of equity, fair that a party should take an unfair advantage of his legal rights, or to scheme to get these rights with this object in mind.

2. Justification of the Penalty Doctrine

2.1. Introduction

1.29 Although the main concern of this thesis is to approach the practical issues, and to see how the practical problems can best be solved, it is nonetheless inevitable to go, rather briefly, through the theoretical justifications put forward for the penalty doctrine, and to consider whether the intervention of courts as to invalidating an agreed damages clause on the ground that it amounts to a penalty could, by any means, be justified.

1.30 The enforcement of an agreed damages clause is, at first glance, supported by the

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[94] *infra.*, paras. 2.26-2.27, 2.35, 2.54

[95] The notion that a party to a contract should not be allowed to recover as compensation a sum which is higher than an amount needed to compensate him for the loss suffered. see Simpson, loc. cit., no. 1, pp. 123-124

principle of freedom of contract- the basic principle which requires that the parties' agreement should be enforced according to its terms. This principle, however, has never been an absolute one, and its scope has, during decades, upon many justifications, been limited. Some of these limitations may, rather easily, be explained- for example, refusing to enforce a contract on the ground that one of the contracting parties lacks capacity- but as to some others, such an explanation, considering the long historical intervention of courts in the parties' bargain, is not an easy task.[96]

1.31 As the historical review of the penalty doctrine shows, the enforcement of the parties' agreement as to an agreed damages clause has gradually been limited to a situation where the agreed sum does not disproportionately exceed the amount of damages which might be conceived to result from breach at the time when the contract is made. Historically, such a blatant intervention with the parties' freedom in contracting has been explained on the general grounds of fairness and being equitable: In short, it was said that it was inequitable to allow a party to a contract to take an unfair advantage of his legal rights by recovering a disproportionately large sum of money as damages; especially where the clause had been agreed upon with this object in mind.[97] This explanation, however, has been criticised by some economists, who have put forward some alternative justifications.[98] There have also been some attempts to explain the situation on the ground of cognitive defects: the core of such an explanation is that penalties are normally the result of a defective cognition, and therefore not susceptible to be subject to the principle of freedom of contract.[99] Some also have tried to justify the doctrine on the basis of a concern for future freedom[100]: they regard penalties as an undue limit on the promisor's future freedom, and argue that, like self-enslavement contracts,

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[96] In *Robophone Facilities Ltd. v. Blank* [1966] 3 All ER 128, for example, Lord Justice Diplock, while stating the rule as to the non-enforceability of penalties said: "I make no attempt, where so many others have failed, to rationalise this common law rule. It seems to be sui generis." at p. 142

[97] See Holdsworth W., History of English Law, edited by: Goodhart A.L. & Hanbury H.G., 7th ed., vol. 1, 1956 (Reprinted 1966), vol. 5, p. 330; Simpson A.W.B., A History of the Common Law of Contract: The Rise of the Action of Assumpsit, 1975, pp. 120-121; see also *supra.*, paras. 1.13-1.14

[98] See *infra.*, paras. 1.51 *et seq.*

[99] See *infra.*, paras. 1.60 *et seq.*

[100] See *infra.*, paras. 1.37 *et seq.*

the parties could not be free to unduly limit their future freedom.[101]

1.32 This section will, thus, be devoted to exploring- and as far as the competence of the writer allows, to analytically discussing- the main justifications for the non-enforceability of penalties. Consideration will first be given to "public policy" as a possibly suggested basis for the intervention of courts. Then the attempts to justify the doctrine on the ground of a "concern for future freedom" will be discussed. The final part of this section will deal with "fairness" as the most plausible basis for the doctrine. The cognitive interpretation of penalties, though it may be considered as a specific version of procedural unfairness, will, due to its importance, be separately considered.

2.2. Public Policy

1.33 The non-enforcement of penalties has sometimes been grounded on being against public policy. The argument may run as follows: the promisee by stipulating a large sum of money- which is out of all proportion to damages which may result from breach- to be paid upon breach, in fact, intends to terrorize the promisor into carrying out his contractual promise, and penalize him in case of breach. This is, in effect, a private punishment[102], and since punishment should normally be considered as something only the State can impose[103], it is, therefore, against public policy to allow the contracting parties to agree upon a private punishment.

1.34 Some judicial statements may support this justification: In *Bridge v. Campbell Discount Co. Ltd.*[104], Lord Radcliffe, considering the nature of penalties and liquidated

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[101] The main basis of this analysis is John Stuart Mill's justification for the non-enforceability of self-enslavement contracts where he argues that "[t]he principle of freedom cannot require that he [*i.e.*, the promisor] should be free not to be free. It is not freedom, to be allowed to alienate his freedom." See John Stuart Mill, On Liberty and Other Essays, edited by John Gray, (Oxford University Press, 1991), p. 114

[102] See Burrows A S, Remedies for Torts and Breach of Contract, (Butterworths, 1994, 2nd ed.), pp. 330-331; *cf.* Collins H, The Law of Contract, (Butterworths, 1993, 2nd ed.), p. 345

[103] See Ugo Mattei, The Comparative Law and Economics of Penalty Clauses in Contracts (1995) 45 The American Journal of Comparative Law 427, where he observes: "They [*i.e.*, courts] believe that punishment is a prerogative of the state and that this prerogative should be safeguarded against private parties seeking private justice. In other words, courts are jealous of their jurisdiction, and they are traditionally loath to accept alternative dispute resolution schemes removed from their control." at p. 443

[104] [1962] AC 600

damages, observed:

> "The refusal to sanction legal proceedings for penalties is in fact a rule of the court's own, produced and maintained for purposes of public policy (except where imposed by positive statutory enactment, as in 8 & 9 Will. 3, c. 11; 4 & 5 Anne, c. 16)."[105]

In *Robophone Facilities, Ltd. v. Blank*[106], Lord Justice Diplock, speaking of the right of the parties to provide for their secondary obligations and rights which arise on non-performance of a primary obligation, added:

> "The right of parties to a contract to make such a stipulation is subject, however, to the rule of public policy that the court will not enforce it against the party in breach if it is satisfied that the stipulated sum was not a genuine estimate of the loss likely to be sustained by the party not in breach, but was in the nature of a penalty or punishment imposed on the contract-breaker."[107]

1.35 It is, however, to be noted that the rule as to penalties is hardly explainable on the ground of public policy in its strict sense: providing for a certain sum of money to be paid, or a certain property to be transferred, upon breach, though it might in certain circumstances act as a penalty for the offending party, is not a sort of punishment which is only exercised by the state. Public policy, in its strict sense, "reflects the mores and fundamental assumptions of the community"[108]. Being a member of a certain society entails some obligations which are of overriding character and cannot be displaced by the private agreement of the parties.[109] These are normally a sort of obligations that are somehow linked to certain external considerations relating to the interests of public[110],

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[105] *Ibid.*, at p. 622

[106] [1966] 3 All ER 128

[107] *Ibid.*, at pp. 141-142; see also *The Angelic Star* [1988] 1 Lloyd's Law Rep. 122, where Gibson LJ said: "The doctrine relating to penalties ... is a rule by which the Court refuses to sanction legal proceeding for recovery of a penalty sum, a rule which the Court had produced and maintained for purposes of public policy ... . The rule is, in my judgment, not designed to strike down any more of a lawful contract than is necessary to give effect to the Court's purpose of applying public policy ... " at pp. 126-127

[108] M P Furmston, Cheshire, Fifoot & Furmston's Law of Contract, (London: Butterworths, 1996, 13th ed.), p. 373

[109] See Lloyd D, Public Policy: A Comparative Study in English and French Law, (University of London: The Athlone Press, 1953), p. 9

[110] To give an example, a contract by which a Mafia group hires a person to assassinate the leader of a rival group is against public policy. Such a contract- though it may well be a valid agreement, as far as the *internal* considerations are concerned- is against some *external* policy considerations which renders it unenforceable.

and ignoring these or eliminating them by private agreements will result in social injury.[111] If the contracting parties agreed upon a penalty, as an agreed remedy, which is merely under the control of state- like a clause providing for the imprisonment of the defaulting party for a certain period of time- then such a stipulation may be invalidated on the basis of public policy. For this agreement affects the social order of the society, and consequently is against public interest: It is obvious that permitting individuals to provide for and enforce criminal punishment- which should, for many policy reasons, only be exercised by state- would seriously affect the public order. This may also be regarded as an agreement which tends to interfere with the due course of justice[112] by providing a criminal punishment for a merely civil contractual breach which is not normally considered as a criminal offence. But where the parties' agreement is only for the payment of a certain sum of money or performance of a certain act- which is not within the exclusive power of state, it would be difficult to assume a social injury or violation of public interests.

1.36 Public policy, however, might sometimes be referred to as a wide concept that includes some internal policy considerations which are aimed to safeguarding some legal principles to ensure fairness in the contracting process. In this sense, it might be possible to ground the non-enforcement of penalties on such policy considerations, for penalties tend to negate, using the disguised form of agreed remedies, the established principle of compensation upon which "a contracting party should only be permitted to recover compensation for loss actually suffered through default, such compensation being

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[111] It appears that Lord Diplock in *Bhagwan v. Director of Public Prosecutors* [1972] AC 60 considers public policy as a means to prevent such social injury: "In past centuries the courts, as expositors of those parts of the common law of England in which Parliament had not yet chosen to intervene, had laid down a number of broadly described categories of purposes which they deemed socially injurious and had determined what were the legal consequences of agreements to achieve them. Those consequences varied with the view which the courts then took of the gravity of the social injury which would be involved if the purpose were achieved. Some purposes attracted no severer consequence than that the agreement to achieve them was void in civil law; but others, where the social injury was thought to be greater or other means of preventing it inadequate, attracted the penal consequences attaching to a misdemeanour at common law." at pp. 79-80

[112] Such agreements are obviously against public policy: see, e.g., Chitty on Contracts, (London: Sweet & Maxwell, 1994, 27th ed.), vol. 1, para. 16-033; M P Furmston, Cheshire, Fifoot & Furmston's Law of Contract, (London: Butterworths, 1996, 13th ed.), p. 372; McKendrick, Contract Law, 2nd ed., para. 15.10 at p. 254; Beale H G, Bishop W D, Furmston M P, Contract, Cases and Materials, (Butterworths, 1995, 3rd ed.), p. 921, and cases cited therein.

assessed, broadly speaking, with a view to putting the innocent party into the position he would have achieved if the contract had been performed"[113]. Put it another way, penalties are against public policy, in the sense just explained, because they undermine the compensatory principle by allowing the innocent party to recover a sum as agreed damages which is disproportionately high in comparison with the damages caused by the breach.[114]

2.3. Concern for Future Freedom

1.37 There have been some attempts to justify the intervention of courts to relieve against penalties on the ground that penalties coerce performance of contracts: they, in effect, pressurize the promisor to perform his contract, and, in this sense, they, to some extent, violate the individual freedom.[115] The central argument runs as follows: penalties unduly limit the future freedom of the promisor (and in some cases both contracting parties), and thus enforcement of such agreements will prevent the parties from achieving well-being.[116]

1.38 There are a few premises for such a conclusion: **First**, any agreement to do non-valuable things should not be supported by the state: a state's role in the society is to help individuals to promote good lives, and to achieve well-being. One way of attaining this goal is by enforcing contracts which normally help people to achieve valuable things. Thus, a contract to promote a non-valuable thing should, and could not be supported by the state.[117]

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[113] Simpson A.W.B., A History of the Common Law of Contract: The Rise of the Action of Assumpsit, 1975, p. 123

[114] In this sense, the justification is almost indistinguishable from the explanations based on substantive unfairness. see *infra.*, para. 1.46; It may also be argued that the reference to public policy in judicial statements just quoted is in this sense.

[115] See Collins H, The Law of Contract, (Butterworths, 1993, 2nd ed.), p. 345; Kercher B., Noone M., Remedies, 2nd ed., p. 239; It is also argued that the compulsory performance of contracts is a remedy which should only be reserved for the courts through granting specific performance in cases where the courts, considering all relevant circumstances, find it appropriate to exercise their jurisdiction. A penalty, which directs towards forcing the promisor to perform, should, therefore, not be enforceable. see Collins, *ibid.*

[116] Smith S A, Future Freedom and Freedom of Contract (1996) 59 MLR 167, at p. 175

[117] See Smith, loc. cit., no. 116, at pp. 175-176

1.39 **Second, agreements which unduly limit future freedom are non-valuable, and thus should not be enforced by the state.**[118] There may be two immediate objections to this premise: **a)** how could it be assumed that a *voluntary* agreement can *unduly* limit future freedom? This may be overcome by observing the nature of autonomy: "[t]he essence of autonomy ... is 'self rule': a person is autonomous if she is able to direct the course of her life to a significant extent."[119] Autonomy in a person's life should be both horizontal (*i.e.* being autonomous in significant portion of life's concerns) and vertical (*i.e.*, autonomy in different historical stages of one's life). The conditions of the vertical autonomy may be lost as a result of one's own actions. A person who diminishes his future ability to make autonomous choices may unduly harm his vertical autonomy; for instance, a person who is fully autonomous until a certain age, and after that, under his voluntary contractual obligation, has to do a certain job for a certain company for the rest of his life, could not be regarded as having autonomy. **b)** Most contracts do somehow limit future freedom, for by entering into an agreement, a party may have to do, or refrain from doing, a certain act. It should however be observed that being autonomous does not only mean enjoying the conditions of autonomy, but to act autonomously. To get a valuable thing through entering into an agreement, autonomy will, to some extent, be lost; but the point is the existence of a balance between the loss of future autonomy and the valuable things gained by that. The concern, therefore, is with losses of future freedom which are unnecessary (because they do not serve any purpose), or disproportionate (because they cannot be justified by the goal they serve).[120]

1.40 **Third, penalty clauses unduly limit the promisor's future freedom in two ways: a)** the obligation to pay an extravagantly large sum of money in the event of the promisor's default prevents the prospective payee from doing other valuable activities with his money; **b)** such an obligation, by pressurizing the promisor into performance, makes it very difficult for him to quit the contract; for they act in terrorem of the defaulting party. It is therefore concluded that penalties do not promote valuable things, and thus state

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[118] For detailed analysis see Smith, *ibid.*, at pp. 176-180

[119] Smith, loc. cit., no. 116, at p. 177

[120] Smith S A, Future Freedom and Freedom of Contract (1996) 59 MLR 167, at p. 179

should not lend its support to their enforcement.

1.41 It cannot be doubted that the agreements which unduly (*i.e.*, unnecessarily or disproportionately) limit future freedom, may not be enforced; but the mere fact that penalties induce performance cannot, it seems, be regarded as an evidence for the view that they excessively limit the promisor's future freedom.[121] No doubt that penalties like any other obligation limit, to some extent, future freedom but it is to be observed that a) they do not prevent the promisor from breaching the contract, they only make it difficult for him; b) even in the extreme supposed case that they make the breach impossible, they could not, it is suggested, be regarded as an undue limitation of future freedom.[122] This point needs some elaboration: A concern for future freedom, as explained above, is a sound basis for refusing the enforcement of agreements by which a contracting party alienates himself from a certain general right completely; for example, the non-enforcement of a contractual undertaking by somebody not to marry to anybody for the rest of her life, or not to get any job forever may be justified on this ground. The reason, as pointed out by Smith[123], is that such agreements unduly limit the future freedom, for they result in the complete deprivation from a certain right. But if somebody agrees not to marry to a *specific person*, or not to get a *certain job* for the rest of his life (*i.e.*, partial deprivation from a certain general right); or agrees not to marry for two years, or not to get a job for six months (*i.e.*, deprivation from a general right for a certain period of time), the concern for future freedom could not be a ground for not enforcing the agreement even though the future freedom is somehow limited. Thus, the non-enforcement of self-enslavement contracts, which may result in the complete deprivation

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[121] This applies with much force to well-planned commercial contracts. In a large construction project, for example, the main contractor may insert a large agreed damages clause in his agreement with the sub-contractor for the due completion. This does commercially make sense, for the sub-contractor's failure may result in the main contractor's inability to meat the key dates in his agreements with both other sub-contractors and also the employer. It is difficult to claim that, in such a situation, the sub-contractor's future freedom has unduly been limited, though the clause may induce him to perform. See Collins H, The Law of Contract, (Butterworths, 1993, 2nd ed.), p. 345

[122] Speaking of undue limitation, I mean a ground for refusing enforcement. A ground upon which the state could and should not support such agreements.

[123] See Smith S A, Future Freedom and Freedom of Contract (1996) 59 MLR 167, at pp. 179-180, where he concludes that "there is a *prima facie* case for refusing to enforce agreements that unduly limit freedom".

from a general right, might be justified on this ground (*i.e.*, a concern for future freedom). However, an agreement to pay a disproportionately large sum of money in the event of breach, though it induces performance and creates a limitation upon the individual's future freedom, does not result in the complete alienation from a general right. It is, therefore, difficult to justify the non-enforcement of such agreements on this ground.

1.42 Secondly, as Smith agrees himself[124], the scope of undue limitation on future freedom- that is, "unnecessary" or "disproportionate" limitation- as a basis for non-enforcement of agreements, is very controversial. Unnecessary limitation, in the sense of a pointless limitation on future freedom, is, in most cases, extremely difficult to be determined: A person who for specific idiosyncratic reasons is eager for an obligation to be duly performed, and is prepared to pay twice as much as the normal price for the due performance of that obligation, and to secure this performance sets a penalty of a large sum of money in case of default, cannot, it seems, be said to have entered into a pointless agreement.[125] Neither could it easily be claimed that this limitation is disproportionate: Such a disproportion should be determined by considering whether there is a balance between the future limitation on freedom and the achievements which results from entering into the agreement. The degree by which such a balance should be identified is by no means clear, and the mere existence of a disproportion between the agreed sum and the actual probable loss should not, it seems, be indicative of a disproportionate limitation on future freedom.

1.43 Thirdly, a perfectly genuine *ex ante* pre-estimate of damages may, due to a change

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[124] See *ibid.*, p. 179; see also pp. 185-186 where he says: "Determining whether a restraint is unnecessary or disproportionate is difficult and, except in cartel cases, the self-interest of contracting parties provides a strong check against disproportionate or unnecessary restraints."

[125] It could, basically, be argued that where damages resulting from breach is difficult to be pre-determined at the time when the contract is entered into, an agreed damages clause will be regarded as a valid liquidated damages clause even though it may, to a significant extent, induce performance. It is quite a plausible point that the parties agree upon such a clause to remove the uncertainty by estimating the extent of their liability and the risks which they run. see *Webster v. Bosanquet* [1912] AC 394 (PC), at p. 398; *Philips Hong Kong Ltd. v. The Attorney General of Hong Kong* (1993) 61 BLR 41, at p. 55; On general incentives of parties to agree upon a stipulated damages clause, see Furmston M P, Contract Planning: Liquidated Damages, Deposits and the Foreseeability Rule (1991) 4 JCL 1, at pp. 1-2; Chitty on Contracts, 27th ed., 1994, para. 26-061, at pp. 1251-1252; *Robophone Facilities Ltd v. Blank* [1966] 3 All ER 128, per Diplock LJ at pp. 141-142

of circumstances, happen to turn into a disproportionately large sum of money compared to the actual loss which may result from breach. Such a clause, upon the basis taken by Smith[126], may unduly limit the promisor's future freedom, and should therefore be considered as unenforceable, whereas it is unlikely to be regarded as a penalty.[127]

1.44 Fourth, the mere fact that undue limitation on future freedom can justify the invalidation of self-enslavement clauses, does not mean that any "autonomy endangering agreement", in the sense employed by Smith[128], could be explained on this basis. As emphasised earlier, self-enslavement agreements normally result in the complete alienation from a general right, and this is the reason why they are invalid. Penalty clauses, however, do not amount to such an alienation. They may only, in some extreme cases, induce performance of a certain contractual obligation.[129]

2.4. Fairness

1.45 It appears that the Courts of Equity have historically based their refusal to enforce penalties on the general grounds of fairness and being equitable. The historical analysis of the courts' intervention to relieve against penalties and forfeitures revealed the fact that they regarded it as inequitable to allow the promisee to recover a sum of money which is disproportionately large in comparison with the damages caused by the breach.[130] In the words of Lord Diplock in *Photo Production Ltd v. Securicor Transport Ltd*[131], the agreement of the parties:

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[126] Though Smith claims that "that the penalty clause test is *ex ante* is consistent with this justification because the extent to which a stipulated damage clause induces performance is crucial in assessing the clause's effect on future freedom." loc. cit., no. 116, at p. 184

[127] See, e.g., *Clydebank Engineering and Shipbuilding Co Ltd v. Don Jose Ramos Yzquierdo Y Castaneda* [1905] AC 6; The relevant time in the application of the tests distinguishing liquidated damages from penalties is the time when the contract is made: see *Dunlop Pneumatic Tyres Co. Ltd. v. New Garage and Motor Co. Ltd.* [1915] AC 79, at p. 86 per Lord Dunedin; *Public Works Commissioner v. Hills* [1906] AC 368, at p. 376; *Webster v. Bosanquet* [1912] AC 394 (PC); *Philips Hong Kong Ltd. v. The Attorney General of Hong Kong* (1993) 61 BLR 41, at p. 59. see also *infra.*, para. 2.20

[128] See Smith S A, Future Freedom and Freedom of Contract (1996) 59 MLR 167, at p. 167

[129] Indeed in some cases, penalty does not even induce performance, like an agreement to pay a certain sum upon different breaches of varying importance. Such a clause is presumably a penalty, but it may not induce the performance of all different obligations of the promisor: even the agreed sum may, in some cases, be less than damages suffered as a result of the breach.

[130] See *supra.*, paras. 1.13-1.14

[131] [1980] AC 827, [1980] 1 All ER 556

> "must not impose upon the breaker of a primary obligation a general secondary obligation to pay to the other party a sum of money that is manifestly intended to be in excess of the amount which would fully compensate the other party for the loss sustained by him in consequence of the breach of the primary obligation."[132]

In fact, the imposition of an unreasonably large sum of money as compensation was, in the eyes of Equity, unjust, extravagant and unconscionable which justified the court's intervention. This may also have been regarded as an indicative of a procedural defect in the formation of contract. Holdsworth, describing the historical evolution of the penalty doctrine, points out:

> "It was obviously against conscience that a person should recover a sum of money wholly in excess of any loss incurred. A person seeking to do so might in some circumstances come perilously near to committing a fraud, and in other circumstances might be unconscientiously seeking to take advantage of an accident."[133]

Though there is an obvious interrelationship between substantive and procedural unfairness in this regard, it is nonetheless appropriate to discuss them separately.

2.4.1. Substantive Unfairness

1.46 The notion of agreed damages being extravagantly large in comparison with the actual expected loss- which is used as the main test to distinguish enforceable liquidated damages from unenforceable penalties- invites the idea that penalties are struck down on the ground of substantive unfairness. The compensatory principle requires that any loss resulting from breach of a contractual obligation should justly be compensated. The principle, thus, does not allow a party to a contract to recover a sum of money greatly in excess of the amount which may compensate the non-breacher. Applying this principle to the agreed damages, clauses providing for damages extravagantly in excess of the actual expected loss should be considered as substantively unfair.[134]

1.47 Despite the historical support for this justification, it has not been immune from criticism:

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[132] *Ibid.*, at pp. 850, 567 respectively

[133] Holdsworth W., History of English Law, edited by: Goodhart A.L. & Hanbury H.G., 7th ed., vol. 1, 1956 (Reprinted 1966), vol. 5, p. 293

[134] See, e.g., Story, Commentaries on Equity Jurisprudence, (London: Sweet & Maxwell, 1892, 2nd ed.) pp. 898-899; Collins H, The Law of Contract, (Butterworths, 1993, 2nd ed.), p. 346 where he argues: "... excessive compensation, just like excessive price, is an unfair bargain, ..."

First, courts have never claimed a *general* jurisdiction over unfair bargains. As it was once pointed out by Lord Nottingham, the Chancery mends no man's bargain. Thus, even taking for granted the substantively unfair consequences arising from an unreasonably large agreed damages, the jurisdiction over such an unfair bargain should be regarded as an exception.[135]

1.48 **Second**, it is not, in fact, possible to detect the unfairness of an agreed damages clause without taking the consideration into account.[136] Merely being in excess of the expected loss could not necessarily indicate a substantively unfair stipulation: the promisee may have paid a consideration for such a term. A contract should, as a whole, be evaluated to detect any unfairness, and since the courts, in determining the nature of an agreed damages clause, do not regard the amount of consideration as a relevant factor, they may fail in determining whether the clause is truly unfair. Thus, a substantively fair agreement as to damages may be struck out as a penalty upon the mere ground that it greatly exceeds the amount of loss expected to result from breach. In fact, this would itself result in unfairness, because a party which has paid a price for the penalty (by possibly being charged a higher price if the contract contains a penalty) would be deprived of its benefits. It should, however, be noted that though taking the consideration into account is not specifically a factor in determining the nature of an agreed damages clause, the courts, in applying the penalty tests, should take all circumstances surrounding the agreement into consideration.[137] Hence, the courts would, having regard to all circumstances among which is the probable price paid for the clause,

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[135] See Burrows A S, Remedies for Torts and Breach of Contract, (Butterworths, 1994, 2nd ed.), p. 329; This has also forcefully been put in an Scottish case where Lord Weir held: "The fundamental principle is that where a bargain is freely entered into, the parties will be held to its terms. ... It may appear that the consequences, should they arise, are unfair to one party but for the court to intervene to strike out or modify these consequences would amount to it passing judgment on what is a fair bargain. The only *exception* to the fundamental principle is where there has been a breach of contract and where the common law remedy of damages is available as a substitute for the effects of a penalty clause." *EFT Commercial Ltd v. Security Change Ltd (No 1)* [1993] SLT 128, at p. 134 [emphasis added]

[136] Smith S A, Future Freedom and Freedom of Contract (1996) 59 MLR 167, at p. 172

[137] As observed by Lord Dunedin, the question of distinguishing liquidated damages from penalties is "a question of construction to be decided upon the terms and inherent circumstances of each particular contract ..." *Dunlop Pneumatic Tyres Co. Ltd. v. New Garage and Motor Co. Ltd.* [1915] AC 79, at p. 87; see also *Sainter v. Ferguson* (1849) 7 CB 716, 137 ER 283

try to achieve fairness in individual cases.[138]

1.49 **Third**, if the concern of the courts in striking out penalties is substantive fairness, then the same result should be achieved as to an underliquidated damages clause, while such a clause is valid and enforceable.[139] The validity of this criticism should not be denied: the approach of English law in distinguishing liquidated damages and underliquidated damages, as far as the applicable law is concerned has not been sensible. The practical effect of the criticism, however, might be lessened by proposing the possibility of the application of the Unfair Contract Terms Act 1977 and other restrictive regulations[140] to such clauses, which would subject them to the reasonableness test.[141]

2.4.2. Procedural Unfairness

1.50 The unreasonable disparity between the agreed damages and the expected actual loss has sometimes been taken as indicative of the existence of a procedural defect in the bargaining process. Thus, the non-enforcement of penalties has been grounded on procedural fairness.[142]

Such a procedural defect may be assumed in two versions: **First**, a defect which, could it be proven independently, would constitute a separate basis for nullity or unenforceability;

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[138] Courts normally use the process of construction, interpretation and implication in a way to achieve fairness in individual cases. For instance, in the purchase of a second-hand car by an induced buyer for an unreasonably high price, the buyer would, at first glance, be unable to upset the agreement or obtain any relief. That is for the simple argument that the adequacy of consideration is not material. The court, however, might use its power to interpret the contract to determine the responsibility of the seller as to the quality and fitness of goods, and thus, using the concept of merchantable quality, try to achieve fair consequences in the parties' contractual relations. see Atiyah P S, Contract and Fair Exchange, (Essays on Contract, Essay 11), (Oxford: Clarendon Press), 1990), pp. 337-338; see also Atiyah P S, An Introduction to the Law of Contract, (Oxford: Clarendon Press, 1995, 5th ed.), pp. 297-298

[139] See *infra.*, para. 3.12; *Cellulose Acetate Silk Co. Ltd. v. Widnes Foundry (1925), Ltd.* [1933] AC 20

[140] E.g., Unfair Terms in Consumer Contracts Regulations 1994: SI 1994/3159

[141] For a detailed analysis see *infra.*, paras. 3.13-3.14

[142] Procedural fairness is concerned with the fairness in the contracting process, while substantive unfairness is concerned with the outcome of this process. These two concepts are strongly interrelated: A procedural defect normally results in a substantive unfairness which in turn can be used as an evidence for the existence of such a procedural defect. They are sometimes difficult to be distinguished: it is argued that substantive unfairness is reduced to a form of procedural unfairness, for a rational, fully informed individual would not have any incentive to agree upon a substantively unfair contract. On the other hand, it may be suggested that the concept of procedural unfairness is redundant, because the outcome of a procedurally defective contract would be shown by substantive unfairness. For further detailed discussion see S. A. Smith, In Defence of Substantive Fairness (1996) 112 LQR 138

like duress, fraud or undue influence. Thus, some economists have suggested that the initial judicial interference in the area of agreed damages clauses was "to protect against fraud and duress in a legal context where alternative, less costly, protections were not available".[143] Some others believe that the parties' agreement on damages which is *ex ante* unreasonably large can only be reasonably explained on the ground of a procedural deficiency, *i.e.* procedural unconscionability or mistake. In other words, such an unreasonable clause should be taken as "evidence of unconscionability or mistake, given the difficulty of observing those two problems."[144]

Second, a procedural issue which is unlikely to be independently considered as a ground for non-enforcement. Attempts to justify the penalty doctrine on the ground that penalties are the result of a defective cognition may fall into this category.[145] Psychologists, by conducting several empirical researches have shown that a human's cognition has specific limits. These limits may, by some force, be applicable to agreed damages clauses. It is therefore very unlikely, it is argued, to assume that parties to a contract have, at the time when they enter into the contract, intended, with full cognition, the consequences of a penalty in different breach scenarios. Thus, the underlying premise for the principle of freedom of contract- that the parties have, with full cognition, entered into the contract to rationally maximize their subjective expected utility- could have no application to penalties.[146]

1.51 The economic explanations of the doctrine may also, it seems, end up as such a procedural justification. Economists normally use the concept of "economic efficiency" to justify the intervention of courts in the parties' bargain as to agreed damages. They start with the assumption that agreements which are, voluntarily and with access to full

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[143] Goetz C J, Scott R E, Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach, (1977) 77 Columbia Law Rev. 554, at p. 593

[144] Samuel A Rea, Efficiency Implications of Penalties and Liquidated Damages (1984) 13 Journal of Legal Studies 147, at pp. 160-161

[145] See Eisenberg Melvin A, The Limits of Cognition and the Limits of Contract, (1995) 47 Stanford Law Rev. 211

[146] For a detailed discussion of this view see *infra.*, paras. 1.60 *et seq.*

information, entered into are presumably efficient.[147] Therefore, the existence of an inefficiency in the parties' agreement will indicate a defect in the bargaining process.[148] Thus, Goetz and Scott argue that in the absence of any procedural unfairness[149], enforcement of an agreed allocation of risk by stipulating for an agreed damages clause will enhance economic efficiency.[150] In their view, the modern law of contract damages is based on the promisor's option to choose between performance and compensatory damages: he is not obliged to perform, instead he may choose to breach upon justly compensating the innocent party for losses caused by the breach if he finds the breach economically efficient. Although the principle of just compensation results in economic efficiency[151], the parties, by allocation of risks through agreeing upon damages, can enhance this efficiency.[152] For in the absence of an agreed allocation of risks, the

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[147] Thus, the non-enforcement of penalties has sometimes been called "a major unexplained puzzle in the economic theory of the common law". Posner R. A., Some Uses and Abuses of Economics in Law (1979) 46 University of Chicago L. Rev. 281, at p. 290; It is sometimes claimed that the unenforceability of penalty clauses is "an accident of legal history" stemming from the equitable jurisdiction of the Chancellor. (see Ugo Mattei, The Comparative Law and Economics of Penalty Clauses in Contracts (1995) 45 The American Journal of Comparative Law 427, at p. 433); It has also been suggested that the reason for the non-enforcement of penalties was a motivation for litigation by judges in the era when they used to receive a portion of the litigation fees. (see Landes W. M. & Posner R. A., Adjudication as a Private Good (1979) 8 Journal of Legal Studies 235, at p. 256); see also Rubin P. H., Unenforceable Contracts: Penalty Clauses and Specific Performance (1981) 10 Journal of Legal Studies 237, where he says: "The general principle of enforcement of contract law is that almost anything which parties agree upon will be enforced." at p. 242.

[148] An economist is interested in defects like information barriers or reduced competitive opportunity which, in Goetz & Scott's view, may rebut the presumption of fair exchange. (see Goetz C J, Scott R E, Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach, (1977) 77 Columbia Law Rev. 554, at p. 592)

[149] See Goetz & Scott, loc. cit., no. 143, at pp. 591 et. seq.

[150] See *Ibid.*, pp. 557 et. seq., esp. at p. 578; see also Polinsky A Mitchell, An Introduction to Law and Economics (Boston and Toronto: Little, Brown and Company, 1989, 2nd ed.), pp. 63-64, where he argues that in principle, an agreed damages "would allocate the contract risk optimally because the liquidated damage payment would equal the optimal damage payment."; Ugo Mattei, The Comparative Law and Economics of Penalty Clauses in Contracts (1995) 45 The American Journal of Comparative Law 427, who concludes that the ban on penalties is difficult to justify on economic terms. In his view "no efficiency reasons can be adduced." at p. 443

[151] See Clarkson K W, Miller R L, Muris T J, Liquidated Damages v Penalties: Sense or Nonsense? [1978] Wisconsin Law Rev. 351, at pp. 358-360

[152] At first glance, it may seem that, since parties by providing for an agreed damages clause, in fact, set the "just compensation" principle aside, efficient results may not be achieved. But, as the example in note 154 shows, the "just compensation" principle is not necessary to achieve efficiency. Therefore, though the principle results in efficient consequences, it cannot explain the distinction between penalties and liquidated damages. (See Clarkson K W, Miller R L, Muris T J, Liquidated Damages v Penalties: Sense or Nonsense? [1978] Wisconsin Law Rev. 351, at pp. 358-363)

efficiency gains from an efficient breach go only to the breacher[153], while the parties' agreement as to damages will distribute these efficiency gains between them.[154] The writers, thus, conclude:

> "... the "just compensation" formula hives all of the gains to the breacher. Why should this solution be regarded as any "fairer" than one which splits the gains fifty-fifty or gives them all to the non-breacher? ... It seems then that the only appropriate fairness inquiry is one concerned solely with process fairness, the bargaining conditions, and not examination of end results. However, if "parties" are to be attacked on this basis, the affirmative case must be made that penalties are in some way symptomatic of those market conditions which characterize process unfairness."[155]

1.52 This analysis, in addition to the general criticisms against the economic theory[156], may be subject to some further objections: **First**, it considers the economic efficiency of penalties where a change in circumstances makes the breach more efficient for the promisor or both parties. Such a change which makes performance more valuable to others (who may offer a higher price) than to the promisee, though theoretically possible, is, in an economically competitive market, unlikely to happen. **Second**, the whole theory

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[153] Goetz and Scott regard this as a limiting result. (see Goetz & Scott, loc. cit., no. 143, at p. 567)

[154] Goetz & Scott, loc. cit., no. 143, at pp. 562-568; The following example will make the situation clear; note that in this example, the costs have not been taken into account: S enters into a contract to construct and sell a certain product to B1. The contractual price is £1000. The performance is fairly valued at £1300 on the due date (*i.e.*, the amount of damages which may fully compensate B1, in case of breach, is £300). If S gets any offer for the subject-matter from B2 at a price higher than £1300, it is economically efficient for him to breach the first contract, and enter into a contract with B2. In such a case, if the contractual price is £(1300+X), the efficiency gains (*i.e.*, £X) will go only to the breaching party. Now, let us introduce a penalty clause into the first agreement: the parties stipulate that upon breach, S shall pay £600 to B1. At first glance, the enforcement of penalty might be regarded as preventing efficient breach, and consequently a hurdle in achieving economic efficiency. But Goetz and Scott argue that it is not: First, if the price offered by B2 is more than £1600, let's say £(1600+X), the breach is still economically efficient, and the efficiency gains will be distributed between the parties as follows: £300 will go to the non-breacher, and £X will go to the breacher. Second, if the offered price by B2 is £(1300+X) which is less than £1600, then the parties (*i.e.*, S and B1) can renegotiate the penalty clause. They economically have enough incentive to do so, because the breach will result in more gains for both parties. In the words of Goetz and Scott, the "obstinate insistence on the enforcement of certain penalties may result in a failure to exploit potential efficiency gains by inducing the penalized party not to breach" (*ibid.*, at pp. 567-568). If, therefore, they set the agreed remedy at a sum which is higher than £1300 (the performance value of B1) by £Y, and less than the price offered by B2 by £Z, the efficient breach, and thus economic efficiency, will be achieved. The distribution of the efficiency gains will be as follows: £Y will go to the non-breacher, and £Z will go to the breacher.

[155] Goetz & Scott, *Ibid.*, at p. 568. The authors also discuss the possibility of undercompensation for the innocent party's non-provable idiosyncratic losses in case that penalties are not enforced. In this sense also they argue that the control over penalties will be regarded as inefficient. (see *ibid.*, pp. 568 et. seq.)

[156] See *infra.*, paras. 1.57 *et seq.*

presupposes the ability of the promisor to choose between performance and an efficient breach, and considers that efficiency will be enhanced by allowing the parties to agree upon damages, because not only will it not prevent efficient breaches, but it will also make them more efficient for both parties. The analysis does, however, ignore many scenarios where the promisor is, for many reasons, really unable to perform the contract, and will have to breach. This may result in the promisee recovering a penal sum which is disproportionately high in comparison with the damages. **Third**, the theory also ignores the change of circumstances against the promisor. Suppose that because of such a change, the second offer received by the promisor is less in amount than the value of performance for the promisee. In such a case, it is economically efficient for the promisor to complete the contract. But if, for any reason, he committed a breach, he will be penalized by having to pay an unreasonably large sum of money. **Fourth**, it also ignores the wasteful costs which may be involved for breach-inducing activities, or costs of any precautions taken by the promisor against such activities. This is the most important factor which leads other economists to reformulate the rule according to the concept of "economic efficiency".

1.53 Thus, Clarkson, Muris and Miller, trying to justify the penalty doctrine from the "economic efficiency" prospective, argue that there are substantial benefits from stipulating damages. The parties will have strong incentives to provide for such damages where the benefits exceed the costs of negotiation of the stipulated damage clauses which enhance the economic efficiency by putting the parties in preferred positions, increasing economic activity and producing goods at lower costs.[157] However, they consider that the existence of a penalty clause in the contract may result in some further wasteful costs: Where the promisee realises that he may gain significant economic benefits from breach- because either the parties have set the agreed damages to an amount which is higher than expected actual loss or, due to a change in circumstances, the actual loss has turned out to be less than the agreed sum- he will have an incentive to involve in breach-inducement activities which may sometimes be costly.[158] In such a situation, the promisor also may

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[157] Clarkson K W, Miller R L, Muris T J, Liquidated Damages v Penalties: Sense or Nonsense? [1978] Wisconsin Law Rev. 351, at pp. 367-368

[158] In a contract for construction of a bridge, for example, with a stipulated damage clause of £5000 per

take some precautions against such activities which will impose some wasteful costs upon him. To achieve economic efficiency, these wasteful costs should be avoided. Thus, Clarkson, Muris and Miller formulated and proposed the following optimal rule for the enforcement of some stipulated damage clauses[159]: **First**, where there is a possibility and incentive of breach-inducement activities, only "reasonable" stipulated damage clauses should be enforced by scrutinizing the relation of the agreed amount to the actual loss caused by the breach. **Second**, if there is no possibility or incentive for breach-inducement activities, then the agreed damages clause should be enforced, regardless of its reasonableness.

1.54 Testing their economic theory with different stipulated damage clauses in different kinds of contracts, the authors concluded that "underliquidated damage clauses", "accord after breach", "covenants not to compete" and "agreements between lender and borrower" are the sort of agreements where there may not reasonably be an incentive or opportunity to induce breach, while such an incentive may reasonably exist in "agreed damages stipulated for delay in construction contracts", "forfeiture of advance payments" and "alternative agreements stipulating for damages".[160] Their final conclusion is that, though the distinction between liquidated damages and penalties should be maintained, the "recognition of the economic basis for the distinction should reduce the considerable confusion surrounding stipulated damages".[161]

1.55 The analysis of Clarkson, Muris and Miller has been criticised by other economists[162] who believe that the parties, agreeing about damages at the time when they enter into the contract, will take into account the incentives of each side to induce or

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each day of delay in completion, the employer who- because of either changed circumstances or stipulation of *ex ante* unreasonably large sum- sees himself economically better off with breach rather than the due performance, may covertly, for instance, by not co-operating or providing wrong information or so, induce breach by the contractor.

[159] See Clarkson K W, Miller R L, Muris T J, Liquidated Damages v Penalties: Sense or Nonsense? [1978] Wisconsin Law Rev. 351, at pp. 375-378

[160] Clarkson, Muris & Miller, *ibid.*, at pp. 383-389

[161] Clarkson, Muris & Miller, *ibid.*, at p. 390

[162] See, e.g., Samuel A Rea, Efficiency Implications of Penalties and Liquidated Damages (1984) 13 Journal of Legal Studies 147

prevent breach, and will determine the amount of damages accordingly. Thus, if the promisee has the possibility of any opportunity or incentive to induce breach, this will be taken into account by the parties, and "will lead to a reduction in the predetermined damage level below the actual damages".[163] In fact, what Rea is trying to suggest is that, in an economically efficient market, there may only be very infrequent situations where the parties may *ex ante* agree on damages which exceed the expected actual loss.[164] The existence of such an *ex ante* unreasonable determination of damages should indicate either a procedural defect in the formation of contract or a mutual mistake.[165] He then concludes that the existing penalty doctrine is consistent with the doctrines of mistake or procedural unconscionability.[166]

1.56 Quite apart from the above criticism, the rule formulated by Clarkson, Muris and Miller on the basis of economic theory, may be open to a few observations:

First, an *ex ante* reasonable agreed damage clause is normally enforced, regardless of whether it is reasonable *ex post*.[167] The economic theory, however, requires the unenforceability of such a clause if it is unreasonable *ex post*.

Second, the economic theory is unable to explain the presumption of being a penalty as to a clause providing for a single sum to be paid upon different breaches of varying importance. Even in such a situation, if the agreed amount is reasonable compared to the actual loss resulting from the breach in question, it should be enforced. This is because in such a case, no possibility of breach-inducement activities could normally be assumed.

Third, there can be found no such a distinction, in the judgements and judicial opinions, between the cases where there is an opportunity or incentive to induce breach, and cases where there is no such an opportunity or incentive, though the theorists have attempted

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[163] Rea, *Ibid.*, at p. 155

[164] It is also argued that since parties do not in fact want to stipulate for a penalty which is an undesirable supracompensatory remedy, judicial scrutiny of agreed damage clauses is unnecessary, and may produce mischief. see Alan Schwartz, The Myth that Promisees Prefer Supracompensatory Remedies: An Analysis of Contracting for Damage Measures (1990) 100 Yale L J 369

[165] Rea, loc. cit., no. 162, at pp. 159-162

[166] *Ibid.*, at p. 163

[167] See *Clydebank Engineering and Shipbuilding Co Ltd v. Don Jose Ramos Yzquierdo Y Castaneda* [1905] AC 6; This is because the relevant time in deciding whether the clause is a penalty is the time when the contract is made: see cases cited in note 127

to explain the end results of some cases on the basis of their theory.

1.57 The core concept of the economic justifications of the penalty doctrine normally is the "economic efficiency". The attempt of an economist is to test the economic efficiency of an agreed damages clause according to some "pragmatic and instrumental"[168] rules and mathematical contingencies of breach. The intervention of courts is only justified where the parties' agreement fails to achieve the economic efficiency. The economist's analysis presupposes that the parties will enter into a contract with full information, full analysis of all contingencies of breach, and even full evaluation of all possible breach-inducement activities and the precautions against that. It fails to take into consideration the important fact that the parties entering into a contract, even as to their primary obligations and rights, may not have access to full information, may fail in acquiring all possible information, and may not be able to evaluate the existing information in a perfect way. The facts of inaccessibility of information and inability to process properly the existing data is much relevant as to the secondary rights and obligations which are not readily present in the parties mind when they are entering into the agreement.[169] In the economist's view, a less than perfect access to information and a less than perfect ability to evaluate will be considered as a defect in bargaining process which may justify the court's intervention. The core of Rea's argument, for example, is that the parties will be very unlikely to agree upon damage clause which is in excess of the expected actual loss. Thus, the existence of an unreasonably large stipulated damage clause will be indicative of a mistake or a defect in the bargaining process. However, the analysis normally fails to realise that there may be no legal ground justifying the intervention of courts for any less than perfect access to information, or any less than perfect ability to analyse the data.[170]

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[168] See Smith S A, Future Freedom and Freedom of Contract (1996) 59 MLR 167, at p. 174

[169] The reason is that such obligations and rights are of secondary importance to the parties. The parties are more concerned about their primary rights and obligations, and primarily make the contract to get these rights. For a detailed discussion on the defects of a human's cognition which affects contracting, especially as to the secondary rights and obligations see: Eisenberg Melvin A, The Limits of Cognition and the Limits of Contract, (1995) 47 Stanford Law Rev. 211; *infra.*, paras. 1.61 *et seq.*

[170] It should also be born in mind that in practice, in most commercially negotiated contracts, like construction projects, the parties are not normally thinking of providing for likely damages resulting from a certain breach: what the contractor is concerned about is normally the impact of agreed damages on his profits. The contractor thus takes two elements into consideration: 1) Whether by the probable application of the clause, there would remain a profit margin for him. 2) He considers his ability to perform (*i.e.* whether he is confident of performance in a certain date). What is, in reality, not thought

1.58 This issue may lead us to a second point in the economic justifications of the doctrine: An economist does not normally take seriously the judiciary's own understanding and analysis of the legal rules.[171] No attempt has ever, it seems, been made to base a judicial decision for non-enforcement of penalties only on economic theory. In fact, it seems to be a legally unacceptable ground to argue against enforcement of the parties' bargain on the basis that it results in economically inefficient consequences. Despite this, there has been some attempts to explain the end results of some cases on the basis of economic theory.[172] This, however, does not make the theory a legally acceptable foundation. It is true that an economically inefficient bargain may be indicative of some defects in the bargaining process[173], but- except cases where the procedural defect has a legally recognisable sanction, like cases of fraud, undue influence, duress- not every bargaining defect could legally be sanctioned. For instance, the mere fact of inability to process the existing data[174] at the time when the contract is made, may lead to some economically inefficient consequences. This is not, however, the sort of defect against which the law has always recognised a sanction.

1.59 It may also be added that economic efficiency does not provide a morally attractive justification.[175] It not only allows, but also encourages a party to breach his contract when it is economically efficient to do so. Such an idea, though it may increase social wealth and result in economically efficient consequences, does not have a morally acceptable basis.[176]

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about is the likely damages which the employer may suffer as a result of the breach. In fact, the promisor is not very much interested in the promisee's loss; he is interested in his own profit.

[171] See Smith S A, Future Freedom and Freedom of Contract (1996) 59 MLR 167, at p. 174

[172] See, e.g., Clarkson K W, Miller R L, Muris T J, Liquidated Damages v Penalties: Sense or Nonsense? [1978] Wisconsin Law Rev. 351, sec. IV

[173] As it has been argued by Samuel A Rea, Efficiency Implications of Penalties and Liquidated Damages (1984) 13 Journal of Legal Studies 147

[174] This is something which most human-beings may unconsciously face when they want to make a rational choice in an uncertain situation. (see Eisenberg Melvin A, The Limits of Cognition and the Limits of Contract, (1995) 47 Stanford Law Rev. 211)

[175] See Dworkin R., A Matter of Principle, 1986, Ch. 12 esp. at pp. 242-246; Smith S A, Future Freedom and Freedom of Contract (1996) 59 MLR 167, at p. 174

[176] It may be interesting to note that, in some religious societies, breach of a contract is even regarded as a sin.

2.5. Penalties are the result of limited human cognition

1.60 A specific version of procedural justifications of the doctrine is the view that grounds the non-enforcement of penalties on the assumption that stipulated damage clauses are normally the result of a limited human cognition. According to this view, it is argued that the underlying premise of the bargain principle- the principle which requires the enforceability of the parties' agreement according to its terms- is that the contracting parties "will act with full cognition to rationally maximize [their] subjective expected utility"[177]. Such a premise cannot be relied upon as to stipulated damage clauses: a variety of empirical researches, conducted by psychologists, illustrate that human being's cognition has specific limits. These limits are specifically relevant and applicable to agreed damage clauses. Put another way, it is very unlikely to assume that parties have, with full cognition, intended the consequences of an agreed damage clause in different breach scenarios. It is therefore concluded that the underlying premise of the bargain principle not being applicable to stipulated damages, the principle itself could not also be applied. "Rather", as stated by Professor Eisenberg, "special scrutiny of liquidated damages provisions is justified because such provisions are subject to the limits of cognition in a special way."[178]

1.61 Empirical evidence, on the basis of cognitive psychological researches[179], demonstrates that an actor, making a decision under uncertainty, will deliberately make a less than perfect search for information: a rational actor will, according to Stigler[180], search for information until the costs of a further search equals the marginal returns from that search. Thus, he will act in the state of rational ignorance from some alternative data. Moreover, the ability of human-being to process the existing available data is limited. Hence, human rationality in making a choice in an uncertain area is bounded by both limited information and limited data-processing ability.

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[177] Eisenberg Melvin A, The Limits of Cognition and the Limits of Contract, (1995) 47 Stanford Law Rev. 211, at p. 212

[178] Eisenberg, *ibid.*, at p. 230

[179] These have neatly been presented by Prof. Eisenberg in his valuable article: Eisenberg Melvin A, The Limits of Cognition and the Limits of Contract, (1995) 47 Stanford Law Rev. 211; the psychological information in this section is mainly based on his work.

[180] George J Stigler, The Economics of Information (1961) 69 Journal of Pol. Sci. 213 (cited by Eisenberg, *ibid*, p. 215)

1.62 Though this does not necessarily result in making irrational decisions, further empirical evidence shows that in certain circumstances, actors will often make a systematically irrational choice: **First**, actors are systematically overoptimistic: they are normally overconfident of their ability to solve problems resulting from uncertain factual issues. Such an overoptimism has a dispositional character which will lead to an irrational decision. **Second**, actors systematically suffer from defective capabilities which will have effect on the way they search for data, analyse them, and make decisions. For instance, the way a certain choice is framed and presented has, according to an empirical research, a significant effect on the actor's decision.[181] Further, there are four other systematic defects in capability: **a)** actors, making a decision about the probability of an event, decide on the basis of data and scenarios which are *readily available* to their mind.[182] **b)** Actors normally take small samples of present events as *representative*, and decide on the basis of the data which they conclude to be representative. **c)** Actors have systematically limited capability to make a rational comparison between present and future states: they give too little weight to future benefits and costs as compared to the present benefits and costs. **d)** Actors are systematically unstable about estimation of risks: they normally under-estimate the low-probability risk of economic losses.[183]

1.63 The limits of cognition, as briefly listed above, have, with a significant force, a special bearing on stipulated damage clauses. The bounded rationality and rational ignorance is specifically applicable to such provisions: the parties to a contract, stipulating for agreed damages, have great disincentive to search for data, and process them properly. A few reasons have been raised to support this proposition: **a)** A party to a

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[181] In substantively identical options of a certain choice, framed in different forms, people have been established to be risk-averse when contemplating gains, and risk-preferring when contemplating losses: for example, faced to choose between a sure gain of £800 and 85 per cent. chance to win £1000, people normally choose the first, while in choosing between a sure loss of £800 and 85 per cent. chance to lose £1000, most people will prefer the latter. See Eisenberg, *ibid.*, pp. 218-219

[182] "Availability" may lead to certain biases in decision-making: for instance, an actor will judge on the basis of recent occurrences which are easily retrievable from mind; also the decision will normally be based on "instantiated, vivid and concrete" data which are more prominent than data and scenarios which are "general, pallid and abstract". See *ibid.*, pp. 220-221

[183] As Arrow observes: "It is a plausible hypothesis that individuals are unable to recognise that there will be many surprises in the future; in short, as much other evidence tends to confirm, there is a tendency to underestimate uncertainties." Arrow K J, Risk Perception in Psychology and Economics (1982) 20 Econ. Inquiry 1, at 5 (cited by Eisenberg, *ibid.*, p. 223)

contract, at the time of entering into the agreement, intends to perform. He is, therefore, unlikely to imagine that the clause will ever come into play against him; for he is normally determined that he will perform, and also experience will tell him that there is a high rate of performance and completion of contracts. b) It is impracticable, if not impossible, to imagine all scenarios of breach, and to consider the consequences of the application of the clause to all these breach scenarios. No doubt such an investigation is very costly, and considering the low probability of the clause actually coming into play, at least in the promisor's mind, the benefits resulting from the clause would not explain bearing the costs of such an investigation. The parties, therefore, are unlikely even to try to think about the clause thoroughly, and it is very likely that they will not even have clearly understood the full implications of such a provision.

1.64 Disposition resulting from overoptimism is also significantly relevant here: the promisor will unrealistically be overoptimistic about the probability of performance. He will therefore think that his performance is very likely, and the probability of breach is very low. This will naturally result in giving a further less thought to the clause.

1.65 Defective capability has also a special bearing in this regard: a) The promisor's present intention to perform, which is vivid and concrete, is readily available to his mind as compared to the abstract possibility of future breach. He will therefore base his decision in agreeing about the clause on these readily available data. b) The small sample of present events which is taken as representative of the future by the promisor is the high probability of performance, according to both what is salient in his mind at the time of entering into the agreement, and the high probability of performance generally. c) The promisor will give too much weight to the short term benefits coming from performance as compared to the probable costs of future breach which may normally happen, if at all, at the later stages of the contract. d) Since the probability of breach is very low in the contracting parties' mind, the promisor will unrealistically underestimate the risk of the stipulated damage clause coming into play.

1.66 It is therefore concluded that the stipulated damage clauses will normally be the result of a defective human cognition, and thus the bargain principle could and should not

be applied to such provisions. A significantly disproportionate agreed damages compared to the actual losses will be indicative of the fact that the clause is the result of a defective cognition: such a clause should not be enforceable unless it is proved that "the parties had a specific and well-thought-through intention that the provision apply in a scenario like the one that actually occurred".[184]

1.67 The cognitive interpretation of stipulated damage clauses does, it appears, provide a sound basis for refusing the enforcement of a disproportionately large agreed damages clause in consumer context. In consumer transactions, it is plausible to argue that, due to the limits of cognition, the parties are unlikely to have a well-thought-through intention that the clause will actually come into play in the real breach scenario. In fact, it is very likely that, due to overoptimism and defective capabilities in processing the existing information and applying them to all possible breach scenarios, the agreed damage clause may not have seriously been intended. It is, however, difficult to extend this to commercial contexts where the parties are normally in the business of entering into such agreements, have the advantage of utilizing the services of lawyers and legal advisors- who, in drafting contracts, are supposed to have regard to all surrounding circumstances and consider all relevant information regarding possible breach scenarios- and are consequently supposed to be fully aware of the consequences of any term in their agreement. In a large construction project, for instance, it is extremely difficult to assume that the main contractor has agreed to the stipulated damages clause as a result of a defective cognition. In such agreements, the contractor is normally fully aware of its capabilities to complete the project, and will normally take into account the possibilities of delay in completion and the amount which is to be paid as a result[185]; such a computation is normally effective in the price which is offered by the contractor: for example, in a contract with a reasonably large amount of agreed damages, the price is likely to be higher than a contract without such a clause. It would therefore seem that the cognitive interpretation could hardly justify the non-enforcement of penalties in commercial context.

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[184] Eisenberg, loc. cit., no. 179, at p. 235

[185] See *supra*., note 170

1.68 Secondly, the cognitive interpretation is unable to justify the existing penalty doctrine; instead it formulates an alternative shape that the scrutiny of the stipulated damage clauses should take: a) Although the gross disproportion between the agreed sum and the actual loss is taken as the indicative of the clause being the result of a limited cognition, if, nonetheless, it is established that such an unreasonably large sum was subject of a well-thought-through intention, it should, according to the cognitive justification, be enforced.[186] This is not consistent with the historical evolution of the penalty doctrine[187]: the Courts of Equity intervened, on the ground of fairness, to relieve against penalties and forfeitures even where the parties had seriously intended the penalty. Neither could it be compatible with the subsequent case law which bases the intervention on the ground that the parties have not genuinely pre-estimated the actual probable damages, but they have agreed on a penalty *intended* to act *in terrorem* of the defaulting party.[188]

b) It is argued that, according to the cognitive justification, the disparity between the agreed amount and *the actual loss* caused by the breach should be determinative of the clause being the result of a limited cognition.[189] Upon this basis, even where the parties have, at the time when the contract is entered into, seriously pre-estimated the loss which might conceivably result from breach, if the agreed sum happened to be much larger than the actual loss caused by the breach, it would be presumed that the clause is, for being the result of a limited cognition, unenforceable. This again is not in consistency with the case law which invariably uses an *ex ante* test to distinguish liquidated damages from penalties.[190]

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[186] See Eisenberg, *ibid.*, at p. 235; Further, even where the clause has been intended as a penalty, the clause would be enforceable if the agreed amount is not disproportionately large in comparison with the actual loss caused by the breach. see Eisenberg, *ibid.*

[187] See *supra.*, section 1, esp. para. 1.28

[188] See, e.g., *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd.* [1915] AC 79, at pp. 86-87; *Philips Hong Kong Ltd. v. The Attorney General of Hong Kong* (1993) 61 BLR 41, at p. 63

[189] See Eisenberg, loc. cit., no. 179, at p. 232; This view itself may be doubted: the limits of cognition may affect the parties' agreement at the time when they enter into the agreement. The agreement of contracting parties who have given every possible thought to the agreed damage clause- by having regard to all possible scenarios of breach, and pre-estimating the amount of damages which may result from breach- could not be considered as being the result of a defective cognition, for the mere reason that the actual loss has happened to be much lesser than the pre-estimated sum.

[190] See the cases cited in note 127

2.6. Conclusion

1.69 Considering the justifications offered for the penalty doctrine, it is difficult to accept a single justification as an absolute and defectless basis for the intervention of courts to relieve against penalties. Each of the justifications is, to some extent, subject to criticism, and cannot fully explain all aspects of the doctrine. It does, however, appear that fairness, as the basis historically taken by the Courts of Equity and supported by the subsequent case law, should be in the front line.[191] This includes both substantive and procedural fairness, though the economic justifications based on economic efficiency are, it appears, not capable of providing a legally acceptable ground for the intervention.

1.70 A disproportionately large agreed damage clause thus would not be enforced because **a)** the fact of stipulating for an unreasonably large sum of money as damages is indicative of a procedural defect in the bargaining process which may result in the clause not being the subject of the parties' serious intention[192]; **b)** even in the absence of such procedural defects, a party to a contract should not be allowed to recover a substantially large sum of money as compared to damages resulting from breach, for this, considering the compensatory nature of damages, may substantively be regarded as unfair. This proposition may gain some support from the Unfair Terms in Consumer Contracts Regulations 1994[193], which, in its Schedule 3, lists a term with the object or effect of "requiring any consumer who fails to fulfil his obligation to pay a disproportionately high sum in compensation"[194] as presumably unfair. Obviously the Regulations base the intervention of courts to relieve against penalties in consumer transactions on unfairness.

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[191] See Collins H, The Law of Contract, (Butterworths, 1993, 2nd ed.), pp. 345-347

[192] See Atiyah P S, An Introduction to the Law of Contract, (Oxford: Clarendon Press, 1995, 5th ed.), p. 299 where he argues that "penal and forfeiture clauses are not usually genuine promises or undertakings at all ..." ; see also Atiyah P S, Freedom of Contract and the New Right, (Essays on Contract, Essay 12), (Oxford: Clarendon Press, 1990), at pp. 368-369 observing: "They [*i.e.*, penalty clauses] are fakes, masquerading as contractual promises. Any attempt by the New Right to argue that the non-enforcement of penalty clauses is inconsistent with the ideology of Freedom of Contract would therefore be, in my view, erroneous, and simplistic."

[193] SI 1994/3159, implementing the EC Council Directive 93/13 on Unfair Terms in Consumer Contracts: see [1993] OJ L 95/29

[194] Para. 1(e) of the Schedule 3 which has the same wording as para. 1(e) of the Directive's Annex

Chapter 2

Distinction between Liquidated Damages And Penalties

Introductory Remarks

2.01 The historical analysis of the evolution of the penalty doctrine, and its theoretical justifications reveals that the agreement of the parties as to damages would constitute a penalty if it is unreasonably large in comparison with the damages which might be conceived to result from breach at the time when the contract is entered into.[1] Such a clause would not be enforced by the courts[2], and the innocent party would have to prove his damages according to the normal rules of contractual damages. If, on the other hand, the agreed damages did not amount to a penalty, it would be regarded as a valid stipulation, normally referred to as liquidated damages, which would be enforced regardless of the actual loss suffered by the innocent party.[3]

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[1] A clear example of a penalty has been given by Lord Halsbury LC in *Clydebank Engineering and Shipbuilding Co. v. Don Jose Ramos Yzquierdo y Castaneda* [1905] AC 6, where he points out: "If you agreed to build a house in a year, and agreed that if you did not build the house for £50, you were to pay a million of money as a penalty, the extravagance of that would be at once apparent." at p. 10. In order for the question of being a penalty to arise, the right conferred on the innocent party upon the other party's breach should not be the essence of the contract. In *Nutting v. Baldwin* [1995] 1 WLR 201, for example, there was a contract for the pooling of the parties' claims against certain agents, and the pooling of expenses- in the form of subscription fees- and also benefits from the proceedings. A committee on behalf of the parties, under one of the contractual terms, had been empowered to determine that a member who failed to contribute to the pool of expenses by paying his subscription fee, shall cease to share in the pool of benefits. The court did not consider such a right as a penalty, even though it arose upon breach of the contract by a member: In Rattee J's view, "[t]his [was] not a penalty for breach of contract. It [was] an essential part of the pooling arrangement thereby effected." at p. 208

[2] See, e.g., *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd.* [1915] AC 79; *Gilbert-Ash (Northern) Ltd v. Modern Engineering (Bristol) Ltd* [1973] 3 All ER 195, [1973] 3 WLR 421, [1974] AC 689; *Ariston SRL v. Charly Records Ltd.* (1990) Independent, 13 April; *Jobson v. Johnson* [1989] 1 All ER 621, per Dillon LJ at p. 628; In Nicholls LJ's view, though in practice a penalty clause is a "dead letter", strictly speaking it "remains in the contract and can be sued on, but it will not be enforced by the court beyond the sum which represents ... the actual loss of the party seeking payment." *Ibid.*, at p. 632-633; *cf. Citicorp Australia Ltd v. Hendry* (1985) 4 NSWLR 1

[3] See, e.g., *Kemble v. Farren* (1829) 6 Bingham 141, 130 ER 1234 per Tindal CJ at p. 148; *Howe v. Smith* (1884) 27 Ch.D. 89 ; *Clydebank Engineering and Shipbuilding Co. Ltd. v. Don Jose Ramos* [1905] AC 6; *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd.* [1915] AC 79, at p. 97 per Lord Parker; *BFI Group v. DCB Integration Systems* (1987) C.I.L.L. 348; *Philips Hong Kong Ltd. v. The Attorney General of Hong Kong* (1993) 61 B.L.R. 41 (P.C). The plaintiff, of course, would be able to claim for unliquidated damages for a breach which is not covered by the liquidated damage clause: see *Aktieselskabet Reidar v. Arcos, Ltd* [1927] 1 KB 352, in which the agreed rate of demurrage was not considered as covering the consequential loss of freight by the shipowner. Thus since the charterer had failed to provide the full cargo, the shipowner, in addition to the demurrage, succeeded to recover the

2.02 In order to distinguish liquidated damages from penalties, several practical rules have been developed during decades the chief of which is that an agreed damage clause, being recognized as a genuine pre-estimate of damages which might result from breach, should be considered as liquidated damages. These rules have neatly been brought together by Lord Dunedin in the leading case of *Dunlop Pneumatic Tyre Co. Ltd v. New Garage and Motor Co. Ltd*[4]. This chapter will seek to examine these rules analytically, after having regard to the essence of penalties and liquidated damages. Considering the essence of liquidated damages clause, two important issues will also be dealt with: First, in applying the tests to distinguish liquidated damages from penalties, whether a subjective or an objective test should be employed. Second, could the parties, in their pre-estimation of damages, provide for losses which are not normally recoverable at common law? Consideration will also be given to the effect of terminology used by the parties to describe the clause, the place of their intention, and also the relevant time for the application of the tests distinguishing liquidated damages from penalties.

1. The Essence of A Penalty and Liquidated Damages

2.03 "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 damages."[5]

This maxim of Lord Dunedin[6] states the nature of the two kinds of agreed damages and has been cited in many of the cases concerning the distinction between penalties and liquidated damages.[7] According to this phrase, an agreed sum which is stipulated to

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consequential loss of freight. see also *Richco International Ltd. v. Alfred C. Toepfer International G.M.B.H. (The Bonde)* [1991] 1 Lloyds Rep. 136, at p. 142 per Potter J.

[4] [1915] AC 79

[5] *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd.* [1915] AC 79, per Lord Dunedin at p. 86

[6] The phrase is a combination of Lord Robertson's speech in *Clydebank Engineering & Shipbuilding Co v. Don Jose Ramos Yzquierdo y Castaneda* [1905] AC 6, at p. 19, in describing the nature of liquidated damages and Lord Halsbury's phrase in *Lord Elphinstone v. Monkland Iron & Coal Co.* (1886) 11 App. Cas. 332, where he identified the nature of penalties.

[7] See, for example, *Bridge v. Campbell Discount Co., Ltd.* [1962] AC 600, [1962] 1 All ER 385; *Ariston SRL v. Charly Records Ltd.* (1990) Independent, 13 April; *Philips Hong Kong Ltd. v. The Attorney General of Hong Kong* (1993) 61 B.L.R. 41 (P.C) ; *J F Finnegan Ltd. v. Community Housing Association* (1993) 34 Con L.R. 104, at p. 115

pressurise the promisor into carrying out his obligation and punish him in the event of breach is a penalty. If, however, the sum showed the genuine attempt of the parties to assess any likely damages which might arise from breach, the amount would be regarded as liquidated damages.

1.1. The nature of penalty: the element of terror and fear

2.04 A serious doubt has been cast upon the description of the essence of penalties as being in the nature of a threat "enforced in terrorem" by Lord Radcliffe in *Bridge v. Campbell Discount Co. Ltd.*[8]:

> "...I do not myself think that it helps to identify a penalty to describe it as in the nature of a threat "enforced in terrorem"... I do not find that that description adds anything of substance to the idea conveyed by the word "penalty" itself, and it obscures the fact that penalties may quite readily be undertaken by parties who are not in the least terrorised by the prospect of having to pay them and yet are, as I understand it, entitled to claim the protection of the court when they are called on to make good their promises."[9]

It is true that the description of penalties as a threat acting *in terrorem* does not have much practical significance. It may, however, convey the real nature of penalties: The intervention of courts as to invalidating penalty clauses is a blatant interference with the principle of freedom of contract. It can, as it was seen[10], best be justified on the basis of fairness, and the obvious example of an unfair stipulation is where the stipulated sum is provided to pressurize the promisor to perform his obligation and punish him for breach.[11] The fact that there might be no terror and fear element in some cases- because the offending party knows that he can claim for the protection of court to use its power to strike down the penal sum- might, with all respect, be justified by emphasizing on the point that the specified essence should be regarded as the nature of the agreed sum without considering courts' power to strike them out. In other words, if the agreed sum, without considering courts' power, can reasonably cause a fear and terror in promisor that

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[8] [1962] 1 All ER 385, [1962] AC 600

[9] *Ibid.*, p.395 and p. 622 respectively

[10] *Supra.*, paras. 1.69-1.70

[11] It has been suggested that the power to strike down a penalty clause has been designed "for the sole purpose of providing relief against oppression for the party having to pay the stipulated sum. It has no place where there is no oppression". *Elsley v. J.G. Collins Insurance Agencies Ltd.* (1978) 83 DLR (3rd) 1, per Dickson J at p. 15

in the event of non-compliance with the contractual provision, he will be penalized by being obliged to pay the agreed amount, the sum will act in terrorem and may be regarded as penalty.

2.05 A review of cases, however, shows that sometimes courts treat an agreed damages clause as a penalty, even though there is no fear or threat for the promisor, produced by the clause. The most obvious example of this is an agreed damage clause providing for losses substantially less than the actual harm which has been held to be penal on the ground that it has been provided for to be payable on the occurrence of different breaches of varying importance.[12]

The Law Commission has also noticed this problem and proposed that such description of the essence of penalties, "gives little or no guidance in distinguishing between a penalty and liquidated damages" and that the ultimate purpose of description should be "to provide for reasonable compensation and nothing more."[13]

For these reasons probably, it has been suggested[14] that the phrase of Lord Dunedin, which states the nature of penalties, is to be treated as a definition and to identify any distinction between liquidated damages and penalties reference should be made to the detailed rules produced by a number of leading cases and brought together by Lord Dunedin in *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd.*[15].

1.2. The nature of liquidated damages

2.06 The nature of liquidated damages was described as a "genuine pre-estimate of likely loss". In this phrase, the words "genuine" and "damages" are worthy of a more detailed discussion.[16]

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[12] See *Wall v. Rederiaktiebolaget Luggude* [1915] 3 KB 66 ; *Watts, Watts and Co. Ltd. v. Mitsui and Co. Ltd.* [1917] AC 227. We will discuss this later in detail: see *infra.*, paras. 2.36 *et seq.*

[13] Law Commission's Working Paper, no. 61, "Penalty Clauses and Forfeiture of Monies Paid", 1975, para. 8

[14] McGregor on Damages, 15th ed., 1988, para. 450

[15] [1915] AC 79; See *infra.*, paras. 2.24 *et seq.*

[16] In most cases, in fact, this is the essential question in determining the nature of an agreed damage clause: In *Gilbert-Ash (Northern) Ltd v. Modern Engineering (Bristol) Ltd* [1973] 3 All ER 195, [1973] 3 WLR 421, [1974] AC 689, for example, a term providing for the entitlement of the contractor "to suspend or withhold payment of any monies due or becoming due to the sub-contractor" in case it made default in complying with any of the conditions of the sub-contract, was held to constitute a penalty. The

1.2.1. Genuine pre-estimate: subjective or objective view

2.07 Apparently, the word "genuine" has not been construed in any case. It has been suggested that probably in this context it means:

> "A serious attempt to estimate loss, one made in good faith, however unreasonable it might appear to others."[17]

This opinion suggests a *subjective* view in determining whether or not the attempt to estimate the likely actual loss flowing from breach has been genuine. Accordingly if the claimant can prove that the parties with good faith made every attempt to estimate the actual damage, the sum will be regarded as a genuine pre-estimate in liquidating damages.

2.08 It might be thought[18] that the famous phrase of Lopes L.J.'s speech in *Law v. Redditch Local Board*[19] supports this view:

> "The distinction between penalties and liquidated damages depends on the intention of the parties to be gathered from the whole of the contract. If the intention is to secure performance of the contract by the imposition of a fine or penalty, then the sum specified is a penalty; but if, on the other hand, the intention is to assess the damages for breach of the contract, it is liquidated damages."[20]

Although at first sight, the phrase seems to propose a subjective approach, with more attention one can see that what has been emphasised in this phrase is the intention of the parties, but it has no reference to the test by which the parties' intention should be discovered and interpreted. Since the accepted test in construction of the intention in English law is an objective test[21], so inevitably it should be accepted that the phrase refers

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reason, *inter alia*, was that it entitled the contractor to suspend or withhold payments due or becoming due, without any regard to its amount if the sub-contractor made any default, regardless of its magnitude, in complying with his contractual obligations. Thus, the agreed sum could not be regarded as a "genuine pre-estimate of damages".

[17] Chitty on Contracts, 27th ed., vol. 1, 1994, para. 26-061, at p. 1254

[18] Ogus, The Law of Damages, 1973, pp. 41-42

[19] [1892] 1 QB 127

[20] *Ibid.*, p. 132

[21] See *Deutsche Genossenchaftsbank v. Burnhope* [1996] 1 Lloyd's Rep. 113, at p. 122 per Lord Steyn; *First Energy (UK) Ltd v. Hungarian International Bank Ltd* [1993] 2 Lloyd's Rep. 194, at p. 201 per Steyn LJ; *Kingswood Estate co Ltd. v. Anderson* [1963] 2 QB 169, per Willmer L.J. at p. 181; *Thake v. Maurice* [1986] 1 QB 644, where Peter Pain J. at p. 657 stated: "... the test as to what the contract in fact was does not depend on what the plaintiffs or the defendant thought it meant, but on what the court objectively determines that the words used meant."; *Cambridge Nutrition Ltd. v. British Broadcasting Corp.* [1990] 3 All ER 523, per Ralph Gibson L.J. at p. 542. See also Furmston M P, Cheshire, Fifoot & Furmston's Law of Contract, 13th ed., 1996, p. 127; Treitel G.H., The Law of Contract, 9th ed., 1995,

to the reasonable intention of the parties which should be discovered from the whole of the contract.[22] Lord Dunedin's speech in *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd.*[23], which has no express reference to the intention of the parties, could be read in this way:

> "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"[24]

The genuine pre-estimate of likely loss, therefore, should be construed as a reasonable attempt of the parties to determine damages which are likely to flow from breach. Put another way, a figure which objectively, and considering the whole terms of the contract and inherent circumstances surrounding it, could be regarded as representing the likely losses which might result from a breach is a genuine pre-estimate of damages. This seems to represent the law and so the courts are unlikely to uphold an agreed sum which is disproportionately large in comparison with the objectively computed likely actual loss, even if it is discovered from the facts of the case that the parties honestly intended it as compensation.[25]

2.09 It might be argued in favour of the subjective view that the essence of a penalty is to act in terrorem and where the parties both honestly and with all attempts which are reasonable to them, even though it may not be reasonable to others, intended that a specific sum of money would be the likely loss which might flow from breach, such a sum

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pp. 1, 8; Anne de Moor, Intention in the Law of Contract (1990) 106 LQR 632; Howarth, The meaning of objectivity in contract (1984) 100 LQR 265, especially at p. 280

[22] Furmston M P, Cheshire, Fifoot & Furmston's Law of Contract, 13th ed., p. 635; Surprisingly some writers thought of the phrase of this book as stating a subjective view. (Ogus, loc. cit., note 18, *ibid.*)

[23] [1915] AC 79

[24] *Ibid.*, pp. 86-87

[25] See also Hosie J., The Assessment of Damages for Delay in Construction Contracts: Liquidated and Unliquidated Damages (1994) 10 Construction Law Journal 214, at p. 221; The objective test has apparently been accepted by the Australian courts as well. In *WT Malouf Pty Ltd. v. Brinds Ltd.* (1981) 52 FLR 442, Samuels JA, with whom Hope JA was in agreement, stated: "... a genuine pre-estimate means a pre-estimate which is objectively of that character; that is to say, a figure which may properly be so called in the light of contract and the 'inherent circumstances'... . It will not be enough that the parties honestly believed it to be so." at p. 462, cited also, with apparent approval, in *Multiplex Constructions Pty Ltd. v. Abgarus Pty Ltd.* [1992] 1 APCLR 1, p. 8; see also *O'Dea v. Allstates Leasing System (WA) Pty Ltd* (1983) 57 ALJR 172, at p. 189 per Deane J.; The position in Australia will shortly be discussed : see *infra.*, paras. 2.51 *et seq.*

would not seem to be regarded as intimidating the promisor into carrying out his contractual obligation. Thus it seems hardly justifiable for such a stipulation to be struck out as being a penalty. The judgment of Lord Halsbury in *Clydebank Engineering and Shipbuilding Co. Ltd. v. Don Jose Ramos Yzquierdo Y Castaneda*[26] might seem to support this view:

> "It seems to me, when one looks to see what was the nature of the transaction in this case, it is hopeless to contend that the parties only intended this as something in terrorem. Both parties recognized the fact of the importance of time: it is a case in which time is of the essence of the contract and so regarded by both parties, and the particular sum fixed upon as being the agreed amount of damages was suggested by the defendants themselves, and to say that that can be unconscionable or something which the parties ought not to insist upon, that it was a mere holding out something in terrorem, after looking at the correspondence between the parties is, to my mind not a very plausible suggestion. ... and I think there is no ground for the contention that this is not pactional damage agreed to between the parties- and for very excellent reason agreed to between the parties- at the time the contract was entered into."

This view, however, cannot be maintained: First, the mere reference to the negotiation and correspondence between the parties does not necessarily show the court's attempt to discover the subjective intention of the parties. In fact, in order to find out the reasonable intention of the parties, the whole terms of the contract and inherent circumstances surrounding it should carefully be taken into account.[27] Secondly and most importantly, a clause may, as it was just discussed, be regarded as a penalty while it has no effect in pressurizing the promisor into carrying out his obligation. Therefore, the mere reason that a subjectively genuine pre-estimate of damages may not act in terrorem of the defaulting party does not necessarily indicate that it could not be regarded as penal in nature.[28]

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[26] [1905] AC 6, at p. 13

[27] See the Australian case of *Multiplex Constructions Ltd. v. Abgarus Ltd.* [1992] 1 APCLR 1; see *supra.*, para. 2.08

[28] It may also be argued that in most contracts, where the parties may provide for an agreed damage clause, the parties' knowledge about the assessment of damages which may result from likely future breaches is, to a large extent, limited (at least where they do not use services of legal advisors). Granted that one of the purposes of the equitable intervention was to keep the parties, as far as possible, to the compensatory principle, it would be against this objective to leave the pre-assessment of the damages to the subjective views of the parties.

1.2.2. Damages which are not recoverable at common law

2.10 The other feature which is worthy of a brief discussion here is how the word "damages" should be interpreted in the context of the distinction between penalties and liquidated damages. In other words, when the essence of liquidated damages is referred to as a genuine pre-estimate of damages, what is meant by the word "damages"? Is it the *actual loss* which is expected to flow from breach or should it be confined to *losses which are recoverable at common law* under the so-called *Hadley v. Baxendale*[29] rule?

The discussion has an obvious practical significance: Suppose that the parties, in pre-estimating damages have not taken into account the issues like the remoteness of damages or the promisee's duty to mitigate the loss. They have, thus, provided for losses which cannot reasonably be regarded as being within the reasonable contemplation of the parties, or can reasonably be mitigated by the possible reasonable steps taken by the promisee. Such a pre-estimation- which covers the sort of losses which are not recoverable under the ordinary rules of damages- may, according to the latter view expressed above, be regarded as a penalty, while it is a valid liquidated damages if the duty of the parties in agreeing upon damages is construed as an attempt to pre-estimate the actual loss.

2.11 The law in this area does not seem to be clear. The *obiter dicta* in *Robophone Facilities Ltd. v. Blank*[30] supports the view that the agreed damages clause may contain compensation for a loss which does not fall within the rule in *Hadley v. Baxendale*[31] since it has not been within the reasonable contemplation of the parties. In this case Diplock L.J. stated:

> "If the contract contained an express undertaking by the defendant to be responsible for all actual loss to the plaintiff occasioned by the defendant's breach, whatever that loss might turn out to be, it would not affect the defendant's liability for the loss actually sustained by the plaintiff that the defendant did not know of the special circumstances which were likely to cause any enhancement of the plaintiff's loss. So, if at the time of the contract the plaintiff informs the defendant that his loss in the event of a particular breach is likely to be £X by describing this sum as liquidated

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[29] (1854) 9 Exch. 341, 156 ER 145

[30] [1966] 3 All ER 128, [1966] 1 WLR 1428

[31] (1854) 9 Exch. 341, 156 ER 145

> damages in the terms of his offer to contract, and the defendant expressly undertakes to pay £X to the plaintiff in the event of such breach, the clause which contains the stipulation is not a "penalty clause" unless £X is not a genuine and reasonable estimate by the plaintiff of *the loss which he will in fact be likely to sustain*. Such a clause is, in my view, enforceable, whether or not the defendant knows what are the special circumstances which make the loss likely to be in the ordinary course of things."[32]

Some commentators suggest, on the basis of this dicta, that damages must mean any actual loss which is likely to flow from breach, even though it is not recoverable in an action for unliquidated damages.[33] It has also been suggested[34] that the dicta should be read in and confined to its context and therefore, so far as the question of remoteness of damages is concerned, the agreed sum might be in excess of what is recoverable under the rule in *Hadley v. Baxendale* by pre-estimating the losses which neither are the natural consequences of the breach, nor have been within the reasonable contemplation of the parties (*i.e.* too remote losses).[35] However, damages which could have been avoided by taking reasonable steps, as the duty of mitigation, could not be recovered as agreed damages, because "to permit these to be taken into account in assessing whether agreed damages are a genuine pre-estimate would either encourage wasteful failure to mitigate, or would overcompensate the wily party who both claimed the liquidated damages and mitigated."[36]

2.12 Attention should also be paid to *Lombard North Central Plc. v. Butterworth*[37] which might be thought to suggest a restrictive view: In an agreement to lease a computer, it was provided that the punctual payment of each instalment of rent was of the essence of the lease, and that in the event of default in due payment, the plaintiffs, *i.e.*, the finance house, would have the right to terminate the contract, retake possession of the

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[32] *Robophone Facilities Ltd. v. Blank* [1966] 3 All ER 128, at p. 143; [1966] 1 WLR 1428, at pp. 1447-8. [emphasis added]

[33] McKendrick E, Contract Law, (2nd ed., 1994), p. 327; Waddams, The Law of Damages, 1983, para. 943; Lewison K., The Interpretation of Contracts, para. 15.07 at p. 357; and for the opposite view see: Smith J.C., The Law of Contract, 2nd ed., 1993, p. 219

[34] Beale H, Remedies for Breach of Contract, p. 57; Burrows A, Remedies for Torts and Breach of Contract, (2nd ed., 1994), p. 327

[35] See also Chitty on Contracts, 27th ed., vol. 1, 1994, para. 26-061

[36] Beale H, Remedies for Breach of Contract, p. 57

[37] [1987] QB 527; [1987] 1 All ER 267

subject matter, and claim for all arrears of the rent, all future rentals, damages for breach of the lease and all expenses incurred in retaking possession of goods. Because of the defendant's default, the plaintiffs terminated the contract and claimed the agreed damages. The Court of Appeal considered the case from the point of view that the actual loss of the plaintiff, in the event of breach, was the loss of his bargain because the stipulation which made due payment of the essence promoted a simple term into a condition, any breach of which entitled the plaintiff to terminate.[38] Mustill L.J., in his discussion of different losses which flow from the breaches of a condition and of a simple term, referred to the measures of recovery at common law, and stated:

> " When deciding upon the penal nature of a clause which prescribes a measure of recovery for damages resulting from a termination founded upon a breach of condition, the comparison should be with the common law measures: namely, with the loss to the promisee resulting from the loss of his bargain."[39]

This phrase might seem to represent a narrower view in deciding whether the parties can validly agree upon damages which are not recoverable at common law.[40]

2.13 It should however be observed that in *Lombard v. Butterworth*[41], the controversial point was not the question whether an agreed damages clause might provide for a loss which is not normally recoverable as unliquidated damages, but it was the power of the parties to promote a simple term into a condition so that breach of that term could be regarded as repudiation. In fact, any reference to the common law measures of recovery, in deciding about the penal nature of the agreed damages clause, is, it seems, to show the amount of damages in repudiatory breach and in breach of simple terms, not to demonstrate that the agreement of the parties upon losses which do not normally fall within the rule in *Hadley v. Baxendale*[42] is not valid. It would thus appear that this case hardly lends support to the narrow view expressed above.

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[38] Unlike the case in which failure to punctual payment was the breach of a simple term (i.e. not repudiatory) and the likely loss following this breach was losses up to the date of termination which was due to the exercise of lessor's own option under the contract. This case will be considered in more detail later: see *infra.*, paras. 5.059 *et seq.*

[39] [1987] QB 527, at p. 537

[40] Beale, Bishop & Furmston's Contract, Cases and Materials, (3rd ed., 1995, Butterworths), pp. 601-602

[41] [1987] 1 QB 527, [1987] 1 All ER 267

[42] (1854) 9 Exch. 341, 156 ER 145

2.14 It would appear that, if unfairness is to be accepted as the basis for the intervention of courts to relieve against penalties[43], it would scarcely seem likely that the agreement of parties in pre-estimating the anticipated actual loss, and not only the legally recoverable loss, could be regarded as unfair. Such an agreement could not, it seems, be indicative of a procedural defect in the bargaining process; on the contrary, it shows that the parties have given careful thought to the clause, and, with serious intention, pre-estimated the amount of likely actual loss. Neither could it substantively be regarded as unfair, because what parties have agreed upon, though it covers some losses which are not legally recoverable, is, in any event, an element of damages which are conceived to result from breach. Furthermore, it is hard to assume that such an agreement has the nature of penalties acting *in terrorem* of the defaulting party; for it does not result in intimidation of the promisor into carrying out his promise, and punishing him in case of breach. It is therefore suggested that the comparison between the agreed amount and the actual loss, not legally recoverable loss, should be the basis for determining the nature of the parties' agreement as to damages.[44]

2.15 It has been suggested that the enforcement of such a clause may, in some cases, result in overcompensation.[45] It would however seem that if overcompensation is assumed to occur in relation to the recovery of any loss which does not fall within the common law measures of recovery,[46] any agreement of the parties as to losses which are not legally recoverable will result in overcompensation, irrespective of the fact whether

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[43] See *supra.*, paras. 1.69-1.70

[44] See *Citicorp Australia Ltd v. Hendry* (1985) 4 NSWLR 1, where, though the legally recoverable loss was recognised as the basis of a comparison between the agreed sum and the anticipated actual harm, the language employed by Mahoney JA demonstrated the unsatisfactory nature of this principle: "There is no doubt that the law regards some provisions relating to the recovery of damages as unenforceable for reasons which are comprehended by the term penalty. But the rationale of these rules, and the rules by which the unacceptable provisions are to be separated from the acceptable, are hardly satisfactory. Provisions such as the present [providing for the actual loss, though not legally recoverable, as claimed by the plaintiff], in reality, not intended to be "in terrorem" but to provide for the recovery of money in the case of a breach. ... However, I do not think this Court should adopt the principles advanced by the plaintiff. ..." at pp. 29-30; In the United States, at least as to the successful party's attorney's fees which are not ordinarily recoverable as damages, the agreed damage clause covering such a loss has, in the majority of jurisdictions, been upheld. see Calamari, John D. & Perillo, Joseph M., The Law of Contracts (2nd ed., 1977, West Publishing Co.), p. 569

[45] Beale H, Remedies for Breach of Contract, p. 57

the agreed damages clause covers too remote losses or the losses which could be avoided by taking reasonable steps as mitigation. Despite this fact, however, the dicta in *Robophone Facilities Ltd. v. Blank*[47] confirmed the agreement of the parties as to losses which could not be recovered in an action for unliquidated damages since they were too remote to be considered within the rule in *Hadley v. Baxendale*[48]; in other words, the decision of the Court of Appeal allowed the parties to a contract to agree upon the recovery of losses which the innocent party is likely to sustain in consequence of the breach, notwithstanding the fact that such a recovery might be regarded as overcompensation.

It is hence fitting to conclude that the reasonable pre-estimate of the parties of likely *actual loss* flowing from breach, should be enforced, even if it does not fall within the common law measures of recovery.

2. Terminology Used by the Parties

2.1. Wording of the clause is not conclusive

2.16 A less controversial point is that the wording used by the parties to describe the nature of agreed damages clause is not conclusive. The Court must find the reasonable intention of the parties at the time the contract was made by the construction of the whole contract and all circumstances in which the contract has been entered into. In doing so, therefore, the words "penalty" or "liquidated damages" used by the parties do not necessarily indicate the nature of the clause.[49] As Lord Dunedin expressed in *Dunlop*

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[46] Probably because the rules of common law provide for such measures that fully compensate the injured party

[47] [1966] 3 All ER 128, at p. 143 ; [1966] 1 WLR 1428, at pp. 1447-1448

[48] (1854) 9 Exch. 341, 156 ER 145

[49] It was, it appears, in the early nineteenth century that the court refused, for the first time, to give effect to the wording used by the parties: see *Kemble v. Farren* (1829) 6 Bingham 141, 130 ER 1234. Before this decision the terminology employed by the parties had a great importance: see, e.g., cases cited in note 82, chapter 1. *cf.* deposit rule; in deciding whether the sum of money paid before breach is a "deposit" or a "part payment", the words used by the parties to call the advance payment is of great importance and can normally determine the nature of payment. See *Howe v. Smith* (1884) 27 Ch.D. 89, per Bowen LJ at p. 97 ; *Harrison v. Holland* [1927] 1 KB 211 ; see also Cheshire, Fifoot & Furmston's Law of Contract, 13th ed., 1996, p. 640; Chitty on Contracts, 27th ed., vol. 1, 1994, para. 29-041; see also *infra.*, para. 6.40

Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd.:[50]

> "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."[51]

The reason for this rule seems to be that the intervention of courts to relieve against penalties is operated against what the parties agreed upon, namely the express intention of the parties; therefore, the form of the words used by them could not conclude the matter.[52]

2.17 According to this rule, although the parties commonly described the clause as "liquidated and ascertained damages", courts, after the construction of the contract and finding the reasonable intention of the parties, held the sum to be a penalty.[53] Conversely, in some cases[54] the agreement of the parties, describing the agreed sum as "penalty", has

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[50] [1915] AC 79

[51] *Ibid.*, at p. 86 ; see also *Clydebank Engineering and shipbuilding Co. Ltd. v. Don Jose Ramos Yzquierdo* [1905] AC 6, where Lord Halsbury at p. 9 pointed out: "It cannot, I think, be denied ... that not much reliance can be placed upon the mere use of certain words. Both in England and Scotland it has been pointed out that the court must proceed according to what is the real nature of the transaction, and that the mere use of the word "penalty" on the one side, or "damages" on the other, would not be conclusive as to the rights of the parties." ; *Wallis v. Smith* (1882) 21 Ch.D. 243 at pp. 249-250 per Fry J: "... it is quite plain that the words "liquidated damages" describing the nature of the payment are by no means conclusive."; *Cellulose Acetate Silk Co Ltd v. Widnes Foundry (1925), Ltd.* [1933] AC 20, at p. 25 per Lord Atkin; *Pagnan & F.lli v. Coprosol SA* [1981] 1 Lloyd's R 283, where Ackner LJ, giving the judgment of the Court, said: "To describe such a claim as a "penalty" could well be because it was so described in the contract. But, if there were such a clause, it could be a wholly legitimate clause providing for the payment of liquidated damages in the event of late shipment. We do not know the true position. The mere use of the word "penalty" is not in itself decisive." at p. 287; *Ariston SRL v. Charly Records Ltd.* (1990) Independent, 13 April, where little reliance was placed on the description of the clause as a "penalty".

[52] Waddams, The Law of Damages, 1983, para. 922; As stated by Deane J. in *O'Dea v. Allstates Leasing System (WA) Pty Ltd* (1983) 57 ALJR 172, "[w]hether or not a provision of a contract imposes a penalty must be determined by reference to the true operation of that provision." at p. 189

[53] *Kemble v. Farren* (1829) 6 Bingham 141, 130 ER 1234; *Magee v. Lavell* (1874) L.R. 9 C.P. 107; *Re Newman* (1876) 4 Ch.D. 724; *Bradley v. Walsh* (1903) 88 LT 737; *Public Works Commissioner v. Hills* [1906] AC 368; *Lock v. Bell* [1931] 1 Ch. 35; The minimum payment clause in hire-purchase cases, which provides for agreed damages "by way of agreed compensation for depreciation" has mostly been held to be a penalty: see, e.g., *Cooden Engineering Co. Ltd. v. Stanford* [1953] 1 QB 86; *Lamdon v. Hurrell* [1955] 1 All ER 839; *Bridge v. Campbell Discount Co. Ltd.* [1962] AC 600

[54] *Ranger v. G.W. Railway* (1854) 5 H.L.C. 72; *Crux v. Aldred* (1866) 14 W.R. 656; *Re White* (1901) 17 TLR 461; *Clydebank Engineering and Shipbuilding Co. Ltd. v. Don Jose Ramos* [1905] AC 6 ; *Diestal v. Stevenson* [1906] 2 KB 345; *Cellulose Acetate Silk Co. Ltd. v. Widnes Foundry (1925), Ltd.* [1933] AC

been ignored and the sum has been treated as liquidated damages and held to be recoverable. In *Alder v. Moore*[55], clause 8 of the contract imposed on the defendant an obligation to sign a declaration not to play professional football in the future in lieu of the sum of money which he was about to receive from the plaintiff; and also to repay the received sum as a *penalty* if he infringed his declaration. In the plaintiff's action for the recovery of the stipulated penalty, Sellers L.J. held that the sum claimed was an agreed and fair pre-estimate of the loss which the plaintiffs had suffered and not a penalty.

2.2. Presumption raised by the terms used

2.18 It has been suggested[56] that the wording used by the parties not only is not conclusive but is also of no use in deciding whether the agreed amount is a genuine pre-estimate of damages, and therefore the less cautious phrases, such as "the names, the parties give the money, penalty or liquidated damages, are immaterial"[57] or "[t]he question does not depend in such cases on the words used"[58], have been preferred. It can, however, be inferred from some judgments that the terminology used by the parties raises a presumption in favour of the term which has been expressed. The well-known phrase of Lord Dunedin, referred to above[59], shows such an inference.

2.19 Although the discussion, as it has been stated[60], might have little practical effect and there is apparently a rare case in which the terminology used by the parties has turned the scales, it would seem that the terminology chosen by the parties, *prima facie*, shows their real intention and at least in procedure, so far as "the burden of proof" is concerned, it might give rise to an inference in favour of the word used. This inference, however, could be rebutted by the party who claims against it. In *Willson v. Love*[61], the parties had

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20; *Alder v. Moore* [1961] 2 QB 57; *Robert Stewart & Sons, Ltd. v. Carapanayoti & Co., Ltd.* [1962] 1 All ER 418, [1962] 1 WLR 34

[55] [1961] 2 QB 57; See also Megarry, R. E. (1961) 77 LQR 300; Goff (1961) 24 MLR 640

[56] McGregor on Damages, 15th ed., 1988, para. 451

[57] *Sparrow v. Paris* (1862) 7 H.& N. 594, 158 ER 608, per Bramwell B. at pp. 599, 610 respectively

[58] *Magee v. Lavell* (1874) L.R. 9 C.P. 107, per Coleridge C.J. at pp. 114-115

[59] *supra.*, para. 2.16

[60] McGregor, *Ibid.*; Ogus, The Law of Damages, 1973, p. 43

[61] [1896] 1 QB 628

themselves called the agreed sum a penalty. In his judgment Lord Esher M.R. stated:

> "A succession of judges have held that the use of the term "penalty" or "liquidated damages" is not conclusive; but no case, I think, decides that the term used by the parties themselves is to be altogether disregarded, and I should say that, where the parties themselves call the sum made payable a "penalty", the onus lies on those who seek to show that it is to be payable as liquidated damages."[62]

This view has been confirmed in a recent decision of the Privy Council in *Philips Hong Kong Ltd. v. The Attorney General of Hong Kong*[63] where Lord Woolf, delivering the judgment of the Board observed:

> " In seeking to establish that the sum described in the Philips contract as liquidated damages was in fact a penalty, Philips has to surmount the strong inference to the contrary resulting from its agreement to make the payments as liquidated damages..."[64]

It may, therefore, well be concluded that the terminology used is not totally irrelevant: it gives rise to a presumption in favour of the expressed term, but it may be shown by the plaintiff that, owing to special circumstances, the first inference has not been true.

3. Time for the Application of the Test to Distinguish Liquidated Damages from Penalties

3.1. Time of making the contract not breach

2.20 In deciding whether a stipulated sum is liquidated damages or a penalty, as it was stated, the whole contract and its surrounding circumstances should thoroughly be examined to find out whether the agreed sum reasonably represents the intention of the parties to pre-estimate the likely damages flowing from breach. Since the parties' attempt to assess the probable loss occurs at the time when the contract is made, this time, therefore, is the most proper time for such an examination. This has been stated by Lord Dunedin as the third rule in *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor*

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[62] *Ibid.*, p. 629-630; see also *Alder v. Moore* [1961] 2 QB 57 at 75 per Devlin L.J.; *Diestal v. Stevenson* [1906] 2 KB 345, at p. 350

[63] (1993) 61 B.L.R. 41

[64] *Ibid.*, at p. 59; see also *Robophone Facilities Ltd. v. Blank* [1966] 1 WLR 1428, [1966] 3 All ER 128, where as to a clause described by the parties as "liquidated or agreed damages", Diplock LJ said: "The onus of showing that such a stipulation is a "penalty clause" lies on the party who is sued on it." at pp. 1447, 142 respectively

Co. Ltd.[65]:

> "The question whether a sum stipulated is penalty or liquidated damages is a question of construction to be decided upon the terms and the 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."[66]

This rule in English law[67] has never, apparently, been doubted and its application can be seen in numerous cases.[68]

3.2. Subsequent events

2.21 The important point is whether, by regarding the time of making the contract as the time for its construction in order to distinguish liquidated damages from penalties, the subsequent events should be ignored. The rule stated above, *prima facie*, suggests that any factual event after entering into the contract should be disregarded. Some cases also

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[65] [1915] AC 79; see also *Public Works Commissioner v. Hills* [1906] AC 368, at p. 376; *Webster v. Bosanquet* [1912] AC 394, at p. 398

[66] *Ibid.*, at p. 86-87

[67] The position is apparently the same in Australia: see, e.g., *Lax v. Glenmore Pty Ltd* (1969) 90 W.N. (Pt 1) (NSW) 703, at 705-706 per Herron CJ. In the United States, the traditional approach is the same: see, e.g., *United States v. Bethlehem Steel Co.* (1907) 205 U.S. 105, at pp. 119-121, where a contractual provision stipulating damages for the late delivery of guns, which was a reasonable pre-estimate of actual losses at the time when the contract had been made, was held to be liquidated damages, even though the end of the war before the contractual date for delivery had in fact eliminated the possibility of actual losses. see also *Southwest Engineering Co. v. United States* (8th Cir. 1965) 341 F. 2nd 998, at p. 1003; however the present position appears to be controversial: some authorities may suggest a comparison between the agreed sum and the actual loss resulted from breach: see sec. 2-718(1) UCC which provides: " Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or *actual harm* caused by the breach, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void as a penalty." (emphasis added) see the interpretation of this section in *Equitable Lumber Corp. v. IPA Land Development Corp.* (1976) 38 N.Y 2nd 516, where it was stated: "section 2-718 does, in some measure, signal a departure from prior law which considered only the anticipated harm at the time of contracting since that section expressly contemplates that a court may examine the "actual harm" sustained in adjudicating the validity of a liquidated damages provision. Thus, decisions which have restricted their analysis of the validity of liquidated damages clauses solely to the anticipated harm at the time of contracting have, to this extent, been abrogated by the Uniform Commercial Code in cases involving transactions in goods."; see also Restatement (Second) of Contracts, sec. 356, comment b which provides: "The amount fixed is reasonable to the extent that it approximates the actual loss that has resulted from the particular breach, even though it may not approximate the loss that might have been anticipated under other possible breaches. ..."; The cases also have taken different approaches: see, e.g., *Colonial at Lynnfield, Inc. v. Sloan* (1st Cir. 1989) 870 F. 2nd 761, at p. 765, where an agreed damages clause, which was a reasonable pre-estimate of damages at the time of contracting, was held to be a penalty on the ground that no actual loss had been sustained. see, on the other hand, *California & Hawaiian Sugar Co. v. Sun Ship, Inc.* (9th Cir. 1986) 794 F. 2nd 1433, at pp. 1435-1437, where the agreed damages were allowed to stand, even though the plaintiff had suffered minimal actual loss.

[68] See, e.g., *Philips Hong Kong Ltd. v. The Attorney General of Hong Kong* (1993) 61 B.L.R. 41

support this view: In *Clydebank Engineering and Shipbuilding Co. Ltd. v. Don Jose Ramos Yzquierdo Y Castaneda*[69], the defendants agreed to build four torpedo-boats for the plaintiffs to be used in the war between Spain and the United States. The parties stipulated for a payment of £500 for every week of delay in delivery of each boat. In fact, the defendants were late in delivering the boats. In an action for the recovery of the agreed sum the court held that the subsequent fact, which shows that in the event of the punctual delivery all the boats would have been sunk together with the Spanish fleet, was irrelevant and the plaintiffs were entitled to recover the agreed sum as liquidated damages.

2.22 It has, however, been suggested that subsequent events might often be used to determine the scope of the parties' agreement and therefore if due to the occurrence of any unforeseen event, the specific breach turned out to be harmless, it might well be argued that the stipulated sum was not payable in those circumstances.[70] This view, with respect, seems to be subject to an objection: Granted that the essence of liquidated damages is a genuine pre-estimate of likely loss and that the parties at the time of entering into the contract have reasonably made every attempt to assess the losses which are probable to flow from the breach, it would be difficult to argue that the reasonable assessment of the parties of the likely loss would be invalidated as being a penalty, even if in fact the amount of actual loss, because of any subsequent event turns to be less than the agreed sum.[71]

2.23 It would, however, seem that subsequent events cannot be regarded as totally irrelevant. These events might be used to see what could reasonably be expected to be the likely loss when the contract was made. This was expressed by the Privy Council in

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[69] [1905] AC 6; see also the American case of *United States v. Bethlehem Steel Co.* (1907) 205 U.S. 105: *supra.*, note 67

[70] Waddams, The Law of Damages, 1983, para. 936

[71] Also, where the agreed damages is a reasonable pre-estimate of actual loss, it is the only recoverable sum, even if the plaintiff's actual loss, because of any subsequent circumstances, turns out to be much greater than the agreed damages: see *Cellulose Acetate Silk Co., Ltd. v. Widnes Foundry (1925), Ltd.* [1933] AC 20; Law Commission's Working Paper, no. 61, "Penalty Clauses and Forfeiture of Monies Paid", 1975, p.30; see *infra.*, para. 3.12

Philips Hong Kong Ltd. v. The Attorney General of Hong Kong[72] where Lord Woolf stated:

> "The fact that the issue has to be determined objectively, judged at the date the contract was made, does not mean what actually happens subsequently is irrelevant. On the contrary it can provide valuable evidence as to what could reasonably be expected to be the loss at the time the contract was made."

A line, therefore, it seems, should be drawn between events which could be expected to be within the reasonable contemplation of parties when the contract is made, and those that are not of this character: The latter is presumably of no effect; the former, however, should be taken into account by the parties when they are pre-estimating the future probable loss.

4. Rules for Distinguishing Liquidated Damages from Penalties

2.24 Although the nature of penalties and liquidated damages, as stated in the judgment of Lord Dunedin[73] can offer guidance to distinguish liquidated damages from penalties, courts, during many decades, have developed more practical rules which stem from the very nature described above. These rules have appeared in some leading cases, and then have well been brought together in the well-known judgment of Lord Dunedin in *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd.*[74] which even now is the most important leading case in this context: In this case, the respondents bought some tyre-covers, tyres and tubes from the appellants who were the manufacturer of these goods. The contract provided, *inter alia*, that the buyers should neither tamper with the appellant's markings on the tyres, nor sell them or offer them for sale below the listed price, nor sell them to people whom the manufacturer had decided not to supply, and not to exhibit or export them without the appellant's consent. The amount of £5 was also stipulated to be paid by the respondents for any tyre to be sold in breach of this term. The buyers defaulted and were sued by the appellants for losses under the agreed damages clause. The House of Lords held the agreed sum to be a genuine pre-estimate of likely damages and not a penalty. The rules, which will be considered below, were

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[72] (1993) 61 B.L.R. 41, at p. 59

[73] *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd.* [1915] AC 79, see *supra.*, para. 2.03

[74] *Ibid.*, pp. 87-88

stated by Lord Dunedin in the course of his judgment.

4.1. Unconscionable or Extravagant Sum

4.1.1. General principle

2.25 The first rule was introduced by Lord Dunedin as follows:

> "It will be held to be a penalty if the sum stipulated for is extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach."[75]

This rule, which is perhaps the most important means to find out whether the agreed damages clause is a pre-estimate of probable loss to be sustained from breach, was first introduced in *Wallis v. Smith*[76]. In this case the possibility of the application of the penalty doctrine as to sums agreed to be paid upon breaches of contract was considered. Then the House of Lords in its two important decisions in *Clydebank Engineering and Shipbuilding Co. v. Don Jose Ramos*[77] and *Dunlop Pneumatic Tyre Co. v. New Garage and Motor Co.*[78] confirmed the idea that the agreed sum being "extravagant", "exorbitant" and "unconscionable" in comparison with the greatest loss which might conceivably be expected to flow from breach would be regarded as a penalty.

2.26 As it appears, these concepts represent a *clear disproportion* between the agreed sum and the likely actual loss, and therefore the agreed amount merely being *in excess* of the anticipated actual loss should not be regarded as penal. Despite this point, in some cases, perhaps in the interest of greater certainty, the agreed sum has been held to be penal merely because it was *in excess* of the likely actual loss which might have been expected to flow from breach at the time when the contract was entered into. In *Cooden Engineering Co. Ltd. v. Stanford*[79], although the operation of the agreed damages clause in one case would have resulted in the recovery of less amount than the actual loss, the

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[75] *Ibid.*, at p. 87; see also *Clydebank Engineering and Shipbuilding Co. Ltd. v. Don Jose Ramos* [1905] AC 6, at p. 10 per Lord Halsbury

[76] (1882) 21 Ch.D. 243

[77] [1905] AC 6

[78] [1915] AC 79

clause was held to be a penalty because, *inter alia*, in most circumstances it amounted to a sum *in excess* of the actual damage. In the course of his judgement, Somervell L.J. stated:

> "Although it cannot be said that the [agreed] amount exceeds the greatest loss that could possibly follow on the breach,... it will exceed it in all, except the exceptional case where the car has become of no value."[80]

On the other hand, in some cases, the mere possibility of the agreed sum being in excess of the likely loss at the time of contracting, has not prevented the court from holding that the sum is a valid liquidated damages clause. In *Robophone Facilities Ltd. v. Blank*[81], Diplock L.J., emphasising on the necessity and advantages of giving the parties to a contract greater latitude to agree upon future damages in advance, recognized that the agreed figure which was reasonably close to the likely actual loss, as far as the prediction was possible, was a valid estimation of loss.[82] In this case, in a contract to hire a telephone answering machine, it was provided that in case of termination of the contract for any reason, the hirer would be liable to pay, in addition to the rentals which had already accrued due, a sum equal to fifty per cent. of the rents for the unexpired period of the contract. Diplock LJ observed that the actual loss resulting from breach in different breach scenarios would fluctuate within the range of forty-seven to fifty-eight per cent., the percentage decreasing progressively as the contract was brought to an end at earlier stages of its life. Thus, although the clause would result in the recovery of a sum in excess of the actual loss in some scenarios, the learned Lord Justice upheld the clause as being liquidated damages. He based his decision, *inter alia*, on the ground that "it would seem to be sound business sense, for parties entering into such a contract and envisaging the possibility of its determination on the hirer's breach, to take steps to avoid the uncertainty, the difficulty and the expense of proving in a court of law the actual loss sustained in that event by agreeing in advance on an easily ascertainable sum to be paid by the hirer which represents a reasonable estimate of the probable loss which the other

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[79] [1953] 1 QB 87, per Somervell LJ at p. 98; On the general tendency to move away from penal damages, and to insist on compensating the innocent party *only* for his actual loss, see Atiyah P. S., The Rise and Fall of Freedom of Contract, p. 677

[80] *Ibid.*, at p. 98

[81] [1966] 3 All ER 128

[82] *Ibid.*, at pp. 143-144 ; see also the judgement of Harman L.J. at p. 137

party would sustain."[83]

2.27 The intervention of courts to invalidate penalties, as it was seen[84], is best justified on the basis of fairness. However, since it is a clear interference with the principle of freedom of contract, it should, it seems, be limited to cases where the unfair consequences resulting from the parties' agreement is evident. The mere fact that the agreed sum is in excess of the actual loss would not necessarily indicate that there might have been some procedural defects in the bargaining process. Nor could it be taken as the evidence of substantive unfairness: the parties are normally the best judges of their own interest. They may have different reasons- such as the difficulty and expense of an accurate pre-estimation, idiosyncratic values which the promisee put on the performance which leads him to pay a sum in excess of the normal price for the performance, and in order to secure that performance, stipulates for a sum apparently in excess of the probable likely loss to be paid upon breach- to provide for agreed damages in excess of the probable actual loss. The courts therefore should not normally take a very searching look at such provisions[85], and invalidate them on the mere ground that they exceed the probable actual loss. The unfairness, justifying the court's intervention, may exist where, as stated in the leading authorities[86], the stipulated sum is "extravagant", "exorbitant" or "unconscionable" in comparison with the anticipated actual loss. In other words, the courts should, it may be suggested, interfere and grant relief against penalties *only* where there is a clear and "gross disproportion"[87] between the stipulated amount and the likely

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[83] *Ibid.*, at p. 141

[84] See *supra.*, paras. 1.69-1.70

[85] As pointed out by Diplock LJ: "The courts should not be astute to descry a "penalty clause" in every provision of a contract which stipulates a sum to be payable by one party to the other in the event of a breach by the former." see *Robophone Facilities Ltd. v. Blank* [1966] 3 All ER 128, at p. 142; see also *J F Finnegan Ltd. v. Community Housing Association Ltd* (1993) 34 Con.L.R. 104, at pp. 116,119 ; *The Angelic Star* [1988] 1 Lloyd's L.R. 122, per Gibson L.J. at pp. 126-127 ; *Philips Hong Kong Ltd. v. The Attorney General of Hong Kong* (1993) 61 B.L.R. 41, at pp. 58-59

[86] *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd.* [1915] AC 79; *Clydebank Engineering & Shipbuilding Co v. Don Jose Ramos Yzquierdo y Castaneda* [1905] AC 6

[87] Furmston M P, Contract Planning: Liquidated Damages, Deposits and the Foreseeability Rule (1991) 4 JCL 1, at p. 5

loss which may be caused by breach.[88]

4.1.2. Where pre-estimate is difficult or impossible

2.28 The application of the rule, apparently requires that the likely loss resulting from breach could reasonably be calculable at the time of contracting, so that the parties can properly make their pre-estimation of likely damages. Otherwise, *i.e.* where the assessment of probable loss, because of the special circumstances of the case or the consequences of breach was difficult or impossible, the sum agreed to be paid in the event of breach would be likely to be regarded as liquidated damages, provided that the pre-estimation of likely loss was the true bargain between the parties. In the words of Lord Dunedin "[i]t 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 damage was the true bargain between the parties."[89] Basically it might be said that one of the most important incentives of the parties to provide for an agreed damages clause, as stated by Lord Halsbury LC[90], is the difficulty, complexity and high litigation expenses of proving actual damages; hence, if the agreed damages are decided not to be recoverable where the likely loss is difficult or impossible to be assessed at the time of contracting, this clause will lose one of its important utilities.

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[88] This is supported by the "Unfair Terms in Consumer Contract Regulations 1994" upon which a term which have the object or effect of "requiring any consumer who fails to fulfil his obligation to pay *a disproportionately high* sum in compensation" has *prima facie* been regarded as unfair. (See Schedule 3, para. 1(e) [emphasis added]) The scope of the Regulations, of course, is much narrower than the common law rules on penalties, since it only applies to standard term contracts for the supply of goods and services, made between commercial sellers of goods or suppliers of services and consumers. An unfair term, according to the sec. 5(1) of the Regulations is not "binding on the consumer".

[89] *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd.* [1915] AC 79, at p. 87-88; see also *Clydebank Engineering and Shipbuilding Co. v.. Don Jose Ramos Yzquierdo y Castaneda* [1905] AC 6, at p. 11 per Lord Halsbury; *Webster v. Bosanquet* [1912] AC 394, at p. 398. This principle has been reaffirmed in *Philips Hong Kong Ltd. v. The Attorney General of Hong Kong* (1993) 61 B.L.R. 41, p.60: In this case the agreed damages which was calculated with some especial formulas has been referred to as "a perfectly sensible approach in a situation such as this where it would be obvious that substantial loss would be suffered in the event of delay but that what that loss would be, would be virtually impossible to calculate in advance." at p. 60; For the Australian approach see *Waterside Workers' Federation of Australia v. Stewart* (1919) 27 CLR 119

[90] *Clydebank Engineering & Shipbuilding Co v. Don Jose Ramos Yzquierdo y Castaneda* [1905] AC 6, at p. 11, where he said: "The very reason why the parties do in fact agree to such a stipulation is that sometimes, although undoubtedly there is damage and undoubtedly damages ought to be recovered, the nature of the damage is such that proof of it is extremely complex, difficult, and expensive."

2.29 This seems to be the case irrespective of whether the agreed sum is made payable upon breach of a single obligation or anyone of several promises. In the latter case, of course, the loss following from the breaches of all obligations must be difficult or impossible to be pre-assessed.[91]

4.1.3. Where the loss is calculable at the relevant time: agreed damages for non-payment of a debt

2.30 The clear application of the rule is where the loss flowing from breach is reasonably calculable at the time when the contract is made. In such a case, if parties provide for an agreed sum which is considerably larger than the likely loss, the sum will be struck out as being disproportionate to the actual damages. The obvious example of this is where the obligation upon breach of which the agreed sum has been stipulated to be payable, is the payment of a sum of money; in other words, "It will 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."[92] The reason for this, it has been suggested, is that the loss which is sustained from non-payment of a sum of money is capable of being determined, therefore, fixing a larger sum can not be a genuine pre-estimate of the likely loss.[93]

It is true that the probable damages following from non-payment of a specified sum of money can normally be calculated at the time of contracting; with all respect, however, it does not follow that the stipulation of any larger sum could not be regarded as a genuine assessment of actual damages. As Jessel, M.R. stated in *Wallis v. Smith*[94]:

> "It has always appeared to me that the doctrine of the English law as to non-payment of money- the general rule being that you cannot recover damages because it is not paid by a certain day, is not quite consistent with reason. A man may be utterly ruined by the non-payment of a sum of money on a given day, the damages may be enormous, and the other party may be wealthy."

The parties to a contract should therefore, it seems, be able to stipulate for the likely loss

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[91] The other aspects of a single sum payable upon different breaches will be discussed later in this chapter; *infra.* paras. 2.36 *et seq.*

[92] *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd.* [1915] AC 79, at p. 87

[93] Furmston M P, Cheshire, Fifoot & Furmston's Law of Contract, 13th ed., 1996, p. 636

[94] (1882) 21 Ch.D. 243, at p. 257

which in special circumstances might be in excess of the sum which ought to have been paid. If, however, the agreed sum exceeds the likely loss, and not only the sum of the primary obligation itself, it may be regarded as extravagant and unconscionable amount and struck out as being a penalty.

2.31 It might be argued that according to the common law rule, substantial damage is not normally recoverable in the event of failure to pay a debt.[95] This rule, however, had been subject to some doubts in rather recent cases[96] and finally in *President of India v. Lips Maritime Corporation*[97], the House of Lords restricted it only to claims for the recovery of interest for late payment.[98] As to other losses which might flow from non-payment or late payment of a debt, however, the House recognized "special damages" which are recoverable according to the general rules about damages.[99] Thus, damages which have been held recoverable in cases like *Wadsworth v. Lydall*[100] because of being

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[95] The only loss recoverable consisted of the debt itself: see for example *Fletcher v. Tayleur* (1855) 17 C.B. 21, at p. 29; *Williams v. Reynolds* (1865) 6 B & S 495, 122 ER 1278; *British Columbia Saw-Mill Co. Ltd. v. Nettleship* (1868) L.R. 3 C.P. 499, at p. 506. There is also a secondary common law rule upon which "debts do not carry interest". see *London, Chatham and Dover Railway Co v. South Eastern Railway Co.* [1893] AC 429, where it was held that, as a common law rule, interest could not be awarded for the late payment of a debt.

[96] *Muhammad Issael Sheikh Ahmad v. Ali* [1947] AC 414, *Trans Trust S.P.R.L. v. Danubian Trading Co.* [1952] 2 QB 297

[97] [1988] 1 AC 395

[98] See *ibid.*, per Lord Brandon of Oakbrook at p. 424. Before that, in *President of India v. La Pintada Compania Navigacion SA* [1984] 2 All ER 773, [1985] AC 104, the House had restricted the common law rule as to non-recoverability of interest for late payment of a debt to interest as general damage under the first part of the rule in *Hadley v. Baxendale* 9 Exch. 341, 156 ER 145. The rule however was held as not being applicable to claims for recovery of interest as special damage under the second limb of the rule in *Hadley v. Baxendale*. However, the house thought it inappropriate to depart from the traditional common law rule, referred to above, mainly on the ground that this departure would create a conflict between the statutory discretion of the courts to award interest on unpaid debts and the creditor's right to recover interest at common law.

[99] As to currency exchange losses, for example, Lord Brandon of Oakbrook (with whom the other members of the House concurred) stated: "... it appears to me that claims to recover currency exchange losses as damages for breach of contract, whether the breach relied on is late payment of a debt or any other breach, are subject to the same rules as apply to claims for damages for breach of contract generally." at p. 424; Lord Mackay of Clashfern also held: "The reasoning of this House in *President of India v. La Pintada Compania Navigacion SA* [1984] 2 All ER 773, [1985] AC 104 makes it clear that damages other than interest may be recovered for breach by late payment." at p. 429; see also Treitel G.H., The Law of Contract, 9th ed., 1995, pp. 895-897

[100] [1981] 1 WLR 598, approved by the House of Lords in *President of India v. La Pintada Compania Navigacion SA* [1984] 2 All ER 773, [1985] AC 104, per Brightman L.J. at p. 602. In this case a purchaser of land who had to pay £10,000 by a certain date, and knew that the vendor intended to use it

late in making the payment of a certain sum of money are justifiable as "special damages". Taking this into account, the common law rule should not, it appears, prevent the parties from agreeing in advance upon the losses which might flow from the late payment of a debt. Furthermore, as it was argued before[101], the parties to a contract should be able to cover by the agreed damages clause the losses which may reasonably flow from breach even though they may not be recoverable at common law. Hence, though there are many *obiter dicta* supporting the idea that a stipulation for payment of a larger sum made payable upon non-payment of that sum should be regarded as a penalty[102], it is, with all respect, suggested that where the agreed damages clause, in such cases, shows the reasonable attempt of the parties to provide for the likely loss which flows from breach, the clause should be upheld as a valid liquidated damages.[103]

4.1.4. Where the obligation to pay a specified sum of money is one of different obligations

2.32 Where there are several obligations upon breach of anyone of them the agreed sum has been made payable and one of these obligations is the payment of a specific sum of money, again an agreed damages clause providing for a larger sum than the amount which ought to have been paid, might be held to be a penalty[104]. That is because in case of several obligations, if the probable loss flowing from any one of breaches could reasonably be pre-estimated at the time of contracting, an agreed damages clause providing for a sum in excess of this calculable loss might be regarded as a penalty; and the loss resulting from the breach of an undertaking to pay a sum of money, as stated

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as a down payment on another piece of land, failed to pay £2,800 of the debt. The vendor, as a result, had to borrow that amount in order to make the down payment. The Court of Appeal held that the interest payable on the £2,800 by the creditor was recoverable as damages from the defaulting purchaser.

[101] *Supra.*, para. 2.14

[102] See, e.g., *Astley v. Weldon* (1801) 2 Bos. & Pul. 346, 126 ER 1318, per Chambre J. at pp. 354, 1323 respectively; *Thompson v. Hudson* (1869) L.R. 4 H.L. 1, per Lord Westbury at 30; *Law v. Redditch Local Board* [1892] 1 QB 127, per Lord Esher M.R. at p. 130

[103] See Burrows A, Remedies for Torts and Breach of Contract, (2nd ed., 1994), p. 323; Ogus, The Law of Damages, 1973, p. 45; McGregor on Damages, 15th ed., 1988, para. 458; It has also been suggested that the second rule, stated by Lord Dunedin, "serves no useful purpose and should be abandoned": Treitel G.H., The Law of Contract, 9th ed., 1995, p. 900

[104] *Astley v. Weldon* (1801) 2 Bos. & Pul. 346, 126 ER 1318; *Kemble v. Farren* (1829) 6 Bingham 141, 130 ER 1234; *Re Newman* (1876) 4 Ch.D. 724; *Wallis v. Smith* (1882) 21 Ch.D. 243, at pp. 256-257

above, is normally considered as calculable. In *Kemble v. Farren*[105], the defendant, an actor, contracted with the plaintiff to act at Covent Garden Theatre as a comedian for four seasons in consideration of £3 6s. 8d. per night. The contract provided, *inter alia*, for the payment of £1000 by either party who refused to fulfil the agreement, or any part of it. The defendant being in default, the plaintiff brought an action to recover the agreed damages. It was held that the stipulated sum was a penalty, for it had been provided to be paid upon any breach of different obligations one of which was the payment of a considerably small sum of money: the plaintiff's failure to pay £3 6s. 8d. might have resulted in his liability to pay the agreed sum, *i.e.* £1000.

Having regard to what was stated above[106], it could again be suggested that merely providing for a larger sum than what ought to have been paid, should not turn the nature of an agreed sum to a penalty. If the agreed sum is not disproportionately in excess of the likely damages which might reasonably flow from the non-payment of a certain sum, it should, it seems, be regarded as a valid liquidated damages clause.

4.1.5. Bargaining power of the parties: is it a material point?

2.33 In considering whether or not the agreed sum is extravagant or unconscionable in comparison with the probable damages resulting from breach, the unequal financial position of the parties which might result in an "unequal bargaining power" has been submitted to be irrelevant.[107] Consequently the court should, determining the nature of the clause, consider the proportion between the agreed sum and the likely damages which might reasonably be expected to flow from breach at the time of contracting, without having regard to any probable unequal bargaining power of the parties.

This seemed to be the case until the recent decision of the Privy Council in *Philips Hong*

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[105] (1829) 6 Bing. 141, 130 ER 1234

[106] See *supra.*, paras. 2.30-2.31

[107] May, Sir Anthony, Keating On Building Contracts (London: Sweet & Maxwell, 5th ed., 1991), p. 226, citing *Imperial Tobacco Co. v. Perslay* [1936] 2 All ER 515, where Lord wright M.R. at p.512 pointed out: "The word unconscionable ... does not bring in at all the idea of an unconscionable bargain. It is merely a synonym for something which is extravagant and exorbitant."; *Robert Stewart & sons Ltd. v. Carapanayoti* [1962] 1 WLR 34, 40; *Bridge v. Campbell Discount Co. Ltd.* [1962] AC 600, 626 per Lord Radcliffe

Kong Ltd. v. The Attorney General of Hong Kong[108]. In this case, the appellant, Philips, entered into a contract with respondent, the government of Hong Kong, in relation to the construction of a specified part of a highway. The contract provided for the payment of an agreed sum as "liquidated damages" in the event of delay by the contractor. Philips failed to meet the key dates of completion and sought a declaration that there was no liability to pay the agreed sum because it amounted to a penalty. The Court of Appeal of Hong Kong allowed an appeal from the decision of the court in the first instance which upheld Philip's claim. Philips appealed. The Privy Council held the clause to be a valid liquidated damages clause on the ground that to identify the true nature of an agreed damages clause, it is not enough to identify hypothetical situations in which the probable actual loss would be greater than the agreed sum.

2.34 The decision of the Privy Council, reviewing the law on penalties and confirming the basic principle that a genuine pre-estimate of the likely loss can constitute a valid liquidated damages clause, represented a little change in relation to the practical rules used to distinguish liquidated damages from penalties. Lord Woolf, delivering the judgment of the Board, stated:

> "Except possibly in the case of situations where one of the parties to the contract is able to dominate the other as to the choice of the terms of a contract, it will normally be insufficient to establish that a provision is objectionably penal to identify situations where the application of the provision could result in a larger sum being recovered by the injured party than his actual loss. Even in such situations so long as the sum payable in the event of non-compliance with the contract is not extravagant, having regard to the range of losses that it could reasonably be anticipated it would have to cover at the time the contract was made, it can still be a genuine pre-estimate of the loss that would be suffered and so a perfectly valid liquidated damage provision."[109]

Thus, in deciding upon the penal nature of a clause, the unequal bargaining power of the parties which may result in domination, should not be disregarded: where there is such an inequality, the penal nature of an agreed damages clause might easily be established by showing, *inter alia*, that in some hypothetical situations, the application of the clause could result in the recovery of greater sum than the actual loss. It could basically be

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[108] (1993) 61 B.L.R. 41

[109] *Ibid.*, at p. 58-59

argued that the relationship between the parties and the bargaining power of them is one of the circumstances which is to be considered to find out the reasonable intention of the parties in pre-estimating the likely actual loss. As stated before[110], in deciding whether the agreed sum is a genuine pre-estimate of the likely actual loss, the reasonable intention of the parties, having regard to the terms of the contract and the whole "inherent circumstances" surrounding it, should be discovered. The bargaining power of the parties is one of these circumstances which may affect the parties' agreement as to pre-assessing damages: There seems to be a difference between a clause in a contract freely negotiated between the parties who are in a position to receive legal advice about different aspects of the contract and sign it with complete understanding of its terms on the one hand, and a clause in an adhesion contract between a business firm and a party who signs a pre-prepared contract without even reading it. It does not obviously follow that the agreed damages clause in the latter case should always be regarded as of penal nature; but it emphasizes the point that in considering the circumstances in which the contract has been entered into, in order to find out the reasonable intention of the parties, their bargaining position should be regarded as an important factor. Thus, in the cases of the inequality of the bargaining power of the parties, the courts might be more willing to find out the requisite degree of disproportion between the agreed sum and the likely actual loss, and to hold the clause as being penal in nature.

2.35 It appears from the passage just quoted[111] that where the parties to a contract are of equal bargaining power, e.g. in most commercial contracts especially in international relations, to prove the penal nature of a clause, it would not be enough to show that in some circumstances which might happen, the agreed damages would be in excess of the probable loss.[112] The attention, however, should be paid to the range of losses that could reasonably be anticipated at the time of contracting, and unless the agreed sum was extravagant and unconscionable in comparison with these losses, it would not be regarded as in the nature of penalty.

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[110] See *supra.*, paras. 2.07-2.09

[111] *supra.*, para. 2.34

[112] See also *J F Finnegan Ltd. v. Community Housing Association* (1993) 34 Con L.R. 104, p. 119

4.2. Single Sum Payable upon Different Breaches

4.2.1. General points: Application of the general test

2.36 The parties to a contract may provide for a sum of money to be payable by the defaulting party in the event of any one of different breaches. To distinguish whether this sum is liquidated damages or penalty, the main test specified before is still applicable: *i.e.* if the agreed sum is extravagant or unconscionable in comparison with the probable loss which might flow from any one of the breaches, the sum will be held to be a penalty. It should, however, be noted that the comparison, in such a case, should be made between the agreed sum and the losses which result from a breach causing the lowest loss (*i.e.* the less significant breach)[113] and if the agreed sum was disproportionately larger than the lower end of losses resulting from different breaches, it would, *prima facie*, be regarded as a penal sum.[114]

4.2.2. Presumption in favour of penalty

2.37 In addition to the general rule, where failure to perform different obligations, upon breach of any one of them the agreed sum has been stipulated to be payable, occasions damages of varying importance, there will be a *presumption* to the effect that the parties have not stipulated for a genuine pre-estimate of likely loss. It was thought that the inevitable result of providing for a single large sum to be paid upon breach of any one of different obligations was that the agreed sum had to be held penal in nature.[115] This "dogmatic" rule of law[116], however, was stated in a more flexible way in *Dunlop*

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[113] *Dunlop Pneumatic Tyre co Ltd. v. New Garage and Motor co Ltd.* [1915] AC 79, per Lord Dunedin at p. 89, where he pointed out that in such a case, "the strength of the chain must be taken at its weakest link."

[114] See *Ariston SRL v. Charly Records Ltd.* (1990) Independent, 13 April, where a single fixed sum of £600 per day was made payable upon the wrongful detention of recording items made available to the other party for the contractual purposes, regardless of the number of items detained. The anticipated loss resulting from detention of each item was different. Since the agreed sum was clearly disproportionate to the loss which may have been suffered by Charly as a result of Ariston's failure to return "only a few of the comparatively unimportant items", the clause was regarded as a "penalty".

[115] *Astley v. Weldon* (1801) 2 Bos. & Pul. 346, 126 ER 1318; see also *Sandeman v. Bedwell* (1879) 2 SCR (NS) (NSW) 145

[116] Ogus. The Law of Damages, 1973, p. 43

Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd.[117] where Lord Dunedin observed:

> "There is a presumption (but no more) that it is penalty where 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."[118]

If, accordingly, a single sum is stipulated to be paid in the event of breach of more than one obligation resulting in varying amount of losses, it will be a presumption[119], not rule of law, that the agreed sum is a penalty.

4.2.3. Displacement of the presumption

2.38 The effect of holding the principle to be a presumption is that it may be rebutted in certain circumstances. In other words, the promisee can show that owing to the special circumstances of the case, the agreed sum has been the genuine pre-estimate of the likely loss. It is to be noted that the burden of proving that the agreed sum has not been a penalty lies upon the promisee who claims the sum to be a valid liquidated damages clause. Furthermore, a survey of cases shows that the courts are also willing to construe the contract in a way to enable them to hold the sum as liquidated damages. The circumstances in which the presumption could be rebutted seem to relate to the nature of losses, the conduct of the parties in making the contract, and the attitude of the courts towards such clauses. These three issues should in turn be dealt with here.

4.2.3.1. The nature of losses flowing from different breaches: uncertain damages

2.39 In some cases, although a single sum is provided to be paid upon breach of any one of different obligations of varying importance, the nature of losses flowing from the non-compliance with any one of these obligations, having regard to the special circumstances of cases, is so uncertain that reasonably makes any pre-assessment impossible or difficult.

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[117] [1915] AC 79; see also *Lamson Store Service Co. v. Weidenbach and Co's Trustees* (1904) 7 WALR 166

[118] *Ibid.*, at 87, see also *Lord Elphinstone v. Monkland Iron and Coal Co.* (1886) 11 App. Cas. 332, at p. 324 per Lord Watson; *Clydebank Engineering and Shipbuilding Co. v.. Don Jose Ramos Yzquierdo y Castaneda* [1905] AC 6, at p. 15 per Lord Davey; *Ford Motor Co (England) Ltd v. Armstrong* (1915) 31 TLR 267; *Lock v. Bell* [1931] 1 Ch 35, at pp. 45-46

[119] See also the speech of Lord Parker of Waddington in *Dunlop Pneumatic Tyre co Ltd. v. New Garage and Motor co Ltd* [1915] AC 79, at pp. 98-99

In such a case, the agreed damages, provided to be a reasonable one, would be held to be liquidated damages. This principle has well been stated in the judgment of Lord Atkinson in *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd.*[120]:

> "... although it may be true... that a presumption is raised in favour of a penalty ..., it seems to me that that presumption is rebutted by the very fact that the damage caused by each and every one of those events, however varying in importance, may be of such an uncertain nature that it can not be accurately ascertained."

Furthermore, as Lord Mersey pointed out in *Webster v. Bosanquet*[121], "the very uncertainty of the loss likely to arise made it most reasonable for the parties to agree beforehand as to what the damages should be"[122]; therefore, having regard to this and the difficulties and expenses of proving the actual loss[123], if the courts do not uphold the speculation of the parties to agree beforehand upon payable sum in the event of breach, the most important utility of agreed damages may be evaded. It is perhaps for this reason that the speculation of the parties to provide for a reasonable sum to be payable in the event of a breach which results in an uncertain loss was referred to as "a perfectly sensible approach" in *Philips Hong Kong Ltd. v. The Attorney General of Hong Kong*[124].

4.2.3.2. Conduct of the Parties in Making Contract

2.40 The parties to a contract, stipulating for an agreed sum to be payable in the event of any one of different breaches of varying importance, may use various methods so that the presumption could be displaced. These methods seem to merit mention:

4.2.3.2.1. Averaging out probable losses flowing from different breaches

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[120] *Ibid.*, at pp. 95-96; see also *Galsworthy v. Strutt* (1848) 1 Ex. 659, 154 ER 280, where Parke B. Said: "Now it is perfectly competent to parties to make a stipulation to pay a fixed sum for the breach of a covenant, the damage arising from which it is extremely difficult to ascertain; and I think that it is not an unreasonable stipulation which the defendant has made, that he should pay £1,000 upon the event of either of the matters mentioned in this agreement." at pp. 663-664, 282 respectively; see also per Alderson B. at pp. 666-667, 283 respectively

[121] [1912] AC 394

[122] *Ibid.*, p.398; See also *Kemble v. Farren* (1829) 6 Bingham 141, 130 ER 1234, pre Tindal C.J. at p. 148

[123] *Clydebank Engineering and Shipbuilding Co. Ltd. v. Don Jose Ramos* [1905] AC 6, per Lord Halsbury L.C. at p. 11

[124] (1993) 61 B.L.R. 41, at p.60

2.41 The parties may wish to agree upon the average amount of likely losses which might arise from any one of different breaches, as agreed damages to be paid upon breach. The clause providing for such an agreement, provided that there is no great difference between the largest and the smallest probable loss, might be regarded as a valid liquidated damages clause. The illustration of this principle, was given by Lord Parker of Waddington in *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd.*[125] where he stated:

> "Supposing it were recited in the agreement that the parties had estimated the probable damage from a breach of one stipulation at from £5 to £15, and the probable damage from a breach of another stipulation at from £2 to £12, and had agreed on a sum of £8 as a reasonable sum to be paid on the breach of either stipulation, I cannot think that the Court would refuse to give effect to the bargain between the parties."[126]

The illustration of Lord Parker implicitly identifies the circumstances in which averaging out might be regarded as an effective method to displace the presumption: first, the likely loss flowing from any one of breaches should not accurately and reasonably be capable of being calculated at the time of contracting; and secondly, there should not be a great disparity between different losses which flow from the breaches.[127] In *Ariston SRL v. Charly Records Ltd*[128], for example, it was argued that the losses resulting from the detention of each item would vary, and "it was" therefore "exceptionally difficult to make a genuine pre-estimate of the damages", and the only way to agree upon damages, at the time when the contract was made, "was to fix on a figure which would represent an average of the daily loss likely to be suffered". Beldam LJ[129], however, preferred the conclusion of the judge at the first instance, and rejected this argument on the following two grounds: First, averaging out would constitute a reasonable pre-estimate where the sum payable for the breach or breaches for which it was provided could be regarded as "proportionate to the extent of those breaches". Thus he was prepared to accept the agreed sum as a valid stipulation if it had been made payable "should the respondents fail

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[125] [1915] AC 79

[126] *Ibid.*, at p. 99

[127] See Ogus, The Law of Damages, 1973, p. 44

[128] (1990) Independent, 13 April, (The transcript of the case is also available through Lexis). For the facts of the case see note 114

[129] With whom Leggatt and Mustill LJJ agreed.

to return *all* or a *substantial part* of the production parts provided by the appellants".[130] Second, the difficulty of making a pre-estimate for each loss resulting from probable breaches was not clear: In the learned Lord Justice's view "[i]t would have not been difficult to have made the daily sum proportionate to what was detained, or per title for each day on which such title could not be manufactured for sale by reason of retention of one or more items".

It could thus be concluded that, where the accurate loss flowing from any one of breaches is identifiable, and also where the loss resulting from a breach is for example £2-£10 and from another £80-£100, agreeing on an average amount as an stipulated damages would not be effective to displace the presumption.[131]

4.2.3.2.2. Delimitating the field of agreed damages

2.42 The parties might determine carefully the field in which the agreed damages clause would be applicable; therefore, although they might refer to the different breaches of the contract and deal with them while agreeing upon the terms of the contract, it could, from the construction of the whole agreement and circumstances in which the contract has been made, be understood that the agreed damages clause will operate in the event of a certain breach, or even certain aspects of a breach. In such a case, though it might, *prima facie*, be thought that a single sum has been made payable upon different breaches, nonetheless, with more attention, the presumption of being a penalty could be rebutted by the fact that the agreed damages clause has been intended to operate in the event of a single breach.[132] In *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd.*[133], for example, though, at first glance, it was thought that the agreed sum of £5 had been made payable upon breach of any one of many obligations of the defendant, Lord Atkinson, in holding the sum to be a valid liquidated damages, rested his judgment, *inter alia*, on the fact that, on the true construction of the contract, the clause had been

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[130] Emphasis added

[131] The possibility of averaging out damages of same kind but difficult to exact assessment, was also pointed out by Scrutton L.J. in *English Hop Growers v. Dering* [1928] 2 KB 174, at pp. 181-182. The case itself seems to deal, *inter alia*, with a single sum which has been stipulated to be payable in the event of a single breach..

[132] See the judgment of Lord Herschell in *Lord Elphinstone v. Monkland Iron and Coal Co.* (1886) 11 App. Cas. 332, at p. 345

[133] [1915] AC 79

intended to operate in the event of a single breach, namely, to sell and endeavour to sell the goods for less than the listed price.[134]

2.43 This was one of the points on which the *Dunlop* case[135] was distinguished from a similar case, namely *Ford Motor Company (England) Ltd. v. Armstrong*[136]: In the latter case, the plaintiffs agreed to sell motor-cars to the defendant to be sold by him in a certain district. It was provided that the defendant should not sell the motor-cars below the listed price and the sum of £250 was agreed to be payable in the event of breach. This sum was also made payable for other breaches varying in importance. The defendant sold five cars below the fixed price. The Court of Appeal held that, unlike the contract in *Dunlop v. New Garage*[137], the agreed sum here was intended to operate in the event of any one of different breaches of varying importance, and therefore, it cannot be regarded as a genuine pre-estimate of likely loss.

4.2.3.2.3. Providing for Different Agreed Damages

2.44 The parties might stipulate for different sums of money to be payable in the event of different breaches[138]. In other words, they may assess in advance the likely losses flowing from non-performance of any one of many obligations, and provide for specified sums to be paid in the event of specific breaches. In such a case, every agreed sum is regarded as a single sum which has been made payable on a single breach. In *Philips Hong Kong Ltd. v. The Attorney General of Hong Kong*[139], two different liquidated damages had been agreed to be payable in the event of two breaches: first, failure to meet the key dates on which the work had to be taken over by other contractors, and secondly, failure to complete the work within the contractual time limits. The possibility of such a provision was recognised by the Privy Council and the appellant's argument that this might result in

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[134] *Ibid.*, pp. 92-93

[135] *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd.* [1915] AC 79

[136] (1915) 31 TLR 267

[137] [1915] AC 79

[138] McGregor on Damages, 15th ed., 1988, para. 462

[139] (1993) 61 B.L.R. 41

double compensation was rejected.[140]

4.2.3.2.4. Graduated Damages

i. General points

2.45 A contractual obligation upon breach of which an agreed sum has been made payable, might have such a nature that it could be broken more than once or in more than one way. For example, delay in performance, especially in building contracts and charterparties, is a breach that occurs continuously from the time that completion has fallen due. Another example is a breach which can happen by doing a specific act or omission: whenever the act or omission happens, the contractual obligation is broken. The contractual undertakings in *Ford v. Armstrong*[141] and *Dunlop v. New Garage*[142] are clear examples of this kind of obligations: In both cases, the defendants had, *inter alia*, undertaken not to sell the items below the fixed price. Every time an item were undersold, a breach would occur. Also, in *Diestal v. Stevenson*[143], in a contract for the sale of coal, it was provided that a shilling for every ton should be paid if the contractual obligation of the seller to deliver the goods, or of the buyer to accept them were not duly performed. Similarly, in this case failure to deliver by the seller or accept by the buyer happens for every unperformed part of the agreement.

2.46 Obligations with this nature are similar to different obligations in the fact that the failure to perform both of them results in different breaches. Therefore, if a single sum is agreed to be paid upon breach of obligations which can be broken more than once or in more than one way, there may arise a presumption that the parties' agreement cannot be a genuine pre-estimate of actual damages. This is for the simple reason that such a provision will operate in the event of breaches of varying importance. Thus, in a construction contract, if a fixed sum is made payable for delay in completion, it is likely to be struck down as being a penalty.

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[140] *Ibid.*, p. 62

[141] (1915) 31 TLR 267

[142] [1915] AC 79

[143] [1906] 2 KB 345

ii. Agreed damages subject to fluctuation

2.47 To avoid this problem and to displace the presumption, the parties to a contract may agree on a system of agreed damages which is graduated in proportion to the extent of the breach; for example in case of delay in performance, it might be stipulated that a specified sum of money should be paid for every week of delay.[144]

The stipulation for graduated sum is very common in building contracts for delay in completion and in charterparties for delay by the charterer in loading or unloading the ship[145], and if the amount of the agreed sum and its fluctuation is in proportion to the losses resulting from breach, it is very likely to be upheld as a genuine pre-estimate of probable loss. In *Philips Hong Kong Ltd. v. The Attorney General of Hong Kong*[146], the construction contract between the parties had provided for a graduated sum , to be calculated in a specific formula, in the event of delay. This clause was upheld by the Privy Council as a genuine attempt to assess the likely loss.

iii. The necessity of fluctuation in a right direction

2.48 The graduated sum must fluctuate in the right direction; *i.e.* it must increase, if the amount of loss resulting from breach is subject to increase and *vice versa*. Thus, depreciation clauses in hire-purchase contracts which provide for an agreed sum as compensation for depreciation of the subject-matter, to be paid upon breach, have normally been held to be penal in nature. That is because the agreed sum in such provisions, together with the payments already made or those which are due, normally amount to a certain proportion of the hire-purchase price. Though during the time depreciation of the subject- matter, and consequently the losses caused by the breach as a result, increases, nonetheless the amount which becomes payable, under the provision, decreases. This, in fact, using the language of Lord Radcliffe in *Bridge v. Campbell Discount Co. Ltd.*[147], "is a sliding scale of compensation, but a scale that slides in the wrong direction."

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[144] *Clydebank Engineering and Shipbuilding Co. v. Don Jose Ramos* [1905] AC 6; *Law v. Redditch Local Board* [1829] 1 QB 127; *Cellulose Acetate Silk Co. Ltd. v. Widnes Foundry (1925), Ltd.* [1933] AC 20

[145] Demurrage clause

[146] (1993) 61 B.L.R. 41

[147] [1962] AC 600, at 623

4.2.3.3. Attitude of the courts

2.49 So far as the obligations which can be broken more than once and in more than one way are concerned, the courts tend to interpret such undertakings as a single obligation; in other words, they mainly look at the objective of the parties and avoid the literal construction of such stipulations which might result in holding the single sum made payable upon breach of these undertakings as *prima facie* a penalty. In construction contracts, for example, delay in completion upon which an agreed sum is normally stipulated to be payable, could result from different ways; but the courts almost always have treated delay as a single breach. In *Law v. Redditch Local Board*[148] Kay L.J., holding the agreed sum which had been stipulated to be paid upon non-completion of a construction contract as being a valid liquidated damages, stated:

> "I cannot agree with the ingenious argument that because there may be many matters, some very small, which would constitute non-completion, these sums may be regarded as payable on several events. According to that argument, there must be considered to be several different non-completion of the works. There may be different causes of non-completion; but non-completion is only one single event."[149]

In *Philips Hong Kong Co. v. The Attorney General of Hong Kong*[150], the argument of the appellant, that delay might be caused by a number of different events and so the agreed sum has been made payable on the occurrence of different breaches and is *prima facie* a penalty, was rejected by the Privy Council. Lord Woolf, citing the judgment of Kay L.J. in *Law v. Redditch Local Board*[151], said: "In this case the only event giving rise to the liability to pay liquidated damages is delay. Although delay may be caused by any number of different circumstances, this is not a case of different causes of loss being compensated by the same figure of liquidated damages."[152]

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[148] [1892] 1 QB 127

[149] *Ibid.*, p. 136

[150] (1993) 61 B.L.R. 49

[151] [1892] 1 QB 127, at p. 136

[152] *Philips Hong Kong Ltd. v. The Attorney General of Hong Kong* (1993) 61 B.L.R. 49, at p. 62; See also *Diestal v. Stevenson* [1906] 2 KB 345 in which despite the parties had provided for a certain sum to be paid in the event of "non-execution of the contract", the court construed the clause as providing for the sum to be payable on only "one kind of breach, namely the non-delivery of the coal [the subject-matter] by the seller or the non-acceptance by the buyer". p. 350

2.50 This has also well been illustrated in cases of covenants in restraint of trade. These covenants are of a nature that can normally be broken more than once and in more than one way; for example an obligation not to do business within a certain area or "not to solicit the customers of a firm"[153] can be broken in a number of different ways. The courts, however, generally treat the sum payable in the event of breach of such stipulations as an agreed damages clause covenanted to be payable upon breach of a single obligation.[154]

5. Australian Law

5.1. Rules for Distinction

2.51 The rules stated by Lord Dunedin in *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd.*[155] have been applied by the Australian courts to distinguish penalties from liquidated damages. In Australia, as in some English courts[156], to determine the nature of an agreed damages clause, it was sufficient to show that it was not a genuine pre-estimate of damages and the "extravagance" and "unconscionability" concepts, which has been set out by Lord Dunedin, were sometimes overlooked[157]. Put it another way, to establish the penal nature of an agreed damages clause, there was no need to show that the sum agreed upon was extravagant or unconscionable in comparison with the greatest loss which might be conceived to flow from the breach at the time when

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[153] The example has been taken from the speech of Lord Parker in *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd.* [1915] AC 79, at p. 98

[154] See, for example, *Crisdee v. Bolton* (1827) 3 Car. & P. 240, 172 ER 403 at pp. 243, 405 respectively; *Price v. Green* (1847) 16 M. & W. 346, 153 ER 1222 per Patteson J. at pp. 354, 1225 respectively ("Here ... there is but one thing to which the £5000 relates, viz. the restriction of trade though extended to two different districts; and it is plain that the parties intended, that if the restriction was violated in either district, the sum should be paid, and not that inquiry should be made as to the actual damage and loss sustained."); *Sainter v. Ferguson* (1849) 7 C. B. 716, 137 ER 283 per Wilde C.J. at pp. 727, 288 respectively; *Reynolds v. Bridge* (1856) 6 El. & Bl. 528, 119 ER 961 at pp. 541-542, 966-967 respectively

[155] [1915] AC 79

[156] See *supra.*, para. 2.26

[157] See in general: Greig & Davis, The Law of Contract, 1978, pp. 1448-1449 (with the Fourth Cumulative Supplement, 1992); Starke, J. G., Seddon, N. C., Ellinghaus, M. P., *Cheshire & Fifoot's Law of Contract*, Fifth Australian Edition, paras. 2420-2421; Lindgren K. E., Carter J. W., Harland D. J., Contract Law in Australia, paras. 2207 *et seq.*; Kercher, B. & Noone, M., *Remedies*, 2nd ed., pp. 240 *et seq.*

the contract was entered into. Instead, it was enough merely to prove that the agreed amount was in excess of the likely actual loss. This was stated by Mason J in *Forestry Commission of New South Wales v. Stefanetto*[158] and has been emphasized in *Malouf (W.T.) Pty Ltd v. Brinds Ltd.*[159]. In the latter case, the majority of the New South Wales court of Appeal held the agreed sum to be penal merely because it was greater than the greatest loss which might be proved to have resulted from breach at the time of making the contract.

2.52 This was the case until the recent decision of the High Court of Australia in *AMEV-UDC Finance Ltd. v. Austin*[160]. In this case, Mason and Wilson JJ, admirably reviewing the law on penalties, illustrated the diversion of the courts, both in England and Australia, from the principal tests of "extravagance" and "unconscionability", by considering cases where the penal nature of an agreed damages clause had merely been determined on the ground that the agreed sum was in excess of the greatest probable loss which might be conceived to flow from breach. They, then, stated:

> "... However, there is much to be said for the view that the courts should return to the *Clydebank* and *Dunlop* concept, thereby allowing parties to a contract greater latitude in determining what their rights and liabilities will be, so that an agreed sum is only characterized as a penalty if it is out of all proportions to damage likely to be suffered as a result of breach."[161]

The learned judges- considering the advantages of giving greater latitude to parties in terms of agreed compensation, such as "greater certainty by allowing the parties to determine more precisely their rights and liabilities", "providing for compensation in situations where loss may be difficult or impossible to quantify or if quantifiable may not be recoverable at common law" and "avoiding costly and time consuming litigation" as to determining the amount of actual damages, and emphasising the "supervisory jurisdiction" of equity and the common law to relieve against provisions which are penal in nature rather than compensatory- proposed a test as to determining the extravagance and unconscionability of an agreed damages clause:

> "The test to be applied in drawing that distinction is one of degree and will

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[158] (1976) 133 CLR 507, at p. 519

[159] (1981) 52 F.L.R. 442

[160] (1986) 162 CLR 170

[161] *Ibid.*, at p. 190

depend on a number of circumstances, including (1) the degree of disproportion between the stipulated sum and the loss likely to be suffered by the plaintiff, a factor relevant to the oppressiveness of the term to the defendant, and (2) the nature of the relationship between the contracting parties, a factor relevant to the unconscionability of the plaintiff's conduct in seeking to enforce the term. *The courts should not, however, be too ready to find the requisite degree of disproportion* lest they impinge on the parties' freedom to settle for themselves the rights and liabilities following a breach of contract."[162]

2.53 The dicta of Mason & Wilson JJ in drawing a distinction between penalties and liquidated damages was applied in *Esanda Finance Corporation Ltd. v. Plessnig*[163]. In this case a term in a hire-purchase agreement made the hirer liable to pay an amount equal to the total rent and all other moneys payable for the full period of hire less deposit, rentals already paid, the wholesale value of the goods and a rebate of terms charges, in case he made a default in the punctual payment of any instalment. The breach also entitled the owner to terminate the contract and retake possession of the goods. It was held that such a stipulated damage clause did not amount to a penalty. The members of the High Court of Australia confirming the dicta in *AMEV-UDC Finance Co. Ltd. v. Austin*[164] rejected the argument of the defendant that there might be some circumstances in which the owner might be able to recover a greater sum than his actual loss. It was, thus, emphasized that the mere possibility of an excess is not enough to render the agreed damages clause unenforceable as a penalty.

The position in Australia, therefore, seems to be slightly different from England. In Australia, the courts have rightly returned to the tests drawn by Lord Halsbury in *Clydebank* and Lord Dunedin in *Dunlop*: They regard the agreed sum as of penal nature only where it is "*out of all proportions*"[165] to the likely loss which might be conceived to result from breach at the time when the contract was made. In doing so, they not only look at any great disparity between the agreed damages and the likely actual loss which

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[162] *Ibid.*, pp. 193-194 [emphasis added]

[163] (1988-1989) 166 CLR 131

[164] (1986) 162 CLR 170

[165] See also the application of this test in *Multiplex Constructions Pty Ltd. v. Abgarus Pty Ltd.* [1992] 1 APCLR 1

could conceivably be proved to result from breach at the time when the contract is made, but do also consider the terms of the agreement and the whole circumstances surrounding it, to see whether the enforcement of the agreed damages clause is unconscionable.

2.54 It seems that the treatment of Australian courts is much more consistent with the very reason for the intervention of courts to relieve against penalties which was the basis for the true tests drawn by Lord Dunedin in *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd.*[166]. Relieving a party to a contract against harshness and oppression of the agreed damages clause which has been designed to intimidate him to perform his contractual obligation and punish him in the event of default, as something unfair and inequitable[167], was the origin of the jurisdiction of courts to intervene in the parties' bargain and to declare the clause unenforceable as being penal. As this jurisdiction is a blatant interference with the principle of freedom of contract, it should be limited to cases where the unfairness is clear. This is so where the agreed sum is extravagantly large in comparison with the anticipated actual harm. Thus, where there is no oppression and unconscionability by providing for an "extravagant" sum to be paid by the defaulting party in the event of breach, there should be no place for the application of the jurisdiction.[168]

5.2. The Place of the Parties' Intention in Determining the Nature of the Clause

2.55 In Australia, to determine the intention of the parties, in order to decide upon the nature of an agreed damages clause, an objective test is employed; *i.e.* like English law, having regard to the whole terms of the contract and inherent circumstances surrounding it, the reasonable intention of the parties, namely what reasonably could have been agreed upon as the likely actual damages resulting from breach, should be discovered. The

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[166] [1915] AC 79

[167] And in some cases, as an indicative of a procedural defect in the bargaining process: see *supra.*, paras. 1.50, 1.70

[168] This view has also been accepted in the Canadian case of *Elsley v. J.G.Collins Insurance Agencies Ltd.* (1978) 83 DLR (3d) 1, at p.15, where Dickson J delivering the judgement of the Supreme Court of Canada stated: "It is now evident that the power to strike down a penalty clause is a blatant interference with freedom of contract and is designed for the sole purpose of providing relief against oppression for the party having to pay the stipulated sum. It has no place where there is no oppression."

statement of Samuels J.A. in *Malouf (W.T.) Pty Ltd. v. Brinds Ltd.*[169] confirms this view:

> "... a genuine pre-estimate means a pre-estimate which is objectively of that character; that is to say a figure which may properly be so called in the light of the contract and the inherent circumstances ... it will not be enough that the parties honestly believed it to be so."

This has also been confirmed in other cases[170] where the (subjective) intention of the parties has not been regarded as sufficiently indicating the nature of the clause: the task of the courts, it has been stated, is to look at the substance of the transaction and to find out whether the clause can *reasonably* reflect a genuine pre-estimate of damages. In this respect, the speech of Deane J in *O'Dea v. Allstates Leasing System (W.A.) Pty Ltd.*[171] merits mention:

> "... whether or not a provision of a contract imposes a penalty must be determined by reference to the true operation of that provision. That question must however be determined as a question of substance which cannot be foreclosed by statements of the parties in their agreement, no matter how genuine they may be, as to their intention in stipulating the sum. The parties to an agreement may have subjectively intended to make a pre-estimate of damages in the event of breach. If, however, that pre-estimate is either extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach or, judged as at the time of making the contract, is unreasonable in the burden which it imposes in the circumstances which have arisen, it is a penalty regardless of the intention of the parties in making it."

It might, therefore, be concluded that the subjective intention of the parties in agreeing upon the nature of the clause is of little importance, and even showing that the parties honestly and with all attempts have intended the sum to be a pre-estimate of the likely loss would not conclude the matter. Having regard to the terms of the contract and the whole circumstances of the case at the time when the contract was made, what reasonably could have been agreed upon would, however, seem to be determinative.

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[169] (1981) 52 F.L.R. 442

[170] *AMEV-UDC Finance Ltd v. Artes Studio, Thorough breds Pty Ltd.* (1989) 15 NSWLR 564 ; *O'Dea v. Allstates Leasing System (W.A.) Pty. Ltd.* (1983) 57 A.L.J.R. 172 ; *Multiplex Constructions Pty Ltd. v. Abgarus Pty Ltd.* [1992] 1 APCLR 1

[171] (1983) 57 A.L.J.R. 172, at p. 189

2.56 It might be thought[172] that, by accepting an objective test in assessing the intention of the parties and placing little importance on their subjective intention, any negotiations and discussions between the parties resulting in the agreed damages clause and the genesis of that should be disregarded. This may be because such issues could prove the true intention of the parties and what they have honestly intended, which has no place in determining the nature of the clause. Such a view is, however, erroneous, and was clearly rejected by the High Court of New South Wales in *Multiplex Constructions Ltd v. Abgarus Ltd*[173]: To discover the reasonable intention of the parties at the time of making the contract, *the whole circumstances* of the case should be examined. Negotiations relating to the clause is obviously one of these circumstances which should be borne in mind. It should, in other words, be determined that in the special circumstances created by the parties' negotiations and the terms agreed by them, what could reasonably have been agreed upon as agreed damages.

2.57 The question which may arise here is which circumstances, other than the negotiations relating to the clause, are relevant to be examined to find out what reasonably could have been agreed upon as liquidated damages. The authorities refer to the "inherent circumstances of each particular contract" at the time when the parties enter into it.[174] It could simply be said that all issues which could be of any weight in determining objectively the reasonable intention of the parties should not be disregarded: Among them, "the relationship between parties"[175], "the genesis of", "understanding of", and "advice received regarding the clause" could be material[176] and the courts should consider all these points in deciding the nature of the clause.

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[172] As contended by the plaintiff in *Multiplex Constructions Pty Ltd. v. Abgarus Pty Ltd.* [1992] 1 APCLR 1, at p. 7

[173] [1992] 1 APCLR 1, at p. 14

[174] *Dunlop Pneumatic Tyre co Ltd. v. New Garage and Motor co Ltd.* [1915] AC 79, at pp. 86-87 per Lord Dunedin; *Malouf (W.T.) Pty Ltd. v. Brinds Ltd.* (1981) 52 F.L.R. 442, at p. 462

[175] See also *infra.*, para. 2.58

[176] *Multiplex Constructions Pty Ltd. v. Abgarus Pty Ltd.* [1992] 1 APCLR 1

5.3. Inequality of Bargaining Power

2.58 As stated above[177], the test to distinguish liquidated damages from penalties in Australia is a little different from what is applied in England. A return to "extravagance" and "unconscionability" concepts was started in Australia by the decision of the High Court in *AMEV-UDC Finance Ltd. v. Austin*[178] and has been applied in the latter cases. The test proposed by Mason and Wilson JJ in that case to draw a distinction between penalties and liquidated damages takes into account the relationship between the parties as a relevant factor to decide about the unconscionability of the agreed damages clause:

> "The test to be applied in drawing that distinction is one of degree and will depend on a number of circumstances, including ... (2) the nature of relationship between the contracting parties, a factor relevant to the unconscionability of the plaintiff's conduct in seeking to enforce the term ..."[179]

The relevance of the bargaining position of the parties seems to be implicit in this passage as one of the important features of "the relationship between the parties". Accordingly, in the case of inequality of the bargaining power of the parties, "quite apart from whether the [agreed damages] clause fails because it lacks a compensatory character, it may also fail as being penalty imposed in circumstances rendering enforcement of the clause unconscionable."[180]

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[177] *supra.*, para. 2.53

[178] (1986) 162 CLR 170

[179] *Ibid.*, at p. 193

[180] *Multiplex Constructions Pty Ltd. v. Abgarus Pty Ltd.* [1992] 1 APCLR 1, at p. 13

Chapter 3

The Relationship between Penalties and Similar Contractual Provisions

Introductory Remarks

3.01 The concept of a "penalty clause" is normally associated with an stipulation for the payment of an extravagantly large sum of money upon breach. A number of other contractual provisions, however, may also resemble to penalties in their function. A clause providing for the forfeiture of moneys already paid by the promisor, or of proprietary or possessory interests held by him is a clear example of such provisions with which the second part of this thesis is concerned.[1] Also stipulations for the payment of a certain sum of money upon the occurrence of events other than breach may sometimes act as a penalty, though the doctrine has no application to such provisions.[2] Related to this example is a clause providing for a bonus payment in case of early completion: Instead of providing for £X to be paid upon failure by the promisor to meet a certain target date, the parties might agree on a lesser contractual price, and for a bonus payment if the promisor could meet the target date.[3]

3.02 There are two provisions which give rise to a considerable debate and controversy in this regard: **First**, an agreed damage clause, in certain circumstances, may act as limiting the liability of the promisor. Since limitation clauses are subject to some restrictive provisions, it should be seen whether these provisions can have any application to such agreed damage clauses. Further, the effect of a penalty clause which, in effect, limits the promisor's liability should be determined: is it simply a void penal stipulation which has no effect in limiting the promisor's liability, or can it, at least in certain situations, be considered as an effective restrictive stipulation? **Second**, clauses which

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[1] See *infra.*, pp. 256 *et seq.*

[2] See *infra.*, chapter 4

[3] Such a clause is also not apparently subject to the penalty doctrine. The use of these provisions, instead of agreed damage clauses, has been recommended in building contracts: see Report of the Committee on Placing and Management of Contracts for Building and Civil Engineering Work, HMSO, 1964, para., 9.22

accelerate the unaccrued liability of the promisor upon breach are usually found in credit agreements, and may sometimes act as a penalty. The extent to which these provisions can be subject to the penalty doctrine is, especially in lease agreements, controversial: it is, on the one hand, argued that such provisions do not increase the liability of the defaulting party, and thus they should not be subject to the penalty doctrine. On the other hand, the difference in value between the early payment and the payment by instalments leads some commentators to suggest that acceleration clauses, like agreed damages, should be scrutinized to see if they are penal in nature.

This chapter will therefore seek to examine in detail these two contractual provisions, in order to illuminate the possible interrelationships between stipulated damage clauses and limitation clauses (sec. 1), and penalties and acceleration clauses (sec. 2).

1. Relationship between an "Agreed Damage Clause" and a "Limitation Clause"

1.1. Introduction

3.03 A contractual clause which excludes or restricts the liability of the defaulting party for losses resulting from breach of a contractual obligation is called an "exemption clause". These clauses, like agreed damages clause, are commonly found in commercial contracts and are subject to judicial and legislative control. The Unfair Contract Terms Act 1977[4] includes the most important features of this control and has imposed some restrictions on the validity of exemption clauses.[5] Since there are some similarities between these clauses and agreed damages clauses, and in some cases the latter may function as limiting the amount of the liability of the party who is in breach, it is, therefore, necessary to distinguish these two clauses and to discuss the possible applicability of the restrictive provisions concerning exemption clauses to agreed damages clauses.

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[4] And in consumer context, the Unfair Terms in Consumer Contracts Regulations 1994 (SI 1994/3159) implementing the EC Directive on Unfair Terms in Consumer Contracts: 93/13/EEC

[5] See Lawson R., Exclusion Clauses, 4th ed., 1995, pp. 44-45; Yates D., Exclusion Clauses in Contracts, 2nd ed., 1982, chap. 1

1.2. Distinguishing Agreed Damages Clause from an Exemption Clause

3.04 Unlike the agreed damages clause which is normally a fixed amount provided to be paid by the defaulting party to the other, an exemption clause fixes a maximum limit to the amount of damages which the aggrieved party is entitled to receive if he can prove his loss resulting from breach.[6] If, therefore, a contract contains a valid exemption clause, the maximum amount of recovery for the proved damages will be restricted to the sum laid down by the clause. However, where there is a valid agreed damages clause, the aggrieved party will be entitled to receive that amount for his loss without any need to prove it.

3.05 Where the amount of agreed damages turns out to be less than the actual loss suffered by the innocent party (as the result of breach), the agreed damages clause will, in effect, function as an exemption clause[7] which, though not fixing a limit to the maximum recoverable loss, fixes an exact amount which is intended to be recoverable as the loss resulting from breach. The effect of such an agreed damages clause will depend on whether the parties, on agreeing upon future damages, have covenanted for liquidated damages or a penalty. Each of these situations should, and will, be given separate consideration.[8]

3.06 As it was discussed before[9], the distinction between liquidated damages and penalties depends on whether there is a gross disproportion between the agreed sum and the likely actual loss which could conceivably be expected to flow from breach at the time when the contract was entered into. Normally when the agreed sum is disproportionately large in comparison with the likely actual loss, the courts have held the sum to be a penalty and unenforceable. However, the situation where there was a great disparity between a small agreed sum and the likely actual loss seemed not to be clear. It was

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[6] Yates D., Exclusion clauses in contracts, 2nd ed., p. 38; Tillotson J., Contract Law in Perspective, 2nd ed., p. 226

[7] *Diestal v. Stevenson* [1906] 2 KB 345 ; *Suisse Atlantique Societe D'armement Maritimes S.A. v. N.V. Rotterdamsche Kolen Centrale* [1967] AC 361 ; *Cellulose Acetate Silk Co. Ltd. v. Widnes Foundry (1925), Ltd.* [1933] AC 20

[8] See *infra.*, paras. 3.10 *et seq.*

[9] See *supra.*, paras. 2.25-2.27

suggested that such a small sum could not be a genuine pre-estimate of future damages resulting from breach and although "it cannot realistically be called a penalty in the conventional sense of an extravagant and unconscionable sum fixed in terrorem", it might be said that "a sum substantially smaller than the probable loss could be a penalty in relation not to the party paying but to the party to be paid the sum: he has agreed to accept as compensation for breach a completely inadequate amount, which is thus fixed in terrorem of him and penalises him."[10] This view was rejected by the House of Lords in the *Suisse Atlantique* case[11] where Lord Upjohn refused to accept the argument that the agreed damages were too small to be regarded as a pre-estimate of future losses, and thus should be of a penal nature. His lordship argued:

> "It is quite clear on the authorities that the parties need not agree on a true estimate of damage. They are perfectly entitled to agree on a low rate."[12]

Therefore, the agreement of the parties on a lower rate than the likely actual loss, though it might limit the liability of the defaulting party, could not be regarded as a penalty *merely* because it is too small to be a genuine pre-estimate of damages which could flow from breach.

3.07 It has been suggested that the law on penalties does not apply to a situation in which the parties have agreed upon damages on a lower rate than the anticipated actual loss, *with the object of limiting the recoverable amount*: such a clause "is to be classed as a form of exception clause, and its validity is therefore dependent on the law governing such contractual terms".[13] According to this view, if parties covenant for a sum smaller than the likely actual loss to be paid upon breach, the contractual provision will lose its

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[10] McGregor on Damages, 15th ed., 1988, para. 498

[11] *Suisse Atlantique Societe D'armement Maritimes S.A. v. N.V. Rotterdamsche Kolen Centrale* [1967] AC 361; See also *Robophone Facilities, Ltd. v. Blank* [1966] 3 All ER 128, at p. 137 where Harman L.J. in considering a situation in which the actual damage amounted to more than the agreed damages, stated: In such a case "no question of penalty arose, for it is only when the agreed damage is disproportionately more than the actual damage suffered on any breach that the question of penalty arises." ; *Cellulose Acetate Silk Co. Ltd. v. Widnes Foundry (1925), Ltd.* [1933] AC 20 ; *Francis Fuel Ltd v. Taggart* [1976] 72 DLR 3rd, 22 at p. 28

[12] *Ibid*, at p. 421; See also *Chandris v. Isbrandtsen Moller Co. Inc.* [1951] 1 KB 240, in which Devlin J. at p. 249 stated that: " a demurrage clause is merely a clause providing for liquidated damages for a certain type of breach... . Even though its amount is less than actual loss, it is not different in its nature from an ordinary liquidated damages clause."

[13] Ogus A I, The Law of Damages, 1973, p. 51

nature as an agreed damages clause, and is to be classified as an exception clause. Thus, the plaintiff will have to prove his actual loss, and the exception clause will debar him from the recovery of more than the stipulated sum.[14] This view, with all respect, would seem to be doubtful and no support among authorities could be found for it. Conversely, though the authorities[15] refuse to regard such a clause as being a penalty merely because it is too low to be a genuine pre-estimate of likely actual damages, they do apply the law on penalties to such clauses[16], and consider the agreed sum as being penal, *inter alia*, on what has sometimes been called "technical grounds"[17]. Put another way, where the agreed sum has been provided to be paid upon different breaches of varying importance, they might regard it as a penalty.[18]

3.08 The distinction between an agreed damages clause which is less than the actual loss and an exemption clause has well been drawn in the *Suisse Atlantique*[19] case. In this case, a charterparty contract provided for the fixed periods of laytime for loading and discharging the vessel and also for the payment of a demurrage at a rate of $1000 US a day. On a consultative question put by the arbitrators as to whether the owners are entitled to recover any actual damage suffered by them by reason of the charterers having failed to load and discharge the vessel within the laytime, the House of Lords unanimously held that the demurrage clause is a valid liquidated damages and no loss more than this agreed sum could be recovered. Lord Upjohn in discussing whether the demurrage clause is a clause of exception or limitation, confined the exemption clauses to "clauses essentially inserted *for the purpose only of protecting one contracting party* from the legal consequences of other express terms of the contract or from terms which

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[14] *Ibid.*

[15] See *supra.*, note 11

[16] In *Cellulose Acetate Silk Co. Ltd. v. Widnes Foundry (1925), Ltd.* [1933] AC 20, for example, the clause providing for an agreed damages which was clearly less than anticipated actual harm was regarded as "liquidated damages". Even the possibility of the clause being regarded as a penalty and its possible effect was raised, but the House found it unnecessary to decide on this point. see at pp. 25-26 per Lord Atkin with whom the other members of the House concurred.

[17] Treitel G.H., The Law of Contract, 9th ed., 1995, p. 902

[18] See for example: *Wall v. Rederiaktiebolaget Luggude* [1915] 3 KB 66 ; *Watts, Watts and Co., Ltd. v. Mitsui and Co., Ltd.* [1917] AC 227

[19] *Suisse Atlantique Societe D'armement Maritimes v. Rotterdamsche Kolen Centrale* [1967] AC 361 at pp. 420-421; See also *Chandris v. Isbrandtsen Moller Co. Inc.* [1951] 1 KB 240, per Devlin J. at p. 249

would otherwise be implied by law or from the terms of the contract regarded as a whole" and added:

> "An agreed damages clause is *for the benefit of both*; the party establishing breach by the other need prove no damage in fact; the other must pay that, no less but no more. But where liability for damage is limited by a clause, then the person seeking to claim damages must prove them at least up to the limit laid down by the clause; the other party, whatever may be the damage in fact, can refuse to pay more if he can rely on the clause."[20]

Thus, where the agreed sum, in effect, limits the liability of the defaulting party to the fixed sum, if it was inserted for the benefit of both parties, then it would be necessary to be distinguished from a limitation clause which is normally stipulated for the purpose of protecting only the debtor. It should, however, be noted that it might be entirely a matter of chance which party will, in fact, be benefited by an agreed damages clause[21], for instance, in a building construction contract, the agreed damages for delay in completion might benefit the owner if in a case of due completion, he was not in fact able to have the building sold or let or use it properly as it had been intended before; and it could be to the advantage of the contractor if the owner loses more than the stipulated sum as a result of the delay. Where, however, in the rare case, the clause benefits only the promisor and there is no possibility or a remote possibility of assuming that the promisee can take advantage of that, it is likely that the clause will be construed as an agreed limitation.

3.09 As a result of this distinction, where the clause is regarded as a limitation clause, it will be necessary for the promisee to establish his actual loss, though he is restricted to the limit set out by the clause. While if the clause is an agreed damages clause which is less than the actual loss and, in effect, limits the liability of the defaulting party, there will be no need for the actual loss to be proved and the innocent party will be entitled to recover the agreed sum even when there is in fact no loss sustained as a result of the

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[20] Ibid. p. 420-421 [emphasis added]; See also the judgments of Viscount Dilhorne at p. 395 and Lord Reid at p. 407 where he stated: "Even if one assumes that the $1000 per day was inadequate and was known to both parties to be inadequate when the contract was made, I do not think that it can be said that giving to the clause its natural meaning could lead to an absurdity or could defeat the main object of the contract or could for any other reason justify cutting down its scope." and particularly Lord Wilberforce at pp. 435-436.

[21] Treitel, Remedies for Breach of Contract (A Comparative Account), 1988, p. 234

breach.[22]

1.3. The Effect of Agreed Damages Less than Actual Loss

3.10 An agreed damage which is less than actual loss, though it could not be regarded as penal merely because it is too small[23], might be considered as having a penal nature in one of the following situations[24]:

(i) Where the agreed sum has been made payable on the occurrence of different breaches of varying importance, the clause might be held to be penal under one of the practical rules laid down by Lord Dunedin in *Dunlop v. New Garage*[25] regardless of the fact that it is less than the actual loss which has in reality been resulted from breach.[26]

(ii) If the agreed sum which was disproportionately large at the time of contracting turns out to be inadequate to cover the actual loss sustained due to a change in circumstances, then the agreed sum may be held to be of penal nature[27]. This is because the time for the application of any test to distinguish penalties from liquidated damages is the time when the contract was made, and any disparity between the agreed sum and the actual loss at the time of breach is of little importance.[28]

3.11 The main issue is whether an agreed sum which is less than the actual loss could effectively limit the liability of the defaulting party to the fixed amount or the promisee would be entitled to ignore the agreed sum and sue for his actual loss. The answer mainly depends on the construction of the clause to see whether the agreed sum is a penalty or liquidated damages.

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[22]Yates D., Exclusion clauses in contracts, 2nd ed., 1982, p. 39

[23] See *supra* para. 3.06

[24] The question whether such a penal sum could limit the liability of the defaulting party, or the promisee can ignore this penal sum and sue for his actual loss, will be discussed later; *infra.*, paras. 3.15 *et seq.*

[25] *Dunlop Pneumatic Tyre Company Ltd. v. New Garage and Motor Co., Ltd.* [1915] AC 79 at p. 87 (See *supra.*, paras. 2.36 *et seq.*)

[26] See *Wall v. Rederiaktiebolaget Luggude* [1915] 3 KB 66 ; *Watts, Watts and Co., Ltd. v. Mitsui and Co., Ltd.* [1917] AC 227 ; Burrows A, Remedies for Torts and Breach of Contract, (2nd ed., 1994), p. 327; Treitel G.H., The Law of Contract, 9th ed., 1995, p. 902; Barton (1976) 92 LQR, p. 25 ; Hudson (1974) 90 LQR, p. 81

[27] Treitel G.H., The Law of Contract, 9th ed., 1995, p. 902

[28] See *supra.*, para. 2.20

1.3.1. Where the agreed sum is a liquidated damages clause

3.12 The agreed sum less than actual loss would normally be construed to be liquidated damages where it is not penal. Such a clause is obviously valid and enforceable, and will effectively limit the entitlement of the promisee to the stipulated sum.[29] In *Cellulose Acetate Silk Co. Ltd. v. Widnes Foundry (1925), Ltd.*[30], a contract for delivery and erection of an acetone recovery plant provided for the payment of a sum of £20 per week by way of penalty if the work were not completed in the contractual stipulated time. In fact, the completion was delayed for thirty weeks. In an action for the price by the contractor, the purchasers counterclaimed £5850 as the actual loss suffered as a result of delay. It was held by the House of Lords that the agreed sum was a valid and enforceable liquidated damages clause. It was thus the only sum which the purchasers were entitled to recover as damages. In the course of his judgement, Lord Atkin stated:

> "Except that it is called a penalty, which on the case is far from conclusive, it appears to be an amount of compensation measured by the period of delay. I agree that it is not a pre-estimate of actual damage. I think it must have been obvious to both the parties that the actual damage would be much more than £20 a week; but it is intended to go towards the damage, and it was all that the sellers were prepared to pay."[31]

Therefore, where the agreed amount is liquidated damages, it will remain valid, enforceable and the only recoverable sum, even where it turns out to be less than the actual loss.

3.13 The controversial point is whether in such a situation- where liquidated damages clause, in effect, functions like a limitation clause- the agreed damages clause is subject to the Unfair Contract Terms Act 1977 or any other statutory restrictions relating limitation

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[29] Treitel, Remedies for Breach of Contract, 1988, p. 233; Treitel G.H., The Law of Contract, 9th ed., 1995, p. 902; McKendrick E., Contract Law, (2nd ed., 1994), pp. 329-330; Chitty on Contracts, 27th ed., vol. 1, 1994, para. 26-067 at p. 1260; Barton (1976) 92 LQR 20 at p.24 ; Yates D., Exclusion Clauses in Contracts, 2nd ed., 1982, p.38; Law Commission's Working Paper, no. 61, "Penalty Clauses and Forfeiture of Monies Paid", 1975, para. 46

[30] [1933] AC 20

[31] *Ibid.* at pp. 25-26 ; See also *Chandris v. Isbrandtsen Moller Co. Inc.* [1951] 1 KB 240 ; *Suisse Atlantique Societe D'armement Maritimes v. Rotterdamsche Kolen Centrale* [1967] AC 361 in which the sum provided to be paid as demurrage was held to be liquidated damages and the only recoverable sum: especially at pp. 389 & 395 per Viscount Dilhorne and at p. 414 per Lord Hudson; *Temloc Ltd. v. Erill Properties Ltd.* (1987) 39 Build. L. R. 30

clauses.[32] There is, apparently, no clear authority on the point. It has been suggested that where an agreed damages clause is held to "restrict or exclude" the liability of the party who is in breach, it may be subject to s. 3 of the Unfair Contract Terms Act 1977.[33] Thus, such an agreed damages clause which, in effect, limits the liability for breach should satisfy the requirement of reasonableness.[34] On the other hand, considering the fact that an agreed damages clause is normally capable of benefiting both contracting parties, even where the parties intended to agree on a sum below the estimated loss, it has been suggested that such a clause is probably not subject to the Unfair Contract Terms Act 1977.[35] Where, however, the true nature of the clause is to limit the liability and the possibility of the clause benefiting the plaintiff is "nothing more than a remote and theoretical one", the application of the statutory, as well as the common law, restrictions has been stated to be probable.[36]

3.14 The agreed damages clause which fixes a sum less than the actual probable loss to be payable in the event of breach seems to be different in nature from a limitation clause which fixes a ceiling for the recoverable damages. That is because, though at first sight such a clause is inserted for the benefit of the defendant, it might also benefit the plaintiff where he has suffered no loss as a result of the breach. This might seem to support the proposition that a liquidated damages clause which is less than the actual loss should not be subject to the statutory, as well as the common law, restrictions; because, unlike a limitation clause, it does not act as only restricting or excluding the liability of the defaulting party. In some cases, in fact, it might extend the liability, *i.e.* where the plaintiff has sustained no damages. In most cases, however, the possibility of such a clause benefiting the creditor is only a theoretical, rather than a practical one. It should

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[32] Such as Unfair Terms in Consumer Contracts Regulations 1994 where it is applicable

[33] McKendrick E., Contract Law, (2nd ed., 1994), p. 330; The Law Commission has suggested that any legislation relating to exemption clauses should be applicable to an agreed damages clause which, in effect, exempt the party from his full liability. (Law Commission's Working Paper, no. 61, "Penalty Clauses and Forfeiture of Monies Paid", 1975, para. 47 at p. 35)

[34] See Unfair Contract Terms Act 1977, ss. 11(1), 11(2) and schedule 2

[35] Treitel G.H., The Law of Contract, 9th ed., 1995, p. 902; though it may, in certain circumstances, be subject to the Unfair Terms in Consumer Contracts Regulations 1994.

[36] Treitel, Remedies for breach of contract, 1988, p. 234

also be noted that the Unfair Contract Terms Act 1977 applies to all clauses which are inserted *for the purpose of restricting or excluding* the liability.[37] Where the parties, at the time of making the contract, could reasonably foresee that the actual probable loss is greater than the agreed sum, their *objective intention* to restrict the liability for the breach of contract seems to be apparent. The clause, therefore, it is suggested, might be subject to the Unfair Contract Terms Act 1977.[38]

In some cases, however, the objective intention of "restricting or excluding" the liability of the defaulting party, by agreeing on a fixed sum as liquidated damages, may not be attributable to the parties. In such a case, if the agreed sum, because of a change in circumstances or any other reason, turned out to be less than the actual loss, the applicability of the restrictive provisions, *inter alia*, the Unfair Contract Terms Act 1977 to such a clause-which, in effect, limits the liability of the party who is in breach- seems to be doubtful.[39]

1.3.2. Where the agreed sum is a penalty

3.15 In a normal situation, where the agreed sum has been held to be of a penal nature, it is considered as unenforceable. Thus, the promisee would have to prove his actual loss resulting from breach, and would be entitled to recover it regardless of the penal sum. If, however, the amount of the penalty is less than the actual loss, the law does not seem to be clear: The controversial point is whether the promisee, in an action for damages resulting from breach, would be limited to the penal sum and can only recover his proved loss up to the stipulated amount or he can waive the penalty as an unenforceable clause and sue for his actual loss without any limit.

3.16 It could be argued that if it is correct to be said that a penalty clause is void and unenforceable, then how could it be assumed that such a void clause turns out to be valid

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[37] ss. 2, 3, 6, 7 Unfair Contract Terms Act 1977

[38] See Benjamin's Sale of Goods, 4th ed., 1992, para. 16-032; Chitty on Contracts, 27th ed., vol. 1, 1994, para. 26-067, note 62; Harris D., Remedies in Contract and Tort, 1988, p. 111; Beale H, Remedies for Breach of Contract, pp. 53-54

[39] See Benjamin's Sale of Goods, 4th ed., 1992, para. 13-033 ; Chitty on contracts, 26th ed., para. 985. In any event the Unfair Terms in Consumer Contracts Regulations 1994 would, in certain circumstances, be applicable.

merely because the amount of actual loss has turned out to be greater than the penal sum. It would follow that the promisee can sue for his actual loss and the penal sum has no limiting effect. The well-known charterparty cases[40] support this proposition: In these cases the agreement of the parties as to damages resulting from breach, "penalty for non-performance of this agreement proved damages, not exceeding estimated amount of freight", was held to be penal, and the action of the charterer for the recovery of his actual loss which was greater than the stipulated amount was upheld.

In *Wall v. Rederiaktiebolaget Luggude*[41], for example, in the course of his judgement, Bailhache J, citing some old authorities[42], discussed the position of a contract which contains an indisputable penalty clause and concluded that if promisee sued for the penal amount, then he would be able to recover his proved damages, but not more than the penal sum fixed; however, he has the right to disregard the penalty and sue for damages which has actually been suffered by him.[43] This case was upheld by the House of Lords in *Watts, Watts and Co. Ltd v. Mitsui and Co., Ltd.*[44], and this approval seemed to make the position clear and stronger as to charterparty cases. It has been suggested[45] that these cases might require reconsideration in the light of the *Suisse Atlantique* case[46]; but, with all respect, the latter case does not seem to discuss the situation in which a penal sum has been argued to act as a limitation of liability. In this case the demurrage clause was held to be not more than a liquidated damages clause which surely limits the liability of the defaulting party to the stipulated sum.[47]

3.17 The important issue which is raised in this relation is whether the rule laid down by

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[40] *Stroms Bruks Aktie Bolag v. Hutchison* [1905] AC 515 ; *Wall v. Rederiaktiebolaget Luggude* [1915] 3 KB 66; *Watts, Watts and Co., Ltd. v. Mitsui and Co., Ltd.* [1917] AC 227

[41] [1915] 3 KB 66

[42] *Inter alia, Lowe v. Peers* (1768) 4 Burr. 2225 at p. 2228 , 98 ER 160 at p. 162 per Lord Mansfield; *Harrison v. Wright* (1811) 13 East 343 , 104 ER 402; see also *Winter v. Trimmer* (1762) 1 Wm. Bl. 395, 69 ER 225, per Lord Mansfield C.J.; *Maylam v. Norris* (1845) 14 LJCP 95

[43] *Ibid.* pp. 72-73

[44] [1917] AC 227

[45] Chitty on Contracts, 27th ed., vol. 1, 1994, para. 26-067, note 65

[46] [1967] AC 361

[47] See *ibid* at p. 421 per Lord Upjohn; at pp. 389, 395 per Viscount Dilhorne; See also *supra.*, para. 3.12

the charterparty cases, particularly *Wall v. Rederiaktiebolaget Luggude*[48], can be applied as to other contracts. In other words, can any general rule be derived from the decisions in the charterparty cases as to nullity and unenforceability of penalties where they are less than actual loss so that the promisee could waive the penalty clause and sue for his actual loss? The question was raised in the House of Lords in *Cellulose Acetate Silk Co. Ltd. v. Widnes Foundry (1925) Ltd.*[49], but the House left it open, stating:

> " I desire to leave open the question whether, where a penalty is plainly less in amount than the prospective damages, there is any legal objection to suing on it, or in a suitable case ignoring it and suing for damages."[50]

Also, in *Robophone Facilities, Ltd. v. Blank*[51], Diplock L.J. stated that "it [was] by no means clear that penalty clauses [were] simply void..." and they could not limit the liability of the defaulting party where they were less than actual loss.[52]

3.18 Most writers and commentators[53], citing mainly the charterparty cases, have suggested that generally the penal sum could be ignored, and the promisee would be able to sue for his actual loss.[54] This view has been doubted[55] arguing that the charterparty cases have a very special character and it might be hazardous to attempt to derive any

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[48] [1915] 3 KB 66

[49] [1933] AC 20

[50] *Ibid*, at p. 26 per Lord Atkin with whom other members of the House agreed.

[51] [1966] 1 WLR 1428 ; [1966] 3 All ER 128

[52] *Ibid*, at pp. 1446, 142 respectively

[53] Cheshire, Fifoot & Furmston, The Law of Contract, 13th ed., p. 635; Yates D., Exclusion Clauses in Contracts, 2nd ed., p. 38; McGregor on Damages, 15th ed., 1988, para. 501; Treitel G.H., The Law of Contract, 9th ed., 1995, p. 902; Anson's Law of Contract, 26th ed., 1984, p. 511; Ogus, The Law of Damages, 1973, pp. 50, 51; Upex R., Davies on Contract, 6th ed., p. 292; Barton (1976) 92 LQR 20, at p. 25

[54] See also Gordon, G.H. (1974) 90 LQR 296, pp. 296-297, citing the Scottish case of *Dingwall v. Burnett* [1912] S.C. 1097 in which a clause in a contract for the lease of a hotel providing for "the penalty of £50 to be paid by the party failing to the party performing or willing to perform over and above performance" was held to be penal and the claim of the owner for damages of £300 for breach of contract (more than penal sum) was upheld. The authority of this case might be weakened by paying attention to the wording of the clause which provides for the penal sum "over and above performance" and it might be said that the clause purports that the parties neither intend to pre-estimate the likely loss nor to limit it to the stipulated sum. (See Hudson (1975) 91 LQR 25) If, however, the plaintiff sues in debt for the penalty, the amount of proved damages may be limited to his claim, i.e. the penal sum: see *Wall v. Rederiaktiebolaget Luggude* [1915] 3 KB 66, at p. 72 per Bailhache J.

[55] See Burrows A, Remedies for Torts and Breach of Contract, (2nd ed., 1994), p. 327; Hudson A. H., Penalties Limiting Damages (1974) 90 LQR 31, at pp. 32-33 & (1975) 91 LQR 25 & (1985) 101 LQR 480

general rule from them. Moreover, a general reliance on the charterparty cases would merely strengthen the position of the party taking advantage from the penalty clause: A party who stipulates for a penal sum to intimidate the other party to perform his obligation, in addition to benefiting from this, ignores it, and recovers his actual damage where the actual loss turns out to be more than the penal sum. Furthermore, the application of the rule set out in the charterparty cases to other contracts would result in a paradoxical situation in which a person breaking the law by stipulating for a penalty would be in a better position than a person who acts in conformity with the law[56]; because if he had stipulated for liquidated damages instead of a penal sum, he would have been limited to the contractual fixed amount. Such a treatment, therefore, would encourage the inclusion of penalties which is the infringement of the law. Thus, it has been submitted that the promisee can only recover his proved damages up to the stipulated penal sum, and no loss more than penal amount is recoverable.

3.19 These lines of reasoning seem to be forceful. The special character and unique quality of charterparty clauses should be paid more attention. As Bailhache J. stated in *Wall v. Rederiaktiebolaget Luggude*[57], such a clause had a historical background in charterparty contracts and originally provided thus: " Penalty for non-performance of this agreement estimated amount of freight". In holding the clause to be of a penal nature, Bailhache J. had much reliance on this background[58] and was of the opinion that the addition of a few words to the original form, which was undoubtedly penal, did not change the nature of the clause. The importance of the historical background of the clause in determining its nature was also pointed out in *Watts v. Mitsui*[59] by Lord Finlay L.C.:

> "I agree with the construction put in the courts below on clause 13 - the penalty clause. If this clause had appeared for the first time I think it might have been construed as imposing a limitation on the damages to be recovered, but the penalty clause is an old one with a settled meaning, and the intention, if it existed, to make so fundamental change in its effect as is

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[56] See Law Commission's Working Paper, no. 61, "Penalty Clauses and Forfeiture of Monies Paid", 1975, paras. 46, 48 at pp. 34-35

[57] [1915] 3 KB 66

[58] On this point see McGregor on Damages, 15th ed., 1988, para. 500

[59] [1917] AC 227

> suggested ought to have been more clearly shown in order to bind the other party to the contract."[60]

On this basis, the clause has been suggested to be an exceptional[61] one and the case itself a "rather weak authority"[62]. Whatever it may be, it could be suggested that it does not seem to be correct to try to derive a general rule from the charterparty cases and the authority of the case, therefore, should be confined to the charterparty clauses.

3.20 There are also some dicta[63] suggesting that the recoverable sum is limited to the amount stipulated by the penalty clause. In *Elphinstone v. Monkland Iron and Coal Co.*[64], Lord Fitzgerald, pointing out the right and power of the parties to stipulate for liquidated damages or penalty under the Law of Scotland, stated:

> "... In the other (i.e. where the parties have provided for a penalty), the penalty is to cover all the damages actually sustained, but it does not estimate them, and the amount of loss (not, however, exceeding the penalty) is to be ascertained in the ordinary way."[65]

Moreover, in the rather recent Canadian case of *Elsley v. Collins*[66] Dickson J. delivering the judgement of the Supreme Court of Canada, held that the clause providing for the payment of $1000 "as and for liquidated damages" in the event of breach by the employee of the covenant not to compete after leaving his employer's employment did effectively limit the liability of the defaulting party. The learned judge, then, citing *Story, Equity Jurisprudence*[67] to show that the foundation of the court's intervention against penalties was relief against oppression and so there is no place to intervene where there is no oppression, pointed out:

> "... If the actual loss turns out to exceed the penalty, the normal rules of enforcement of contract should apply to allow recovery of only the agreed

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[60] *Ibid.*, p. 235

[61] McGregor, loc. cit. , para. 500

[62] Burrows A, Remedies for Torts and Breach of Contract, (2nd ed., 1994), p. 327

[63] *Wilbeam v. Ashton* (1807) 1 Camp. 78; 170 ER 883 where Lord Ellenborough stated: "Beyond the penalty you shall not go; within it you are to give the party any compensation which he can prove himself entitled to."; *Elphinstone v. Monkland Iron and Coal Co.* (1886) 11 App. Cas 332; *Public Works Commissioners v. Hills* [1906] AC 368, per Lord Dunedin at 375 : "... a penalty which covers the damage if proved, but does not assess it..."

[64] (1886) 11 App. Cas. 332

[65] *Ibid.*, p. 346

[66] *Elsley v. J.G. Collins Insurance Agencies Ltd.* (1978) 83 DLR (3rd) 1

[67] 14th ed., s. 1728

> sum. The party imposing the penalty should not be able to obtain the benefit of whatever intimidating force the penalty clause may have in inducing performance, and then ignore the clause when it turns out to be to his advantage to do so. A penalty clause should function as a limitation on the damages recoverable, while still being ineffective to increase damages above the actual loss sustained when such loss is less than the stipulated amount."[68]

3.21 It would seem that in determining the limitative effect of a penalty where it is less than the actual loss, attention should be paid to the construction of the contract to find out whether *an intention to limit the liability to the stipulated sum* could be attributed to the contracting parties. On this basis two different possibilities of the penal sum being less than actual damage[69] should be given separate consideration.

3.22 **First**, where the parties, at the time of contracting, have stipulated for an extravagant sum to be paid in the event of breach, and then due to a change in circumstances, it has turned out to be less than the actual loss, there is no justification to suggest that the parties have *intended* the exorbitant penal sum to act as limiting the liability of the defaulting party where it turns out to be less than actual loss. Furthermore, as it has been proposed by the Law Commission, such a view would lead to "odd consequences": (a) "the party said to be "terrorized" by the clause benefits from and seeks to uphold it", and (b) "striking down the clause because it appeared to penalise the party in breach at the earlier time will be to his disadvantage at the later time because instead of only having to pay the agreed sum, he will be liable for the full amount of damage suffered by the party who sought to impose the invalid penalty."[70] It may, therefore, be suggested that in such a case the penalty clause has no effect, for no

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[68] *Ibid.*, at p. 15 ; For the opposite view see the dictum of Lee J. in *W & J Investments v. Bunting* [1984] 1 NSWLR 331 at pp. 335-336, where he, relying on the charterparty cases discussed, said: "The conclusion that a penalty clause is unenforceable does no more than deny [the innocent party] the right to recover damages in terms of that clause, and that is because the amount provided for in the clause is not in the context and circumstances of the agreement to be regarded as a genuine pre-estimate of the damages which flow from a breach of the agreement. But this conclusion does not have the consequence that a breach of [the agreement] will not give rise to a right in damages, nor that ... on repudiation of the agreement recovery of an amount equal to or greater than the amount referred to in the clause cannot necessarily be had."

[69] See *supra.*, para. 3.10

[70] Law Commission's Working Paper, no. 61, "Penalty Clauses and Forfeiture of Monies Paid", 1975, para. 48 at p. 35

intention to limit the liability could be attributed to the parties. The result is that the penal sum could be ignored, and the actual loss would be recoverable.

3.23 **Second**, where, however, the stipulated sum is regarded as penal on the technical grounds, *i.e.* where a single sum is made payable on the occurrence of different breaches of varying importance, though the parties have not, presumably, covenanted for a genuine pre-estimate of likely actual damages- and in fact this might be the reason for striking down such a sum as not being liquidated damages- it could well be assumed that at least the parties have had the *intention* of setting a limit for the recoverable damage upon the occurrence of anyone of these breaches. As to breaches resulting in losses amounting to £10, £80 and £250, for example, the parties provide for the agreed sum of £100 to be paid upon anyone of these breaches. Such an agreed sum is not liquidated damages, for mainly it could not be regarded as a genuine pre-estimate of damages. However, it has been intended by the parties to be paid upon any one of breaches, and as to a breach resulting in losses larger than the agreed amount, the intention of limiting the liability, it seems, could be attributed to the contracting parties. Moreover, the stipulated sum in such a case is not exorbitant, extravagant or unconscionable and strictly speaking, it could not act as intimidating the promisor into performing his obligation and penalizing him in the event of breach. Therefore, though such an amount is not presumably a genuine per-estimate of the likely actual loss and it could not be regarded as the recoverable sum in the event of a breach losses resulting from which are less than the stipulated sum, it would seem that it would limit the liability of the defaulting party in respect of a breach losses resulting from that are greater than the covenanted amount.[71]

2. Acceleration Clauses

2.1. Introduction

3.24 The parties to a contract may provide for a clause by which the whole outstanding balance of the contractual consideration might be called upon by the creditor in the event of the occurrence of a designated event. Such a clause, which is called an acceleration clause, is commonly found in credit agreements, e.g. loan, conditional sale, hire-purchase

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[71] Given the correctness of this view, the limitative effect of the clause should, it appears, be subject to its reasonableness under the restrictive provisions- such as Unfair Contract Terms Act 1977- where they are applicable. see *supra.*, paras. 3.13-3.14

and lease contracts. For instance, it is a common provision in lease agreements that if the lessee made default in the payment of an instalment of the rent, then the whole rental for the remaining contractual period would immediately become due and payable.

3.25 Since, at first glance, an acceleration clause does not increase the liability of the defaulting party and only accelerate the payment which should have been paid by instalments, it might be assumed that there is no room for the application of the rules against penalties as to such a clause. On the other hand, it is thought that acceleration clauses should be subject to the penalty doctrine, because in fact early payment is more expensive than payment by instalments, and therefore the situation is like the one in which it has been provided that in the event of a default in the payment of a debt, a larger sum should be paid to the creditor, which is obviously subject to the penalty doctrine.

3.26 The acceleration of instalments might be provided for upon the contractual right of the creditor to terminate the contract. In other words, it might be stipulated that in the event of a default in the punctual payment of any instalment, the creditor would be entitled to terminate the contract, and upon termination, the whole unpaid instalments or a specified portion of that would immediately become due and payable. Much confusion might arise if mere acceleration clauses on the one hand and termination clauses which might result in the acceleration on the other, are not distinguished. Accordingly, this section, first and foremost, will be devoted to distinguishing acceleration and termination clauses, then acceleration clauses in some important credit agreements will separately be discussed.

2.2. Distinguishing Termination Clause from Acceleration Clause

3.27 If a contract contained the acceleration of the whole or a portion of the unaccrued instalments upon termination of the contract by the creditor for the other party's default, the clause then would be subject to the penalty doctrine.[72] This clause should be distinguished from a clause providing merely for the acceleration of future instalments in

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[72] Such a clause is called "termination clause" or "minimum payment clause", and is very commonly found in hire-purchase contracts. It will be discussed in detail later. See *infra.*, chapter 5

the event of the debtor's default in the punctual payment of an instalment.[73] In the latter, despite the activation of the clause, the contract remains on foot for the remaining contractual period, and the defaulting party, in spite of his liability to pay the whole outstanding balance promptly, has the right to benefit from the subject-matter of the contract in the contractual time. While by the activation of a termination clause, the contract ceases to be of any effect, and the defaulting party loses his contractual right for the remaining period. The effect of this distinction lies on the point that in case of termination of the contract, the liability of the defaulting party to pay the accelerated amount of the whole or a portion of future payments ceases to be in the nature of a *contractual consideration*, and obtains the character of *damages* which has been agreed in advance to be equal in amount to the accelerated amount of future payments. In other words, the sum provided to be paid upon termination of the contract in the event of the debtor's default, whatever it is, is an agreed damages, and is obviously subject to the rules concerning distinction between liquidated damages and penalties. However, the effect of an acceleration clause is not to convert the nature of payment, but only to advance the defaulting party's primary payment obligation. Putting it another way, by the activation of an acceleration clause in a lease, for example, the lessee has to pay the same rent, but instead of paying by instalments, he has to advance the whole rent promptly.

3.28 The important issue which is raised and needs more discussion is whether an acceleration clause- by which it has been provided that upon the debtor's default, the whole unaccrued instalments would become due- is subject to the penalty doctrine. The obvious examples of these clauses are accelerations provided for in loan agreements. The position in these contracts, therefore, will first be considered, then some important credit agreements, e.g. hire-purchase, conditional sale and lease, will be dealt with.

2.3. Acceleration Clauses in Loan Agreements

3.29 In a contract for loan, the parties may provide for the acceleration of the principal in the event of the debtor's default in punctual payment. In such a case, since the liability of the debtor has not been increased and only the way of payment has changed, the

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[73] Goode R. M., Acceleration Clauses [1982] JBL 148, pp. 148-149 ; Goode, Payment obligations in Commercial and Financial Transactions, p. 52

acceleration clause will not be subject to the penalty doctrine.[74] Putting it another way, there is an existing debt which the agreement of the parties has been provided for its repayment by instalments provided that the instalments are paid punctually. In the event of default, in fact, the right given to the debtor to repay the debt by instalments is withdrawn, and he is therefore obliged to pay his existing debt, without any excess, immediately. Therefore, there seems no compelling reason for the application of the penalty doctrine.[75] In *The Protector Endowment Loan Co. v. Grice*[76], the plaintiffs had lent £50 to the debtor who covenanted to repay it together with interest, negotiation expenses and a premium for the insurance of the debtor's life. The defendant was the guarantor of the debtor's bond which provided that the total amount repayable, namely £70, would become due if a default in the payment of a single instalment happened. Default having been made, the plaintiff claimed the whole unpaid instalments relying on the acceleration clause. The Court of Appeal, reversing the judgement of Bowen J. at first instance, unanimously held that the amount claimed was not a penalty and could be recovered. It seems that the point underlying the decision of the Court of Appeal was that upon the bond, there was an existing debt of £70 which had been agreed to be paid by instalments, and a covenant requiring its acceleration in the event of default should not be penal. This point could be inferred from the judgement of Brett LJ where he stated:

> "The contract is that the borrower shall repay £70, there is no other debt, and no other sum is mentioned. It is an agreement to repay by quarterly instalments; but if default should be made, then the whole sum of £70 was

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[74] *The Protector Endowment Loan and Annuity Company v. Grice* (1880) 5 QBD 592 ; *Sterne v. Beck* 1 De. G. J. & S. 595, 46 ER 236; *Thompson v. Hudson* (1869) Law Rep. 4 H.L. (English and Irish Appeal Cases) 1 where Lord Hatherley L.C. at pp. 15-16 stated: "... where there is a debt due, and an agreement is entered into at the time of that debt having become due and not being paid in regard to farther indulgence to be conceded to the debtor, or farther time to be accorded to him for the payment of the debt, or in regard to his paying it immediately, if that be a portion of the stipulations of the agreement, or at some further time which may be named, and the creditor is willing to allow him certain advantages and deductions from that debt, as well as to extend the time for its payment, if adequate and proper security in the mind of the creditor be afforded him as his part of the bargain in respect of which he is to make these concessions, then it is perfectly competent to the creditor to say: 'If the payment be not made *modo et forma* as I have stipulated, then forthwith the right to the original debt reverts, and it is to be open to me to proceed with reference to the original debt, and to exercise all those powers which I possess for compelling payment of the original debt; in other words I am entitled to be replaced in the position in which I was when this agreement, which has been now broken, was entered into.'"

[75] See also Chitty on Contracts, 27th ed., vol. 1, 1994, para. 26-065; McGregor on Damages, 15th ed., 1988, para. 523 note 44; McKendrick E., Contract Law, (2nd ed., 1994), p. 330; Treitel G.H., The Law of Contract, 9th ed., 1995, p. 900

[76] (1880) 5 QBD 592

> to become payable at once. In my opinion the stipulation to pay immediately is not to be treated as a penalty; but a stipulation to pay a large sum upon default would be a penalty, and could not be recovered."[77]

A clear application of this principle can be found in the decision of the House of Lords in *Wallingford v. Mutual Society*[78] in which Lord Selborne L.C., dealing, *inter alia*, with a mortgage bond, given to secure the due payment by instalments of a sum due, containing an acceleration clause in the event of default, stated:

> "I cannot think that such an acceleration of payments has anything common with a penalty. It was a contract for certain payments which were *debita in presenti* although *solvenda in futuro*; and, being such, it is consistent both with principle and with authority to hold, that if the party who ought to have paid them, or any of them, at the proper time failed to do so, the default was his own, and the time might lawfully be accelerated for the other payments which were originally deferred."[79]

3.30 If the contract of the parties, besides the acceleration of the principal, provided that upon default, the whole unaccrued interest for the remaining period of the loan would become accelerated and payable immediately, the position then would seem to be different. This normally happens when the parties have pre-calculated and integrated the interest with the principal and provided for the payment of the integrated amount of the principal and interest by instalments, and that on default, the whole unaccrued instalments would become due. Suppose that L lends £5000 to B with the interest of £1000 to be repaid in the period of five years by the yearly instalments of £1200. If the contract contained an acceleration clause, then upon a default, for example in the payment of the third instalment, the whole unpaid balance, *i.e.* £3600, would become due and payable immediately. In such a case, despite B is not entitled to use the remaining period of 2 years to repay his debt by instalments, he must pay the interest of £400 for that period. Put another way, B has to pay a large sum of £2400 for the remaining amount of his debt which is £2000. This would seem to fall within the rules distinguishing liquidated

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[77] *Ibid*, at p. 596

[78] (1880) 5 App Cas 685; See also *White and Carter (Councils) Ltd. v. McGregor* [1962] AC 413 in which the House of Lords seemed to have presupposed the validity of the acceleration clause.; *Oresundsvarvet Aktiebolag v. Marcos Diamantis Lemos (The "Angelic Star")* [1988] 1 Lloyds L.R. 122, at p. 125 per Donaldson M.R. and at p. 126 per Neill LJ

[79] *Ibid.* at p. 696, see also at p. 702 per Lord Hatherley, pp. 705-706 per Lord Blackburn and p. 710 per Lord Watson

damages from penalties.

3.31 It might be thought that *The Protector Endowment Loan Co. v. Grice*[80] can be used to show that the acceleration of interest, as well as principal, is not susceptible to be subject to the penalty doctrine. Support for this view might be lent by the facts of the case where the sum of £70, being "the principal of the loan, interest thereon, the expenses of negotiating it, and a margin representing a premium for the insurance of the debtor's life" was provided to be repaid in five yearly instalments. It is however to be noted that, as pointed out by Professor Goode[81], what was under discussion in this case was a bond of £70 which was the abstract payment obligation of the defendant. This amount was as an existing debt which had been provided to be paid by instalments, and upon failure, the amount of that present debt, i.e. £70, had been stipulated to be accelerated. "The sum of £70", therefore, "was what had been bargained for at the outset; no greater sum was claimed in the event of default."[82] The judgement of Brett LJ, referred to above[83], clearly shows the correctness of this inference. Thus, *The Protector Endowment Loan Co. v. Grice*[84] could not be used as an authority to show that a clause providing for the acceleration of principal and interest is not subject to the penalty doctrine. Conversely, according to the general rules, laid down by Lord Dunedin[85] to distinguish liquidated damages from penalties, providing for the payment of a larger sum in the event of a failure to pay a stipulated sum should be considered as having a penal nature. The decision of the Court of Appeal in *The "Angelic Star"*[86] supports this view: In this case, a contract for building, selling and delivering a vessel provided for the payment of 80% of the price by "delivery credit" which, in fact, was a loan equal to the remainder of the price with 8.5 per cent annual interest. Part 13 of Article 7 of the agreement provided that in the event of a default in the punctual payment of an instalment, "the loan together with all

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[80] (1880) 5 QBD 592

[81] Goode R. M., Acceleration Clauses [1982] JBL 148, pp. 150-151

[82] *Ibid.*

[83] *Supra.*, para. 3.29

[84] (1880) 5 QBD 592

[85] *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd.* [1915] AC 79

[86] *The "Angelic Star"* [1988] 1 Lloyd's L.R. 122

other monies due to the lenders by the owners" should immediately become payable. Default having been made, the plaintiffs brought an action, applying for a summary judgement against the defendants. The Court of Appeal, holding that a clause which provided for the acceleration of the principal and interest for the full term of a loan would constitute a penalty, unanimously did not interpret Article 7 as imposing on the defendant the liability to pay the unaccrued interest for the remaining period of the contract, and thus recognized it as a valid stipulation. In the course of his judgement, Sir John Donaldson, M.R. stated:

> " Clearly a clause which provided that in the event of any breach of contract a long term loan would immediately become repayable and that interest thereon for the full term would not only be still payable but would be payable at once would constitute a penalty as being "a payment of money stipulated as *in terrorem* of the offending party."[87]

3.32 It should by now be apparent that in loan agreements, the acceleration of the principal is not subject to the rules against penalties. However, a clause providing for the acceleration of the unaccrued interest, as well as principal, in the event of default, without stipulating for a reasonable discount given on the basis of, *inter alia*, remaining period of the agreement is vulnerable as a penalty.

2.4. Acceleration Clauses in Conditional Sale and Hire-purchase Agreements

3.33 A conditional Sale agreement, in addition to providing for a termination clause and a minimum payment upon termination, might contain an acceleration clause by which upon a default in punctual payment of an instalment, the whole instalments of price would immediately become payable . Since the instalments of the price in conditional sale agreements normally have an element of finance charge which is a component like interest in loan agreements, in principle there seems no reason to differentiate them from a loan agreement by which the repayment of the integrated amount of the principal and interest has been stipulated to be made by instalments. Accordingly, the acceleration clause in a conditional sale agreement would be subject to the rules distinguishing liquidated damages from penalties. Thus, in normal cases, if the clause has not provided for a reasonable rebate to be calculated on the basis, *inter alia*, of the finance charge for the

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[87] *Ibid.*, at p. 125 ; see also the judgement of Gibson LJ at p. 126

unexpired period after the activation of the acceleration clause, it might be held to be of a penal nature.[88] This view is supported by the judgement of Woolf J in *Wadham Stringer Finance Ltd. v. Meaney*[89]: In a conditional sale agreement in respect of a motor car, in which the payment had been provided to be made by a deposit and consecutive monthly instalments, it was stipulated that in the event of a default in the punctual payment of any instalment, the whole unpaid instalments would be accelerated. Upon the occurrence of the default, it was held that as the right to call for the accelerated payment would only arise upon breach (*i.e.*, failure to make a punctual payment), the rules as to penalties would be applicable to the seller's right to recover the accelerated payments[90], although upon the actual application of the rules, the clause in question was recognized as a genuine pre-estimate of the seller's loss. That was mainly because the clause had provided for an allowance[91] that by taking it into account the buyer was only to pay a specified proportion of the charges which could not be of a penal nature.[92]

3.34 There seems to be no direct English authority as to the validity and effect of an acceleration clause in hire-purchase contracts. However, the situation in this respect appears to be the same as conditional sale agreements.[93] Put another way, the clause providing for the acceleration of the whole future rentals, upon the occurrence of a default, in hire-purchase contracts, is normally subject to the penalty doctrine. That is

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[88] Goode R. M., Acceleration Clauses [1982] JBL 148, p. 151

[89] [1981] 1 WLR 39

[90] In the course of his judgement, Woolf J stated: "... it is clear that the seller's right to serve a notice under clause 11 arises because of the buyer's breach of the agreement in failing to pay instalments and as the right to call for accelerated payment only arises upon such a breach, I would apply the principles as to penalties to the seller's right to recover accelerated payments under a conditional sale agreement in the same way as they apply to hire-purchase agreements." see *ibid.*, at p. 48

[91] The clause 11(a) had provided that upon the service of a notice by the seller to call upon the buyer to pay the accelerated payments, the latter had to pay "any unpaid deposit and/or acceptance fee and such percentage of the charges specified in the schedule as will accrue down to a date three months after the date of the instalment which would next have followed the date of notice..." see *ibid.*, at pp. 42-43

[92] In considering whether the clause was a penalty or liquidated damages, the learned judge, in addition to having regard to the fact that by the activation of the clause the title in goods vested in the buyer, put emphasis on the allowance given by the acceleration clause under which, in the words of Woolf J, "the obligation of the buyer [was] only to pay a proportion of the charges calculated at a date three months after the date of the instalment which would next have followed the date of notice". In his view, such a stipulation could not amount to a penalty. see *ibid.*, at p. 48

[93] Goode R. M., Acceleration Clauses [1982] JBL 148, p. 152

because, like conditional sale agreements, the rentals in hire-purchase contracts have a component of a finance charge which is mainly computed on the basis of the length of the period for which the credit is given, and if the acceleration clause does not provide for a provision as to a reasonable rebate of the unaccrued finance charges upon acceleration, it will, in effect, act as a term providing for the payment of a large sum in the event of a default in the punctual payment of a smaller amount which is subject to the rules against penalties.

3.35 Since the statutory right of the hirer in hire-purchase agreements to terminate the contract could only be exercised where the termination notice is given by the hirer before the final payment falls due[94], the effect of the acceleration clause would be to extinguish the hirer's right to terminate the agreement.[95] The hirer therefore would be obliged to pay the full price, and the contract would be converted to a conditional sale agreement.[96]

2.5. Acceleration Clauses in Commercial Leases

3.36 In commercial leases, the parties to the contract, normally provide for an acceleration clause by which it is intended that, upon default, the whole unpaid balance of rentals becomes due and payable immediately. In the meantime, it is very common in such an agreement to provide for a clause conferring on the lessor, upon the lessee's failure, the right to terminate the contract and claim for the whole or a proportion of the unpaid balance of the rents upon termination. It is to be observed again that the payments under an acceleration clause and those under a termination clause, though they might be equal in amount, are different in nature. The former is claimed as rentals for the whole period of lease and do not prevent the lessee to use the subject-matter of the lease for the remaining period of the contract, while in the latter, the right of the lessee to utilise the subject-matter of the lease is terminated and the sum, normally described as a

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[94] Sec 27(1) of the hire-purchase Act 1965 provides: "At any time before the final payment under a hire-purchase agreement or ... falls due, the hirer or ... shall be entitled to terminate the agreement by giving notice of termination in writing to any person entitled or authorised to receive the sums payable under the agreement."

[95] See *Wadham Stringer Finance Ltd. v. Meaney* [1981] 1 WLR 39 where such a clause was not considered void as being against the statutory right of the hirer to terminate the agreement.

[96] Goode R. M., Acceleration Clauses [1982] JBL 148, p. 152

"minimum payment", is claimed as damages resulting from breach.[97] The effect of this distinction lies on the point that the latter is undoubtedly subject to the penalty doctrine, and may be held to be penal in nature if there is a gross disproportion between that sum and the likely actual damages which might conceivably be proved to result from breach at the time when the contract is made..

3.37 In relation to the validity of acceleration clauses in lease agreements, at first sight, there might seem no substantial difference between such a clause in lease and hire-purchase agreements; and therefore it might be suggested that the acceleration clause in lease would be subject to the penalty doctrine. On the other hand, with further consideration, it might be argued that in any agreement for lease there is a possibility of providing for the whole rent to be due in advance, *i.e.* at the time when the contract is made, and then stipulating that it should be paid by instalments if certain conditions, *inter alia*, punctual payment, are met. It may therefore be open to the lessor to argue that, as a result of this possibility, the situation is the same as a present debt which has been agreed to be paid by instalments, and so there should be no objection to a clause providing for the acceleration of the whole unpaid balance of the rentals upon default, particularly because, unlike hire-purchase agreements, there might be no identified finance charge in a lease.[98] The effect of this argument is that providing merely for the acceleration of rentals, in the event of default, without bringing the contract to an end should not be subject to the rules against penalties.

3.38 Again, there seems to be no English authority on the point, and the reason appears to be that in almost all litigated cases, the lessor has taken advantage of his right to terminate the contract and therefore the effect of the minimum payment upon termination has been discussed. In principle, it is difficult to treat the following two cases as similar:

(I) A case in which the lessor is entitled to the whole rentals at the time when the contract is made, but, due to indulgence or any other reason, has agreed to accept its payment by instalments; and,

(ii) A case, like most lease contracts, in which the creditor has no right to claim for the

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[97] The same distinction is also applicable in relation to hire-purchase and conditional sale agreements. see also *supra*., paras. 3.27, 3.33

[98] Goode, *Ibid*., p. 152

whole debt at the time of contracting, and is obliged by the contract to receive it by instalments, unless a default in the punctual payment occurs.

As to the former, the situation seems to be indistinguishable from a present debt which is agreed to be repaid by instalments, and providing for its acceleration upon default, as it was pointed out[99], should not be subject to the penalty doctrine. In the latter case, however, there is no compelling reason to differentiate the situation from an acceleration clause in a hire-purchase agreement[100]: in both obviously an element of finance charge, or interest is involved[101] and the instalments of the rent or hire are the integrated amount of the principal and finance charge or interest.[102] The mere fact that "a lease does not provide for an *identified* credit charge"[103], would not, with all respect, seem to provide a convincing reason for treating an acceleration clause in a lease in a different way from that clause in a hire-purchase agreement.[104] It does, therefore, seem that in such a case, the acceleration clause should be subject to the rules against penalties and if the clause does not provide for a reasonable allowance to be made for the accelerated payment, it

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[99] See *supra.*, para. 3.29

[100] As to whether drafting should have such a large consequence see below, para. 3.39

[101] It is upon this basis that it has been suggested that "at times of high interest rates even the acceleration (without repossession of goods) of periodic payments will confer a marked benefit on the recipient which might, in some cases, be sufficient to invite judicial intervention." see Waddams S M, The Law of Damages, 1983, p. 529, para. 930

[102] There is of course no doubt that the economic purpose and objectives of these two contracts, i.e. lease and hire-purchase, are to a large extend different. Hire-purchase is normally used as a means to finance a certain transaction. Therefore, in computing the instalments of hire, the cash price of the subject-matter and the finance charge are two crucial elements. In fact the instalments of hire in a hire-purchase agreement has less relation to the real hiring value of the subject-matter. Thus, the instalments of hire would be much less if the whole rentals are to be paid within two years, for example, instead of being paid in one year. In a lease, on the other hand, the rent is normally calculated according to the real hiring value of the subject-matter. It does however appear that, even in the latter, an element of interest may be involved: for instance, a real hiring value of a television for a year may be £100 if it is to be paid in advance, but where it is agreed to be spread over the contractual period and is paid by monthly instalments, then, due to the element of interest or "time charges", it is increased to a higher amount, say £120. As far as our discussion is concerned, therefore, the "real hiring value for the whole contractual period" and "interest or time charges" may respectively be equated to "cash price" and "finance charges" in hire-purchase agreements. It is however not to be denied that determining the amount of interest or time charge in a lease, in order to decide upon the nature of the acceleration clause, is not as easy as finding out the amount of the finance charge in a hire-purchase agreement.

[103] Goode R. M., Acceleration Clauses [1982] JBL 148, p. 152 [emphasis added]

[104] It should also be noted that in some cases, some lease agreements, which are very similar in effect to hire-purchase contracts, provide for a certain finance charge: for instance, in a lease of a photocopier for a period of time which at the end of that period the subject-matter is almost of no value, in calculating the instalments of the rent, the cash price of the photocopier and an element of finance charge may normally be involved.

might be held to be of a penal nature and unenforceable.[105]

3.39 A crucial comment should be made on this conclusion. In determining whether a lease has provided for the all rent to be due in advance at the time when the contract is made, the whole terms of the contract and all circumstances surrounding it should be considered to decide whether the parties have *truly intended* that the whole rent should become immediately payable at that time. That the lease contains a clause providing for the rent to be due in advance should not therefore be, by any means, conclusive, though it might be considered as an important element in this relation. This is because in general, as it has been pointed out by Lord Dunedin in *Dunlop pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd.*[106], "[t]he 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", and in the words of Lord Radcliffe in *Bridge v. Campbell Discount Co.*[107], citing Lord Davey in the *Clydebank Engineering*[108] case, "[t]he court's jurisdiction to relieve against penalties depends on a 'question not of words or of forms of speech, but of substance and of things'". Therefore in deciding whether the rules against penalties should be applied to a specific clause, the whole contractual terms and inherent circumstances surrounding the contract should carefully be considered.[109] Upon this consideration, if it was concluded that the contract had *truly* provided for a present obligation of the lessee to pay the entire rent at the time when the contract had been

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[105] In calculating the element of interest or time charges, the current interest rate at the time when the contract is made may, it is suggested, be taken into account.

[106] [1915] AC 79, at pp. 86-87

[107] [1962] AC 600, at p. 624

[108] *Clydebank Engineering and Shipbuilding Co. Ltd. v. Don Jose Ramos Yzquierdo Y Castaneda* [1905] AC 6 at 15

[109] Thus, in the Australian case of *O'Dea v. Allstates Leasing System (W.A.) Pty. Ltd.* (1983) 57 ALJR 172, although the lease agreement contained a clause providing for the whole rentals to be due in advance, *i.e.* clause 1(a), the High Court of Australia, unanimously held that the clause accelerating the unpaid balance of instalments upon default was subject to the penalty doctrine, and in fact was a penalty. The reason, *inter alia*, was that taking the contract as a whole and considering all the terms, specially the clause providing for termination and retaking possession of the subject-matter, there could not be assumed to be a present obligation for the whole rental to be payable at the time of making the contract. See particularly the judgement of Gibbs C.J. at p. 175; This case and the position in Australia will be fully considered: see *infra.*, paras. 3.41 *et seq.*

entered into, then as to the clause providing for the acceleration of the whole balance of unpaid rentals upon default, the question of being a penalty would not arise.

3.40 There is another important issue which should be considered here. Suppose that in a contract providing for the entire rentals to be due in advance and then payable by instalments, the parties have provided for an acceleration clause and also a clause conferring on the lessor the right of termination and claiming for the whole balance of the unpaid rentals as "minimum payment" in the event of default. What would be the situation if the lessor, upon the occurrence of a default, claimed for the accelerated amount of rentals and then because of the non-payment of the accelerated sum, exercised his right to terminate the contract? It might seem that in this case, the lessor has no claim for the minimum payment, and has only exercised his right to terminate the contract upon the non-payment of the entire balance of the unpaid rentals which has already become due under the acceleration clause. Thus, since there was an obligation to pay the whole rentals in advance, the question of penalty would not arise. While, if the lessor had first exercised his right to terminate and claimed for the minimum payment, the situation would have been different, and the rules against penalties would have been applicable. Put another way, the same financial results would have been achieved with different legal consequences. To avoid this unfortunate situation and to resolve the problem it had been suggested that in the case of the activation of the acceleration clause before termination, the court could exercise its equitable power to grant relief against forfeiture "to adjust the monetary liability in the light of the effect of an order for redelivery"[110], but with further consideration, the writer later suggested that relief against forfeiture "which in any event might not be appropriate as to moneys not yet paid to the creditor" is not the correct solution.[111] Instead the right of the lessor to elect between two remedies was suggested to be the correct analysis of the situation:

> "Enforcement of the acceleration clause in effect compels the debtor to complete the contract and thus debars termination of the contract and a consequential claim for damages for loss of future profits. Alternatively the creditor can exercise a right to terminate the contract, in which case he gives up his right to sue for the accelerated payment .... and is restricted to

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[110] Goode R. M., Acceleration Clauses [1982] JBL 148, pp. 152-153

[111] Goode, Payment Obligations in Commercial and Financial Transactions, p. 52, note 72

a claim in damages."[112]

This view could be reinforced by paying attention to the different characters of the payments under the acceleration and termination clauses. Although both sums might be equal in amount, payment of the whole balance of the unpaid rentals under the acceleration clause is *rent* in character, for the lessee is entitled to use the subject-matter of the contract for the remaining period of the contractual time. After the lessor exercising his right to terminate the contract, however, the amount payable loses its nature as rent and becomes payable as *damages* resulting from breach.

Therefore, if the lessor terminates the contract because of the non-payment of the accelerated amount of the future rentals, the accelerated amount ceases to be payable as rent and becomes due as damages which seems to be subject to the penalty doctrine.

2.6. Australian Law

3.41 In Australia, as to contracts which create a present debt and provide for its repayment by instalments, the validity of a clause stipulating for the acceleration of the whole balance of the unpaid instalments in the event of default in punctual payment has not been doubted.[113] The Australian courts, following the authority of the decision of the Court of Appeal in *The Protector Endowment Loan v. Grice*[114] have held that where there is an existing debt which has been agreed to be paid by instalments, an acceleration clause which requires the whole balance of the unpaid instalments to become due and payable immediately will not be subject to the rules distinguishing liquidated damages from penalties. The reason for this has well been stated in the judgement of Gibbs C.J. in

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[112] Goode, *Ibid.*, p. 52

[113] See for *example: O'Dea v. Allstates Leasing System(W.A.) Pty. Ltd.* (1983) 57 ALJR 172; *Acron Pacific Ltd v. Offshore Oil N.L.* (1985) 157 C.L.R. 514 where Mason A.C.J., Wilson, Brennan and Dawson JJ., applying the decision in *Wallingford v. Mutual Society* (1880) App Cas 685, at p.702 and *O'Dea* (*Ibid.*) at pp. 366-367, 382, 386 stated that "Of course, there is no penalty if the provision of the moratorium deed [the agreement] simply grant an indulgence for the payment of a debt that is due and payable." at p. 518 ; *Lamson Store Service Co. Ltd. v. Russell Wilkins and Sons Ltd.* (1906) 4 C.L.R. 672 ; *Western Electric Co. (Australia) Ltd. v. Ward* (1933) 51 W.N. (N.S.W) 19 ; *Re Mutual (Qld) Kniting Mills Pty Ltd* [1959] Qd R 357 ; *I.A.C. (Leasing) Ltd. v. Humphrey* (1972) 126 C.L.R. 131 . See also Greig D.W. & Davis J.L.R., The Law of Contract, 1987, pp. 1454-1455 ; Barnes T, Agreed Damages Clauses in Financing Contracts (1986) 14 ABLR 63, at p. 68 ; Muir G A, Stipulation for the Payment of Agreed Sums (1985) 10 Sydney L. Rev. 503, at pp. 522, 524 ; Meagher, Penalties in Chattel Lease, (Essays in Equity, edited by Finn P D), 1985, 46, at pp. 48-49

[114] (1880) QBD 592

O'Dea v. Allstates Leasing System(W.A.) Pty. Ltd.[115]:

> "In all the cases of this kind there is a present debt, which, by reason of an indulgence given by the creditor, is payable either in the future, or in a lesser amount, provided that certain conditions are met. The failure of the conditions does not mean that the creditor becomes entitled to damages; the consequence is that the sum which was always owed, but which the debtor was allowed to pay by instalments or in a smaller amount, becomes recoverable at once or in full."

Where, however, the acceleration clause provided for an additional obligation for the debtor, e.g. to pay the unaccrued interest for the remaining period of the agreement, the clause would be regarded as being subject to the rules against penalties. Thus, in *Warner v. Caruana*[116] in a contract for the mortgage of land, a clause providing that in the event of any failure in the punctual payment of instalments, the whole unpaid balance of principal and interests thereon for the unexpired period of the agreement would become immediately payable, was struck down as being a penalty.

3.42 As a matter of construction, there has been a discussion in the Australian authorities as to how in a lease providing for the periodic payment of rentals, an existing debt of the entire rent at the time of contracting could be assumed so that the acceleration clause, providing for the whole balance of the unpaid instalments to be due upon default, could be regarded outside the ambit of the law relating to penalties. The settled point is that where such an assumption is possible, *i.e.* where the parties have agreed that the whole rent become due in advance at the time when the contract was entered into, the acceleration clause would not be subject to the rules against penalties.

3.43 The most controversial case in this regard is the decision of the High Court in *Lamson Store Service Co. Ltd. v. Russell Wilkins and Sons Ltd.*[117] In this case in an agreement for the leasing of a patented cable system, which was installed by the appellant in the respondent's shop, for the period of 10 years, the lessees agreed to pay the rent annually in advance, and to operate the system continuously in their shop. It was also provided that in the event of any breach of the agreed conditions, or upon the lessees'

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[115] *O'Dea v. Allstates Leasing System(W.A.) Pty. Ltd.* (1983) 57 A.L.J.R. 172, at p. 174

[116] [1974] 2 NSWLR 301

[117] (1906) 4 C.L.R. 672

bankruptcy, the whole instalments of rent for the remaining period of the contract would immediately become due. Two months after the installation of the system, the respondent company was ordered to be wound up, and the appellant claimed to prove the whole balance of the ten years' rent in the liquidation. The majority of the High Court upheld the claim. Griffith C.J., delivering the main judgment of the Court, construed the agreement as one in which the parties had agreed that the entire rental should become due and payable in advance at the time of contracting subject to a stipulation giving the lessee the right to pay the rent by yearly instalments:

> "In my opinion the agreement now in question expresses a clear intention that a sum equal to the rent for ten years shall be paid by the lessees in any event."[118]

Upon this construction, the Chief Justice found the case indistinguishable from *The Protector Endowment Loan Co. v. Grice*[119]. The dissenting judgment of the court was delivered by O'Connor J. who considering the terms of the contract, decided that in this case the whole amount of the rent had not been due in advance and no more than annual instalments could become due every year. He, therefore, concluded:

> "... under these circumstances the facts necessary to make the principle of *The Protector Loan Co. v. Grice* applicable do not exist."[120]

This conclusion led O'Connor J. to consider whether the immediate payment as stipulated by the acceleration clause was a genuine pre-estimate of the lessor's probable loss, and he finally decided that the clause was no more than a penal stipulation. It should be pointed out that the commercial importance of the continued use of the system throughout the contractual period was emphasized by the majority of the court, and in considering the case, this aspect of the case has always been highlighted by other courts.

3.44 This case was referred to with apparent approval in *I.A.C. (Leasing) Ltd. v. Humphrey*[121]. In the latter case, an agreement for the lease of a certain equipment provided that the lessee should pay the entire rent subject to adjustment of rent as provided in clause 4. That clause provided that if during the lease the lessee should default in the payment of any rent instalment, then the entire balance of unpaid rents

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[118] *Ibid.*, at p. 684

[119] (1880) 5 QBD 592

[120] *Ibid.*, at p. 692

would become due, "rebated to reflect their then value, ascertained by applying an interest rate of ten per cent per annum to each such instalment over the period by which the date for payment thereof is by virtue of this clause brought forward." Walsh J. delivering the main judgment of the court, considering the circumstances of the case, concluded that the acceleration as provided in cl. 4 was not subject to the rules against penalties, and even if it was, the provision of the clause would not constitute a penalty. Then he added:

> "That conclusion would be required if the agreement ought to be construed in the way in which the majority of this court construed the agreement under consideration in *Lamson Store Service Co. Ltd. v. Russell Wilkins & Sons Ltd.*, that is, as an agreement to pay a total rent, being the sum of the monthly instalments, subject only to such adjustments as were specified in the agreement."[122]

Even if the case did not fall within the principles laid down by the *Lamson Store* case, cl. 4, in Walsh J's view, would not be a penalty because "the agreement provided its own limitation upon the liability of the lessor to gain a large profit by reason of the equipment being repossessed after a relatively short period."[123]

The notable point was that the issue of the correctness of the *Lamson Store* case was not raised in the argument[124] and it might be suggested that its apparent approval in this case was mainly because in any event the clause in question did not constitute a penalty.

3.45 In *O'Dea v. Allstates Leasing System(W.A.) Pty. Ltd.*[125], however, the correctness of the *Lamson Store* case was questioned: In an agreement for the lease of a motor car, it was provided that the entire rent of $39,550.32 should be due upon the signing of the agreement; however, the lessor was not entitled to enforce the payment of the rent otherwise than by the instalments if the lessee performed all his contractual obligations, *inter alia*, punctual payment of instalments. The contract also provided for a termination clause by which in the event of the lessee's default in performing any contractual obligation, the lessor was entitled to retake possession of the vehicle and terminate the

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[121] (1972) 126 C.L.R. 131

[122] *Ibid.*, at p. 141

[123] *Ibid.*

[124] See Greig D W & Davis J.L.R., The Law of Contract, 1987, p. 1456

[125] (1983) 57 ALJR 172

contract, and upon termination, "all moneys due for unexpired terms would become immediately due and payable, plus reasonable costs of repossession". The lessee having failed in the payment of the rent, the lessor repossessed the vehicle and sued the lessees for the sum of the total rent outstanding. The High Court unanimously held that the lessor's contractual right to recover the entire amount of unpaid instalments did constitute a penalty. The majority of the court presupposed the correctness of the principle by which if, at the time of contracting, there was an existing debt which, due to the indulgence given by the creditor, was payable by instalments, then a clause providing for its acceleration in the event of default in punctual payment would not be subject to the rules against penalties. However, they held that as a matter of construction this principle did not apply to the facts of the case. In other words, considering the whole terms of the contract, it could not be concluded that the entire rent was due and payable in advance when the contract was made.[126] In considering the *Lamson Store*[127] case, Gibbs C.J., completely reviewing the case, stated[128]:

> "In my opinion the principle of cases such as *The Protector Loan Co. v. Grice*[129] applies where there is a present debt, that is, a debt actually due before the breach which accelerated the payment, and with all respect I would prefer the reasoning of O'Connor J. to that of Griffith C.J. and would hold that in that case there was no present debt for the entire amount ... . If *Lamson Store Service Co. Ltd. v. Russell Wilkins & Sons Ltd.*[130] cannot be confined to its own special facts I would decline to follow it."

Although the Chief Justice paid attention to the special circumstances of the case and the commercial importance of the continued use of the subject-matter in the *Lamson Store* case, he found it difficult to see how it could be relevant to the question whether the whole rent was due in advance. The other members of the court also cast doubt on the correctness of the decision in the *Lamson Store* case, and Murphy J. emphatically suggested that this case should be overruled.[131] On this basis, it has been suggested that

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[126] See *ibid.*, at p. 175 per Gibbs CJ, at p. 181 per Wilson J, at p. 185 per Brennan J, and at pp. 188, 189 per Deane J.

[127] *Lamson Store Service Co. Ltd v. Russell Wilkins & Sons Ltd.* (1906) 4 C.L.R. 672

[128] *O'Dea v. Allstates Leasing System(W.A.) Pty. Ltd.* (1983) 57 A.L.J.R. 172, at pp. 177-178

[129] (1880) 5 QBD 592

[130] (1906) 4 C.L.R. 672

[131] *O'Dea v. Allstates Leasing System(W.A.) Pty. Ltd.* (1983) 57 A.L.J.R. 172, at p. 178

"the *Lamson Store* case is no longer good law"[132] or "one should be cautious before attempting to apply such a decision to other cases even if the contract is similar or identical."[133]

3.46 It should be noted that in all these cases the principle by which an acceleration clause would not be subject to the penalty doctrine if there was an existing debt- e.g. where the whole rent was due in advance at the time of signing the agreement and was agreed to be paid by instalments- has not been in doubt. The whole question is, in an agreement for lease, how and when, as a matter of construction, it could be said that the entire rent is due and payable at the time of contracting, but the agreement of the parties has provided for its payment by instalments. The decision of the High Court in *O'Dea v. Allstates Leasing System(W.A.) Pty. Ltd.*[134] showed that considering the whole terms of the contract and inherent circumstances surrounding it, if the *intention* of providing for the whole rent to be due in advance at the time of contracting could be attributed to the parties, then a clause providing for the acceleration of the entire balance of unpaid rents in the event of default would not be subject to the penalty doctrine.

3.47 Two important issues could be inferred from the *O'Dea*[135] case. **First**, in determining whether the parties have agreed for the entire rent to be due in advance when the contract was made, the mere existence of a provision in the contract stipulating for that result should not be regarded as conclusive. As Gibbs C.J. pointed out:

> "If cl. 1(a) [the clause providing for the whole rent to be due in advance] were read in isolation, it might create a present debt for the entire rental, although it would allow the lessee the indulgence of paying the sum due by instalments, provided the payments were duly and punctually made .... But *the contract must be viewed as a whole, and not in fragments*. When cll. 1(a), 6(a) and 12 [i.e. the termination clause] are read together, it becomes apparent that at the date of the contract there was no presently existing obligation to pay the instalments, and if there were a default in payment of the instalments the whole became payable."[136]

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[132] Meagher, Penalties in Chattel Lease, (Essays in Equity, edited by Finn P D), 1985, p. 46 at p. 50

[133] Barnes, Agreed Damages Clauses in Financing Contracts (1986) 14 ABLR 63, at p. 69

[134] (1983) 57 ALJR 172

[135] *O'Dea v. Allstates Leasing System(W.A.) Pty. Ltd.* (1983) 57 A.L.J.R. 172

[136] *Ibid.*, at p. 175 [emphasis added]

3.48 **Secondly**, if, in addition to the acceleration clause, the parties provided for a clause conferring the right of termination and claiming for a "minimum payment", which might be equal in amount to the whole balance of the unpaid instalments of the rent, the nature of payments under each of these clauses is different. In the latter case, the payment is characterized as "damages" resulting from breach, while in the former what the lessee has to pay is "rent" which, due to his default, has become payable immediately. Therefore, if, upon default, the lessor claimed for the accelerated amount of rentals, and then because of the lessee's default in paying the accelerated sum terminated the contract, the sum claimed would cease to be characterized as *rent*, and become payable as *damages* which is undoubtedly subject to the law relating penalties. In other words, as Deane J., in the course of his judgement stated:

> "Once Allstates [the lessor] elected to terminate the hiring and retake possession of the machine pursuant to the provision of cl. 12 [i.e. the termination clause], its rights against the lessees in respect of moneys attributable to the unexpired term of the hiring which it had terminated were the rights conferred by cl. 12. The amount payable under that clause was not the balance of the agreed payment for thirty-six months' hiring. It was not a payment for hire at all: it became payable as a consequence of the lessees' breach when Allstates elected under cl. 12 to terminate the hiring by depriving the lessees of possession and use of the machine which was the subject of the hiring."[137]

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[137] *Ibid.*, at p. 188

Chapter 4

Breach, a Prerequisite for the Application of the Penalty Doctrine

Introduction

4.01 The rules relating to the distinction between penalties and liquidated damages are applicable where there is a breach of contractual undertakings between the contracting parties.[1] If, therefore, A breached his contract with B, and a sum had been stipulated to be payable upon his breach, then the question of that sum being a penalty or liquidated damages would arise. This is considered as a settled principle in the English law and during decades cases, though discussing the different aspects of this principle and sometimes criticizing it, have always applied it to factual scenarios.

The principle however brings about some anomalies, specially where it is applied to agreed sums provided to be paid upon termination of the contract. Termination may, according to the terms of the contract, be triggered off by the promisor's breach, happening of some events other than breach, or exercise of an option by the promisor to bring the contract to an end. The issue of the applicability of the penalty doctrine, in this regard, may raise some important questions: Whether the doctrine could have any application at all to a sum of money provided to be paid upon termination? In case of applicability, should the cases where termination is based upon breach be treated differently from cases where the contract is brought to an end for the happening of some events other than breach? And in any event, could such a treatment be regarded as satisfactory? These are the sort of questions which the first section of this chapter will deal with, after elaborating the conventional approach towards the role of breach in the

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[1] Furmston M P, Cheshire, Fifoot & Furmston's Law of Contract, 13th ed., 1996, p. 638; Chitty on Contracts, 27th ed., vol. 1, 1994, para. 26-064 at p. 1257; Treitel G.H., The Law of Contract, 9th ed., 1995, p. 930; Ogus, The Law of Damages, 1973, pp. 56-57 ; Burrows A, Remedies for Torts and Breach of Contract, (2nd ed., 1994), p. 331; Furmston M P, Contract Planning: Liquidated Damages, Deposits and the Foreseeability Rule (1991) 4 JCL 1, at p. 8 ; Fridman G H L, Hire-purchase: Estoppel-Penalties (1961) 24 MLR 502, at pp. 507-508 ; Wedderburn K.W., Hire-purchase, Penalties, Freedom of Contract [1961] CLJ 156; Meagher, Penalties in Chattel Lease (Chapter 3 of "Essays in Equity" by Finn, P D), 1985, 46, at pp. 50-51

application of the penalty doctrine. In the second section, the possibility of the application of the penalty doctrine to alternative promises will be considered. Such promises are normally of a character that by performing either of the alternatives, the promisor is discharged from his contractual obligations. The question of the applicability of the doctrine normally arises where one of these alternatives is the payment of a certain sum of money. Accepting breach as a prerequisite for the application of the penalty doctrine, when and how could the application of the doctrine to such a promise, framed as in alternative, be justified? This is the main issue which we will attempt to analyse in the second section.

1. The applicability of the doctrine where there is a breach

1.1. The Conventional Approach

4.02 The question of an agreed sum being a penalty or liquidated damages does, as it was referred to, arise where it has been provided to be paid upon breach. The main effect of this principle is that where a sum of money was stipulated to be payable on the occurrence of some events other than breach, it would be recoverable without any penalty analysis. In *Alder v. Moore*[2], the defendant, a professional footballer, was paid £500 by the plaintiff under an insurance policy after his injury and providing a certificate which showed that he was no longer able to play professional football. The payment was subject to his declaration not to play professional football again:

> " In consideration of the above payment I hereby declare and agree that I will take no part as a playing member of any form of professional football and that in the event of infringement of this condition I will be subject to a penalty of the amount stated above."

After a few months, the plaintiff recovered and entered into professional football again. As to the plaintiff's action to claim £500 under the declaration, the majority of the Court of Appeal construed the declaration as not imposing the plaintiff a promise not to play professional football again, and so his starting to play professional football was not recognised as a breach of an undertaking. The only effect was that by entering into professional football, the plaintiff had agreed to repay £500, and since there was no breach of a contractual promise, the plaintiff's contention that the stipulated sum was a

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[2] [1961] 2 QB 57, [1961] 2 WLR 426, [1961] 1 All ER 1; for a critical consideration of the case see Goff (1961) 24 MLR 637

penalty and not recoverable was rejected. The majority of the court believed that, there being no breach of contract, the question of a penalty did not arise, and the stipulated amount, as a sum provided to be paid on the happening of an event, could be recovered.[3]

4.03 This principle has been emphasized in numerous cases[4], although some dissenting judgements have criticized its application in relation to hire-purchase contracts.[5] In its rather recent judgement, *Export Credits Guarantee Department (ECGD) v. Universal Oil Products Co.*[6], the House of Lords implicitly approved the previous cases and confirmed the view that the question of the application of the penalty doctrine would not

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[3] Similarly, a clause providing for the buyer's option to extend the date for taking delivery upon payment of a "carrying charge" has been regarded as outside the scope of the rules against penalties, because the delay cannot be categorized as breach: see, e.g., *Thos. P. Gonzalez Corp. v. F. R. Waring (International) (Pty) Ltd.* [1980] 2 Lloyds Rep. 160, where, as to the buyer's argument to the effect that the stipulation for payment of the carrying charge amounted to a penalty, Megaw LJ (with whom Shaw and Waller LJJ agreed) held: "... this contract was indeed a contract in which there was provision for an extension, so that the provision of a ship during that extended period would not constitute a breach of contract. ... Accordingly, I think that, on the penalty point, the learned judge was right ...". (at p. 163) Ackner J, at the first instance, had rejected the buyers' argument on the ground, *inter alia*, that the charges did not amount to a specified sum of money provided to be paid upon a breach of the contract. see also *Richco International Ltd. v. Alfred C. Toepfer International G.M.B.H. (The Bonde)* [1991] 1 Lloyds Rep. 136, where Potter J. said: "since the buyer has a right to extend the shipment period on giving proper notice, it seems to me that the obligation to pay carrying charges as provided is better regarded as the price to be paid for that extension than as a liquidated damage provision in respect of a breach." at p. 145

[4] *Chester & Cole v. Wright* (1930) Unreported, see *infra.*, note 17; *Re Apex Supply Co.* [1942] 1 Ch. 108; *Associated Distributors v. Hall* [1938] 2 KB 83, [1938] 1 All ER 511 ; *Bridge v. Campbell Discount Co. Ltd.* [1962] AC 600; *Sterling Industrial Facilities Ltd v. Lydiate Textiles Ltd* (1962) 106 SJ 669, where Diplock LJ has been reported as having said: "A penalty was a sum agreed to be paid in the event of non-performance of a contractual obligation. Here there was no question of any breach of obligation, but the defendants were sued in respect of sums payable in a specified eventuality. ... This might have been an improvident bargain but the law did not relieve against improvident bargains where the parties were at arm's length ..."; *Export Credits Guarantee Department (ECGD) v. Universal Oil Products Co.* [1983] 1 WLR 399, [1983] 2 All ER 205; *Transag Haulage Ltd. v. Leyland DAF Finance Plc.* [1994] 2 BCLC 88, at p. 98 per Knox J.; see also the Australian case of *I.A.C. (Leasing) Ltd. v. Humphrey* (1972) 126 CLR 131. It could basically be argued that the rules against penalties- as stated by Lord Dunedin in *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd.* [1915] AC 79, and Lord Halsbury LC in *Clydebank Engineering and Shipbuilding Co. v.. Don Jose Ramos Yzquierdo y Castaneda* [1905] AC 6- have been stated in the context of a breach of contract.

[5] See, for example, judgements of Lords Denning and Devlin in *Bridge v. Campbell Discount Co. Ltd.* [1962] AC 600 ; Again judgement of Lord Denning in *United Dominions Trust (Commercial) Ltd. v. Ennis* [1968] 1 QB 54, [1967] 3 WLR 1, [1967] 2 All ER 345

[6] [1983] 1 WLR 399, [1983] 2 All ER 205 ; see also the decision of Viscount Simonds in *Tool Metal Manufacturing Co. Ltd. v. Tungsten Electric Co. Ltd.* [1955] 1 WLR 761 at p. 767; also in the recent Scottish case of *EFT Commercial Ltd v. Security Change Ltd (No 1)* [1993] SLT 128, it was emphatically held that, both in England and Scotland, the penalty doctrine could have no application in a case which is not a case of breach of contract: see at p. 131, 133 per Lord Hope, at p. 134 per Lord Weir, and at p. 135 per Lord Caplan; see also *Granor Finance Ltd v. Liquidator of Eastore Ltd,* [1974] SLT 296

arise where there was no breach between the two contracting parties. The facts of this case were complex: Under a series of contracts, A engaged in the building of an oil refinery. The financing of the project was promised by a consortium of Bankers, B, who undertook to pay the defendants as work proceeded, in consideration of the receipt of some promissory notes from A. The payment of the promissory notes, issued by A to B, was guaranteed by the plaintiffs who did this in consideration of a premium paid to them by the defendants under a contract between them, a clause of which provided for the reimbursement of the plaintiffs by the defendants where A dishonoured any promissory notes if defendants were in breach of the construction contract. Some promissory notes being dishonoured by A, the plaintiffs paid a sum of £39 million to B and claimed it from the defendants under the reimbursement clause, contending that the defendants were in breach of the construction contract when A dishonoured the promissory notes. The defendants argued that the reimbursement clause was a penalty since it imposed on the defendant an undertaking to reimburse the plaintiffs irrespective of the loss caused by the breach and seriousness or triviality of the breach. This argument was rejected by the House of Lords emphasizing the fact that the clause had only provided for the reimbursement of a sum which in fact the plaintiffs had lost; and even if the penalty doctrine had applied to the case, the stipulated sum would have never constituted a penalty. However, the House held that the penalty doctrine was not applicable here, since the payment had been stipulated on the happening of an event which was not a breach of the contract between the plaintiffs and the defendants. Lord Roskill, delivering the main judgment of the House, held:

> "The clause was not a penalty clause because it provided for payment of money on the happening of a specified event other than a breach of a contractual duty owed by the contemplated payer to the contemplated payee."[7]

4.04 The position of the common law, therefore, can be summed up by saying that the distinction between penalties and liquidated damages is only relevant if there is a breach of a contractual promise between the contracting parties. The reason for this limited approach on the scope of the doctrine, it has been suggested, is that "it has never been the function of the courts to relieve a party from a contract on the mere ground that it proves

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[7] *Ibid.*, at p. 402 (WLR) and p. 223 (All ER)

to be onerous or imprudent"[8]. The scope of any interference on the equitable grounds is well established and if the courts relieve a party on the mere ground of harshness or oppression, then as stated by Holroyd Pearce LJ in *Campbell Discount Co. Ltd. v. Bridge*[9], "it would be a novel extension for the law...". Such an extension, considering the fact that equity would not interfere with freely negotiated contracts, even if it turns out to be harsh or disadvantageous to one of the parties unless there was a fraud, sharp practice, mistake or any other improper or unconscionable conduct[10], and paying attention to the famous principle that "the Chancery mends no man's bargain"[11] would not be justifiable.

1.2. Confusion on the application of the principle to termination clauses

4.05 Some difficulties might arise where the principle, discussed above, is applied to termination clauses, especially in hire-purchase contracts. In these contracts, it is normally provided that on the occurrence of some specific events, like death[12], or bankruptcy of the hirer, as well as the breach of contract by him, the owner has the right to terminate the contract. Moreover, the hirer usually has the option to terminate the agreement by returning the goods. Upon termination, it is normally provided that the hirer would be liable to pay a specific sum of money, normally up to a specified portion of the hire-purchase price, taking into account all the previous payments. When discussing the applicability of the penalty doctrine to such a payment, it might first appear that this payment- normally called as a "minimum payment"- has been stipulated upon termination, and since termination is naturally different from breach, so the question of the

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[8] *AMEV-UDC Finance Ltd. v. Austin* (1986) 162 CLR 170, per Mason & Wilson JJ at p. 184, citing *ECGD, ibid.*, at pp. 402-403 (223-224)

[9] [1961] 2 WLR 596, at p. 604

[10] See *Kilmer v. British Columbia Orchard Lands, Ltd.* [1913] AC 319; *Steedman v. Drinkle* [1916] 1 AC 275 ; *Mussen v. Van Diemen's Land Co.* [1938] Ch. 253; and especially *Stockloser v. Johnson* [1954] 1 QB 476; see also Fridman, G.H.L. (1961) 24 MLR 502, at p. 509; Wedderburn K.W. [1961] C.L.J. 156, at p. 158

[11] Harman LJ, firmly adhering to this principle, disapproved the efforts of those who try to invent new equities, saying: "I think Lord Denning is one of them." *Campbell Discount Co. Ltd. v. Bridge* [1961] 2 WLR 596, at p. 605 ; nevertheless, both Harman and Pearce LJJ. regretted the unsatisfactory results which in some cases the principle might cause. See *infra.*, para. 4.29

[12] Under ss. 86 and 87 of the Consumer Credit Act 1974, where the provisions of the Act is applicable, a clause providing for the determination on the hirer's death is either ineffective or exercisable by the order of the court.

applicability of the penalty doctrine would not arise. With some more attention, however, it would seem necessary to distinguish terminations based on breach of the contract and those which are triggered off by some events other than breach. It is, therefore, appropriate to discuss the subject in separate divisions. Moreover, under the provisions of the Hire-Purchase Act 1965, replaced now by the Consumer Credit Act 1974[13], the legislature took a harmonized approach towards both terminations based on breach and those which are not triggered off by the breach of contract. Thus, where these provisions operate, the above distinction, based on the developments of case law during years, will have no application. Thus, the relevant provisions of these Acts are also worthy of a rather detailed discussion.

1.2.1. Termination based on breach

4.06 Over many years, case law has had so many developments regarding the application of the penalty doctrine to cases where a sum of money has been stipulated to be paid upon terminations which are based on breach of the contract. At first, it was thought[14] that the rules distinguishing liquidated damages from penalties had no application where the money had been provided to be payable upon termination, regardless of the fact whether termination had been based on breach of a contractual undertaking or other events like the hirer's death or bankruptcy or his option to exercise his right to terminate the contract.

4.07 The reason for this, it was supposed, was that **firstly** the operation of the penalty doctrine is where the stipulated sum had been provided to be paid as damages upon breach of contract. Here the amount was stipulated to be paid upon termination, and therefore if there was any damage to the owner, it was the result of his own act in determining the agreement, not because of, for example, the hirer being in arrears; and any interference as to such damages was regarded as being outside the scope of the

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[13] It should be noted that the provisions of the Hire-Purchase Act 1965 are still applicable to the contracts made before May 19, 1985.

[14] *Elsey & Co. Ltd. v. Hyde*, only reported, apparently, in Jones and Proudfoot's Notes on Hire Purchase Law, 2nd ed., 1926, p. 107, and referred to in *Re Apex Supply Co.* [1942] 1 Ch. 108 and in *Cooden Engineering Co. v. Stanford* [1953] 1 QB 86 ; Also dicta in *Re Apex Supply Co., ibid.*

penalty doctrine. The reasoning of Salter J. in *Elsey v. Hyde*[15] supported this argument:

> "The fact that the hirer is in arrear with his payments will not entitle the owner to any damages for depreciation of these things. The reason that they have suffered is that they have second-hand goods put on their hands before they have received very much money in respect of them. That is not the result of the hirer's breach of contract, in being late in his payments, it is the result of their own election to determine the hiring, and there is no question whether the sum paid shall be regarded as liquidated damages or penalty."

Secondly, it was difficult to accept that providing for a sum of money to be paid upon termination should be regarded as a valid stipulation when termination had been based upon events other than breach and the same sum might be considered as a penalty where the owner had determined the contract for the hirer's breach. As Salter J. in another part of his judgment argued:[16]

> "It appears to me that no question of penalty could arise in such a case, and if this sum is not a penalty where it is payable on the determination of the hiring by the owner, by reason of the levy execution, it seems to me it would be a strange result if it were to be held a penalty where it is payable on the termination of the hiring by the owner on the ground of non-payment of rent by the hirer."

4.08 This view, which had been approved in some cases[17], was the law until the decision of the Court of Appeal in *Cooden Engineering Co. v. Stanford*[18] where in a hire-purchase of a motorcar, the defendants, the hirer, fell into arrear and the plaintiffs, retaking the possession of the subject-matter and terminating the agreement, claimed to recover from the defendants- under the minimum payment clause- the balance of the instalments. The majority of the Court of Appeal (Jenkins LJ dissenting) held that the sum claimed was a penalty and not recoverable. Jenkins LJ, delivering the dissenting judgement and applying

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[15] *Ibid*, at p. III

[16] *Ibid.*

[17] *Re Apex Supply Co. Ltd.* [1942] 1 Ch. 108 ; *Chester & Cole, Ltd. v. Wright* (unreported) its transcript can be found in Jones and Proudfoot's Notes on Hire Purchase Law, 2nd ed., p. 124, and it was referred to in *Re Apex Supply Co. Ltd.*, *ibid.* and *Cooden Engineering Co. v. Stanford* [1953] 1 QB 86; In this case, Greer LJ (at p. 130) pointed out: "... it may very well be that the view which is, I think, the view of Salter J., in *Elsey & Co. Ltd. v. Hyde*, which was cited before us, is the right way to look at this clause, namely, that is not either liquidated damages or a penalty, but it is a sum payable in respect of one event, namely, the determination and end of the hiring agreement, whether that end of hiring agreement arises from the hirer delivering the car back again, or whether it arises from the owner taking it out of the possession of the hirer in the events in which he is entitled to take it out."

[18] [1953] 1 QB 86

the decision of Salter J in *Elsey v. Hyde*[19], held:

> "In order to be such [the stipulated sum to be payable upon determination of the hiring to be a penalty in the relevant sense at all], the sum in question must ... be ... a sum which the hirer undertakes to pay to the owners in the event of, and in respect of, some breach by the hirer of the terms of the hire-purchase agreement."

Then his lordship- describing the facts of the case, particularly the termination clause- added:

> "[In this case] it is not payable because the hirer has committed a breach of contract (which he need not necessarily have done) but because the hiring has been determined."[20]

Moreover, he based his judgement on the point that it seemed impossible for the covenanted sum to be a valid stipulation where determination had been based upon some events like death of the hirer or presentation of a winding-up petition against the hirer (being a company) and the same sum to be regarded as having a penal character "where the determination by reason of which it becomes payable happens to be brought about by notice founded on or automatically by some breach of contract on the part of the hirer."[21]

4.09 The majority did not accept these arguments and implicitly held that *Elsey v. Hyde*[22] had wrongly been decided. Hodson LJ stated that he found it difficult "to see the validity of the distinction between a claim to receive payment of a sum of money because of a right to determine arising from breach of contract and a claim to receive payment of the same sum by reason of breach of contract giving a right to determine."[23] Also Somervell LJ, declaring his explicit disagreement with the suggestion of Salter J. on the point that if a sum is payable on the occurrence of some events, "if it is not a penalty in one case, it cannot be in the other", held:

> "The events may in fact be so similar that a conclusion on one decides the other. ... But it cannot, I think, follow as a matter of law that a sum exigible for a breach cannot in law be a penalty because it is made payable in the happening of some other event which is not a breach."[24]

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[19] *Supra.*, note 14

[20] *Cooden Engineering Co. v. Stanford* [1953] 1 QB 86, at p. 110

[21] *Ibid.*, at p. 111

[22] *Supra.*, note 14

[23] *Cooden Engineering Co. Ltd. v. Stanford* [1953] 1 QB 86, at p. 116

[24] *Ibid.*, at p. 96

4.10 The majority's view, insisting on the substance and not merely the form of the agreement seems to be preferable, though to some extent it interferes with the sanctity of contracts.[25] It is because that in deciding upon the nature of an agreed sum, the substance of the clause, and not its form, should be considered. As stated by Lord Radcliffe in *Bridge v. Campbell Discount Co. Ltd.*[26], citing Lord Davey in the *Clydebank Engineering*[27] case, "the court's jurisdiction to relieve against penalties depends on a "question not of words or of form of speech, but of substance and of things"".[28]

It should also be noted that deciding upon the application of the penalty doctrine merely according to the form of the clause would have the undesirable consequence that the law on penalties could, by skilful draftsmanship, easily be evaded. Put another way, by drafting the hiring agreement in a way that the contract could be terminated on the happening of some other events, as well as breach, and by stipulating the minimum payment upon termination, the applicability of the law relating penalties- and therefore the interference of the courts to protect the weaker contracting party- would be negated.

4.11 Thus, where termination of the contract is based upon breach of a contractual undertaking, the sum provided to be paid upon termination would clearly be subject to the penalty doctrine.[29] Such a sum, if it could not be considered as a genuine pre-estimate of the anticipated damages which could conceivably flow from breach/termination[30], might be struck out as being a penalty. This principle has been applied in numerous cases:[31] In *Lamdon Trust Ltd. v. Hurrell*[32], for example, in a hire-

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[25] See G.W. Cheyne (1953) 11 C.L.J. 439, pp. 439-440

[26] [1962] AC 600, at p. 624

[27] *Clydebank Engineering and Shipbuilding Co. Ltd. v. Don Jose Ramos Yzquierdo Y Castaneda* [1905] AC 6, at p. 15

[28] See also the speech of Mason & Wilson JJ. in the Australian case of *AMEV-UDC Finance Ltd. v. Austin* (1986) 162 CLR 170, at pp. 184-185

[29] McGregor on Damages, 15th ed., 1988, para. 514 ; Burrows A, Remedies for Torts and Breach of Contract, (2nd ed., 1994), p. 332; Ogus, The Law of Damages, 1973, pp. 58-59; Treitel G.H., The Law of Contract, 9th ed., 1995, p. 904; Cheyne (1953) 11 C.L.J. 439, pp. 439-440; Meagher, Penalties in Chattel Lease (Chapter 3 of "Essays in Equity" by Finn, P D), 1985, 46, at p. 51

[30] Where the breach is a breach of condition *or* a fundamental *or* repudiatory breach. This situation will shortly be discussed. See *infra.*, chapter 5, section 4

[31] See, for example, the decision of the House of Lords in *Bridge v. Campbell Discount Co. Ltd.* [1962] AC 600 ; *Lamdon Trust Ltd. v. Hurrell* [1955] 1 WLR 391 ; *United Dominion Trust (Commercial) Ltd. v.*

purchase agreement the defendant, the hirer, failed to pay the fifth instalment of the price. The plaintiffs terminated the contract, retook the possession of the subject matter, resold it and claimed from the defendant, under the "minimum payment" clause, a sum of money to bring up the hirer's payment up to the approximately three-quarters of the purchase price. The court, applying the decision of the Court of Appeal in *Cooden Engineering Co. Ltd. v. Stanford*[33], held that the stipulated sum could not be regarded as a genuine pre-estimate of damages, but was an extravagant and extortionate sum held in terrorem. It was therefore a penalty and not recoverable. Denning LJ, in the course of his judgement, stated:

> "At one time it was thought that the courts of this country were powerless to interfere with clauses such as this, but I am glad to say that in *Cooden Engineering Co. Ltd. v. Stanford*[34], the Court of Appeal held that if the clause imposes a penalty (as opposed to liquidated damages) it is invalid and unenforceable."[35]

1.2.2. Termination not based upon breach

4.12 From the conventional approach, that the penalty doctrine is only applicable where there is a breach of contract, it follows that where termination is not based upon breach of contract, the rules distinguishing liquidated damages from penalties would have no application.[36] It should, therefore, be noted that the treatment of the termination based upon breach of a contractual promise in the same way as the breach itself has no extended application in the context of determining whether the penalty doctrine is applicable. The reason for this seems to be that in case of termination based on breach, though the promisee's contractual right to claim the minimum payment results from termination,

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Ennis [1968] 1 QB 54, at pp. 65, 68, 69 ; *Financing Ltd. v. Baldock* [1963] 2 QB 104 ; The position in Australia is apparently the same: see *O'Dea v. Allstates Leasing System (W.A.) Pty. Ltd.* (1983) 57 A.L.J.R. 172 ; *AMEV-UDC Finance Ltd. v. Austin* (1986) 162 CLR 170, at pp. 184-185 per Mason & Wilson JJ. and at pp. 210-211 per Dawson J. ; *Lessors (Aust.) Pty. Ltd. v. Westley* [1964-65] N.S.W.R. 2091

[32] *Ibid.*

[33] [1953] 1 QB 86

[34] *Ibid.*

[35] *Lamdon Trust Ltd. v. Hurrell* [1955] 1 WLR 391, at pp. 393-394

[36] Furmston M P, Contract Planning: Liquidated Damages, Deposits and the Foreseeability Rule (1991) 4 JCL 1, at p. 8 ; McGregor on Damages, 15th ed., 1988, para. 515 ; Treitel G.H., The Law of Contract, 9th ed., 1995, p. 904; Burrows A, Remedies for Torts and Breach of Contract, (2nd ed., 1994), p. 332; Ogus, The Law of Damages, 1973, pp.58-59 ; Meagher, Penalties in Chattel Lease (Chapter 3 of "Essays

there is also a breach of contract upon which the termination is based.[37] But where termination is grounded on some events other than breach, there is no breach of the contract to be the base for the application of the penalty doctrine.

4.13 The application of this principle can clearly be seen in a number of cases: In *Chester & Cole v. Wright*[38], in a hire-purchase agreement, the owner, because of the hirer's death, determined the contract. The Divisional Court came to the conclusion that the stipulated sum to be paid on the occurrence of some events- *inter alia*, the hirer's death- was recoverable. Greer LJ, in considering the application of the penalty doctrine to the case, held that the stipulated sum was neither a penalty nor liquidated damages, "it was a sum payable in respect of one event, namely, the determination and end of the hiring agreement ... ". His lordship argued:

> "There is no reason in law why, for a sufficient consideration, there should not be in the same document two contracts, one a contract to hire the motor-car on the terms of the agreement, and another, a contract that if that agreement comes to an end, then a certain sum will be payable by the hirer."

4.14 In *Re Apex Supply Co.*[39], upon the hirer's company going into liquidation, the owner, under a contractual right, determined the hiring agreement. On a summons taken out by the owner company, claiming to prove the stipulated sum under the minimum payment clause, Simonds J. held that in this case no question of penalty arose and the liquidators of the hiring company had to admit the proof of the stipulated amount.

4.15 Also in *Associated Distributors v. Hall*[40], in a hire-purchase agreement, the defendant, the hirer, exercised his option to terminate the contract. As to the plaintiff's

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in Equity" by Finn P D), p. 51

[37] McGregor, loc. cit., para. 515

[38] Unreported, the transcript can be found in Jones and Proudfoot's Notes on Hire-Purchase Law, 2nd ed., p. 124 ; it has also been referred to in *Re Apex Supply Co.* [1942] 1 Ch. 108 and *Cooden Engineering Co. Ltd. v. Stanford* [1953] 1 QB 86

[39] [1942] 1 Ch. 108; see also the Scottish case of *EFT Commercial Ltd v. Security Change Ltd (No 1)* [1993] SLT 128 (Termination by the lessor of a lease upon the appointment of a receiver to the lessee; the lessor's claim to recover the sum of money payable upon termination was not regarded as subject to the law against penalties)

[40] [1938] 2 KB 83

claim to recover the arrears of the rent and some further sums under the minimum payment clause, it was held that no question as to the stipulated sum being liquidated damages or penalty arose, and therefore the amount for which the hirer had made himself liable could be recovered. In the course of his judgement, Slesser LJ, indicating that the payment of the stipulated amount is a condition for exercising the hirer's option to terminate the agreement, pointed out:

> "He [the hirer] has exercised an option and the terms on which he may exercise the option are those set out in cl. 7. The question therefore whether these payments constitute liquidated damages or a penalty in the instances mentioned does not arise in the present case."[41]

4.16 This principle, however, has been criticized in some cases: In *Bridge v. Campbell Discount Co. Ltd.*[42], a hire-purchase agreement was entered into by the parties. The hirer after having paid an initial payment and one monthly instalment of the purchase price wrote to the finance company saying: "I am very sorry but I will not be able to pay any more payments on the Bedford Dormobile." A clause of the agreement gave the right of termination to the hirer if he wanted to exercise his option and to the owner on the happening of some events, *inter alia*, the hirer's breach. Upon termination, it was provided that the hirer should pay to the owners by way of agreed compensation for depreciation of the subject-matter such further sums to make the rentals paid and payable equal to two-thirds of the hire-purchase price. Receiving the hirer's letter, the finance company claimed for a sum of money under the minimum payment clause. The Court of Appeal[43] construed the letter as an exercise of the contractual right to terminate by the hirer, and therefore, applying the decision in *Associated Distributors v. Hall*[44], held that no question of penalty arose since the hirer had exercised his option and the minimum

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[41] *Ibid.*, at p. 88 ; see also the decision of the Court of Appeal in *Goulston Discount Co. Ltd. v. Harman* (1962) 106 SJ 369, in which the court (Willmer LJ dissenting) held that the hirer had exercised his option to terminate the agreement and upon this termination, the minimum payment clause came to operation. Although the stipulated sum would have constituted a penalty, had the owner company determined upon the hirer's breach, no question of penalty arose here, because the termination had been based upon the exercise by the hirer of his option to determine and the stipulated amount was recoverable. The stipulated sum was thus held to be recoverable.

[42] [1962] AC 600

[43] The decision of the Court of Appeal has been reported in: [1961] 1 QB 445 ; [1961] 2 WLR 596 ; [1961] 2 All ER 97

[44] [1938] 2 KB 83

payment was a consideration for the exercise of the option. On appeal, the House of Lords treated the letter as indicating the hirer's willingness to break the contract and since the termination of the hiring had happened upon breach, the House held the penalty doctrine to be applicable and in fact the stipulated sum to be a penalty.

4.17 Although the House, by treating the agreement as a contract terminated upon breach and therefore the position as in *Cooden Engineering Co. Ltd. v. Stanford*[45], sidestepped the important question whether the Court of Appeal was right in holding that the question of the applicability of the penalty doctrine did not arise where the hirer had exercised his option to terminate the agreement, the members of the House, nonetheless, except Lord Radcliffe who reserved his judicial opinion, expressed their view on the issue. Viscount Simonds and Lord Morton adhered to the conventional approach, while Lord Denning and on a narrower ground Lord Devlin cast a serious doubt on its correctness. Viscount Simonds thought that the hirer had agreed to pay a price to be able to exercise his option:

> "It [clause 6] confers on the hirer a right for which he agrees to pay a price. He need not exercise it if he does not want to."[46]

Lord Morton, emphasizing on the point that "the person to whom the option is given is free to exercise it or to disregard it, as he thinks fit"[47] agreed holding that the provision conferring an option to determine an agreement cannot be a penalty. Lord Denning, having declared that *Associated Distributors v. Hall*[48] has wrongly been decided, was of the idea that "the courts have power to grant relief against the penal sum contained in this "minimum payment" clause no matter for what reason the hiring is terminated."[49] His lordship also pointed out:

> "The "minimum payment" clause is single and indivisible, and no just distinction can be drawn between the cases where the hirer is in breach and where he is not."[50]

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[45] [1953] 1 QB 86

[46] *Bridge v. Campbell Discount Co. Ltd.* [1962] AC 600, at p. 613

[47] *Ibid.*, at pp. 616-617

[48] [1938] 2 KB 83

[49] *Bridge v. Campbell Discount Co. Ltd.* [1962] AC 600, at p. 631

[50] *Ibid.*

Finally, Lord Devlin, indicating also that the decision in the *Hall* case[51] was wrong, agreed with the conclusion reached by Lord Denning, but based his argument on a rather narrower ground and said:

> "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 altogether: it cannot be a part of clause 9 when that clause is applied by virtue of clause 6 or clause 8 and a part of it when it is applied by virtue of clause 7."[52]

As it appears from the passage quoted above, Lord Morton emphasized the indivisibility of the minimum payment clause and that it cannot be a valid stipulation where the contract is terminated by virtue of the exercise of the hirer's option or because of the happening of some events other than breach as provided for in the contract, and a void and unenforceable provision where termination is based upon the breach of the contract by the hirer.

4.18 Since on this point the opinions in the House of Lords were equally divided, so it appears that the decision of the Court of Appeal on this issue remains on foot and therefore the conventional approach that the courts have no power to interfere where termination has been based upon some events other than breach still seems to represent the law. Accordingly if the agreement was terminated by the hirer because of the exercise of his option under the contract or by the owner on the occurrence of the stipulated events other than breach, as to the sum provided to be paid upon termination, the question of being a penalty or liquidated damages would not arise.

4.19 Another case of this type is *United Dominions Trust (Commercial) Ltd. v. Ennis*[53] in which the scenario was very similar to that of *Bridge v. Campbell Discount Co. Ltd.*[54]. The Court of Appeal there was careful to hold that the hirer's letter had not been an exercise by him of the option to determine,[55] but the finance company had to be taken to

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[51] *Associated Distributors v. Hall* [1938] 2 KB 83

[52] *Bridge v. Campbell Discount Co. Ltd.* [1962] AC 600, at p. 634

[53] [1968] 1 QB 54

[54] [1962] AC 600

[55] The court did not achieve this result in a similar case: *Goulston Discount Co. Ltd. v. Harman* (1962) 106 S.J. 369, in this case, though the hirers had declared their inability to go on with the contract in a

have terminated the agreement for the hirer's breach in non-payment of the monthly instalments. Thus, the penalty doctrine was held to be applicable to the stipulated amount to be paid upon termination, and in fact the sum, not being a genuine pre-estimate of the likely actual losses, was held to constitute a penalty. Again, two members of the court[56] were equally divided on the point whether the penalty doctrine would have been applicable if the agreement had been determined by the exercise of the hirer's option. Lord Denning M.R. emphasized his previous view that *Associated Distributors v. Hall*[57] was wrongly decided, and it was open to the court to reconsider this decision.[58] Harman LJ, however, thought that to apply the penalty doctrine, there had to be a breach, stating:

"I do not think you can have a penalty without a breach of contract ..."[59]

1.3. Critical Analysis of the Principle

1.3.1. Anomalies Resulting form the Principle

4.20 The principle that a breach of contractual undertaking is a prerequisite to the application of the penalty doctrine, particularly in relation to its application to termination clauses, raises some unsatisfactory anomalies. First, the principle makes it easy for the application of the penalty doctrine to be avoided by skilful drafting. Second, it gives rise to clearly unjust consequences in relation to hire-purchase and other similar contracts.

1.3.1.1. Avoidance of the application of the doctrine by skilful drafting

4.21 The distinction between the situation where there is a breach and where there is not, can easily be avoided by skilful draftsmanship.[60] A clever and experienced draftsman could draw the contract in a way that the specified money would be payable on an event which could not be considered as a breach of contract, and would therefore avoid the

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letter, the court construed the letter as exercising an option to terminate by the hirer. Willmer LJ, the dissenting judge, thought that the letter should be construed as a plain breach of contract. Thus, his lordship, applying the law against penalties, held that the agreed sum to be paid upon termination constituted a penalty.

[56] Salmon LJ did not express his opinion on the issue.

[57] [1938] 2 KB 83

[58] *United Dominions Trust (Commercial) Ltd. v. Ennis* [1968] 1 QB 54, at p. 64

[59] *Ibid.*, at p. 67

[60] Furmston M P, Contract Planning: Liquidated Damages, Deposits and the Foreseeability Rule (1991) 4 JCL 1, at p. 8

application of the rules relating to penalties to the case. In this regard, the comments of Sir Anthony Mason on an essay written about the Australian case of *O'Dea v. Allstates Leasing System (W.A.) Pty. Ltd.*[61] deserve mention:

> "There are many situations in which a contract can be so drawn that an amount ordinarily payable as damages for breach of contract can be expressed in the form of an obligation to pay a specific sum of money on a contingency unrelated to a breach of contract. Take, for example, an agistment contract. If it contains a promise that the owner of cattle shall not depasture more than a specified number of cattle on the land and that he shall pay a nominated rate per head for cattle depastured in breach of that promise the doctrine may apply. But if the contract is so drawn that there is no promise to restrict the number of cattle depastured and there is merely an agreement to pay the nominated rate per head in respect of cattle over and above the stipulated number, the doctrine will not apply."[62]

It is obvious that such a distinction, considering the possibility of the avoidance of the application of the penalty doctrine with skilful drafting, facilitates the evasion of the law of penalties.

1.3.1.2. Unjust consequence in relation to hire-purchase agreements

4.22 More importantly, in practice, in relation to termination clauses in hire-purchase agreements[63], a hirer who wants to return the goods and put an end to the agreement, would be better off if he defaults in payment and breaks the contract than if he exercises his contractual option to terminate the agreement. This is because determining the contract by the hirer under the exercise of his contractual right, makes him liable to pay the stipulated amount upon termination without being able to invoke the law on penalties, while had he broken the agreement and had, therefore, the contract been determined by the owner, as to the amounts payable on termination, the penalty doctrine would have been applicable. The result would be that by being honest and terminating the agreement in a right and lawful manner, the hirer makes himself liable to pay a large amount, whereas if he had defaulted in the payment, the stipulated amount might have been regarded as a penalty and a reasonable sum as the owner's actual loss would have been

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[61] (1983) 57 A.L.J.R. 172

[62] Sir Anthony Mason's Commentary upon the seminar version of "Penalties in Chattel Lease" by R P Meagher (Chapter 3 of "Essays in Equity" edited by P D Finn), 1985, 46, at pp. 51-52

[63] And by analogy, as to termination clauses in other contracts like chattel lease

payable.[64] This situation would lead, as stated by Lord Denning in his forceful judgement in *Bridge v. Campbell Discount Co. Ltd.*[65], to an "absurd paradox" :

> "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."

Obviously, this is another unsatisfactory result of the principle which considers the breach as a prerequisite to the application of the penalty doctrine.

1.3.2. The Reasons Supporting the Non-interference of the Courts

4.23 The reason for these anomalies, it has been suggested, is that the equitable principles are well-established[66] and as to relieve against penalties, their operation is where the promisor is in breach of a contractual undertaking. Extending the application of the penalty doctrine to situations where a large sum has been stipulated to be paid upon the occurrence of some events other than breach, requires invention of some new general equitable remedies.[67] Since the rules as to penalties and the court's jurisdiction to relieve a party from the payment of a penal sum is a clear intrusion into the old principle of freedom of contract[68], it should be confined as much as possible and therefore any extension in the application of the doctrine by creating new equitable remedies would not be possible. The unwillingness of the courts to interfere in freely contracted agreements over the limits well drawn in the past, and their reluctance therefore to extend the scope of the equitable principles relating to penalties has well been shown in some judicial statements. Among them the well-summed up statement of Diplock LJ in *Sterling Industrial Facilities, Ltd. v. Lydiate Textiles, Ltd.*[69], cited by Lord Roskill in *ECGD*[70],

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[64] This anomalous result has also been acknowledged in *EFT Commercial Ltd v. Security Change Ltd (No 1)* [1993] SLT 128, at p. 134 per Lord Weir and at p. 136 per Lord Caplan: "... it has to be acknowledged that in practice the difference between the rights available on a breach of contract and the rights which may be available by agreement in other circumstances can give rise to anomalies." see also Fridman G H L, Hire-purchase: Estoppel-Penalties (1961) 24 MLR 502, at p. 508; Wedderburn K.W., Hire-purchase, Penalties, Freedom of Contract [1961] CLJ 156, at p. 158

[65] [1962] AC 600, at p. 629

[66] Fridman (1961) 24 MLR 502, at p. 509

[67] Wedderburn [1961] C.L.J. 156, at p. 158

[68] Wedderburn, *ibid.* ; Fridman, *ibid.*, at p. 509

[69] Shortly reported in: (1962) 106 SJ 669

[70] *Export Credits Guarantee Department v. Universal Oil Products Co.* [1983] 2 All ER 205, [1983] 2 Lloyds Law Rep. 152, at pp. 224, 155 respectively

deserves mention:

> "I, for my part, am not prepared to extend the law by relieving against an obligation in a contract entered into between two parties which does not fall within the well-defined limits in which the Court has in the past shown itself willing to interfere."

His lordship emphasized that such clauses might be as improvident bargains, but the law did not relieve against improvident bargains where the parties were at arm's length.

4.24 Moreover, it has not been the function of the courts to upset freely negotiated contracts without proving some improper conduct, sharp practice or fraud[71], therefore merely being oppressive or imprudent[72] should not be considered sufficient to relieve a party from a contractual promise. Unless an improper or unconscionable conduct, or something in the nature of fraud or sharp practice is proved, equity would not interfere with freely entered into agreements, however they turned out to be harsh or disadvantageous to one of the parties.[73] Thus, although, as to the payments stipulated to be paid upon the termination of contract on the happening of some events other than breach, non-interference of the courts might result in some unpleasant and hard consequences, it is nonetheless outside of the scope of the well-established equitable rules relating to penalties and therefore of the courts jurisdiction to interfere in such freely negotiated contracts.

4.25 It has also been suggested[74] that the intervention of the courts in case of termination clauses where termination is triggered off by some events other than breach, might result in deprivation of the owner of all remedies, although the parties themselves, by stipulating

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[71] See Fridman (1961) 24 MLR 502, at p. 509; Wedderburn [1961] C.L.J. 156, at p. 158

[72] See the judgement of Mason & Wilson JJ. in *AMEV-UDC Finance Ltd. v. Austin* (1986) 162 CLR 170, at p. 184

[73] *Ibid.*

[74] See, for example, the judgement of Curran LJ in the Northern Ireland case of *Lombank, Ltd v. Kennedy and Whitelaw; Lombank, Ltd. v. Crossan* [1961] N.I.L.R. 192, where he pointed out: "In my opinion, it is important to observe that, in applying the doctrine, equity has never intervened to deprive the plaintiff of a remedy; he could always recover what he was justly entitled to by way of damages for breach of contract. In the present case, if my foregoing opinion is right, if it be declared that the amount in question is irrecoverable on the ground that it is a penalty, the plaintiff would have no remedy for any loss due to depreciation, although it was clearly the intention of the parties to the hiring that the hirer should be liable therefore." at p. 218 ; Also see Burrows A, Remedies for Torts and Breach of Contract, (2nd ed., 1994), p. 332

for a payment to be made upon termination, have clearly expressed their intention that in case of termination, a sum of money, as compensation for depreciation of goods, would be paid to the owner. The reason for this is that by holding the stipulated sum to be a penalty and unenforceable, there would be no liability to pay unliquidated damages for some events which could not be considered as breach.[75]

1.3.3. The Reasons for the Possibility of the Application of the Penalty Doctrine

4.26 On the other hand, it has been argued that in either case whether the owner determines the contract on the basis of a default in the payment of instalments or the hirer terminates it because of the exercise of his option under the agreement, there is the same non-performance and the same provision to pay the stipulated amount as compensation for depreciation by the hirer[76]. Therefore, there should logically be no difference as to the application of the penalty doctrine with regard to both situations. Furthermore, a review of the history of the intervention of the courts to relieve a party from penalty clearly shows that the prerequisite to relief is not breach itself, but it is the legal liability which is the essential requirement to grant relief against payment of a penal sum.[77] Hence, if the legal liability could be accepted as the basis for the application of the penalty doctrine, the doctrine, therefore, should be applicable irrespective of whether the stipulated sum had become payable on the determination upon breach or any other event.

4.27 It should also be noted that in the application of the penalty doctrine as to cases where the agreement has been determined upon some events other than breach, no question of a new break with the old principle of freedom of contract or extending the scope of the equitable rules relating to penalties would arise; for, as argued by Lord MacDermott L.C.J. in the Northern Ireland case of *Lombank, Ltd. v. Kennedy*[78], "...

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[75] As Lord Caplan argued in the recent Scottish case of *EFT Commercial Ltd v. Security Change Ltd (No 1)* [1993] SLT 128, "... upon termination of a contract on the occurrence of an event not amounting to breach no provision for compensation exists other than that agreed by the parties themselves." at p. 135

[76] See McGregor on Damages, 15th ed., 1988, para. 516 at p. 324 ; The argument was originally put by Lord MacDermott CJ in *Lombank, Ltd. v. Kennedy* [1961] N.I.L.R. 192, at p. 206

[77] Clarke, Mr Justice M.J.R., Commentary on Professor Furmston's article entitled "Contract Planning: Liquidated Damages, Deposits and the Foreseeability Rule" (1991) 4 JCL 11, at p. 12, citing the judgement of Deane J. in the Australian case of *AMEV-UDC Finance Ltd. v. Austin* (1986) 162 CLR 170, at p. 199

[78] [1961] N.I.L.R. 192

equitable principles which aim at the promotion of fair dealing have a way of outlasting the particular forms of conduct that [beget] them, and the question here, as I see it, is not one of extending the principles of the rule but of applying them to a modern form of contract dealing with a modern form of transaction."[79] The point has also been made by Deane J, in the Australian case of *AMEV-UDC Finance Ltd. v. Austin*[80], who- emphasizing that the common law rules relating to penalties have derived from equitable principles determining the availability of relief in Chancery, and pointing out that the rules with true equitable foundation are concerned with substance rather than form- argued:

> "It would ... have been out of accord with equity's concern with substance for the availability of equitable relief against the enforcement of a performance bond ... to have depended upon whether it was possible to identify some implied contractual warranty of which the failure to perform or pay constituted a technical breach of contract on the part of the plaintiff. In fact, of course, equity observed no such limitation upon its jurisdiction to grant relief...."

It follows from this argument that the equitable rules relating to relief against penalties were applicable where there was a legal liability, notwithstanding the fact that that liability had raised from breach or any other event. Thus, no question of extension of the law relating to penalties or a new break with the principle of freedom of contract would arise.[81]

4.28 It has also been pointed out that the application of the penalty doctrine to the clauses providing for the payment of a sum of money in the event of termination upon events other than breach of contract would not inevitably result in the deprivation of the plaintiff of all remedies.[82] Equity, as a matter of fairness, after intervention and declaring the clause void as a penalty would compensate the owner for the actual losses he might be suffered as a result of termination. As it has been stated by Lord MacDermott L.C.J.,

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[79] *Ibid.*, at p. 208

[80] (1986) 162 CLR 170, at p. 197

[81] It has, moreover, been suggested that basically "the precepts of "freely" negotiated contracts are [not] appropriate to deal with a society in which finance companies [for example] dictate terms of "agreements" to consumers, standard exemptions and all, to the tune of a total hire-purchase debt of some £900 million." (Wedderburn K.W., Hire-purchase, Penalties, Freedom of Contract [1961] CLJ 156, at pp. 158-159)

[82] McGregor on Damages, 15th ed., 1988, para. 517 at p. 325

in the course of his judgement, in *Lombank, Ltd. v. Kennedy*[83]:

> "In the case of the breach or non-performance which is actionable what equity says to the parties is, in effect this- "You have agreed that a measured sum for compensation will be payable. That is really a penalty to secure performance and will not be enforced. But notwithstanding what you have agreed, the loss actually suffered will, as a matter of fairness, be recoverable instead." There seems to be no good reason why equity should not speak in the same terms where the non-performance is not actionable, and all the more so where the difference between what is actionable and what is not depends on a provision which does not really affect the equities of the situation."

4.29 The oddity and anomalous results of the distinction between situations where termination is based upon breach and where it is grounded on events other than breach, with regard to the application of the penalty doctrine, has been noticed in some judicial statements, even by judges who believe in this distinction. In *Campbell Discount Co. Ltd. v. Bridge*[84], for example, Holroyd Pearce LJ, holding that the rules distinguishing liquidated damages from penalties have no application where the hirer, by the exercise of his contractual option, has terminated the contract, regretted the result of the case[85], and Harman LJ, having agreed with the decision of Holroyd Pearce LJ, expressed his "uneasy feeling" on the point that "the position of the law as it stands is not satisfactory"[86]. The court, however, suggested in effect that if relief in such cases is preferable it should be achieved by legislation and it is not the job of the courts, but of the legislature to create such underlying and essential changes as to the law relating to penalties.[87] This position has rightly been questioned by some writers why, if such changes seem to be necessary, the courts themselves should not create new principles or apply the existing rules by analogy to allow the relief to be granted against penalties in proper cases.[88]

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[83] [1961] N.I.L.R. 192, at p. 208

[84] [1961] 1 QB 445

[85] *Ibid.*, at p. 458

[86] *Ibid.*, at p. 458; see also *EFT Commercial Ltd v. Security Change Ltd (No 1)* [1993] SLT 128, at p. 136 per Lord Caplan, and at p. 134 per Lord Weir

[87] See Wedderburn [1961] C.L.J. 156, at p. 159 ; Fridman (1961) 24 MLR 502, at p. 509

[88] Fridman, *Ibid.*

1.3.4. The Effect of the Hire-Purchase Act 1965 and the Consumer Credit Act 1974

4.30 It is fitting here to refer to the Acts of Parliament relating to the subject and the way they dealt with the problem. The Hire-Purchase Act 1965, which continues to apply to the hire-purchase agreements entered into before May 19, 1985[89], is concerned with agreements made between the parties where the hirer is an individual and the total purchase price does not exceed the amount of £5000.[90] The Consumer Credit Act 1974 applies to hire-purchase agreements[91] made by an individual as a hirer and has the ceiling of £15000 which is calculated by the total purchase price less the deposit and any finance charges.[92]

4.31 In the case of agreements within the scope of the Hire-Purchase Act 1965, any provision in the agreement whereby the hirer [or the buyer] after the termination in any manner whatsoever of a hire-purchase agreement [or conditional sale agreement] is subject to a liability to pay an amount which exceeds whichever is the lesser of (i) the amount by which one-half of the hire-purchase price exceeds the total of the sums paid and the sums due in respect of the hire-purchase price immediately before the termination and (ii) an amount equal to the loss sustained by the owner or seller in consequence of the termination of the agreement, has been considered as void and unenforceable.[93] By section 173(1) read in conjunction with sections 100(1) and 100(3) of the Consumer Credit Act 1974, the same provisions as the Hire-Purchase Act 1965 has been repeated with a little difference that its application has been confined to termination by the hirer under his statutory right.[94]

4.32 It is, therefore, obvious that where a hire-purchase or conditional sale agreement met the requirements of the Act and became a regulated hire-purchase or conditional sale

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[89] S.I. 1983/1551, arts. 2,6

[90] s. 2(2) (with reference to S.I. 1978/461), s. 4

[91] Such an agreement within the scope of the Act, has been called a regulated agreement: s. 8(3)

[92] ss. 8(2), 8(3), 9(3) [and S.I. 1983/1878]

[93] s. 29(2)(c), with regard to s. 28(1)(a)

[94] Under s. 99 of the Act ; The position of the Act in this respect has been criticized by some writers: see, e.g., McGregor on Damages, 15th ed., 1988, para. 520 at p. 327

agreement, the unsatisfactory position of the common law and equity and the uncertainties resulting from them as to termination clauses, with regard to the application of the penalty doctrine, would not arise. In other words, a hirer or buyer who lawfully terminates a regulated hire-purchase or conditional sale agreement would not be worse off than he would be if he had broken the agreement.[95]

4.33 The policy taken by the legislature as to the hire-purchase agreements would seem to be satisfactory and solve the unpleasant and unjust results of the application of the common law rules as to the application of the penalty doctrine to termination clauses. It should, however, be noted that the Acts only apply to the regulated hire-purchase agreements and allied contracts like conditional sale, and have no application as to the termination clauses in both hire-purchase or allied agreements which fall outside of the scope of the Acts, and also contracts other than hire-purchase. As to the latter kinds of contracts, the equity and common law rules would continue to apply. Therefore, proposing measures like raising the figure below which the Consumer Credit Act 1974 applies, though they could be considered as useful steps in relation to hire-purchase and allied agreements, would not solve the problem completely.

4.33* The Unfair Terms in Consumer Contracts Regulations 1994 is also worthy of a reference here. These Regulations, implementing the EC Council Directive 93/13 on Unfair Terms in Consumer Contracts, expressly provide that, in contracts made between a consumer and a seller or supplier, any term which has "not individually been negotiated", and "contrary to the requirement of good faith causes a significant imbalance in the parties' rights and obligations to the detriment of the consumer" should be regarded as "unfair", and would not be binding on the consumer. In its "indicative and non-exhaustive" list of terms which may *prima facie* be regarded as "unfair", the Regulations refer to a term which has the object or effect of "requiring any consumer who fails to fulfil his obligation to pay a disproportionately high sum in compensation". (para. 1(e), Schedule 3) The list, however, is not exhaustive; and the Regulations, it may be suggested, cover also a situation where a disproportionately high sum of money has been

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[95] See Treitel G.H., The Law of Contract, 9th ed., 1995, p. 904

provided to be paid upon the occurrence of events other than breach. Such a term, being regarded as unfair, would fall within the scope of the Regulations, and would not be binding on the consumer.

1.3.5. Concluding Discussion

4.34 It seems clear enough that the common law rules relating to the penalty doctrine as to its application to the amounts payable upon the termination of contract need some review and reconsideration. The improper and sometimes unjust consequences which result from the application of the common law rules in this regard emphasize the need for this revision. One solution is the suggestion, put by Jenkins LJ in *Cooden Engineering Co. Ltd. v. Stanford*[96], that the penalty doctrine has no application to amounts which are payable upon termination of the contract, whether the termination is based upon breach or it is grounded on events other than that. Having suggested this, his lordship expressed his opinion that there might be some kind of equitable relief available to the hirer if the stipulated sum was so oppressive and unconscionable:

> "Although in the view I take the sum payable under clause 11 is not a penalty in the sense contended for in the present appeal [i.e. penalty in the *Dunlop*[97] sense], it might I suppose conceivably have been argued that the provision in question is a penal provision in the sense that it is so oppressive and unconscionable that equity should grant relief from it upon equitable terms."[98]

It is followed from the phrase just quoted that according to Jenkins LJ's view, two separate doctrines are available to grant relief against penalties: first, the penalty doctrine in the sense of the *"Dunlop"* case which has no application to the sums payable upon termination of contract, and second, the doctrine by which equity grants relief against unconscionable and oppressive bargains upon which the stipulated sum to be paid upon termination might be regarded as a penalty and unenforceable.

This view has been criticized by some writers saying: "Given that both [doctrines] descended from fairly ancient equitable principles the question may be asked "why should this be so?" and "why should the distinction be perpetuated?""[99]

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[96] [1953] 1 QB 86

[97] *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd.* [1915] AC 79

[98] *Cooden Engineering Co. Ltd. v. Stanford* [1953] 1 QB 86, at p. 112

[99] Clarke, Mr Justice M.J.R., Commentary on Professor Furmston's article entitled "Contract Planning:

4.35 The alternative solution is the view expressed by Lord Denning in *Bridge v. Campbell Discount Co. Ltd.*[1] that the courts have power to grant relief against a penal sum stipulated to be paid upon termination, whether the termination is based upon breach or it is grounded on any other event.[2] Accordingly, if a contract was terminated by the hirer for the exercise of his option under the contract or by the owner because of the hirer's default in payment or any other event as provided in the agreement, the stipulated sum to be payable upon termination by the hirer would be subject to the penalty doctrine, and if it was extravagant or unconscionable in comparison with the owner's anticipated actual loss, it would be a penalty and unenforceable.

4.36 Although these two solutions, at first glance, look very different, they have a common feature and that is the emphasis on the court's power to grant relief against a penal sum stipulated to be paid upon termination. According to the first view, however, in determining the penal nature of the sum, to allow the court to interfere upon equitable rules, attention should be paid to the unconscionability and oppressiveness of the stipulated sum; while the second view permits the courts to relieve against a penalty, in the sense expressed in the *"Dunlop"* case, stipulated to be paid upon termination. Since the distinction between a penalty in *"Dunlop"* sense and an equitable penalty, considering that both have their roots in equitable rules, might result in unpleasant consequences and add to the uncertainty of the law in this area, it would seem that Lord Denning's view should prevail. Hence, the provisional proposal of the Law Commission[3] on the subject seems to be acceptable:

> "... Our proposal is that the rules as to penalty should be applied wherever the object of the disputed contractual obligation is to secure the act or result which is the true purpose of the contract."

4.37 In support of Lord Denning's view, it could be added that the purpose of a sum

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Liquidated Damages, Deposits and the Foreseeability Rule" (1991) 4 JCL 11, at p. 14

[1] [1962] AC 600, agreeing with the forceful dissenting judgement of Lord MacDermott in *Lombank, Ltd. v. Kennedy* [1961] N.I.L.R. 192 ; Also see the judgement of Deane J. in *AMEV-UDC Finance Ltd. v. Austin* (1986) 162 CLR 170, at pp. 197-199

[2] *Ibid.*, at p. 631

[3] Law Commission's Working Paper, no. 61, "Penalty Clauses and Forfeiture of Monies Paid", 1975, para. 26

stipulated to be paid upon termination is mostly either to asses the promisee's likely actual loss as a result of termination, or to punish the promisor for, and prevent him from non-performance of the agreement.[4] In other words, almost always it is provided to secure the performance of the agreement and therefore, it should be subject to the penalty doctrine whether the termination is triggered off by the breach of contract or events other than that.

4.38 It should also be noted that if the true basis for the intervention of courts to relieve against penalty is, as it has been suggested by some leading academic lawyers[5], unfairness, the prerequisite to the intervention, logically, exists in the case of any extravagant and unconscionable legal liability, even that liability has not been caused, directly or indirectly, by the breach of a contractual undertaking. It might be said that extending the application of the penalty doctrine to any legal liability, even where it is not caused by breach, is a clear interference with the principle of freedom of contract and should, therefore, be avoided. The point, however, is that the whole doctrine is an interference with the old principle of freedom of contract: If such an intrusion is acceptable on the ground of unfairness with regard to any liability- direct or indirect- arising from breach, it should also be justifiable in relation to any legal liability, as far as it is provided to secure the performance of the agreement. It does not seem to be a proper treatment that in the same situations with the existence of the same grounds, two different attitudes are applied.

4.39 Furthermore, as it appears from the history of the intervention of the courts of equity to grant relief, the purpose of such equitable rules was to prevent a party to a contract to take an unfair advantage of his legal rights for the purpose of injustice, or fraud, or oppression, or harsh and vindictive injury.[6] It seems to be inconsistent with this purpose, if equity has made the breach a prerequisite to grant relief with regard to

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[4] See Burrows A, Remedies for Torts and Breach of Contract, (2nd ed., 1994), p. 332

[5] Furmston M P, Contract Planning: Liquidated Damages, Deposits and the Foreseeability Rule (1991) 4 JCL 1, at p. 8; see also *supra.*, paras. 1.69-1.70

[6] See Holdsworth, History of English Law, 7th ed., vol. 5, p. 330; Story's Commentaries on Equity Jurisprudence (1839) vol. II, p. 508 (cited by Lord Denning in *Bridge v. Campbell Discount Co. Ltd.* [1962] AC 600, at p. 629); see also *supra.*, paras. 1.13-1.14

termination clauses, and prevents relief where termination is based upon events other than breach. It would, as pointed out by Lord Denning[7], mean that "equity commits itself to an absurd paradox" which in some cases might result in injustice. In the words of Deane J., in the course of his judgement in the Australian case of *AMEV-UDC Finance Ltd. v. Austin*[8], the prerequisite to relief- considering the underlying purpose of equity- could not be only the breach, as distinct from legal liability:

> "It would have been contrary to the underlying theses of the equitable jurisdiction to prevent unconscionable advantage being taken of the harshness of the common law to have made the existence of legal fault in the plaintiff, as distinct from legal liability, a prerequisite of entitlement to relief or to have made the contumacy of the plaintiff's conduct giving rise to legal liability a ground for equitable relief against the liability."[9]

4.40 For the reasons referred to above, it is submitted that the courts should grant relief against a penal sum provided to be paid in the event of termination, irrespective of whether the agreement has been terminated by the hirer on the exercise of his option or by the owner on the occurrence of events stipulated in the contract. The important point is that the courts, as stated by Lord Denning[10], have power to do so.

2. Moneys Payable as Alternative Promises

2.1. Introductory Remarks

4.41 Alternative obligations are promises in a contract under which the promisor has the option of performing one of the alternatives; and having performed one of them, he would be discharged from his contractual promise. For example, in a contract for the sale of 200 tons of specific goods, with tolerance of 5 per cent. more or less, the seller will be discharged if he delivers each one of 190-210 tons and he has the option to choose either of the alternatives that he thinks fit. The settled principle as to the alternative obligations is that if the promisor failed to perform the agreement, then damages for non-performance would be computed according to the alternative that is most beneficial to the

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[7] *Ibid.*, at p. 629

[8] (1986) 162 CLR 170

[9] *Ibid.*, at p. 198

[10] *Bridge v. Campbell Discount Co. Ltd.* [1962] AC 600, at p. 631

promisor, not the one which is the most profitable alternative to the promisee. That is why that in the above example, as to the buyer's action for non-delivery, the sellers were held to be liable up to only 190 tons[11]. It should be noted that the principle is applicable as to the true alternative promises, not the obligations which are only framed in the alternative way. It is, therefore, necessary to distinguish true alternative obligations from the undertakings merely framed in the alternative.

2.2. True alternative promises

4.42 The true alternative contract is one under which in any event, regardless of which alternative is chosen to be performed by the promisor, the promisee will get the performance for which he has bargained. On the other hand, if the contract has only been framed in the alternative, the promisee will get the bargained performance merely in the case that the promisor performs a specific alternative and the other choice is not, in fact, what he has bargained for.[12] This is normally the case where one of the alternatives is doing a specific act which is the main purpose of making the contract and the other choice is the payment of a specific sum of money. The second alternative, in such cases, is not normally what the promisee pays the consideration for, and therefore performing this choice, though it will normally discharge the promisor from his contractual duty, will not result in the promisee getting what he has bargained for. As to this kind of alternative obligations, the principle stated above[13], has no application. Put another way, if the contract was not performed by the promisor, the court would not assess damages on the basis of the alternative which is most beneficial to the promisor, but upon the non-performance of the promise which is the main purpose of the agreement, the promisor would be held liable to perform the other alternative, i.e. to pay the monetary sum as specified by the parties in the second choice.

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[11] *Re Thornett & Fehr* [1921] 1 KB 219 ; see also *Robinson v. Robinson* (1851) 1 De G.M. & G. 247, 21 LJ Ch. 111, 42 ER 547 ; *Withers v. General Theatre Corpn Ltd.* [1933] All ER Rep 385 ; *Johnson Matthey Banking v. The State Trading Corporation of India* [1984] 1 Lloyd's Rep. 427 ; for more cases on the subject see McGregor on Damages, 15th ed., 1988, para. 366, 367 at pp. 228-230

[12] McGregor, loc. cit., para. 522 at pp. 328-329

[13] *Supra.*, para. 4.41

4.43 This proposition is supported by the case of *Deverill v. Burnell*[14] in which the plaintiff, having shipped certain goods to a place, drew some drafts and entrusted them to the defendant to present them for acceptance on the condition that the defendant should return the drafts, if not paid after acceptance, to plaintiff or pay the plaintiff the amount of the bills. Upon non-payment of the drafts after acceptance, the defendant neither returned the bills nor paid the amount of them to the plaintiff. In an action by the plaintiff, it was held that the defendant by not returning the drafts, was liable to pay the amount of them. The majority of the court, Bovill CJ dissenting, construed the agreement as not a pure alternative obligation, but as promises merely framed in the alternative. On the true interpretation of the agreement, the contractual duty of the defendant, first and foremost, was to return the bills and if he did not, then he would be under the liability to pay the amount of the drafts as the second choice. Unlike pure alternative agreements, the defendant had no option to choose one of the promises, but his first liability was to return the drafts as the main purpose of the agreement. Therefore, damages for non-performance should not, it was held, be computed upon the obligation which is most beneficial to the defendant, i.e. the value of the bills which was nil.

2.3. Application of the penalty doctrine to promises framed in the alternative

4.44 Having discussed briefly the pure alternative obligations and promises which are merely framed in the alternative, we should now turn to an important question which arises in relation to the latter alternative agreements. As to these contracts, what the situation would be if the amount provided to be paid as an alternative was extravagant or unconscionable in comparison with the likely actual losses which might result from the non-performance of the other alternative? Is the stipulation for payment of a specified sum as an alternative obligation subject to the penalty doctrine? Apparently, there is no authority on the point. It has been suggested that "in such circumstances the second alternative takes on the characteristics of a penalty"[15]. However, the technical question remains that the sum stipulated in the second alternative has not been provided to be paid in the event of breach, and where there is no breach of contract, in principle no question

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[14] (1873) L.R. 8 C.P. 475, 42 L.J.C.P. 214, 28 L.T. 874

[15] McGregor, loc. cit., para. 523 at p. 329

of the application of the rules relating to penalties would arise.

4.45 It would seem that the answer to the problem lies on the construction of the agreement. If an agreement which has been merely framed as an alternative obligation was construed as a true alternative contract, then the question of breach being a prerequisite for the application of the doctrine, as an obstacle for its application, might arise. But as it was referred to[16], the true construction of the agreement is that such a contract could not be a pure alternative obligation in which the promisor has the option of choosing one of the alternatives to perform. Such an agreement should be construed as a contract under which the first duty of the promisor is to perform the choice which is the main purpose of making the contract, and if he fails to perform this alternative, then he would inevitably have to perform the second option. If the substance of such an agreement is observed, it will be apparent that there is no difference between this agreement and a contract upon which the parties have agreed that in the event of default in the performance of the promise, the promisor would have to pay a stipulated amount as losses resulting from breach. The majority's view in *Deverill v. Burnell*[17], supports this argument: In that case, Grove J. in the course of his judgement stated:

> "It seems to me we must construe a promise relating to a matter of business as persons would in the ordinary affairs of life construe it, and no particular technical construction is to be put on it, and in ordinary case ..., "I will return you your horse by such a day, or pay you a day's hire", if I do not return the animal, I must pay a day's hire. Here it seems to me the reasonable construction is that, ..., by the agreement the plaintiff has said, "I do not estimate the value of what I may lose at the actual time of the *breach*, but I choose to say if you do not return the bills, I will take as my *damages* the amount of the value." ... What do these words in ordinary parlance mean? They surely mean, "If the bills are not returned, I am willing that the amount shall be the amount of the *loss*."[18]

If such a construction is put on the agreements which are only framed in the alternative, then the non-performance of the main choice would be equivalent to the breach of contract, and the sum payable upon the second option would be like an amount stipulated to be paid upon breach.

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[16] *Supra.*, para. 4.42

[17] (1873) L.R. 8 C.P. 475, 42 L.J.C.P. 214, 28 L.T. 874

[18] *Ibid.*, at p. 875 [emphasis added]

4.46 It should be added, in the support of this argument, that, firstly, as it has been emphasized in numerous cases, the question of the applicability of the penalty doctrine, is a question of substance, not of form[19], and in substance there seems to be no substantial difference between the agreement of the parties on the amount of damages, whether it is drafted as a clause providing for the payment upon the occurrence of breach or as an alternative obligation in the event of non-performance of the main option. Secondly, if the law relating to penalties was not applicable to the obligations framed in the alternative where the second alternative is the payment of an extravagant sum, by the argument that there is no breach to be considered as the prerequisite to the application of the doctrine, then the whole penalty doctrine could easily be evaded by drafting the stipulated sum as an alternative obligation.

4.47 For the whole reasons referred to above, it could well be concluded that the obligations which are *merely framed* as alternatives are subject to the penalty doctrine and the technical question of breach as a prerequisite to the application of the doctrine would not also prevent the doctrine from being applied here. This is because, upon the true construction of such agreements, a breach of the contractual undertaking could well be assumed. It should however not be denied that a court, considering the terms of the contract and the whole surrounding circumstances, may conclude that the parties have really intended to enter into a pure alternative contract. The true construction in such a case, it seems, is that the promisor has the option of not performing upon the payment of the price, provided for as an alternative promise, for the exercise of this option. In such a case, obviously, under the law as it stands, the penalty doctrine will have no application.

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[19] E.g., see the speech of Lord Radcliffe in *Bridge v. Campbell Discount Co. Ltd.* [1962] AC 600, where he pointed out: "The court's jurisdiction to relieve against penalties depends on 'a question not of words or of forms of speech, but of substance and of things.'" p. 624

Chapter 5

Termination Clauses: Application of the Penalty Doctrine to Minimum Payment Clauses

1. Introductory Remarks

5.001 In commercial contracts, especially financing transactions, it is commonly provided that on the occurrence of specific events, the agreement, either automatically or by the exercise of the contractual power to terminate by one of the parties, would be brought to an end. Upon termination, there might be a provision requiring one of the parties, normally the debtor, to pay a specified sum of money to the other, commonly called as a "minimum payment clause". For instance, in hire-purchase agreements, it is the universal practice of the finance companies to provide for a termination clause, in the event of the happening of specific events, *inter alia* death or bankruptcy of the hirer and any breach of the contract by him; and upon termination, the hirer is contractually required, under the minimum payment clause, to bring his payments up to a specified portion of the purchase price.

5.002 It was discussed in the previous chapter that if termination was triggered off by the promisor's breach of his contractual obligation, the minimum payment clause would undoubtedly be subject to the rules against penalties. If, therefore, the stipulated payment could not be considered as a genuine pre-estimate of the promisee's actual loss resulting from breach, the minimum payment clause would be struck out as being a penalty and the promisee would be compensated for his losses under the common law rules. Whether the penalty doctrine has any application in relation to the sums payable upon termination based on events other than breach has not been, as it was fully considered[1], completely settled yet. However, the law as it stands now, though to some extent unsatisfactory, does not recognize the application of the rules against penalties as to amounts provided to be paid on the occurrence of events other than breach.[2] Hence, the discussion here

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[1] See *supra.*, paras. 4.12 *et seq.*

[2] See *supra.*, paras. 4.02-4.04

will be confined to the application of the penalty doctrine to the minimum payment clauses which operate in the event of termination based upon breach of a contract by the promisor.

5.003 Providing for a termination clause is also a common practice in construction contracts. The Standard Form of Civil Engineering Contract- which is commonly known as the I.C.E. conditions of contract[3] and extensively used in various types of engineering work[4]- in clause 63, empowers the employer to terminate the contractor's employment upon the happening of specific events and to enter upon the site and expel the contractor, after giving seven-day notice in writing, without releasing him from his contractual liabilities under the agreement. This obviously, in effect, brings the contract to an end and upon that, by clause 63(4), the contractor is made liable for any excess by which "the costs of completion, damages for delay in completion (if any) and other expenses incurred by the employer" exceed the amount which would have been due to the contractor had he completed the work. In fact, this provision is a minimum payment which the contractor is provided to be liable for, in the event of, *inter alia*, the breach of the construction contract and termination of the agreement by the employer. Nevertheless, the rules and principles in this area as to the application of the penalty doctrine to such a payment, have mostly been developed in litigations relating to minimum payment clauses in instalment payment contracts, e.g. hire-purchase contracts, conditional sale agreements and chattel leases. This is thought to be due to the practical importance of such clauses in these contracts and various litigation which arise on the point of the application of the penalty doctrine to them. Furthermore, having regard to the true nature of financing transactions could justify the constant stipulation of the minimum payment clauses- which have been the real source of litigations in this relation- in these contracts. It should, however, be noted that the minimum payment clauses in other commercial contracts are, *prima facie*, governed by these principles.

5.004 It is preliminarily to be pointed out that to determine whether a minimum payment

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[3] 6th ed., 1991

[4] See May, Sir Anthony, Keating On Building Contracts (London: Sweet & Maxwell, 5th ed., 1991), p. 810

provided to be paid upon breach (or termination based on breach) constitutes a penalty, the general rules and principles laid down by Lord Dunedin in *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd.*[5] would be applied. Some special aspects of these rules in relation to their application to minimum payment clauses are, however, worthy of a detailed discussion here.[6] Furthermore, termination of the contract might be based on either a repudiatory or a non-repudiatory breach. This basis for termination results in important principles in relation to the assessment of loss and the application of the penalty doctrine to the minimum payment clauses. These rules should also be given a rather detailed consideration.[7] It is also appropriate to consider, in some detail, the factors which should be taken into account in order to draw up a valid minimum payment clause.[8] Before considering the main subjects as listed above, however, there is a necessity of having a close look at the nature of financing transactions; for their true nature, as distinct from pure hiring agreements, would justify both the insertion of the minimum payment clauses in such agreements and the importance of upholding these clauses if they have been drafted carefully, considering all aspects of the contract.

2. The True Nature of Financing Transactions

2.1. Financing and Security Functions

5.005 As the litigated cases show, the minimum payment clauses are normally seen in hire-purchase agreements and chattel leases. Examining the true nature of these agreements, one can easily recognize that they are not normally a pure contract of hire and therefore they should be dealt with rather differently from pure hiring agreements. The nature of pure hiring agreements is creating a bailment under which the hirer has the right to use the subject-matter in the specified period, in return for the payment of a real hiring charge.[9] In these agreements, the rentals provided to be paid by the hirer are directly related to the hiring value of the subject-matter in the stipulated period of time.

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[5] [1915] AC 79

[6] See *infra.*, section 3, paras. 5.012 *et seq.*

[7] See *infra.*, section 4, paras. 5.048 *et seq.*

[8] See *infra.*, section 5, paras. 5.087 *et seq.*

[9] See Halsbury's Laws of England, vol. 2 (4th ed., 1991): "It is a contract by which the hirer obtains the right to use the chattel hired, in return for the payment to the owner of the price of the hiring." para. 1850 at p. 868

5.006 Considering carefully the nature of hire-purchase agreements, however, shows that they are not a pure bailment with an option to purchase[10]; their object is normally to provide finance to the hirer to acquire the equipment, and to secure the return of the provided finance with interest by creating a proprietary right over the subject-matter.[11] Put another way, a customer, who needs finance to get a certain piece of equipment, enters into a hire-purchase agreement with either the dealer, if the dealer himself wishes to provide finance, or a finance company, who becomes the owner of the subject-matter by payment of the cash price to the dealer. In the former the real nature of the agreement is a "credit sale": the dealer provides finance to the customer to acquire the subject-matter and keeps for himself a proprietary right over that to secure the return of the finance plus a proper interest. By doing so, in fact, he sells the goods to the customer with two conditions: a) to get the price by instalments over a specified period of time, and b) to keep the title of the goods for himself until he gets the last instalment.

5.007 In the latter case, i.e. entering into a hire-purchase agreement with a finance company which is a normal practice in England, the true nature of the agreement seems to be a "secured loan".[12] In other words, the finance company, which has not probably even seen the subject-matter, only provides finance to the customer for the purpose of acquiring the subject-matter. This process is, in practice, done through acquiring the goods by the finance company with the payment of a cash price to the dealer and letting them to the customer in the form of a hire-purchase agreement. All the finance company is concerned about, therefore, is the receipt of the capital (i.e. the finance provided to acquire the subject-matter with all expenses incurred in this relation) plus a reasonable interest, which in fact constitutes the purchase price provided to be paid by the hirer over a period of time in the form of termly instalments in the hire-purchase agreement. The

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[10] See Ziegel, Jacob S., The Minimum Payment Clause Muddle [1964] C.L.J. 108, at p. 108

[11] In fact, these transactions are very similar, in effect, to contracts for the purchase of land by the aid of a mortgage; as it was pointed out by Lord Denning: "Just as a man who buys land may raise part of the price by a mortgage of it, so, also, a man who buys goods may raise part of the price by hire-purchase of them." (*Bridge v. Campbell Discount Co. Ltd.* [1962] 1 All ER 385, at p. 398) Despite this similarity, these two situations have been treated differently: the protection afforded to a mortgagor [e.g. his right of redemption, and restricting the mortgagee's right only to principal and interest] is not always available to a buyer by the aid of hire-purchase.

[12] Ziegel, *Ibid.*; see also Furmston M P, Termination of Hire-purchase Contracts: Minimum Payments and Penalties (1964) 15 N.I.L.Q. 235, at p. 236

return of the purchase price is secured by a real right which the finance company maintains for itself in the equipment.

5.008 Equally, chattel leases are normally made in the form of finance leases as distinct from operating leases (or pure leases). The finance lease has, in fact, financing and security functions.[13] To put it somewhat differently, the lessor provides finance to acquire the equipment to use as capital goods. He, then, leases the equipment to the lessee for the period of normally the useful economic life of the goods, so that at the end of the agreement, the subject-matter is either abandoned or sold to the lessee for a very insignificant price. In fact, the real nature of the agreement, as it has been suggested[14], is "leasing finance" and in result it is very similar to a "conditional contract of sale". In order to secure the return of the capital plus interest in the form of instalments of the lease, the lessor maintains for itself a real right in the subject-matter. Thus, a finance lease, in truth, acts as a means to provide finance and to secure the receipt of the capital plus interest by the lessor as instalments of the leasing agreement. Just like hire-purchase agreements, the lessor is concerned about the receipt of the finance provided with a proper interest which constitutes the purchase price. The payment of this price is spread over the leasing period and is expected to be paid by the lessee in the form of instalments.

2.2. The Justification for the Insertion of "Minimum Payment Clauses"

5.009 As it appears from the above analysis, the true nature of financing transactions- like hire-purchase and most chattel leases- are not a pure bailment/bailment with the option to purchase. Both agreements, however, are mostly used as a means to provide finance and also as a security device to ensure the repayment of capital (i.e. finance provided with all other expenses) and a fair interest.[15] Paying enough attention to this nature could justify the insertion of the minimum payment clause in these agreements: the creditor expects to receive his capital and interest in any event, even where the contract- because of any reason, automatically or by the exercise of the contractual power of one of

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[13] Chin, Nyuk Y, Finance Leases and Loss of Bargain: Judicial Impulses in the High Court (1993) 23 Western Australia Law Rev. 279, at pp. 280-281

[14] Chin, loc. cit., at pp. 281-282

[15] See also Ziegel J S, Hire-purchase Agreements: A Plea for Greater Realism (1960) 104 S.J. 996; *cf.* observations of Lord Denning in *Bridge v. Campbell Discount Co. Ltd.* [1962] AC 600, at pp. 626-627 as

the parties- is terminated. To achieve this expectation, the finance company or the lessor stipulates for a clause providing that in case the contract is prematurely brought to an end, the hirer/lessee (i.e. the debtor) will be liable to pay the arrears of rent, any outstanding rentals at the date of termination duly discounted to show its then value, and any difference between the realisable value and the residual value of the equipment, if the realisable value is not enough to cover the residual value, giving credit for any excess resulting from the repossession and resale of the subject-matter. This stipulation is, in fact, a minimum payment clause and since it reflects the real expectations of the creditor who extends finance, it is believed[16] that it should, as far as possible, be upheld unless it imposes an extra or a different liability upon the debtor. It is submitted that even in this case, as long as the disparity between the stipulated amount and the expectancy value of the transaction is not "extravagant" or "unconscionable", there should be no ground for refusing to uphold the validity of the clause as a genuine pre-estimate of the creditor's actual loss.

5.010 The necessity of allowing the lessor to recover the expectancy value of the agreement has also been considered in the Unidroit Convention On Financial Leasing[17]. Art 13(3) of the convention provides that the contractual provision for the computation of the amount to be paid upon termination of the agreement by the lessor should be enforceable between the parties unless it is "substantially in excess" of damages fixed by Art 13(2)(b), viz. "such damages as will place the lessor in the position in which it would have been had the lessee performed the leasing agreement in accordance with its terms".[18]

Obviously, if the contract was not breached by the lessee and if he performed all his contractual obligations, the lessor would be able to gain the purchase price and repossess

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to the true nature of hire-purchase agreements.

[16] Goode R M, Penalties in Finance Leases (1988) 104 L.Q.R. 25, at p. 29; Ziegel, Jacob S., The Minimum Payment Clause Muddle [1964] C.L.J. 108, at p. 109; Chin, Nyuk Y, Finance Leases and Loss of Bargain: Judicial Impulses in the High Court (1993) 23 Western Australia Law Rev. 279, at p. 286

[17] Concluded on 28 May 1988 at Ottawa

[18] The Convention in its Article 13(2) speaks of the right of termination by the lessor arising out of the lessee's substantial default, and then respects, under Article 13(3), the right of parties to provide for the manner in which the damages upon termination would be recoverable unless it is substantially in excess of the lessor's loss of bargain. It is however silent about the lessor's contractual right to terminate, and the consequences provided for upon such a termination by the parties.

the equipment, which is normally worth its residual value, at the end of the contractual period. If, therefore, the lease was prematurely terminated upon the lessee's breach, the lessor, under the provisions of the convention, should be able to recover any difference between the purchase price and the rents previously paid by the lessee, taking into account the accelerated receipt of future rentals by giving a proper allowance as to that and the difference between the realisable value and the residual value of the equipment, as far as he has taken reasonable steps to mitigate his loss. Thus, a contractual clause providing for the payment of a minimum payment upon termination should not be struck out as being a penalty in so far as it takes into account the above considerations in computing the recoverable amount.

5.011 Despite the above observations which show the legitimacy of allowing the creditor, in financing transactions, to recover the expectancy value of the agreement- and so regarding the minimum payment clause, drafted with taking the expectancy value into account, as a genuine pre-estimate of the creditor's actual loss- cases, during decades, have treated the subject in a somewhat different manner. The true nature of such agreements has normally been overlooked, and the courts have usually stereotyped financing transactions as a pure contracts of hire. This fact has caused some problems, uncertainties and sometimes unjust results in this area of the law.[19]

3. Application of the General Rules

3.1. General Considerations

5.012 As it was pointed out, where the minimum payment stipulated to be paid upon termination is subject to the rules against penalty, in order to determine the nature of the clause, the general rules distinguishing liquidated damages from penalties[20], as laid down by Lord Dunedin in the leading case of *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd.*[21], would be applied. Thus, the basic rule is that if the stipulated minimum payment is "extravagant" or "unconscionable" in comparison with the likely

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[19] The cases in this relation and the present legal position will shortly be discussed: see *infra.*, paras. 5.053 *et seq.*

[20] *Supra.*, paras. 2.24 *et seq.*

[21] [1915] AC 79

actual loss resulting from breach, the minimum payment clause will be struck out as being a penalty. It should, however, be borne in mind that since the likely actual loss in case of financing transactions, is normally readily calculable at the time when the contract is entered into, to be a genuine pre-estimate of actual loss, the stipulated amount, as far as the pre-estimation is possible, should not be disproportionate to the likely loss resulting from breach.

5.013 Because of technical points which are applied in case of the application of the penalty doctrine to termination clauses, some particular aspects of the general principles as to the distinction between penalties and liquidated damages are worthy of a detailed discussion here. These aspects are as follows: **first**, how far is the express or imputed intention of the parties material? and **second**, is the description which the parties give to the minimum payment in their agreement conclusive? It would also seem necessary that, in discussing the application of the general rules to determine the nature of the minimum payment clause, the effect of fixing the minimum payment in an arbitrary way by the contracting parties, as shown in cases, should analytically be discussed.

3.2. Intention of the Contracting Parties

3.2.1. Materiality of the Intention as to Determining the Kind of Loss against which the Minimum Payment is Provided for

5.014 The general rule as to the intention of parties, as we have seen[22], is the application of an objective test, rather than a subjective one. Put another way, if, considering the terms of the contract and all surrounding circumstances, the parties have reasonably attempted to pre-calculate the likely actual loss which might conceivably flow from breach, the clause will be very likely to be upheld as a genuine pre-estimate of damages. Thus, generally speaking, the subjective intention of the parties as to assessing in advance the future likely losses would be less likely to be material.

In the context of termination clauses, however, the intention of the parties might be material as to determining the kind of loss against which the contract is going to provide

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[22] *Supra.*, paras. 2.07-2.09

for the minimum payment clause. To put it somewhat differently, in order to determine whether the minimum payment is a genuine pre-estimate of actual loss, it is, as the first step, necessary to find out what actual loss the parties is seeking to guard against: Is that the loss resulting directly from breach or is it the loss which flows from termination of the contract based upon breach?

5.015 It has been suggested that the intention of the parties is material as to determining this factor.[23] Therefore, if the parties' express or imputed intention is to provide the minimum payment to guard the promisee against the loss resulting from termination, i.e. loss of bargain, this element should be taken into account in determining the nature of the minimum payment clause. On this basis, it has been submitted that in hire-purchase agreements, the minimum payment clause "which is designed to ensure that the hirer's liability will not exceed the owner's loss as represented by a deficiency in the discounted hire-purchase price should be taken as reasonable and enforceable even if it is not a loss which directly flows from the breach for the purpose of rules as to remoteness"[24]. Accordingly the minimum payment clause which provides for the liability of the promisor to pay the arrears of rents, duly discounted future rentals and the difference between the residual value and the realisable value of the subject-matter, giving credit for any increased value to the creditor resulting from repossession and resale of the equipment, should normally have a chance of being upheld as a genuine pre-estimate of actual loss.

3.2.2. Actual Loss or Legally Recoverable Loss?

5.016 It might be objected that the intention of the parties could not be determinative as to the kind of loss against which the minimum payment has been provided to guard the promisee. For, what the actual recoverable loss is, would normally be determined by the common law rules and the parties can not go beyond these rules and provide for a loss, in the form of agreed damages, which is not recoverable at common law. In other words, ***although*** the parties may intend that the loss resulting from termination, instead of loss which directly results from breach, would be the loss against which the minimum payment has been provided for, ***yet***, considering the seriousness or triviality of breach, this might

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[23] See Goode R.M., Hire-Purchase Law and Practice, 2nd ed., 1970, p. 393

[24] Goode, loc. cit., p. 395

not be the legally recoverable loss and so the parties' pre-assessment might not be regarded as a genuine pre-estimate of actual loss. In summary, the only loss against which the parties can provide for the minimum payment clause, is the legally recoverable loss. Although some cases[25] might seem to support this view, it is, nonetheless, suggested that this is not the right approach to the subject and the parties can provide for the actual loss [even not recoverable at common law] to be recovered in the event of termination. The following reasons may support the suggestion:

5.017 **First**, as it was argued in detail[26], the loss against which the parties can provide for the agreed damages clause, is not restricted to the legally recoverable loss, but it can include the actual loss which is not recoverable at common law. The dicta of Diplock LJ in *Robophone Facilities, Ltd. v. Blank*[27], clearly supports this view.[28]

5.018 **Second**, it is clear that if the promisor voluntarily, on the basis of his contractual right, terminated the contract, then the minimum payment provided to be paid upon termination would be recoverable, and no question of the application of the penalty doctrine would arise, because, as it was discussed[29], the rules against penalty is applicable only where there is a breach of a contractual obligation by the promisor, and the exercise of a contractual right to terminate the agreement cannot be regarded as a breach. Now, if the contract can provide for the promisor's contractual right to be exercised without any loss to the promisee, why should the parties not be able to provide for such a result in the case of the exercise of a contractual right to terminate the agreement by the promisee on the basis of the promisor's breach? Put it somewhat differently, if the agreement can provide for the right of the promisee to terminate the contract upon the promisor's breach, why not be able to provide for it without any loss to the promisee?

5.019 **Third**, as to financing transactions, which are the main source of litigation

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[25] These cases will be shortly discussed: see *infra.*, paras. 5.053 *et seq.*

[26] *Supra.*, para. 2.14

[27] [1966] 3 All ER 128, at p. 143

[28] See the reasoning of Diplock LJ and the comments on that in: *supra.*, para. 2.11

[29] *Supra.*, para. 4.12

regarding the application of the penalty doctrine to minimum payment clauses, the view expressed is in conformity with the true nature of these transactions; for the real character of such agreements requires the legitimacy of allowing the creditor to recover his actual loss resulting from termination, i.e. the loss of profit, since it is the sensible expectation of the creditor who extends finance and maintains a real right in the subject-matter for himself to secure the repayment of the capital and a proper interest.

5.020 **Fourth**, the observations of Lord Devlin, in the course of his judgement, in *Bridge v. Campbell Discount Co. Ltd.*[30], could be read in a way to support this view:

> "If a hire-purchase agreement is terminated before its natural end and the car is returned to or retaken by the owner, it will usually have depreciated in value and be worth less than the cash price paid for it. This will cause loss to the owner if the depreciation exceeds in value that part of any instalments paid as is to be counted as return of capital. The possibility of such an excess is a contingency against which the owner is entitled to protect himself. If the sum payable on termination under cl.9(b) "by way of agreed compensation for depreciation of the vehicle" could be justified as a genuine pre-estimate of that excess, it would, I think, be recoverable under the agreement, whether the termination was the result of a breach, or of the exercise of the option, or of some other event."

From the words quoted above, it appears that the creditor is entitled to provide for an agreed damages to guard himself against loss of bargain, since providing for the difference between the depreciated value and the capital received as a part of instalments paid at the date of termination will, in effect, cause the promisee to acquire the rental paid and the future rentals duly discounted to show the cash price (viz., future rentals without finance charge element) less the realisable value of the subject-matter. The loss proposed by Lord Devlin is obviously equal to loss of bargain.[31] Thus, if the minimum payment

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[30] [1962] AC 600 , [1962] 1 All ER 385, at pp. 633, 402 respectively

[31] To clarify the issue, if we use the following abbreviations, then it can easily be computed that the loss against which, in the words of Lord Devlin, the owner is entitled to protect himself is, in fact, loss of bargain:
C.P.: cash price, which includes (C.P.)1 [the cash price element in the rentals paid] and (C.P.)2 [the cash price element in the future rentals]
I: Interest or finance charge which includes I1 [finance charge element in the rental paid] and I2 [finance charge in the future rentals]
L.B.: Loss of bargain ; X: Loss proposed by Lord Devlin
D.V.: Depreciated value of the subject-matter
R.V.: Realisable value of the subject-matter
Now, we can assess loss of bargain as follows:
L.B.= (Rentals paid + Duly discounted future rentals) - Realisable value
L.B.={[(C.P.)1 + I1] + [(C.P.)2]} - R.V.

could be regarded as the parties' genuine pre-estimate of the promisee's actual loss, as shown above, then it should normally be upheld as being a valid liquidated damages.

5.021 **Fifth**, referring to the judgement of Lord Radcliffe in *Bridge v. Campbell Discount Co. Ltd.*[32], clearly shows that his lordship, after having discussed the true purpose of the minimum payment clause and the possibility of the clause being subject to the penalty doctrine where termination is triggered off by the hirer's breach and at the same time, not being subject to these rules if the contract is terminated by the exercise of the hirer's option or on the happening of some events which do not involve any breach of agreement, observes two main defects in the stipulated minimum payment. His Lordship states:

> "The total hire-purchase price is called up to the extent of two-thirds, regardless of two considerations essential to any measurement of the owner's loss: the price includes a considerable interest element which the owner does not in result forgo so far as the compensation is paid immediately, and the vehicle comes back into the owner's possession with a realisable value that, in many circumstances, may exceed the one-third balance of the price which the owner has not got in. In my opinion, a clause of this kind, when founded on in consequences of a contractual breach, comes within the range of the court's jurisdiction to relieve against penalties,..."[33]

Then, the learned judge recognizes the necessity that, in this kind of transaction, the owner should have a kind of protection against the loss which results from the premature termination of the agreement. He, however, doubts whether the owner can have such a protection "without much more elaborate provisions for adjustment according to the circumstances in which the claim falls due"[34].

In fact, in a normal market, realisable value is supposed to be the difference between the cash price and the depreciated value of the subject-matter; i.e. R.V.= C.P. - D.V.
Therefore, we will have:
L.B.= $\underline{(C.P.)1}$ + I1 + $\underline{(C.P.)2}$ - C.P. + D.V.
L.B.= C.P. + I1 - C.P. + D.V.
L.B.= I1 + D.V.
Equally, the loss proposed by Lord Devlin can be computed as follows:
X= Rentals paid + (Difference between the depreciated value and cash price element in the rentals paid)
X= [$\underline{(C.P.)1}$ + I1] + [D.V. - $\underline{(C.P.)1}$]
X= I1 + D.V.
As it is clear, the proposed loss by Lord Devlin is equal to loss of bargain.

[32] [1962] AC 600 , [1962] 1 All ER 385

[33] *Ibid.*, at pp. 625, 396-397 respectively

[34] *Ibid.*, at pp. 625, 397 respectively

It appears from the words quoted above that if the parties provide in detail for the owner's loss resulting from termination of the agreement- taking the interest element and the realisable value of the repossessed goods into consideration in formulating the minimum payment clause, by giving credit to the realisable value of the subject-matter and also allowing a proper rebate for the accelerated receipt of the future rentals- then there should be no objection to the pre-assessment of the parties as providing for a genuine pre-estimate of the owner's loss resulting from termination, i.e. his loss of bargain. Thus, it could be suggested that the observations of Lord Radcliffe is in line with the expressed view and supports that.

5.022 The argument so far could be summed up as follows: The loss against which the parties can provide for an agreed damages clause is not just the legally recoverable loss, but it could include the creditor's actual loss, even though it might not be recoverable at common law. The important point in this relation is that the kind of loss against which the creditor intends to protect himself, would depend on the express or implied intention of the parties. Determining this loss which is the first step in deciding whether a minimum payment clause is a genuine pre-estimate of that loss, should practically be done by a reference to the terms of the contract and all inherent circumstances surrounding it to find out the true intention of the parties.

5.023 It should still be borne in mind that the treatment of some cases, which will shortly be discussed, is based on the idea of the legally recoverable loss. These cases, in determining the nature of the agreed damages clause, have turned to a simple comparison between the stipulated amount as the minimum payment and the loss which is normally recoverable in an action for unliquidated damages at common law. This consideration has led them to take the nature of the breach into account: *whether* the breach is a breach of a fundamental term, a fundamental breach of the agreement or a repudiation *or* it is a breach of a minor term which does not amount to a repudiation. As we shall see, the treatment of the issue in this way might lead to a considerable amount of uncertainty and in some cases, it might work substantial injustice.

3.3. Description of Payment

3.3.1. Different Descriptions of the Minimum Payment Clause

5.024 The minimum payment clause may be described by the parties to a contract in various ways[35]: It might be described as "agreed damages for depreciation of goods" or as "agreed damages for "loss of profit" or just for "loss"", or it might be silent as to the description of the stipulated payment. The apparent difference between these descriptions is that in describing the payment as depreciation of goods, the loss against which the parties have provided for the clause would be limited to only the depreciation factor; and so the factors like drop in the market value of the goods would apparently be excluded. While where the minimum payment is characterized as an agreed damages for loss of profit or simply loss, all the elements which might produce loss have been taken into account. In other words, in the latter case, the minimum payment "will cover the whole of the deficiency"[36]. Furthermore, in a case where the nature of the minimum payment has not been defined by the parties, the stipulated sum, it is believed, should be taken as providing for the creditor's actual loss resulting from termination, i.e. the loss of profit.[37]

3.3.2. Is the Description of Payment Conclusive?

5.025 Despite the apparent dissimilarity between the different descriptions of the clause, the real and important question is whether the parties' characterisation is conclusive. In other words, if the parties described the nature of payment in a specific way, should the labelling of the clause deter the creditor from the recovery of the actual loss suffered as a result of termination, considering the fact that if the clause had been characterized in another way, the actual loss would have been recoverable? For instance, the parties define the minimum payment as agreed damages for depreciation and in formulating the payment take into account the whole loss-producing elements, even drop in the market value. Now, assuming that the clause would have been valid had it been labelled as the loss of profit, could the damages agreed by the parties be struck out as being a penalty on

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[35] See Goode R.M., Hire-Purchase Law and Practice, 2nd ed., 1970, p. 395

[36] Goode, *Ibid.*

[37] *Anglo Auto Finance Co. Ltd. v. James* [1963] 1 WLR 1042, in which the treatment of the Court of Appeal showed that the non-characterisation of the minimum payment should normally be regarded as covering the whole loss of bargain by the stipulated payment. See also Goode, *ibid.*, p. 397

the mere ground that it covers the whole deficiency which the parties had not intended it to be regarded as the agreed loss by describing the payment as "loss for depreciation" of goods?

5.026 The point seems to be controversial. It has been suggested that the creditor should be held to the description of the minimum payment which has been given by himself[38]. This is because to determine the nature of the minimum payment clause, when applying the penalty doctrine to the clause, as it was emphasized, the nature of the loss against which the agreement is seeking to protect, as the first step, should be ascertained, and this issue could be concluded by a reference to the description given to the clause by the parties. Furthermore, ignoring the description of payment and extending the loss, against which the minimum payment should be compared, to the loss of profit in every case would "involve the rewriting of the contract to extend the nature of the loss to be covered beyond which that the parties have chosen"[39]. On the other hand, considering the general test in assessing the weight which is to be given to the description of an agreed damages clause as liquidated damages or a penalty[40], it has been submitted that the characterization of the minimum payment clause is not conclusive[41]: All the minimum payment clauses, regardless of the description of payment, have the same basic function and that is to provide for the creditor's actual loss resulting from termination of the contract. The main reasoning behind this view is that, as pointed out by Lord Radcliffe in *Bridge v. Campbell Discount Co. Ltd.*[42], the jurisdiction of courts to relieve against penalty is "a question not of words or of forms of speech, but of substance and of things"[43]. Thus, having regard to the substance of the agreement, the true intention of the parties has been submitted to be to provide for the loss of profit resulting from termination of the contract by the creditor upon the promisor's breach. The form of drafting of the minimum payment clause, especially the description given to the payment,

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[38] Goode, *ibid.*, p. 396

[39] *Ibid.*, p. 396

[40] It was discussed before that such a description is not conclusive at all: see *supra.*, para. 2.16

[41] Ziegel, Jacob S., The Minimum Payment Clause Muddle [1964] C.L.J. 108, at p. 126

[42] [1962] AC 600 , [1962] 1 All ER 385

[43] *Ibid.*, at pp. 624, 396 respectively (citing Lord Davey in *Clydebank Engineering and Shipbuilding Co. v. Don Jose Ramos Yzquierdo y Castaneda* [1905] AC 6, at p. 15)

should not therefore divert attention from the real substance of the agreement.

5.027 It seems to be true that in the application of the penalty doctrine, as the first step, the nature of the loss against which the agreement is attempting to guard should be ascertained; but it, with all respect, does not follow that the description given to the payment by the parties could inevitably show the true character of damages against which the minimum payment should be compared. The true nature of such a loss should be determined by a reference to the substance of the agreement, and not only the form; for, as it has been emphasized, the jurisdiction to relieve against penalties is a question of substance, and the form of the agreement is only important to the extent that it reflects the substance of the contract.

It could accordingly be submitted that **first**, where, considering the terms of the contract and all surrounding circumstances, the description of the payment shows the true intention of the parties as to determining the nature of the loss against which the promisee is attempting to protect himself, then in order to ascertain the nature of the minimum payment clause, the stipulated sum should be compared with the loss described by the parties. Thus, if the parties define the minimum payment as compensation for depreciation of goods and this description shows their true intention and reflects the substance of the agreement, then providing for a formula which covers the whole deficiency, even the drop in the market value, might result in the clause being a penalty. **Second**, if, however, the characterization of payment does not reflect the substance of the agreement, and the real intention of the parties is discovered to be to provide for the loss of profit, then the description given to the payment will not be important. If, therefore, regardless of this description, the minimum payment could show a genuine pre-estimate of the promisee's actual loss resulting from termination, the clause might be upheld as a valid liquidated damages clause.

However, the description of the payment, in general, should, it seems, give rise to a presumption in favour of that description. Such a presumption could, of course, be rebutted by a party who claims to the contrary. It is however to be noted that where the contract is drafted by one of he parties, like contracts drafted by banks or finance houses

in loan or hire-purchase agreements, the rebuttal of the presumption, pending rendering enough evidence showing the true intention of the parties, should readily be attainable by a party who has not drafted the contract.

3.3.3. The Presumption as to the Effect of the Description of Payment in Financing Transactions

5.028 The important point is that in financing transactions like hire-purchase agreements and finance leases, the characterization of payment does not normally reflect the substance of the agreement; and the real intention of the parties, regardless of the description given to the payment, seems to be to provide for loss of bargain. The following reasons support this proposition:

5.029 **First**, having regard to the true nature of these transactions, providing for a minimum payment clause is normally for the purpose of acquiring the expectancy value of the agreement; i.e., the creditor who extends finance and maintains a real right for himself in the subject-matter to secure the repayment of the capital plus a proper interest, normally wishes to provide for the minimum payment clause to facilitate and simplify the obtaining of the extended finance and interest (viz. the expectancy value). Therefore, the real nature of financing transactions clearly indicates the true character of the loss against which the agreement is seeking to guard, namely loss of bargain which covers the whole deficiency.

5.030 **Second**, drafting the minimum payment clause in different ways in various financing transactions, *inter alia*, giving different descriptions to the payment, seems to be for the purpose of avoiding the courts to hold the clause as being a penalty. In so many cases[44], the minimum payment has been described as "agreed compensation for depreciation of the goods". Considering the policy of the courts as regards such clauses, especially regarding the clause as a sliding scale of compensation, which slides in a wrong

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[44] E.g., *Elsey & Co., Ltd. v. Hyde* only reported in Jones and Proudfoot's Notes on Hire Purchase Law, 2nd ed., p. 107, and referred to in *Re Apex Supply Co.* [1942] 1 Ch. 108 and in *Cooden Engineering Co. v. Stanford.*; *Cooden Engineering Co. Ltd. v. Stanford* [1953] 1 QB 86; *Bridge v. Campbell Discount Co. Ltd.* [1962] AC 600, [1962] 1 All ER 385

direction[45], the clause was drafted in a somewhat different manner to inspire the indication that the scale of compensation slides in a right direction.[46] Afterwards in some cases, the minimum payment clause was drafted without giving any description to the payment.[47] On the whole, resorting to the different draftsmanships, and characterizing the payment in the various manners seems to have been done with the aim of enabling the promisee to acquire the expectancy value, i.e. the loss of profit. Therefore, the characterization of payment in different manners should not divert attention from the true purpose of the minimum payment clause in financing transactions.

5.031 **Third**, a brief survey of cases involving the minimum payment clause in financing transactions shows that the courts, regardless of the description given to the payment, have treated the stipulated amount as the sum provided to compensate the creditor as to any deficiency in the purchase price. In *Cooden Engineering Co. Ltd. v. Stanford*[48], the basis for the majority's judgement in determining the nature of the minimum payment clause and holding it as a penalty, was to accept the stipulated payment as provided to compensate the owner for his loss of bargain, despite the fact that the parties had described the payment as compensation for depreciation of goods.[49]

In *Bridge v. Campbell Discount Co. Ltd.*[50], the parties agreed on a minimum payment

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[45] *Bridge v. Campbell Discount Co. Ltd., ibid.*, per Lord Radcliffe at pp. 623, 396 respectively

[46] See cases like *Phonographic Equipment (1958) Ltd. v. Muslu* [1961] 1 WLR 1379; *Lombank Ltd. v. Excell* [1964] 1 QB 415

[47] E.g., *Anglo Auto Finance Co. Ltd. v. James* [1963] 1 WLR 1042

[48] [1953] 1 QB 86

[49] For example, Somervell LJ [with whom Hodson LJ agreed on this point], referring to the hirer's argument that upon termination the owner could get back his car plus the agreed purchase price less a nominal value [for the exercise of the option to purchase], pointed out: "Although it cannot be said that the amount exceeds the greatest loss that could possibly follow on the breach, ..., it will exceed it in all except the exceptional case where the car has become of no value." (ibid., at p. 98) Even Jenkins LJ (dissenting on the issue of the applicability of the doctrine), assuming the applicability, was of the same opinion; he observed: "... apart from that exceptional case [where the value of the car had been reduced to nothing before repossession by the owner], it seems that the sum payable under clause 11 on the owners' determination of the hiring must always exceed ... any damage to the owners which could flow from any breach of contract on the part of the hirer on which a determination by the owners under clause 11 might be founded." (*Ibid.*, at p. 109) It is clear that the judgments did not compare the stipulated amount with the owner's loss resulting from *only* depreciation of the subject-matter, but with his overall loss resulting from termination based upon breach.

[50] [1962] AC 600, [1962] 1 All ER 385

and defined it as "agreed compensation for depreciation of the vehicle". In the course of his judgement, Lord Radcliffe, having considered the fact that if the basis for the agreed compensation was supposed to be the measure of depreciation, then the provided measure would be a sliding scale of compensation which slides in a wrong direction, added:

> "The fact that this anomalous result is deliberately produced by the formula employed suggests, I think, that the real purpose of this clause is not to provide compensation for depreciation at all but to afford the owners a substantial guarantee against the loss of their hiring contract."[51]

His Lordship, then, considered the real nature of the transaction saying:

> "The purpose of an owner entering into a hire-purchase transaction is to turn goods into cash; as a moneylender, which is what he is in all but form, his purpose is to recover with interest the amount of his advance. This clause [i.e. the minimum payment clause] is designed to provide him with a guarantee at the expenses of the hirer that, come what may, he will get out of the deal in money at any rate two-thirds of the total hire-purchase, which is defined as being cash price plus hiring charges and option fee."[52]

At the end, the learned judge concluded that on this basis, the clause constituted a penalty, since it had failed to take into account two important elements, i.e. the considerable interest element in the purchase price, and the realisable value of the repossessed subject-matter. Also Lord Denning, revealing the true nature of the transaction at the beginning of his judgement, regarded the minimum payment clause, despite the description given to it by the parties, as "compensation for loss of the future instalments which the respondents [i.e. the owners] expected to receive"[53] and argued for the penal nature of such an amount on other grounds. Lord Devlin, having expressed the settled principle of going beyond the form and giving effect to the real substance of the agreement, where the words used by the parties have not been designed to represent the true nature of the transaction, treated the agreement of the parties as to the minimum payment clause "a fictitious agreement to treat the sum as compensation for depreciation"[54] and stated:

> "As I understand it, none of your Lordships believe that the sum was

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[51] *Ibid.*, at pp. 623, 396 respectively

[52] *Ibid.*

[53] *Ibid.*, at pp. 628, 399 respectively

[54] *Ibid.*, at pp. 634, 402

arrived at in that way."[55]

It appears from the words quoted above that the court has given effect to the real characteristic of the minimum payment clause in financing transactions and treated it as a sum stipulated to compensate the creditor for his loss of bargain, irrespective of any description which the parties had given to the payment.

5.032 **Fourth**, it might be argued that basically damages resulting from depreciation of the subject-matter do not arise from the hirer/lessee's breach. The natural depreciation of the subject-matter is not itself a breach of contract and the hirer/lessee's default of a contractual obligation, like punctual payment of rents, does not cause any damages to the owner/lessor for depreciation. As it has been stated by Salter J. in the important case of *Elsey & Co., Ltd. v. Hyde*[56]:

> "The fact that the hirer is in arrear with his payments will not entitle the owner to any damages for depreciation of these things. The reason that they have suffered is that they have second-hand goods put on their hands before they have received very much money in respect of them. That is not the result of the hirer's breach of contract, in being late in his payments, it is the result of their own election to determine the hiring, and it appears to me, even in this case, there is no question of penalty at all ..."

Although the learned judge has concluded the matter with the non-application of the penalty doctrine to the subject, the law, as it stands now, is that in such a case the rules against penalty are applicable.[57] The reasoning of the learned judge, however, might seem to remain on foot. The point has also been referred to by Lord Radcliffe in *Bridge v. Campbell Discount Co. Ltd.*[58]. Now, assuming the force of this reasoning, it could be contended that essentially the labelling of the minimum payment clause as agreed compensation for depreciation could not indicate the true nature of the parties' agreement; for, the loss resulting from the natural depreciation of the subject-matter

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[55] *Ibid.*

[56] *Elsey & Co., Ltd. v. Hyde* only reported in Jones and Proudfoot's Notes on Hire Purchase Law, 2nd ed., p. 107, and referred to in *Re Apex Supply Co.* [1942] 1 Ch. 108 and in *Cooden Engineering Co. v. Stanford* [1953] 1 QB 86

[57] See *supra.*, paras. 4.08, 4.11

[58] [1962] AC 600, [1962] 1 All ER 385, where he said: "... such losses [resulting from depreciation as referred to the loss of value in the vehicle, and even, with less accurate use of language, the loss of market value due to the unpredictable movements of the second-hand car market] do not arise from any default of the hirer. ... if one really tied oneself to this idea of compensation for depreciation, the case for treating the clause as a genuine pre-estimate of the damages suffered by depreciation would be almost unarguable." at pp. 623, 395 respectively

could not be attributed to the hirer/lessee's breach. Therefore, turning to the true nature of the clause, it should be an agreed sum to compensate the owner/lessor for the loss of profit.

It should, however, be mentioned that this line of reasoning might be disposed of by the argument that it is true that the loss resulting from depreciation does not arise *directly* from the hirer/lessee's breach, but it is in fact the breach and the termination of the agreement by the owner/lessor upon that breach that leaves the repossessed depreciated subject-matter in the owner/lessor's hands; and, but for the hirer/lessee's default and the owner/lessor's termination and repossession upon that, the owner/lessor would not have to bear the loss flowing from termination.

5.033 Quite apart from the last argument, in view of the above observations, it may, as a conclusion, be submitted that in financing transactions, the *prima facie* rule is that the description of the minimum payment does not normally indicate the parties' true intention, and the presumption is that the stipulated sum has been provided to compensate the creditor for his loss of profit. Thus, to determine the nature of the minimum payment clause, when applying the penalty doctrine, the loss against which the stipulated sum should be compared should, in principle, be the loss of profit, though in practice, some cases have limited this principle to a situation where the loss of profit is the legally recoverable loss in an action at common law, i.e. where the breach of the agreement is a fundamental breach or a breach of a fundamental term or a repudiation.

3.4. Fixing the Minimum Payment in an Arbitrary Way: A Review of Cases

3.4.1. The Penal Nature of a Minimum Payment Fixed in an Arbitrary Way

5.034 As pointed out before, applying the rules against penalties to a minimum payment clause to determine the nature of the stipulated payment, the general rules distinguishing liquidated damages from penalties would be applied. In most cases, the minimum payment clause which provides, in effect, that a specific portion of the total purchase price should be paid by the promisor, taking into account the payments made by him before termination, in the event of a default by him of contractual promises- *inter alia*, to pay the stipulated instalments on time- would be held to be a penalty. This is because the

stipulated sum has been made payable irrespective of whether the default occurs in the payment of the first or last instalment.[59] Since the likely actual loss resulting from breach in the case of default in payment of each instalment is likely to be different, the stipulation of a specific portion of the total purchase price to be paid on the happening of every default, whether trivial or serious and whether in the payment of the first or last instalment, can not be considered as a genuine pre-estimate of the likely actual loss of the promisee at the time when the contract is made. More importantly, the stipulated sum is normally made payable irrespective of the nature of goods, whether they are used or new and the different makes of the same categories of goods. The stipulation is also usually related to the total purchase price rather than the cash price of the goods, it therefore ignores the substantial finance charge element which is not due at the time of determination.[60] Furthermore, it ignores the fact that upon termination, the subject-matter of the agreement is normally repossessed and resold by the promisee, and this leaves the realisable value of the equipment in his hands. Considering all these elements, a minimum payment providing, in an arbitrary way, for the liability of the promisor to bring his payments up to a specific portion of the purchase price, whether 75%, 50% or two-thirds, might compensate the promisee more excessively than his actual loss resulting from termination and therefore, it could not be considered as a genuine pre-estimate of likely actual damages.

5.035 In *Lamdon Trust Ltd. v. Hurrell*[61], in a hire-purchase agreement, it was provided that in the event of a default in payment of each instalment, the owner had the right to terminate the agreement. Upon termination, under the "minimum payment" clause, the hirer had to pay a sum sufficient to bring up his total payments to approximately three-quarters of the purchase price. On the hirer's default in the payment of the fifth instalment, the owner company terminated the agreement, retook possession of the subject-matter, resold it, and claimed for the specified sum under the minimum payment clause. It was held that since, *inter alia*, this sum was payable whether the default

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[59] Chitty on Contracts, 27th ed., vol. 1, 1994, para. 26-061 at p. 1255; Treitel G.H., The Law of Contract, 9th ed., 1995, p. 905; McGregor on Damages, 15th ed., 1988, para. 481 at pp. 300-301; Ziegel, Jacob S., The Minimum Payment Clause Muddle [1964] C.L.J. 108, at p. 117

[60] Ziegel, *Ibid.*

[61] [1955] 1 WLR 391

occurred in the payment of the first or last instalment, it could not be a genuine pre-estimate of the owner's likely actual loss, and so it was a penalty. Denning L.J., in the course of his judgement, having observed the usual practice of hire-purchase finance companies to stipulate for compensation for depreciation at the rate of 75 per cent. of the price, pointed out:

> "This means, therefore, that, if the hirer should fail to pay the first instalment or any later instalment, the owners can not only retake the car and resell it for their own benefit, but also compel the hirer to pay three-quarters of the price. This seems to me to be altogether exorbitant."[62]

It appears from the whole judgement that the fact that the minimum payment provision had failed to take into account the value of the repossessed car was the chief reason why the stipulation was held to be a penalty.

3.4.2. Drafting the Clause Using the Principle of Graduated Damages

3.4.2.1. Describing the Payment as "Compensation for Depreciation"

5.036 Some attempts have been made to use the principle of "graduated damages"[63] to support the minimum payment clause. It was stated above that the presumption of being a penalty, raised by stipulating for a single sum to be paid upon different breaches of varying importance, could be rebutted by providing for graduated damages which are proportioned to the seriousness of the breach.[64] One of these attempts was to describe the stipulated payment as compensation for depreciation. In *Bridge v. Campbell Discount Co. Ltd.*[65], it was provided that the "minimum payment" up to the two-thirds of the purchase price, as "*agreed compensation for depreciation*" of goods would be payable in the event of termination for, *inter alia*, a default in punctual payment by the hirer. The majority of the House of Lords, holding that the hiring agreement had been terminated by the owner upon the hirer's breach in the payment of instalments, held that the minimum payment clause amounted to a penalty. The reason was, *inter alia*, that the

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[62] *Ibid.*, at p. 393 ; see also *Anglo Auto Finance Co. Ltd. v. James* [1963] 1 WLR 1042 ; *United Dominions Trust (Commercial) Ltd. v. Ennis* [1968] 1 QB 54 ; *Cooden Engineering Co. Ltd. v. Stanford* [1953] 1 QB 86

[63] See *supra.*, paras. 2.47-2.48

[64] For example, in case of stipulation of damages for delay in completion in construction contracts, providing for a sum to be paid for every week of delay is a graduated damage and it is very likely to be upheld as being a genuine pre-estimate of damages.

[65] [1962] AC 600

stipulated payment decreased by each payment made by the hirer, while the depreciation obviously increased the longer the hirer had the car in his possession. Lord Morton, in the course of his judgement, stated:

> "I find it impossible to regard the sum stipulated in clause 9 [the minimum payment clause] as a genuine pre-estimate of the loss which would be suffered by the respondents in the events specified in the same clause. ... This was a second-hand car when the appellant took it over on hire-purchase. The depreciation in its value would naturally become greater the longer it remained in the appellant's hands. Yet the sum to be paid under clause 9(b) is largest when, as in the present case, the car is returned after it has been in the hirer's possession for a very short time, and gets progressively smaller as time goes on."[66]

And in the words of Lord Radcliffe, "It is a sliding scale of compensation, but a scale that slides in the wrong direction,..."[67]. Such a minimum payment, therefore, acts in inverse proportion to the depreciation and cannot be a genuine pre-estimate of the likely actual damages.

5.037 It has been submitted that "depreciation", in termination clauses, is used in an elliptical sense to mean "excess depreciation"[68]; in other words, it is only intended to cover the amount by which depreciation exceeds payments that are being made.[69] Since the goods are likely to depreciate far more rapidly in the early months of the agreement, especially when they are new, so the excess depreciation is likely to be high in the early months of the contract than later on and it is also likely to become progressively smaller. It follows that the compensation provided is a scale which slides in a right direction. Put another way, the excess of depreciation over the sums already paid seems to become progressively smaller, the longer the equipment remains in the hirer's possession. It is, therefore, apparent that, regarding the "depreciation" as excess depreciation of the subject-matter, the scale of compensation would slide in a right direction. On this basis, the argument of Lord Morton and the observations of Lord Radcliffe should be interpreted as not assuming the depreciation as any excess in depreciation over the amounts already paid, but as the depreciation of the goods itself, as it is the apparent

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[66] *Ibid.*, at p. 616

[67] *Ibid.*, at p. 623

[68] Ziegel, Jacob S., The Minimum Payment Clause Muddle [1964] C.L.J. 108, at p.119

[69] Goode R.M., Hire-Purchase Law and Practice, 2nd ed., 1970, p. 396

meaning of the words used by the parties.[70]

3.4.2.2. Framing the Clause as a Sliding Scale of Compensation in a Right Direction

5.038 The possibility of the argument of "a sliding scale of compensation, but in a wrong direction" seemed to have led some draftsmen to draw the minimum payment clause in another way to show that the scale of compensation slides in a right direction. In *Phonographic Equipment (1958) Ltd. v. Muslu*[71], the parties entered into a hire-purchase agreement for a jukebox. The contract provided, *inter alia*, that in the event of determination of the agreement- because of any reason, *inter alia*, the hirer's default in the payment of instalments- the hirer should pay all arrears of rent, the cost of all repairs necessary to put the machine in good order and "by way of agreed depreciation of the goods a sum equal to ... 50 per cent. of the total hire-purchase price payable under this agreement ... plus ... a further 5 per cent. of such total hire-purchase price for each month which has elapsed between the date of the agreement and the receipt of the goods by the owners up to 75 per cent. of the said total price, less ... the total of the sum already paid and the moneys due to the owners for hire rentals at the date of the receipt of the goods by them." The Court of Appeal held such a clause to be enforceable as not being a penalty. Donovan L.J., delivering the main judgement of the court, thought that considering the contract as a whole, the fact that the stipulated sum begins to abate after the sixth month and disappears at the 18th, looks more like an attempt to pre-estimate the

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[70] It is however to be noted that, as argued before, the description of the minimum payment clause should not divert attention from the true purpose of the minimum payment clause, especially in the financing transactions. In these contracts, the *prima facie* intention of the parties is to provide for the compensation of the owner for his loss of profit, whatever the minimum payment clause is described. This is what Lord Radcliffe recognized as the true purpose of the stipulation in *Bridge v. Campbell Discount Co. Ltd.* [1962] 1 All ER 385, saying: "... the real purpose of this clause is not to provide compensation for depreciation at all but to afford the owners a substantial guarantee against the loss of their hiring agreement." (at p. 396) Considering the minimum payment clause as providing for the owner's loss of profit, the clause, failing to take into account the realisable value of the repossessed subject-matter which comes back to the owner's possession and the interest (i.e. the finance charge) element in the future instalments, was held to be a penalty. As Lord Radcliffe pointed out: "The total hire-purchase price is called up to the extent of two-thirds, regardless of two considerations essential to any measurement of the owner's loss; the price includes a considerable interest element which the owner does not in the result forgo so far as the compensation is paid immediately, and the vehicle comes back into the owner's possession with a realisable value that, in many circumstances, may exceed the one-third balance of the price which the owner has not got in." (*Ibid.*, at pp. 396-397) It may therefore be concluded that, in the *Bridge*'s case, had the minimum payment clause provided for a proper rebate for the accelerated receipt of the future instalments and taken into account the realisable value of the subject-matter, it would have been likely to be upheld as a valid liquidated damages, regardless of the description given to it by the parties.

loss resulting from depreciation rather than the fixing of a penalty to act in terrorem of the offending party.[72] This decision was cited in the arguments in *Bridge v. Campbell Discount Co. Ltd.*[73] but it was not discussed in the judgements delivered in that case. In considering the relation between these two cases and whether they can be reconciled, it was pointed out[74] that the form of the depreciation clauses in these two cases were different, for the clause in the *Muslu* case[75], unlike the one in *Bridge v. Campbell Discount Co. Ltd.*[76], provided for a compensation scale which slid in the right way, since as depreciation increased, the stipulated amount also grew at the rate of 5 per cent. per month. Accordingly, it has been proposed that if the depreciation clause provided for an amount which slid in the right direction, it might be upheld as not being a penalty.[77]

Leaving aside the description of the minimum payment as depreciation of the subject-matter, the decision of the Court of Appeal in this case seems to create some difficulty in the application of the penalty doctrine to the minimum payment clauses in financing transactions; for, in this case, like the *Bridge*'s case, the parties had failed to take into account the realisable value of the equipment and the substantial interest element in the future instalments which had been provided to be received by the owner immediately upon termination. Despite these facts, the Court of Appeal recognized the clause as a valid liquidated damages.

5.039 It does, however, seem that the *Muslu* case[78] was contrary to the decision of the House of Lords in *Bridge v. Campbell Discount Co. Ltd.*[79]. Although the apparent form

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[71] [1961] 1 WLR 1379

[72] *Ibid.*, at p. 1386

[73] [1962] AC 600

[74] Upjohn L.J. in *Lombank Ltd. v. Excell* [1964] 1 QB 415, where he stated (at p. 426): "There appears here on the face of it to be a perfectly proper clause of depreciation, for clause 6© [the depreciation clause] is dealing with the calculation of depreciation on a perfectly simple mathematical formula which slides, and slides the right way, for depreciation increases at the rate of 5 per cent. per month."

[75] *Phonographic Equipment (1958) Ltd. v. Muslu* [1961] 1 WLR 1379

[76] [1962] AC 600

[77] Treitel G.H., The Law of Contract, 9th ed., 1995, p. 905

[78] *Phonographic Equipment (1958) Ltd. v. Muslu* [1961] 1 WLR 1379

[79][1962] AC 600, [1962] 1 All ER 385

of the depreciation clauses in these two cases was different, in fact, with a careful analysis they led to a same point. The alleged reconciliation, with all respect, seems to be subject to a serious objection. It is true that in the early months of the agreement, i.e. until the monthly increase of the stipulated compensation reached to the amount of 75 per cent. of the purchase price, the scale of compensation slid in a right direction; but after that point, the increments of five per cent. stopped though the depreciation increased the longer the subject matter remained in the possession of the hirer. Therefore, the situation turned to be like that in *Bridge v. Campbell Discount Co. Ltd.*[80] and the previous cases, so that if the agreement was determined and the possession of the goods was retaken in the sixth month of the contract, the situation would exactly be the same as that in *Lamdon Trust Ltd. v. Hurrell*[81] in which the contract was terminated after six months and 75 per cent. of the total hire-purchase price had been stipulated to be payable upon termination.[82] It is, therefore, apparent that not only are these two cases not reconcilable, but the decision in the *Bridge*'s case[83] is in contradiction with the *Muslu* case.[84] Hence, it might be suggested that the *Muslu*'s case has implicitly been overruled by the judgement of the House of Lords in *Bridge v. Campbell Discount Co. Ltd.*[85]. In fact, in *E.P. Finance Co. Ltd. v. Dooley*[86], Veale J. in the course of his judgement, as to a clause similar to the depreciation clause in the *Muslu* case, emphasized the penal nature of the term and pointed out:

> "I think that although in *Bridge*'s case the speeches did not refer to *Muslu*'s case with disapproval- they did not indeed refer to it at all- the whole ratio decidendi was contrary to that in *Muslu*'s case and accordingly I hold that I am not bound to follow *Muslu*'s case. On the contrary, I hold that clause 6 in the present case is a penalty ... "[87]

Nevertheless, Winn J. in *Lombank Ltd v. Cook*[88] and Ashworth J. in *Lombank, Ltd. v.*

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[80] *Ibid.*

[81] [1955] 1 WLR 391

[82] McGregor on Damages, 15th ed., 1988, para. 481 at pp. 300-301

[83] *Bridge v. Campbell Discount Co., Ltd.* [1962] AC 600, [1962] 1 All ER 385

[84] *Phonographic Equipment (1958) Ltd. v. Muslu* [1961] 1 WLR 1379 ; see McGregor on Damages, 15th ed., 1988, para. 481

[85] [1962] AC 600

[86] [1963] 1 WLR 1313

[87] *Ibid.*, at p. 1323

[88] [1962] 1 WLR 1133

Archbold[89], applying the decision of the Court of Appeal in *Muslu*'s case, thought that as to rather identical depreciation clauses, they were bound to hold that the clauses there were enforceable as not being a penalty.

5.040 In *Lombank Ltd. v. Excell*[90], though the application of the decision of the Court of Appeal in *Muslu*'s case was confined to a very limited area, nevertheless the court in a very cautious judgement, thought that it was not open to the court to say that the decision in *Muslu*'s case was contrary to *Bridge v. Campbell Discount Co. Ltd.* and had therefore wrongly been decided. In this case, in an agreement for the hire-purchase of a motor-car, a depreciation clause very similar to that in the *Muslu* case was provided for. The County Court judge found himself bound to apply the previous decision of the Court of Appeal and held that the clause was not a penalty. On appeal, holding that the question of a clause being liquidated damages or a penalty depended on the construction of the clause considering all surrounding circumstances, the Court of Appeal remitted the case to the County Court judge for the evidence to be called as to the relevant circumstances. Upjohn L.J., in the course of his judgement- having expressed that it was not possible to maintain the view that according to *Muslu*'s case, any similar depreciation clause, regardless of the subject-matter of the hiring and all relevant surrounding circumstances, would be valid- pointed out:

> "What the court determined, and it was all that they could determine so as to bind us, was that where the subject-matter of the hire-purchase was a particular jukebox, clause 6(c) [i.e. the depreciation clause] was valid .... We are, however, quite unable to accept the view of Winn J. that the court determined that this clause must be valid in all circumstances, and we would overrule his decision."[91]

Thus, according to this decision, the applicability of the rule set out by the *Muslu* case was limited to a situation where the subject of hiring was a jukebox. In other events, however, the nature of the clause should be determined by the careful construction of the clause, considering all appropriate inherent circumstances.

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[89] [1962] C.L.Y. 1409

[90] [1964] 1 QB 415

[91] *Ibid.*, at p. 426

5.041 This interpretation of *Muslu*'s case[92] results in an unsatisfactory consequence: Even where the depreciation clause has not been drafted with regard to the inherent circumstances of the case- and according to the general rules, relating to the penalty doctrine, could not be considered as a genuine pre-estimate of the likely actual damages- it might be upheld, for it might appear to meet the requirements of the *Muslu* case. The result seems to be inconsistent with the principles relating to the penalty doctrine and it is submitted that the case should not be followed, because firstly, it is irreconcilable with principles set out by Lord Dunedin in the leading case of *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd.*[93]; and secondly, it is contrary to the decision of the House of Lords in *Bridge v. Campbell Discount Co. Ltd.*[94] and has been implicitly overruled.

3.4.3. A Move towards Providing for the True Loss of Bargain

3.4.3.1. Providing for the Loss of Profit with Repossession of the Subject-matter

5.042 In view of the above observations, a minimum payment clause in financing transactions should be upheld if it has been provided for to compensate the owner for his loss of profit by stipulating for the liability of the hirer to pay the arrears of rent plus all future instalments giving a legitimate rebate for the accelerated receipt of them and also giving credit for the realisable value of the repossessed goods, regardless of the description given to the clause by the parties. It should be noted that such a provision requires the hirer to pay only the amount of deficiency and directly relates to two substantial elements: first, the extent of the depreciation of goods; second, the period which the contract has been on foot since it takes into account the amounts which have already been paid to the owner.[95] In fact, it is not an arbitrary provision and will not compensate the owner excessively in comparison with a situation where the hirer commits no breach and the agreement runs its full course.

5.043 A practical, but not complete, movement towards providing for such a clause can

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[92] *Phonographic Equipment (1958) Ltd. v. Muslu* [1961] 1 WLR 1379

[93] [1915] AC 79

[94] [1962] AC 600

[95] Ziegel, Jacob S., The Minimum Payment Clause Muddle [1964] C.L.J. 108, at p. 126

be seen in *Anglo Auto Finance Co. Ltd. v. James*[96]. In this case, in a hire-purchase agreement, it was provided that the owner would be entitled to recover "a sum equal to the amount (if any) by which the hire-purchase price (less the deposit plus monthly instalments already paid) exceeds the net amount realised by the sale of the ... vehicle by the owner" upon termination for, *inter alia*, the hirer's default in punctual payment. As it appears, the clause took into consideration the realisable value of the subject-matter and its only defect was the failure to give a proper rebate as to the accelerated receipt of the future instalments. In fact, this provision was much more accurate than the minimum payment clause in the *Bridge*'s case[97]. The clause, however, was held to be a penalty. Willmer L.J., delivering the main judgement of the court, having applied the decision of the House of Lords in *Bridge v. Campbell Discount Co. Ltd.*[98], held that the clause providing in effect for the owner company being entitled in all circumstances to recover 100 per cent. of the total purchase price could not be regarded as a genuine pre-estimate of damages resulting from breach and should be taken as amounting to a penalty which acts *in terrorem* of the hirer to induce him to carry on with the contract.[99] The Lord Justice based his conclusion on the following two main grounds:

I) The observations of Lord Radcliffe in the *Bridge*'s case that the minimum payment clause in that case had not taken into consideration the interest element in the future instalments and the realisable value of the goods.[100] After quoting the relevant passage of Lord Radcliffe's speech, the Lord Justice stated:

> "That was a case in which the particular clause in the contract provided for a minimum payment of two-thirds. Here the clause is different, and provides for the plaintiff company always being able in effect to recover 100 per cent., whether determination takes place in the first month of the contract or in the forty-seventh month of the contract."[101]

It should, however, be noted that first, the observations of Lord Radcliffe do not relate to

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[96] [1963] 1 WLR 1042

[97] *Bridge v. Campbell Discount Co., Ltd.* [1962] AC 600, [1962] 1 All ER 385

[98] *Ibid.*

[99] *Anglo-Auto Finance Co. Ltd. v. James* [1963] 1 WLR 1042, at p. 1045

[100] See *Bridge v. Campbell Discount Co. Ltd.* [1962] AC 600, [1962] 1 All ER 385, at pp. 625, 396-397 respectively; see also *supra.*, note 70

[101] *Anglo-Auto Finance Co. Ltd. v. James* [1963] 1 WLR 1042, at pp. 1046-1047

the stipulation of two-thirds or 100 per cent. of the purchase price, but it only gives the impression that any deficiency clause in hire-purchase agreement should take those two essential elements into consideration, i.e. the realisable value of the subject-matter and the interest element in the future instalments. Although the clause in the *Bridge*'s case[102] had failed to take both these elements into account, the provision in this case was a step towards providing at least for the realisable value of the repossessed subject-matter to be credited in favour of the hirer.[103] The judgement, however, might seem to give the impression that in any event, providing for the liability of the hirer to pay the full purchase price (even with taking the above elements into account) should be doomed to failure. Such an impression, if it exists, in view of the above observations deserves criticism. Second, in assessing the stipulated amount, sums already paid to the owner are, in any event, taken into consideration. Therefore, the payable amount under the clause will vary on the basis that the default occurs in the payment of first or forty-seventh instalment. In other words, it will relate to the period that the agreement has been in force.

II) The other point on which Willmer L.J. based his judgement was that the clause in this case had not been described as a "minimum payment for depreciation or deterioration". Willmer L.J., in the final part of his speech stated:

> "Clause 5(b) is the only clause which deals with the question of compensation in the event of the termination of the hiring. No clause is contained in the contract purporting to deal with depreciation or deterioration of the vehicle. Had such a clause been inserted (and assuming, of course, that it did not amount to a penalty clause), it may be that the plaintiff company would have been entitled to recover something considerably more."[104]

It is however to be noted that the clause in this case was clearly a deficiency clause which also dealt, it seems, with the depreciation of the subject-matter. The reason is that in formulating the minimum payment, it took into account the realisable value of the subject-matter: this is obviously a factor by which the owner's loss resulting from any

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[102] [1962] 1 All ER 385, [1962] AC 600

[103] The only defect, as stated, was the failure to give a proper credit as to the accelerated receipt of the future instalments and had Willmer L.J. reasoned his judgement on this point, it would have been completely sensible. see McGregor on Damages, 15th ed., 1988, para. 482

[104] *Anglo Auto Finance Co. Ltd. v. James* [1963] 1 WLR 1042, at p. 1047

depreciation of the subject-matter is normally covered. Furthermore, as argued before[105], the description given to the clause, *prima facie*, does not show the real nature of the clause in financing transactions, and deficiency clauses of this kind normally provide for the compensation of the owner for his loss of profit irrespective of the description given to them, even where they are silent as to the description of the nature of payment.

5.044 It is therefore to be concluded that although providing for a minimum payment in an arbitrary way- like a portion of the purchase price, whether 75%, two-thirds, 50% or 100%- is likely to fail as constituting a penalty, nonetheless providing for the full outstanding balance of the purchase price to be paid in the event of termination giving credit to the interest element in future instalments and an allowance to the realisable value of the repossessed subject-matter, should be upheld as a valid stipulation.

3.4.3.2. Loss of Bargain if the Subject-matter is Left in the Promisor's Possession

5.045 An alternative way in financing transactions would seem to be to leave the subject-matter in the hirer's possession and to provide for the payment of the full outstanding balance of the purchase price upon termination, giving credit to the accelerated receipt of the future instalments. In fact, just as providing for the acceleration of future payments upon any default by the hirer, leaving the agreement on foot to run its full course, is supposed to be a valid stipulation if a proper rebate is given to the accelerated receipt of the future instalments[106], a provision requiring the hirer to pay such an accelerated amount upon termination, leaving the subject-matter in his hands should also be valid.

5.046 The advantages of such a provision are as follows: First, the owner is compensated for his loss of bargain and in fact he acquires what he would have earned had the contract run its full course and had there been no default by the hirer. On the other hand, the hirer is left with the subject-matter and acquires it for the contracted price with a difference that due to his default, he has to pay the future instalments immediately with an allowance, of course, for the interest element in the future payments. Second, the question of depreciation of the subject-matter and all difficulties relating to the

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[105] *Supra.*, paras. 5.025 *et seq.*

[106] See *supra.*, paras. 3.33-3.34

assessment of the realisable value, like whether the resale of the subject-matter has been done properly, which might come across in so many cases, would not arise.

It should also be noted here that the question of depreciation may sometimes affect the hirer more than the owner. Suppose that A enters into a hire-purchase agreement as regards to a car with the hire-purchase price of £10,000. He pays £1,000 and stipulates to pay the rest by instalments. In fact, he borrows £9,000 from the finance company which is to be paid by instalments. Since he has paid £1,000 of the price, he gets an equity to the extent of his payments in the purchased car. But as he gets the car, it immediately starts to depreciate in value so that if it is offered for a sale, it is likely to worth £8,000 or even less than that. This amount is not enough to pay off his loan to the finance company. As a result he gets a negative equity in the subject-matter. As the car depreciates in value, the hirer's negative equity gets big and bigger and in fact, the depreciation affects him more than it might affect the owner. That is why a stipulation for depreciation of goods, providing for the repossession of the subject-matter by the owner and reselling it, even by giving credit as to the realisable value to the hirer, cannot normally safeguard the reasonable interests of the hirer. While, leaving the subject-matter in his possession and providing for the outstanding balance of the future instalments to be paid by him, giving a proper rebate as to the finance charge in those payments, would at least have the effect that the hirer acquires the subject-matter which he had bargained for.

5.047 The disadvantage of this method, however, is that by such a provision, the creditor might lose his real right in the subject-matter which is intended to be used as a security to guarantee the payment of instalments by the hirer: The creditor's real purpose, in financing transactions, is to extend finance and to keep a real right in the subject-matter for himself to guarantee the repayment of the extended finance. In fact, as to a debtor who is unable to meet the due payment of instalments, such a stipulation- providing for the subject-matter to be left to him and his liability to pay the whole outstanding balance of the instalments, giving a proper rebate as to the accelerated receipt of the future payments- would ruin the owner's security and would leave him with an insolvent hirer who is unable to pay a single instalment.

4. The Relevance of the Basis for Termination

4.1. General Considerations

5.048 From what we have discussed so far is clear that a contract may provide for the promisee's right to terminate the contract upon specific events, *inter alia*, the promisor's breach. Such a breach may be categorized as a repudiation, breach of a fundamental term or a fundamental breach (hereinafter referred to as a repudiatory breach) which, even without a contractual stipulation, gives rise to a right of the promisee to terminate at common law. It may also be a breach of a non-essential term (*i.e.*, a non-repudiatory breach), the termination upon which may only happen through a contractual stipulation. The question which is to be considered now is whether the basis of termination[107] has any relevance to determining the nature of the minimum payment provided to be paid upon termination.

5.049 As it appears from some cases, the basis for termination based on breach may be considered as a relevant factor as to determining the amount of damages to which the innocent party is entitled at common law. If, therefore, the parties, in pre-estimating the loss resulting from breach, are supposed to limit themselves to the legally recoverable loss, such a basis should be regarded as a material point in determining the nature of the minimum payment clause. This, however, as we will see, may lead to some unsatisfactory consequences among which is the possibility of sidestepping the common law principle by providing for a "time of the essence" stipulation. Thus, the promisee, by careful draftsmanship, can elevate a simple term into the category of conditions breach of which will entitle him to loss of bargain. This section will be devoted to considering this issue in detail: First, the measure of damages recoverable for breach at common law, and the relevance of the nature of breach in this regard will be discussed. The consideration will next be given to the effect of determining the nature of breach on the application of the rules against penalties to minimum payment clauses. A detailed discussion of the possibility of sidestepping the principle by elevating a simple term into the category of conditions, the unsatisfactory consequences resulting from that, and the possible solutions

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[107] It is to be observed that in this chapter we are only dealing with a termination based upon breach. The basis for termination here thus refers to whether termination has been based upon a repudiatory or non-repudiatory breach.

to avoid these consequences will form the next part of this section. Based on previous conclusions, the section will also examine two important issues: factors which are to be taken into account in drawing up a minimum payment clause, and unliquidated damages where the minimum payment clause is a penalty. The section will finalise by a deliberate consideration of the issue in Australian law.

4.2. Measure of Damages Recoverable for Breach at Common Law

4.2.1. The Presumption: Recoverability of loss of bargain

5.050 It should first be noticed that the *prima facie* measure of damages at common law upon the happening of a breach is the recovery of loss of bargain. For instance, in a contract for the sale of goods, in case of non-delivery or non-acceptance of the purchased goods, the measure of damages is normally determined by a reference to the difference between the contract price and the market price of the goods at the time of breach.[108] It seems that in commercial contracts containing the right of the promisee to terminate the agreement upon breach, recovery of loss of bargain was the presumption as to measuring the amount of damages recoverable by the promisee after termination. Some cases support this proposition: In *Yeoman Credit Co. v. Waragowski*[109], in a hire-purchase agreement, the owner who repossessed the vehicle upon the happening of a breach by the hirer was held to be entitled to recover losses amounting to all unpaid rentals less the sum realised in the resale of the vehicle, and less the fee for the exercise of the option to purchase.

5.051 A year later, in *Yeoman Credit Co. v. McLean*[110], the assessment of damages in the *Waragowski*'s case[111] was accepted by Master Jacob with a qualification. The learned Master, considering the necessity of giving another allowance for the early receipt of the future instalments in assessing the owner's damages resulting from breach, pointed out:

> "The accelerated receipt of the proceeds of sale represents moneys in the hands of the plaintiffs which they would, in the ordinary course of their

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[108] Carter J W, The Effect of Discharge of a Contract on the Assessment of Damages for Breach or Repudiation (Part II) (1989) 1 JCL 249; Carter J W, Termination Clauses (1990) 3 JCL 90, at p. 111

[109] [1961] 1 WLR 1124, [1961] 3 All ER 145

[110] [1962] 1 WLR 131

[111] *Yeoman Credit Co. v. Waragowski* [1961] 1 WLR 1124, [1961] 3 All ER 145

> business as a finance company, put to use again to earn a further profit or interest... . If, therefore, in assessing the damages suffered by the plaintiffs, no reduction is to be made in the amount of their hire charges, the plaintiffs would, in effect, be receiving two amounts of profit or interest at the same time on the same sum of money."[112]

Having argued that this point had not been discussed in the *Waragowski* case[113], Master Jacob held that the decision in that case did not preclude him from reaching this conclusion. Thus, the amount of the owner's damages upon the hirer's breach of the contract and the consequent repossession of the subject-matter by the owner was held to be the outstanding balance of the hire-purchase price (i.e. the whole rents outstanding), giving credit to the realisable value of the subject-matter, and a legitimate allowance for the accelerated receipt of the future instalments. As it appears, such an assessment is, in fact, calculating the damages of the owner resulting from breach and the consequent termination, on the basis of his loss of bargain. In allowing a discount for the accelerated receipt of the future instalments, the fact that the hirer might be unable to satisfy the judgement immediately was held to be irrelevant since such a probable loss was not the result of the hirer's breach and further, the judgement itself allowed interest at the legal rate.

5.052 The decision in the *McLean*'s case[114] was soon approved by the Court of Appeal in *Overstone Ltd. v. Shipway*[115]. This case, however, introduced an apparently irrelevant point that the right of the owner to recover his loss (amounting to loss of bargain) was limited to a situation where the owner, in repossessing the subject-matter, had acted "reasonably". The irrelevance of the idea of "reasonableness", in such a situation, seems to be out of any doubt: The parties are completely free to provide for the right of the

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[112] [1962] 1 WLR 131, at p. 133; see also *Interoffice Telephones Ltd. v. Robert Freeman & Co. Ltd.* [1958] 1 QB 190 (CA) where as to a claim for the recovery of damages in a hiring agreement, terminated by the owner on the hirer's breach, Jenkins LJ said: "Then off the net rental as ascertained some discount should be allowed by reason of the fact that the plaintiffs would be receiving in one sum an amount which, had the contract run its full length, they would have received only over a period of six years." at p. 195

[113] *Yeoman Credit Co. v. Waragowski* [1961] 1 WLR 1124, [1961] 3 All ER 145; Master Jacob observed: "It is true in the case cited no such discount was made in the assessment of damages, but this point, whether such a discount should or should not be made, was not raised, nor argued, nor dealt with in the Court of Appeal." *Yeoman Credit Co. v. McLean* [1962] 1 WLR 131, at p. 134

[114] *Yeoman Credit Co. v. McLean* [1962] 1 WLR 131

[115] [1962] 1 WLR 117, [1962] 1 All ER 52

owner to repossess the subject-matter upon the occurrence of some specific events; and with such a provision, if the owner exercised his right of repossession within the scope of the contractual stipulation, the question of reasonableness of this act would not apparently arise.[116]

4.2.2. Relevance of the Nature of Breach to the Recoverable Damage

4.2.2.1. Loss up to the Date of Termination where the Contract is Terminated for a Non-repudiatory Breach

5.053 The assessment of damages with regard to the owner's loss of bargain was the case until the decision of the Court of Appeal in *Financings Ltd. v. Baldock*[117]. In this case, in a hire-purchase agreement, it was provided that on the happening of any breach by the hirer, the owner would have the right to terminate the agreement and repossess the five-ton Bedford lorry, the subject-matter of the agreement. The contract also provided for a minimum payment clause under which upon termination, the hirer was liable to bring his payments up to two-thirds of the hire-purchase price as compensation for depreciation. Upon the hirer's default in the payment of two instalments, the owner gave notice of termination, repossessed the vehicle, hold it for 14 days, but having heard nothing from the hirer, who had said that he might be able to pay the arrears within 3 days, delivered it to the original dealers to be disposed of. To recover his damages, the owner did not rely on the minimum payment clause which was clearly penal, since it had not given any credit for the realisable value of the subject-matter and the early receipt of the future instalments up to the two-thirds of the purchase price.[118] Instead, he claimed for his general damages at common law and obtained a judgement for damages to be assessed.

5.054 In assessing the owner's damages, Master Harwood, applying the dicta in *Overstone Ltd. v. Shipway*[119], and having considered that the owner had not acted reasonably in exercising his right to repossess the vehicle, limited his loss to the

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[116] See Meagher, R P; Penalties in Chattel Leases (Chapter 3 of Essays in Equity, by Finn, P D), 1985, p. 53

[117] [1963] 2 QB 104, [1963] 1 All ER 443

[118] such a clause had been recently held to be a penalty in *Bridge v. Campbell Discount Co. Ltd.* [1962] AC 600, [1962] 1 All ER 385.

[119] [1962] 1 WLR 117, [1962] 1 All ER 52

instalments in arrear at the date of termination. On appeal, the Court of Appeal, approving, in effect, the assessment of Master Harwood, refused to accept the novel concept of "reasonableness" as the basis for awarding loss of bargain damages, arguing that the power of termination had been expressly conferred upon the plaintiffs by the agreement, and in terminating the agreement and repossessing the vehicle, they had done nothing but the exercise of their contractual right within the contractual stipulation.[120] The court, however, held that the principle laid down in *Waragowski* case[121] as to the assessment of the owner's damages for the hirer's breach would only apply where the hirer had repudiated the agreement[122], and there being no repudiation by the hirer, the amount of damages would be limited to the arrears of rent at the date of termination plus interest. Denning L.J., in the course of his judgement, pointed out:

> "Once the hirer repudiated his liability for future rentals, the owners were entitled to treat the repudiation as itself a breach going to the root of the contract: and, on accepting it as such, they were entitled to regard the hiring as at an end and retake the vehicle. The *repudiation* being itself a breach which took place before the termination, it is within the class of breaches for which the owners can recover damages according to the principle I have already stated. But if there is no repudiation, and simply, as here, a failure to pay one or two instalments (the failure not going to the root of the contract and only giving a right to terminate by virtue of an express stipulation in the contract), the owners can only recover the instalments in arrear, with interest, and nothing else: for there was no other breach in existence at the termination of the hiring."[123]

Also Diplock L.J., having argued that the hirer's failure to pay two instalments, considering the terms of the contract and the circumstances of the case, *inter alia*, evincing no clear intention by the hirer to show his unwillingness or inability to pay either

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[120] Upjohn L.J., in the course of his judgement, stated: "I should be sorry to find a new concept of law introduced that a man may unreasonably exercise his right of termination, which was clearly given to him by the contract which he has entered into with the hirer, and thereby alter his rights and liabilities. As I observed earlier, the owners were perfectly entitled to determine the agreement on the failure to pay an instalment, and they are not to be criticized for that." (*Financings Ltd. v. Baldock* [1963] 2 QB 104, [1963] 1 All ER 443, at p. 115) It should also be noted that the concept of "reasonable solution" was interpreted as intending to refer to the well-settled rule of law that a party to a contract has an option to treat the contract as rescinded when the other party has wrongfully repudiated it. (*Ibid.*, per Diplock L.J. at pp. 122-123)

[121] *Yeoman Credit Co. v. Waragowski* [1961] 1 WLR 1124, [1961] 3 All ER 145

[122] The members of the court, in fact, tried to show that in the *Waragowski* case and other cases following it, the breach culminating in termination was so grave that went to the root of the contract. However, the cases themselves did not discuss the question of repudiation as a basis for the entitlement of the owner to recover his loss of bargain.

[123] *Financings Ltd. v. Baldock* [1963] 2 QB 104, at pp. 112-113

arrears of rent or further instalments, could not be regarded as a breach going to the root of the contract, stated:

> "The owner's only remedy would have been to sue for the two instalments overdue and their measure of damages would have been the amount of these instalments, together with interest..."[124]

5.055 Two important points should be made as to this case: First, in reaching this conclusion, it appears, the court placed much reliance on Salter J's reasoning in *Elsey & Co. Ltd. v. Hyde*[125] to the effect that, on termination of a contract by an owner who exercises his contractual right for the hirer's breach, the owner's loss would be limited to the interest on the amount unpaid and nothing more, because the loss for depreciation of the subject-matter "is not the result of the hirer's breach of contract, in being late in his payments", but it is the result of the owner's election to terminate the agreement. It should, however, be noticed that this line of reasoning in that case was invoked to prove that the amounts payable, under the contract, upon termination were not subject to the rules against penalties. Although this conclusion itself had been overruled[126] by the decision of the Court of Appeal in *Cooden Engineering Co. Ltd. v. Stanford*[127], nonetheless its reasoning was referred to as a good law in the *Baldock*'s case[128].

Second, this decision shows that where termination occurred on the basis of the exercise of a contractual power by the owner for the hirer's non-repudiatory breach which does not go to the root of the agreement, the amount of the owner's damages would be limited to his loss up to date of termination, i.e. the arrears of rent with interest. The reason for this, in principle, is that in such a case, any damage flowing from termination is not the result of the hirer's breach, but it is the consequence of the exercise of the owner's contractual right to terminate the agreement: He has determined the contract for a non-repudiatory breach and he has to bear any losses resulting from that. In case of a

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[124] *Ibid.*, at p. 120

[125] *Elsey & Co., Ltd. v. Hyde* only reported in Jones and Proudfoot's Notes on Hire Purchase Law, 2nd ed., p. 107, and referred to in *Re Apex Supply Co.* [1942] 1 Ch. 108 and in *Cooden Engineering Co. v. Stanford* [1953] 1 QB 86

[126] See *supra.*, paras. 4.08-4.09

[127] [1953] 1 QB 86

[128] *Financings Ltd. v. Baldock* [1963] 2 QB 104, [1963] 1 All ER 443, per Denning L.J. at p. 112

repudiatory breach, however, the breach amounts to a right of termination at common law: In such a case, any loss resulting from termination is attributable to the hirer's breach and therefore, he has to be liable for these damages.

The conclusion and its reasoning introduce two interlocking ideas as to assessing the owner's damages resulting from termination:

I) The materiality of the nature of the breach: Whether the breach is repudiatory or not will determine the amount of the owner's loss resulting from breach.

II) The idea of causation: The owner would be entitled to recover damages resulting from termination (i.e. loss of bargain) only where these damages resulted from the breach. These ideas are tightly related to each other so that, as it has been stated, the loss resulting from termination is caused by the hirer's breach where the breach is repudiatory.

5.056 By the decision of the Court of Appeal in the *Baldock*'s case, in English law of damages, a new era as to the question of the assessment of damages flowing from breach started. As a result, to prove the causal connection between the breach and the losses resulting from termination, the nature of breach was investigated and where the breach was a breach of a fundamental term, a fundamental breach or a repudiation (i.e. a repudiatory breach), the promisee could be compensated for his loss flowing from termination (i.e. loss of bargain). Otherwise, i.e. where the breach was a non-repudiatory one, the promisee's loss would be limited to any damages up to the date of termination and loss of bargain was supposed to result from the promisee's own act in terminating the agreement.[129] Thus, in *Charterhouse Credit Co. Ltd. v. Tolly*[130], as to a hire-purchase agreement, termination upon a contractual right where the hirer had, in fact, repudiated the contract was contrasted with a termination following a contractual right where there

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[129] Chitty on Contracts, 27th ed., vol. 1, 1994, para. 26-066; Furmston M P, Cheshire, Fifoot & Furmston's Law of Contract, 13th ed., 1996, p. 638; Furmston M P, Contract Planning: Liquidated Damages, Deposits and the Foreseeability Rule (1991) 4 JCL 1, at p. 9; Treitel G H, Damages on Rescission for Breach of Contract [1987] L.M.C.L.Q. 143; McGregor on Damages, 15th ed., 1988, para. 483; Meagher R P, Penalties in Chattel Leases (Chapter 3 of "Essays in Equity, by Finn, P D"), 1985, at pp. 53-54

[130] [1963] 2 QB 683, per Donovan L.J. at p. 702. The case itself has been overruled on some other grounds by *Photo Production Ltd. v. Securicor Transport Ltd.* [1980] AC 827

was only a simple, non-repudiatory breach.[131]

4.2.2.2. Unsatisfactory Consequences Resulting from the Principle

5.057 The treatment of the Court of Appeal in distinguishing termination upon a contractual right based on a non-repudiatory breach from a situation where termination is grounded upon a repudiatory breach may result in unsatisfactory, and sometimes unfair consequences. The situation is illustrated by a clear example given by Lord Denning in *Financings Ltd. v. Baldock*[132]:

> "A hirer does not pay two instalments, whereupon the owners retake the vehicle. There is no repudiation. The damages are limited to the unpaid instalments with interest. But take another case. If he had been more courteous and had written: "I cannot pay any more instalments", that would have been a repudiation and the damages would be multiplied tenfold."[133]

It is undoubtedly unreasonable and unjust that the extent of the promisor's liability could be multiplied because of being courteous. Such a law with such a consequence should be reconsidered.

4.3. The Effect of Determining the Nature of Breach on the Application of the Penalty Doctrine to a Minimum Payment Clause

5.058 As a result of the principle laid down in *Baldock*'s case, when applying the rules against penalty to minimum payment clauses, a clause providing for a larger sum than the amount which, considering the nature of breach, was legally recoverable was held to be a penalty.[134] In other words, a minimum payment clause stipulating for the liability of the hirer to pay the owner's loss of bargain upon termination was recognized as a penalty where the hirer's breach, amounting to the exercise of the owner's contractual right to terminate, was a minor, non-repudiatory breach. The reason for this, in addition to the

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[131] See also *Brady v. St Margaret's Trust Ltd* [1963] 2 QB 494 ; *United Dominions Trust (Commercial) Ltd. v. Ennis* [1968] 1 QB 54 ; *Eshun v. Moorgate Mercantile Co. Ltd.* [1971] 1 WLR 722 ; *Capital Finance Co. Ltd. v. Donati* (1977) 121 S.J. 270 ; *Lombard North Central Plc. v. Butterworth* [1987] 1 QB 527 ; For a similar decision in building contracts see *Thomas Feather & Co. (Bradford) Ltd. v. Keighley Corp.* (1953) 52 L.G.R. 30 in which the employer, having exercised his contractual right to determine the contract for the contractor's unauthorised sub-contracting, was held unable to recover the extra cost of employing another contractor to finish the work. See also Beale H., Penalties in Termination Provisions (1988) 104 L.Q.R. 355, at p. 356

[132] [1963] 2 QB 104, [1963] 1 All ER 443

[133] *Ibid.*, at p. 113

[134] See Chitty on Contracts, 27th ed., vol. 1, 1994, para. 26-066

idea of limiting the innocent party to the legally recoverable loss, was that the promisee's right to terminate the agreement was stipulated upon the happening of every breach of the contract by the promisor (whether trivial or serious). Since in such a case, the accepted principle, as laid down by Lord Dunedin in the leading case of *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd.*[135], was that the strength of the chain should be taken at its weakest link[136], so the stipulated minimum payment, being compared with the legally recoverable loss resulting from a trivial breach, would have a rare chance to be considered as a valid liquidated damages[137]. This was because, according to the principle in the *Baldock*'s case, the legally recoverable loss could be the promisee's loss of bargain only where the promisor had committed a repudiatory breach.

5.059 The effect of determining the nature of breach on the application of the rules against penalty to agreed damages clauses, like a minimum payment clause in a hire-purchase agreement, can clearly be seen in the case of *Lombard North Central Plc. v. Butterworth*[138]. It is necessary to refer briefly to the facts of the case again: In an agreement for the lease of a computer, it was provided that the punctual payment of the instalments was to be of the essence [cl. 2(a)], that in the event of the defendant defaulting in the punctual payment of the instalments, the agreement might be terminated either by notice in writing or by taking possession of the goods (cl. 5), and that upon termination, the lessee would be under the liability to pay the arrears of rents, all further instalments which would, but for the termination of the agreement, have fallen due less a discount for accelerated payment, and damages for any breach of the contract [cl. 6(a)]. The first two instalments was duly paid but the lessee was late in the payment of the next three rentals. On a further delay in making the sixth payment, the plaintiffs gave a notice of termination, retook the subject-matter and resold it. They, then, issued a writ, not on the basis of cl. 6(a), but on a similar ground claiming for a sum of money as damages

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[135] [1915] AC 79

[136] "If there are various breaches to which one indiscriminate sum to be paid in breach is applied, then the strength of the chain must be taken at its weakest link." *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd., Ibid.*, per Lord Dunedin at p. 89

[137] See McGregor on Damages, 15th ed., 1988, para. 483; Meagher R P, Penalties in Chattel Leases (Chapter 3 of "Essays in Equity, by Finn, P D"), 1985, at p. 56

[138] [1987] 1 QB 527

resulting from the lessee's breach, consisting of the arrears of rentals and all future instalments with a credit given for the accelerated receipt of them and a further allowance for the realisable value of the subject-matter.

5.060 The Court of Appeal held that the lessee's delays in making payments, apart from cl. 2(a), could not be regarded as a repudiatory breach and accordingly, on the basis of the principle laid down in the *Baldock*'s case, the agreed damages clause providing for nearly loss of bargain[139] should be held a penalty, for the stipulated amount was excessively large in comparison with the loss which was legally recoverable at common law for a non-repudiatory breach, i.e. the arrears of rent at the date of termination plus interest. The insertion or exclusion of an allowance for the realisable value of the subject-matter in the minimum payment clause would not alter the conclusion, for even with the inclusion of a further allowance for the realisable value of the computer, the clause would stipulate for the lessor's loss of bargain which was excessively large in comparison with the legally recoverable loss in the absence of a repudiatory breach. As Nicholls LJ observed:

> "... I consider that, in the absence of a repudiatory breach, the outcome of this issue is not dependent upon the inclusion or exclusion of a resale price allowance, and indeed the legal result would have been the same if clause 6 had contained a resale price allowance."[140]

Nevertheless, the court held that the lessor was entitled to recover the claimed amount (i.e. his loss of bargain). The reasoning of the court was mainly based on the following ground: The effect of cl. 2(a) was to elevate a simple term into the category of a condition, breach of which went to the root of the contract. Thus, the breach being recognized as a repudiatory one, the lessee was held liable to compensate the lessor for his loss of bargain, consisting of the arrears of rent and all future rentals with a discount for the accelerated payment and an allowance for the realisable value of the computer.

It would therefore appear that in the application of the rules against penalty to a minimum payment clause, the nature of the clause would be determined with a reference to the

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[139] The only defect of the clause was apparently not giving any allowance for the realisable value of the repossessed subject-matter.

[140] *Lombard North Central Plc. v. Butterworth* [1987] 1 QB 527, at p. 543

nature of the breach upon which the termination is provided to be based.

5.061 It could, as a result of the above observations, be concluded that:

I) If termination was stipulated to be based upon a repudiatory breach, then the minimum payment clause providing for the innocent party's loss of bargain would be likely to be upheld as a valid liquidated damages clause.

II) If the breach upon which termination is stipulated to be grounded was a non-repudiatory breach, the minimum payment clause would probably constitute a penalty if it provided for the promisee's loss of bargain.

III) Where the contractual right to terminate was given to the innocent party, regardless of the nature of the promisor's breach, whether trivial or serious,[141] the strength of the chain would be taken at its weakest link. Therefore, the minimum payment clause providing for loss of bargain would have a rare chance to be upheld as a valid stipulation.

4.4. Sidestepping the Principle: Elevating a Term into the Category of Conditions

5.062 The practical result achieved in *Lombard North Central Plc. v. Butterworth*[142] was the consequence of cl. 2(a) which provided that the time for the payment of the instalments was to be of the essence of the agreement. In fact, there was no practical difference between this case and the *Baldock*'s case[143], except providing for a "time of the essence" clause in the *Butterworth*[144] case and that was this clause which justified achieving a substantially different result in the latter case. Both Lord Justices who gave a detailed judgment in the case, however, considered this result as an unsatisfactory consequence. Nicholls L.J. viewed it with "considerable dissatisfaction"[145] and Mustill L.J. said:

> "This is not a result which I view with much satisfaction ... "[146]

The importance of such a clause makes it necessary to consider, in detail, its effect and

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[141] E.g., providing for a right of termination on the occurrence of every default by the promisor, which is a normal course in most financing transactions.

[142] [1987] 1 QB 527

[143] *Financings Ltd. v. Baldock* [1963] 2 QB 104, [1963] 1 All ER 443

[144] *Lombard North Central Plc. v. Butterworth* [1987] 1 QB 527

[145] *Ibid.*, at p. 546

[146] *Ibid.*, at p. 540

the reason for unsatisfactory consequences resulting from that and to look for any solutions to remove such an unsatisfactory result.

4.4.1. The Effect of a "Time of the Essence" Provision

5.063 As it was pointed out, the principle laid down in the *Baldock*'s case drew a line between a repudiatory and a non-repudiatory breach in assessing the innocent party's damages resulting from termination of the agreement for the other party's breach. In the case itself, the failure of the hirer to pay two instalments of the rent being recognized as a non-repudiatory breach, the owner was held unable to recover his loss of bargain and was limited to the recovery of any damages up to the date of termination, i.e. the arrears of rent with interest. The result of the case was unsatisfactory for the finance companies and made them draw the agreement in a way that the breach upon which the termination was provided for could be regarded as a breach of condition. One way of doing this and in fact avoiding the unsatisfactory results of the *Baldock*'s case[147] was to elevate every term providing for the promisor's obligations to the category of conditions by providing that the time for the performance of the promisor's obligations would be of the essence of the contract. In fact, there was a hint in the *Baldock*'s case itself that drawing the contract in this way might lead to a different result: Diplock L.J., in the course of his speech, observed that time of payment in that case was not of the essence of the contract.[148] He pointed out that "in the absence of any express provision to the contrary in the contract"[149], the failure to pay two instalments could not be regarded as going to the root of the agreement. These parts of the Lord Justice's speech implies that had there been a provision to the contrary in the contract and if the time of payments had been provided to be of the essence of the agreement, then another result might have been achieved.

5.064 The decision of the Court of Appeal in the *Butterworth* case[150] confirmed this implication and regarded the "time of the essence" provision as elevating a simple term

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[147] *Financings Ltd. v. Baldock* [1963] 2 QB 104, [1963] 1 All ER 443

[148] [1963] 2 QB 104, at p. 118

[149] [1963] 2 QB 104, at p. 120

[150] *Lombard North Central Plc. v. Butterworth* [1987] 1 QB 527

into the category of conditions breach of which went to the root of the contract and entitled the innocent party to recover his loss of bargain. Mustill L.J., having observed that according to the authorities for at least a century, it is open to the parties to assign a term to the category of conditions by their express agreement and that "making time of the essence is the same as making timely performance a condition"[151], stated:

> "... it is axiomatic that a person who establishes a breach of condition can terminate and claim damages for loss of the bargain, and I know of no authority which suggests that the position is any different where late performance is made into a breach of condition by a stipulation that time is of the essence."[152]

Also Nicholls L.J., arguing that determining the effect of the "time of the essence" provision is a question of construction which should be decided by considering all terms of the contract, concluded:

> "... the "time of the essence" provision seems to me to be intended to bring about the result that default in punctual payment is to be regarded (to use a once fashionable term) as a breach going to the root of the contract and, hence, as giving rise to the consequences in damages attendant upon such a breach. ... If that construction of the agreement is correct then, as at present advised, it seems to me that the legal consequence is that the plaintiff are entitled to claim damages for loss of the whole transaction."[153]

It is, therefore, apparent that the specific effect of the "time of the essence" provision is to elevate a simple term into the category of a condition so that the failure of which goes to the root of the contract in order to enable the innocent party to recover his loss of bargain. As a result, with the existence of such a provision, if the minimum payment clause provides for the entitlement of the promisee to recover loss of the whole transaction- by stipulating, for instance in a hire-purchase agreement, that the owner is entitled upon termination for the hirer's breach to recover arrears of rent and all future instalments giving a proper credit for the accelerated payment and a further allowance for the realisable value of the repossessed subject-matter- the clause will be very likely to be upheld as a valid liquidated damages clause.

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[151] *Ibid.*, at p. 536

[152] *Ibid.*

[153] *Ibid.*, at p. 546

4.4.2. The Provision is not Subject to the Penalty Doctrine

5.065 It should be noted here that the clause elevating a term into the category of conditions, like the "time of the essence" provision, is not subject to the law relating penalties.[154] In other words, it could not be struck out as being a penalty by the reason that the existence of this clause, in effect, indirectly multiplies the amount of damages recoverable from the contract breaker. That is because such a clause does not determine the amount of damages which are recoverable in the event of termination for breach. As it was referred to, the express agreement of the contracting parties to promote a simple term into the category of conditions has been confirmed by the authorities for at least a century[155] and the "time of the essence" provision also has such an effect. As Mustill L.J. rightly argued:

> "A clause expressly assigning a particular obligation to the category of conditions is not a clause which purports to fix the damage for breach of the obligation, and is not subject to the law governing penalty clauses. I acknowledge, of course, that by promoting a term into the category where all breaches are ranked as breaches of condition, the parties indirectly bring about a situation where, for breaches which are relatively small, the injured party is enabled to recover damages as on the loss of the bargain, whereas without the stipulation his measure of recovery would be different. But I am unable to accept that this permits the court to strike down as a penalty the clause which brings about this promotion. To do so would be to reverse the current of more than 100 years' doctrine, which permits the parties to treat as a condition something which would not otherwise be so. I am not prepared to take this step."[156]

5.066 This proposition is supported by the decision of the Privy Council in *Steedman v. Drinkle*[157], where in a contract for the sale of land by instalments, upon the default of the purchaser in punctual payment and termination of the contract by the vendor, the purchaser claimed specific performance. The Judicial Committee of the Privy Council

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[154] Chitty on Contracts, 27th ed., vol. 1, 1994, para. 26-066 at p. 1259; McKendrick E, Contract Law, (2nd ed., 1994), para. 21.3 at p. 326; Downes A., Textbook on Contract, 3rd ed., 1993, p. 330, suggesting that such a provision is presumably subject to the rule in *Export Credits Guarantee Department v. Universal Oil Products* [1983] 2 All ER 205

[155] See for example: *Bettini v. Gye* (1876) 1 Q.B.D. 183, at p. 187 ; *HongKong Fir Shipping Co. Ltd. v. Kawasaki Kisen Kaisha Ltd.* [1962] 2 QB 26, at p. 70 ; *Financings Ltd. v. Baldock* [1963] 2 QB 104 ; *Photo Production Ltd. v. Securicor Transport Ltd.* [1980] AC 827, at p. 849 ; *Bunge Corporation, New York v. Tradax Export S.A., Panama* [1981] 1 WLR 711, at pp. 715, 719 (All cited in *Lombard Plc. v. Butterworth* [1987] 1 QB 527, per Mustill L.J. at p. 536)

[156] *Lombard North Central Plc. v. Butterworth* [1987] 1 QB 527, at p. 537

refused to decree specific performance on the ground that such a jurisdiction had never been exercised where the parties intimated that it should not apply to their agreement by providing for the time of the performance to be of the essence. The decision seems to follow that the "time of the essence" provision is valid and should not be struck down merely because the term, without such a stipulation, is not a condition breach of which entitles the promisee to a different measure of damages.

4.4.3. The Unsatisfactory Results of the Provision

5.067 As to the assessment of damages in relation to termination clauses and the application of the penalty doctrine to the minimum payment provided to be paid upon termination of the contract by the innocent party for the other party's breach, the stipulation with the effect of elevating a term into the category of conditions, like a "time of the essence" provision, brings about some unsatisfactory results. The reason for such an unsatisfactory consequence has well been illustrated in the judgment of Nicholls L.J. in *Lombard North Central Plc. v. Butterworth*[158] where he states:

> "There is no practical difference between (1) an agreement containing such a power [i.e. the power to terminate the contract upon the non-payment of instalments] and (2) an agreement containing a provision to the effect that time for payment of each instalment is of the essence, so that any breach will go to the root of the contract. The difference between these two agreements is one of drafting form, and wholly without substance."[159]

In fact, the only justification for achieving different results in the cases of *Baldock*[160] and *Butterworth*[161] was the existence of the provision to the effect that time of payments in the latter case was of the essence. It is, as stated by Nicholls L.J., only the question of form and no substantial difference can be found between these two cases to justify the substantial difference in the results.[162] That means that the amount of recoverable damages in the event of termination and also the nature and validity of the minimum payment clause will be determined by the skill of draftsman[163]: If he draws the contract in

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[157] [1916] 1 AC 275

[158] [1987] 1 QB 527

[159] *Ibid.*, at p. 546

[160] *Financings Ltd. v. Baldock* [1963] 2 QB 104, [1963] 1 All ER 443

[161] *Lombard North Central Plc. v. Butterworth* [1987] 1 QB 527

[162] Treitel G H, Damages on Rescission for Breach of Contract [1987] L.M.C.L.Q. 143, at p. 144

[163] See Furmston M P, Contract Planning: Liquidated Damages, Deposits and the Foreseeability Rule

a way that the obligations of the promisor is promoted to the category of conditions, the recoverable amount as damages payable upon termination will substantially be greater than a case in which the promisor's obligations could not be regarded as conditions. As a result, the minimum payment clause providing for the promisee's loss of bargain would be valid in the first case, whereas in the second, it is very likely to be struck down as being a penalty. Thus, the application of the rules against penalties to the minimum payment clause would bring about substantially different results by a small change in terminology.[164] That is why it has been suggested that, as a result of such triumph of the form over substance, "the law as to penalties is subverted to such an extent that it is not worth preserving as a separate body of rules."[165]

4.4.4. How to Avoid the Unsatisfactory Consequences of the Provision

5.068 The more important issue is whether this acceptedly unsatisfactory result could be avoided? Could stipulations like the "time of the essence" provision be interpreted in a way to refrain the promisee from side-stepping the legal principles by skilful draftsmanship? The answer appears to be "yes": There seems to be two different, but related, analysis to show that merely the "time of the essence" provision should not be regarded as altering the outcome of the case in such a way illustrated in the *"Baldock"* and *"Butterworth"* cases: **First**, the provision elevating a term into a condition, ***only*** confers upon the promisee a right to terminate and is not enough indication of intention for recoverability of loss of bargain damages. **Second**, providing for the right of the promisee to terminate for the promisor's breach is, by itself, an enough indication of intention for the recoverability of loss of bargain damages, even in the absence of a provision elevating a term into the category of conditions.

4.4.4.1. The provision only confers the right to terminate

5.069 It has been suggested[166] that a clause with the effect of elevating a term into the category of conditions should only be construed as conferring upon the innocent party the

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(1991) 4 JCL 1, at p. 9; Koffman L. & Macdonald E., The Law of Contract (London: Fourmat Publishing, 1992), pp. 378-379

[164] Chitty on Contracts, 27th ed., vol. 1, 1994, para. 26-066 at p. 1260

[165] *Ibid.*

[166] Chitty on Contracts, 27th ed., vol. 1, 1994, para. 26-066 at p. 1260

right to terminate the agreement, but not entitling him to recover damages for his loss of bargain unless the agreement of the parties as to the recoverable damages upon termination could be regarded as a valid liquidated damages. This proposition has been explained in clear terms[167]: Where the breach of a specific term is described in a contract as being "repudiatory", the word "repudiatory" may refer to the ***nature*** of the breach or its ***legal consequences***. In the first sense, it is used to justify ***why*** a breach results in termination, but in the second, it is just to point out ***that*** the breach will result in termination. In this sense, the breach may lead to termination, even though it does not amount to repudiation. The express agreement of the parties to the effect that the innocent party will have a right to terminate the agreement for the other party's default, can clearly play this role; in other words, such an agreement makes the breach repudiatory in the second sense, for it points out that the breach will have a consequence of termination. Looking at the *Baldock*'s case[168] with this analysis, it can be inferred that, because of the express agreement of the parties in that case to confer the right of termination upon the owner for the hirer's default in punctual payment of instalments, the breach was repudiatory in the second sense. Also in the *Butterworth* case[169], the failure of the lessee in punctual payment of instalments was not to be regarded as a repudiation in the first sense, but since the contract had conferred the right of termination upon the lessor for the lessee's breach and since the punctual payment by the express agreement of the parties had been provided to be of the essence, so the breach was a repudiatory breach in the second sense; for, the effect of both these stipulations was to point out that the breach would justify the termination. The only difference between these two cases was that in the latter case, the contract emphasized the fact of the justification of termination upon breach ***twice*** rather than ***once*** which was the case in the *Baldock*'s case. Therefore, in fact, in both cases the breach was repudiatory in the second sense.

5.070 It might be said that in the *Butterworth* case, the "time of the essence" provision made a simple term a ***condition*** breach of which went to the root of the contract. But again the matter is the ambiguity of the word "condition". A term of a contract may be

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[167] Treitel G H, Damages on Rescission for Breach of Contract [1987] L.M.C.L.Q. 143, at pp. 144-146

[168] *Financings Ltd. v. Baldock* [1963] 2 QB 104, [1963] 1 All ER 443

[169] *Lombard North Central Plc. v. Butterworth* [1987] 1 QB 527

classified as a condition either by the ***express agreement of the parties*** or by ***law***. Where the express agreement of the parties turns a term into a condition, the breach of such a term is repudiatory in the second sense, whereas the breach of a term which is classified by the law as a condition is repudiatory in the first sense. According to this analysis, even in the *Baldock*'s case, the undertaking of the hirer to pay the instalments punctually was a condition in a sense that breach of which was regarded as a repudiatory breach in the second sense, and so it was in the *Butterworth* case, even if the time of payment had not been provided to be of the essence of the agreement.

It could accordingly be concluded that there was no sufficient distinction between these two cases to justify the substantial difference in the outcome, and unless there was a ***valid*** minimum payment clause conferring the right of damages upon the innocent party, as implicitly referred to by Diplock L.J. in the *Baldock*'s case[170], the outcome of both cases should have been the same. This outcome, since the right to damages for loss of bargain should be confined to the repudiatory breach in the first sense and since there was no breach in this sense in both cases, should have been the recovery of losses up to the date of termination, i.e. the arrears of rent with interest.

5.071 Two points could be made on this analysis:

I) The effect of this analysis, in fact, is that the intention of the parties as to giving the legal consequences of a repudiatory breach to a simple term- by conferring the right of termination upon the innocent party for the breach of that term, *or* describing it as a condition by conferring the pre-said right or providing for the time of performance to be of the essence- is only effective to the extent that failure of that term justifies termination of the agreement by the innocent party, but does not confer on him the right to recover damages resulting from that termination. Such a distinction by giving the innocent party the right to terminate and then depriving him from the right to damages seems to be meaningless and without any reason: Why the parties who are free to give the legal consequences of a repudiatory breach to a simple term cannot confer these consequences completely? Why should they be taken as free to agree on a right of termination as a part

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[170] *Financings Ltd. v. Baldock* [1963] 2 QB 104, at p. 121

of the consequences of a repudiatory breach and then assumed to be deprived to recover the damages resulting from that termination as the other part of the effect of such a breach? And finally, why the parties who agree on a right of the innocent party to terminate the agreement for the other party's breach cannot take this step without any loss to be suffered by the promisee?

II) This analysis seems to recognize the right of the contracting parties to agree on a valid minimum payment clause to enable the innocent party to recover his damages. But, assuming that the pre-estimated loss by the parties should be confined to the legally recoverable loss as it was apparently proposed by Mustill L.J. in the *Butterworth* case[171], and that the legally recoverable loss in both cases of "*Baldock*'s"[172] and "*Butterworth*"[173], as it was suggested[174], should be limited to the loss up to the date of termination, how could the parties' agreement on a minimum payment clause providing for the innocent party's actual loss resulting from termination be a valid stipulation, unless we assume that the breach occurs at the very end of the contractual period which would be a rare case? Hence, it should inevitably be concluded that the pre-discussed analysis recognizes the right and power of the parties to agree on the minimum payment clause providing for damages which are not legally recoverable at common law.[175]

4.4.4.2. Providing for the right to terminate is enough for the recovery of loss of bargain

5.072 The effect of the "time of the essence" provision in the *Butterworth* case[176] was to make the timely performance a condition so that breach of which could be regarded as a repudiatory breach. Now, it might be argued that providing for the right of the promisee to terminate the contract for the other party's breach (i.e. in fact, providing the consequence of a repudiatory breach for a simple term) implies the intention of the parties to promote the breach of that term to the category of repudiatory breaches. Putting another way, the parties are free, according to the authorities for a century, to agree as to

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[171] *Lombard Plc. v. Butterworth* [1987] 1 QB 527, at p. 537

[172] *Financings Ltd. v. Baldock* [1963] 2 QB 104, [1963] 1 All ER 443

[173] *Lombard North Central Plc. v. Butterworth* [1987] 1 QB 527

[174] See above para. 5.070

[175] *Supra.*, para. 2.14; Also see above, paras. 5.016 *et seq.*

[176] *Lombard North Central Plc. v. Butterworth* [1987] 1 QB 527

of the consequences of a repudiatory breach and then assumed to be deprived to recover the damages resulting from that termination as the other part of the effect of such a breach? And finally, why the parties who agree on a right of the innocent party to terminate the agreement for the other party's breach cannot take this step without any loss to be suffered by the promisee?

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[171] *Lombard Plc. v. Butterworth* [1987] 1 QB 527, at p. 537

[172] *Financings Ltd. v. Baldock* [1963] 2 QB 104, [1963] 1 All ER 443

[173] *Lombard North Central Plc. v. Butterworth* [1987] 1 QB 527

[174] See above para. 5.070

[175] *Supra.*, para. 2.14; Also see above, paras. 5.016 *et seq.*

[176] *Lombard North Central Plc. v. Butterworth* [1987] 1 QB 527

the nature of a term; in fact, their agreement as to this issue shows the seriousness or triviality of the breach of that term in their mind. Such an agreement might be express or implied: Where the parties expressly agree on a nature of a term as a condition, breach of such a term will go to the root of the contract and be considered as a repudiatory breach. The parties' implicit intention also has the same effect. Just as providing for the time of performance to be of the essence implies the intention of the parties to promote a term into the category of conditions, stipulating for the right of termination would also seem to have such an effect.

It has basically been argued that the right of the innocent party to recover loss of bargain damages in the event of a repudiatory breach has its roots in the intention of the parties; viz., the parties have intended that loss of bargain would be recoverable where termination is based on a repudiatory breach.[177] Now, if the parties expressly or implicitly indicate that a specific term is elevated into the category of conditions so that the breach of which would be regarded as a repudiatory breach, such an agreement is, in fact, an indirect way of stating when the parties have envisaged loss of bargain to be recoverable. Regarding the time of the promisor's performance to be of the essence, and conferring a right of termination upon the promisee in case of breach of a specific term are both implicit indications by the parties that the breach of such a term should be regarded as a repudiatory breach.

It might, as a result, be concluded that there is no distinction between the two cases of "*Baldock*" and "*Butterworth*": In both, the breach of the term providing for the punctual payment should be regarded as a repudiatory breach enabling the promisee to recover his loss of bargain. Hence, in both cases, had the parties agreed on a minimum payment clause providing for the creditor's loss of bargain in the event of termination, the clause should have been regarded as a valid liquidated damages.

5.073 Some cases support this argument: In *Sotiros Shipping Inc and Aeco Maritime*

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[177] See Carter J W, The Effect of Discharge of a Contract on the Assessment of Damages for Breach or Repudiation (Part II) (1989) 1 JCL 249, p. 261

SA v. Sameiet Solholt[178], in a contract for the sale of a ship it was provided that upon failure of the sellers to deliver the ship on the contractual time, the buyers would have the right to terminate the contract; and that upon termination, the sellers would be under the liability to "make compensation for any loss caused to the buyers by non-fulfilment of this contract". (cl. 14) The sellers were, in fact, late in delivering the ship. The buyers terminated the agreement and claimed for damages resulting from breach. The Court of Appeal, having emphasized that the actual loss suffered by the buyers was attributable to the seller's breach, and not to the buyers' act in terminating the contract[179], had no doubt that the buyers were entitled to recover their loss of bargain[180], even though the seller's failure to deliver the ship on the specified date, apart from the buyer's contractual right to terminate the agreement upon breach, was not regarded as a repudiatory breach. It follows that presumably the buyer's contractual right to terminate the agreement for the seller's breach was regarded as elevating the seller's contractual undertaking to deliver on time into the category of conditions breach of which entitled the buyer to recover his loss of bargain.

4.5. The Effect of Providing Expressly for loss of bargain to be the Recoverable Damage

5.074 Assuming that merely providing for the right of termination upon breach does not sufficiently indicate that the promisor's breach would be regarded as a repudiatory breach, it has alternatively been suggested that, to avoid the unsatisfactory consequences resulting from the *Baldock*'s case[181], the parties could expressly provide for loss of bargain to be recoverable upon termination of the contract for the promisor's breach.[182] The argument supporting this proposition runs thus: The rationale behind the *Baldock*'s case and other cases following that presumably is that merely providing for the right of termination upon breach, does not put the promisor on enough notice that for his breach, loss of bargain will be recoverable. What the stipulations elevating a term into the category of conditions, like the "time of the essence" provision, do is, in fact, to put the

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[178] [1983] 1 Lloyd's Rep. 605 (*The Solholt* case)

[179] *Ibid.*, at p. 607 per Donaldson M.R.

[180] Although the final result was the dismissal of the buyer's claim on the issue of mitigation.

[181] *Financings Ltd. v. Baldock* [1963] 2 QB 104, [1963] 1 All ER 443

[182] Beale H., Penalties in Termination Provisions (1988) 104 L.Q.R. 355, at p. 357

promisor on notice that his breach will be regarded as a breach of condition going to the root of the contract, and enable the promisee to recover his loss of bargain. Now, if such stipulations make the promisor aware of the consequences of breach, while they are not express as to these effects, undoubtedly the express agreement of the parties as to the ability of the promisee to recover loss of bargain for the other party's breach will put him on complete notice as to the consequences of his breach. Therefore, stipulating for such a provision would enable the promisee to recover his loss of bargain. In other words, a valid minimum payment clause to the effect of the recoverability of loss of bargain upon termination for the promisor's default, would be an effective provision and should be upheld, unless it exceeds excessively the genuine pre-estimate of the promisee's actual loss resulting from termination (i.e. his loss of bargain).

5.075 The dicta of Diplock L.J. in *Robophone Facilities, Ltd. v. Blank*[183] to the effect that the parties may agree on *actual* losses resulting from premature termination of the contract, even though they might normally be too remote to be recoverable at common law, supports this view.[184] As it was already concluded[185]- relying, *inter alia*, on this dicta- the loss which the parties are supposed to pre-estimate, when entering into a contract, is not confined to the loss which is recoverable at common law. It might also include the promisee's actual loss resulting from termination based on breach, even though it might be assumed not to be recoverable under the general law of damages. Therefore, even assuming that upon termination for a non-repudiatory breach, the actual loss resulting from termination (i.e. the promisee's loss of bargain) is not legally recoverable at common law, the parties' agreement on the minimum payment clause might include such a loss, and there seems no reason why, contrary to the observations of Nicholls L.J. in the *Butterworth* case[186], such a clause should not be upheld.

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[183] [1966] 3 All ER 128

[184] The learned Lord Justice, in the course of his judgment stated: "If the contract contained an express undertaking by the defendant to be responsible for all actual loss to the plaintiff occasioned by the defendant's breach, whatever that loss might turn out to be, it would not affect the defendant's liability for the loss actually sustained by the plaintiff that the defendant did not know of the special circumstances which were likely to cause any enhancement of the plaintiff's loss." see *ibid.*, at p. 143

[185] See *supra.*, paras. 2.10 *et seq.*; Also above, paras. 5.016 *et seq.*

[186] *Lombard North Central Plc. v. Butterworth* [1987] 1 QB 527, at p. 543, see *supra.*, para. 5.060

5.076 Furthermore, there is an indication to the validity of this conclusion in the judgment of Willmer L.J. in *Anglo Auto Finance Co. Ltd. v. James*[187] where the Lord Justice, having concluded that the minimum payment clause providing, in effect, for the payment of the full hire-purchase price less the realisable value of the subject-matter would constitute a penalty, added:

> "Clause 5(b) [the minimum payment clause] is the only clause which deals with the question of compensation in the event of the termination of the hiring. No clause is contained in the contract purporting to deal with depreciation or deterioration of the vehicle. Had such a clause been inserted (and assuming, of course, it did not amount to penalty clause), it may be that the plaintiffs would have been entitled to recover something considerably more."[188]

It would seem to be a hint in this passage that if the minimum payment clause covered the actual loss resulting from termination, it would be upheld, even though such a loss was not recoverable in an action for unliquidated damages at common law.

5.077 It has been suggested[189] that even though in commercial contracts, and generally in non-consumer contexts, the above outcome as to the validity of a minimum payment clause providing for the promisee's loss of bargain upon termination would raise no problems and so such a clause should be enforced, ***nonetheless***, in consumer context, there are good reasons for not enforcing such clauses. For, consumers entering into contracts containing such a minimum payment clause may not notice the effect of the provision and this problem is more likely to happen in standard form contracts in which the consumer usually signs the agreement without even reading or understanding it.

These arguments, with all respect, do not seem to be convincing and are subject to serious objections: **First**, the effect of the clause, considering its express language as to the recoverability of loss of bargain, would seem to be clear enough for everyone who makes the agreement. **Second**, basically such a problem is more likely to happen where the parties achieve this result by providing for the time to be of the essence, since it ***implicitly*** indicates the right of the promisee to recover loss of bargain. Nevertheless, as

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[187] [1963] 1 WLR 1042

[188] *Ibid.*, at p. 1047

[189] Beale H., Penalties in Termination Provisions (1988) 104 L.Q.R. 355, at p. 359

to the effect of such a provision, no distinction between consumer and non-consumer contexts has been recognized.

In any event, even if the protection of consumer requires the non-enforceability of a minimum payment clause providing for loss of bargain upon termination for a minor breach, such a step, it is submitted, should be taken by the legislator, and its effect, of course, should also be extended to clauses promoting a minor term into the category of conditions. The Unfair Terms in Consumer Contracts Regulations 1994[190] might be invoked in this relation: Under the Regulations, in any contract concluded between a seller or supplier and a consumer[191], any "unfair" term[192] which has not been individually negotiated[193] is not binding on the consumer[194], even though the rest of the contract may continue in existence without the unfair term.[195] A contractual term will be regarded as "unfair" if, "contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations under the contract to the detriment of the consumer".[196] A minimum payment clause providing for the liability of a consumer to pay loss of bargain damages upon termination for his minor breach, if it was stipulated for in a standard form contract for the sale or supply of goods or services, might be caught by the provisions of the Regulations[197]; and having been regarded as an "unfair" term, it might be struck down as an unenforceable clause.

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[190] Implementing the EEC Council Directive 93/13 on Unfair Terms in Consumer Contracts

[191] Sec. 3(1)

[192] Sec. 4

[193] Sec 3(1). Sec 3(3) provides: "... a term shall always be regarded as not having been individually negotiated where it has been drafted in advance and the consumer has not been able to influence the substance of the term." It should, however, be noted that the fact that a clause in a contract has been individually negotiated does not prevent the rest of the contract to fall within the scope of the Directive if the overall assessment of the contract shows that it is a "pre-formulated standard contract". sec 3(4)

[194] Sec. 5(1)

[195] Sec. 5(2) provides: "The contract shall continue to bind the parties if it is capable of continuing in existence without the unfair term."

[196] Sec. 4(1)

[197] Although such a provision does not, it seems, fall within the category of the "indicative and non-exhaustive" list of terms, provided by Schedule 3 of the Regulations, which may be considered as unfair, nonetheless this list, as it appears from the language of section 4(4) is not exhaustive, and a clause, falling within the scope of the definition of unfair terms, as provided by section 4(1), may still be regarded as not being binding on the consumer.

4.6. Concluding Discussion

5.078 Taking the whole discussion into account, the followings could be suggested as conclusions and propositions:

4.6.1. The Present Status of the Law in England

5.079 The law, as it stands in England, with regard to a minimum payment provided to be paid upon termination based on breach seems to be as thus:

I) Where termination of the agreement is based upon breach of a minor term (*i.e.*, a non-repudiatory breach), damages recoverable are limited to the loss up to date of termination, e.g. the arrears of rent with interest in financing transactions. Therefore, a minimum payment clause providing for a sum excessively larger than the legally recoverable amount- for instance, the innocent party's actual loss resulting from termination (i.e. loss of bargain)- is presumably doomed to be struck out as being a penalty.

II) Where a repudiatory breach (referred to as fundamental breach, breach of a fundamental term and repudiation in this context) is stipulated to be the basis of the right of the innocent party to terminate the agreement, the breach will go to the root of the contract and justify its termination at common law. The legally recoverable loss would therefore be the actual loss resulting from termination (i.e. loss of bargain) and a minimum payment clause providing for such a loss would be very likely to be upheld as a valid liquidated damages.

III) If termination has been provided to be based upon every breach of the contract by the promisor, whether repudiatory or not, the strength of the chain would be taken at the weakest link and therefore, a minimum payment clause providing for loss of bargain damages would have a rare chance of being upheld as a valid stipulation.

IV) The stipulations elevating a term into the category of conditions, like a "time of the essence" provision, have the effect of turning the breach of a minor term into a repudiatory breach giving rise to the innocent party's right to recover his actual loss resulting from termination. In such a case also, the minimum payment clause stipulating for the promisee's loss of bargain would have a chance of being upheld.

4.6.2. The Contractual Right to Terminate: Indicating the Intention for the Recoverability of loss of bargain

5.080 The present state of the law does not seem to be satisfactory.[198] To avoid the unsatisfactory, and sometimes unfair, consequences resulting from the present legal position, different solutions and arguments have been suggested.[199] It would seem that providing for the right of termination upon breach of a specific term by the promisor, in the absence of evidence to the contrary, *prima facie* indicates the intention of the parties that breach of that term would be regarded as a repudiatory breach going to the root of the agreement and enabling the promisee to recover his loss of bargain in the event of termination for that breach. The indication is even stronger where the parties expressly provide for a minimum payment clause to the effect that loss of bargain damages (or even greater than that in case of the clause being a penalty) would be recoverable upon the exercise of the contractual right to terminate by the promisee for the other party's breach. As a result, a minimum payment clause providing for the recoverability of the promisee's loss of bargain upon the exercise of his contractual right to terminate for the promisor's breach should- in any event, whether the breach is apparently serious or trivial- be upheld. For, in fact, although the loss which the parties are supposed to pre-estimate when entering into the contract and agreeing on the minimum payment clause- as it was submitted earlier[200]- should not be taken as confined to the legally recoverable loss[201], nevertheless, according to the above argument, assuming that the parties have conferred the right of termination upon the promisee for the other party's breach, loss of bargain is the loss which should also be recoverable at common law. Therefore, a clause providing for such a loss as an agreed damages clause (in the form of minimum payment) should not be struck out as being a penalty. Several reasons support this proposition:

4.6.3. Reasons Supporting the Proposal

5.081 **I) Basically, as to the assessment of the promisee's damages, the distinction**

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[198] See *supra.*, para. 5.067

[199] These suggestions and arguments for them were in detail considered. see *supra.*, paras. 5.068 *et seq.*

[200] *Supra.*, para. 2.14; Also see above, paras. 5.016 *et seq.*

[201] Assuming the force of this submission, even where conferring the right of termination is not taken as making the breach upon which the termination is based a repudiatory breach and so the legally recoverable loss is supposed to be determined by reference to the nature of breach, the minimum payment clause providing for the promisee's actual loss resulting from termination based on breach (i.e. his loss of bargain) should be regarded as a valid stipulation.

traditionally made between termination upon a contractual right for the promisor's repudiatory breach and such termination based on the promisor's minor breach is not without problems: **First**, providing for the promisee's right to terminate for the other party's breach, so far as the classification of contractual terms is concerned, promotes a minor term- upon breach of which the termination has been stipulated- into the category of conditions[202] so that the breach of which should be regarded as a repudiatory breach. **Second**, such a distinction, as it was referred to earlier[203], sometimes leads to unsatisfactory and unjust consequences. For instance, if, in the *Baldock*'s case, the hirer, because of being polite and genteel, had written to the finance company that he could not pay the instalments, his failure to pay rentals would have been regarded as a repudiation and the owner would, as a result, have been entitled to recover loss of bargain damages. In fact, the law which imposes a considerably great liability on the promisor, because of his politeness, should not be regarded as a good law. **Third**, it is not more than a question of form in some cases. If, for example, the parties provided for the time of performance to be of the essence, a simple term would be promoted to the category of conditions and termination for breach of that term would be regarded as entitling the promisee to loss of bargain damages. In fact, as it was suggested by some leading lawyers[204], the amount of recoverable damages, as a result of such a distinction, would depend on the skill of draftsman. Thus, it is a kind of triumph of form over substance and is not in line with the important principle of giving effect to the true intention of the parties. **Fourth**, the basis for such a distinction apparently lies in the causation theory: It has been argued that where termination merely occurs by the exercise of a contractual

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[202] See Carter J.W., Breach of Contract, 2nd ed., 1991, para. 1221 at pp. 449-450, also para. 507 at p. 100; Carter J W, The Effect of Discharge of a Contract on the Assessment of Damages for Breach or Repudiation (Part II) (1989) 1 JCL 249, at pp. 259-260; see also *Mardorf Peach & Co. Ltd. v. Attica Sea Carriers Corp. of Liberia (The Laconia)* [1977] AC 850, where a time charterparty provided for the payment of the hire semi-monthly in advance. It further provided under clause 5: "... failing the punctual and regular payment of the hire, ..., or on any breach of this charterparty, the owners shall be at liberty to withdraw the vessel from the service of the charterers ...". The hirers failed to pay a single instalment of hire on time, and the shipowners withdrew the vessel and, in effect, terminated the operation of the contract. All members of the House of Lords had no doubt as to the validity of such a provision, and the effectiveness of the withdrawal for the hirer's breach. In effect, the hirer's contractual obligation to pay the instalment of hire on time acted as a condition, for the contract provided for the shipowner's right to terminate upon failure to make a punctual payment.

[203] See above, paras. 5.062-5.063

[204] See Furmston M P, Contract Planning: Liquidated Damages, Deposits and the Foreseeability Rule (1991) 4 JCL 1, at p. 9

right to terminate in the absence of a repudiatory breach, loss of bargain results from the promisee's own act in exercising his right to terminate. Had he not exercised this right, he would not have suffered the loss of the whole transaction. As a result, the promisee should bear the losses which results from his own act. This basis, however, does not reflect the reality and sometimes gives the defaulting promisor a windfall[205]: In commercial relations, the purpose of providing for the right of termination is mainly to save the time and expense by avoiding the necessity of having recourse to the problematic case law in respect of proving a fundamental breach or a repudiation. Compelling the promisee, after exercising this right, to prove a repudiatory breach to enable him to recover his actual loss resulting from termination- by arguing that such a loss, in the absence of a repudiatory breach, has been resulted from the promisee's own act- would be regarded as forcing him to something which the parties have intended to avoid. This, in fact, pays insufficient attention to the realities of commercial life and merely adds to the time and expenses of litigation.[206] This artificial separation between the promisor's breach and the promisee's right of termination, as it has been suggested in some Australian cases[207], is a distinction between "legal fault" and "legal liability" and "lie[s] ill with modern notions of causation and remoteness in the law of contract".

5.082 Furthermore, it would seem that in determining the recoverable amount of damages, much attention should be paid to the intention of the parties[208]: Where the parties expressly stipulate for a clause providing that the promisee's loss of bargain would be recoverable in the event of termination for the promisor's breach, effect should be given to such a stipulation. Thus, for instance, a minimum payment clause providing for the owner's loss of bargain to be recovered upon the exercise of the promisee's right of

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[205] Clarke, Mr Justice M.J.R., Commentary on Professor Furmston's article entitled "Contract Planning: Liquidated Damages, Deposits and the Foreseeability Rule" (1991) 4 JCL 11, at p. 12

[206] See Carter J W, The Effect of Discharge of a Contract on the Assessment of Damages for Breach or Repudiation (Part II) (1989) 1 JCL 249, at p. 263; also Carter J.W., Breach of Contract, 2nd ed., 1991, para. 1222 at p. 452

[207] *AMEV-UDC Finance Ltd. v. Austin* (1986) 162 C.L.R. 170, per Deane J at p. 206 ; See also Chin, Nyuk Y, Finance Leases and Loss of Bargain: Judicial Impulses in the High Court (1993) 23 University of Western Australia Law Rev. 279, at pp. 292-293

[208] On this point and contrasting the intention theory with the theories of causation and nature of breach: see Carter J W, The Effect of Discharge of a Contract on the Assessment of Damages for Breach or Repudiation (Part II) (1989) 1 JCL 249, esp. at pp. 252-253, 263

termination for the hirer's breach should be valid and enforceable. The causation theory and the nature and extent of the breach, for the reasons referred to above, should not be regarded as a bar to achieve this result where termination is based upon breach of a minor term. Where there is no express intention as to the recoverable damages, attention should be paid to the implied or imputed intention of the contracting parties. As it was suggested, providing for the right of termination, in the absence of a contrary evidence, *prima facie*, indicates the parties' intention that the actual loss flowing from termination (*i.e.* loss of bargain) would be the recoverable damages.[209] It is submitted that the implied intention of the parties in this relation should be regarded as effective and enforceable. Where, also, the minimum payment clause, because of being in excess of the actual loss resulting from termination, is held to be a penalty, again it would seem that the penalty clause, at least, gives the impression that the parties intended loss of bargain to be the recoverable damage in the event of termination.[210] Having regard to such an intention, loss of bargain damages should be considered as the promisee's recoverable damage.

5.083 II) This view is in line with cases like *the Solholt* case[211] in which the Court of Appeal assumed without any doubt that loss of bargain was the recoverable damages, where the buyers had exercised their right of termination for the seller's minor breach in being late in delivery. Moreover, in this case, Donaldson M.R., in the course of his speech, emphasized on the point that the buyers' actual loss should be attributed to the breach, not to the act of the buyers in terminating the agreement:

> "It is trite law that in deciding whether or not to exercise a right to cancel the contract in such circumstances, the buyer need have no regard to the fact that in the absence of cancellation he would suffer no loss. If he cancels, the loss will be attributable to the sellers' breach of contract and not to the cancellation."[212]

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[209] See Cornwell P, Commentary on "Termination Clauses by Carter" (1990) 3 JCL 126, at p. 128

[210] See Goode R M, Penalties in Finance Leases (1988) 104 L.Q.R. 25, at p. 28, proposing also the alternative argument that the penalty clause may be held to be enforceable up to the actual loss resulting from termination; Carter J W, Termination Clauses (1990) 3 JCL 90, at p. 119; Cornwell P, Commentary on "Termination Clauses by Carter" (1990) 3 JCL 126, at p. 129

[211] *Sotiros Shipping Inc v. Sameiet Solholt* [1983] 1 Lloyd's Rep. 605; see *supra.*, para. 5.073

[212] *Ibid.*, at p. 607

5.084 **III)** The view is also in complete conformity with the true nature of financing transactions. As it was discussed earlier[213], the true nature of these agreements is to extend finance and to provide for a real right in the subject-matter for the financier to secure the repayment of the extended finance. Thus, in such a transactions, the financier's legitimate expectation is to get his extended sum of money with a proper interest and this, in fact, justifies any provision for the recovery of loss of bargain in the event of termination. Presumably, even in the absence of a minimum payment clause, providing for the right of termination for the hirer/lessee's default in such transactions should be taken as an indication that the financier intends to achieve his reasonable expectation, i.e. the recovery of loss of bargain in the event of a premature termination of the agreement.

5.085 **IV)** The view is also supported by the decision of the Supreme Court of Canada in *Keneric Tractor Sales Ltd. v. Langille*[214], a case concerning an agreement to lease certain pieces of agricultural equipment. The contract gave the lessor, in the event of default by the lessee, an option to terminate the agreement, and repossess and sell the equipment. Upon termination, the contract provided for the liability of the lessee to pay "the difference between (a) the sum of all rentals called for by the lease plus an amount equal to twenty (20) percent of the aggregate minimum rental charge for the unexpired portion of the lease term ... and (b) the sum of all rental paid and proceeds of the sale". The lessee's other option under the contract was to claim damages at law. The lessors failed to pay the rentals after the first year of the agreement. The lessee, relying on its contractual right, repossessed the equipment, sold it and claimed damages. The apparent ground of the claim for damages was the agreement of the parties as to the recoverable loss in the event of termination, but, in fact, as it was pointed out by Hart J.A. in the Nova Scotia Court of Appeal[215], it was grounded on the recovery of damages in general common law. The trial judge, having found that the plaintiff had acted reasonably in disposing of the equipment, calculated the lessor's damages by deducting from the agreed value of the equipment, the amount of rentals already paid, adding the percentage margin

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[213] See above, paras. 5.005 *et seq.*

[214] [1987] 2 S.C.R. 440 , (1988) 43 D.L.R. (4th) 171; see Ziegel J S, Damages for Breach of Finance Leases in Canada (1988) 104 L.Q.R. 513

[215] The decision of the Court of Appeal has been reported in *Langille v. Keneric Tractor Sales Ltd* (1985) 19 D.L.R. (4th) 652, see at p. 656 per Hart J.A.

(which was a contractual basis for computing the rent), and then deducting the net proceeds of the sale. The appeal to the Nova Scotia Court of Appeal and the Supreme Court of Canada were dismissed.

In the Supreme Court, one of the issues raised was the question whether the assessment of damages would have made any difference, had it been proved by the lessee that the breach had not been a repudiatory breach.[216] In other words, the question was whether loss of bargain damages should be confined to cases where termination was based on a repudiatory breach rather than a case where the agreement was terminated merely by the exercise of a contractual right to terminate. The Supreme Court of Canada answered these questions in negative. Wilson J., in the course of her judgment, stated:

> "Repudiation may be triggered by either the inability or the unwillingness of a party to perform his contractual obligations. The same is true of a breach of contract that gives rise to a right to terminate; it may be the result of inability or unwillingness to perform. The breach and the repudiation are merely subdivisions within a general category of conduct, i.e., conduct which gives the innocent party the right to treat the contract as terminated. Thus, there is no conceptual difference between a breach of contract that gives the innocent party the right to terminate and the repudiation of a contract so as to justify a different assessment of damages when termination flows from the former rather than the latter. General contract principles should be applied in both instances."[217]

Although the decision of the court as to the assessment of loss of bargain damages, because of not giving a credit for the accelerated receipt of the future instalments[218], may be criticized, nonetheless the reasoning put by Wilson J., giving the leading judgment of the court, clearly supports our proposed view.

4.6.4. Validity of a Minimum Payment Providing for the Recovery of loss of bargain

5.086 As a final point, it should be concluded that in any event, the minimum payment

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[216] In Wilson J.'s words, "[t]he question at hand is whether the assessment of damages in a case of termination based on breach of a term of the contract should be any different from the assessment of damages in a case of termination based on repudiation". see (1988) 43 DLR (4th) 171, at p. 180

[217] *Keneric Tractor Sales Ltd. v. Langille* [1987] 2 S.C.R. 440 , (1988) 43 D.L.R. (4th) 171, at pp. 454 and 180 respectively

[218] Contrast the decision of the Court of Appeal in *Anglo Auto Finance Co. Ltd. v. James* [1963] 1 WLR 1042

clause providing for the promisee's loss of bargain to be recovered in the event of termination for the promisor's breach should be upheld *either* for the reason that such a loss, as it was submitted, is the legally recoverable loss where the right of termination for the promisee is provided for in the event of any breach by the promisor, *or*, even assuming that loss of bargain is the recoverable damage only where the breach is repudiatory, on the ground that the parties, in agreeing as to the minimum payment as an agreed damages clause, should not be taken as confined to the legally recoverable loss, but they can pre-estimate the actual loss resulting from termination, even if it is not recoverable in an action for unliquidated damages at common law.

5. Factors to be Taken into Account in Drawing up a Minimum Payment Clause

5.1. General Remarks

5.087 Under the present status of English law, where termination is provided to be exercised for a non-repudiatory breach or for every breach, whether serious or trivial, the minimum payment clause providing for the promisee's loss of bargain would be very likely to be a penalty, for it is excessively large in comparison with the legally recoverable loss [i.e. the arrears of rent with interest]. Hence, in such a situation, in order to be valid, the clause should not greatly exceed the legally recoverable amount. Where, however, the termination clause is provided to be activated for a repudiatory breach, loss of bargain would be recoverable and the minimum payment clause providing for the promisee's loss of bargain would be a valid stipulation.

The present law, however, has been criticized: The proposition supported by different arguments is that where a right of termination is provided for the promisee in the event of breach, whether repudiatory or not, the minimum payment clause providing for the promisee's loss of bargain should be upheld. This loss of bargain is the actual loss to the promisee resulting from termination for breach. In many commercial contracts, such a loss is computed as a difference between the contractual price of the promisor's performance and its market price at the time when the breach occurs.[219] In financing

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[219] Carter J W, The Effect of Discharge of a Contract on the Assessment of Damages for Breach or Repudiation (Part II) (1989) 1 JCL 249

transactions, however, determining loss of bargain and drawing up the minimum payment clause in a way to include that, and not to exceed it greatly, is of considerable importance.

5.088 In such a transaction, for the clause to be valid, two important factors should be taken into consideration: **First**, the future instalments contain a considerable amount of interest. In premature termination of the agreement and providing for loss of bargain damages upon that, a proper credit should be given for such an interest.[220] That is because the promisee recovers the future instalments before the due termination of the agreement and for this accelerated realisation, a proper rebate as to the interest element in such instalments should be given. **Second**, it is normally provided that upon termination the creditor has the right to repossess the subject-matter of the agreement and resell it. The amount realised in such a sale is the second element which needs to be taken into account. In other words, a proper allowance should be given for the increased value to the creditor, resulting from repossession.[221]

5.089 In this regard, the issues which need to be discussed in detail are as follows: I) As to giving a rebate for the interest element in future rentals, what amount of discount should be given? Should the recoverable amount be the present value of future instalments, or should the interest [*i.e.* finance charge] as computed in making the contract be deducted from the future instalments? II) The conduct of the creditor in selling the repossessed equipment and giving credit for the realisable value in different kinds of financing transactions. III) After repossessing the equipment, does the creditor have any duty to mitigate his loss by conducting in a suitable way in disposing of the equipment. These issues will, in turn, be discussed here.

5.2. How to Discount Future Instalments?

5.090 There is no doubt that in computing loss of bargain damages resulting from

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[220] Fridman G H L, The Decline of a Claim for Damages: A Moral Tale (1963) 26 M.L.R. 198, at p. 202; Meagher R P, Penalties in Chattel Leases (Chapter 3 of "Essays in Equity, by Finn, P D"), 1985, at p. 54; Barnes T., Agreed Damages Clauses in Financing Contracts in the Light of Citicorp Australia Ltd. v Hendry [1986] A.B.L.R. 63, at p. 67; *Bridge v. Campbell Discount Co. Ltd.* [1962] AC 600, per Lord Radcliffe at p. 625

[221] Fridman, *ibid.*; Meagher, *ibid.*; Barnes, *ibid.*; *Bridge v. Campbell Discount Co. Ltd., ibid.*

premature termination of the agreement for the promisor's breach, the future instalments should be properly discounted.[222] The important issue, however, is how this rebate should be computed. Two related views might, in this relation, seem relevant: **First**, the rebate should be assessed according to the percentage return which the creditor himself has contracted for. In other words, the whole finance charge [or interest] element should be taken away from the future instalments by giving a discount at the rate in which the finance charge has been computed when the contract has been entered into. This seems to be the accepted view in the cases of *Yeoman Credit, Ltd. v. McLean*[223] and *Overstone, Ltd. v. Shipway*[224]. In the latter case, in describing the assessment of Master Jacob in the former, Holroyd Pearce L.J. pointed out:

> "As a means of arriving at the correct figure, he [Master Jacob] calculated the interest rate implicit in the hire-purchase charges, and gave credit at that rate for sums received by the owners before their due date. ... But the learned master rightly pointed out that, in assessing damages, the function of the court is not to act as mathematicians, but to endeavour to ascertain the amount of the loss suffered by the injured party and, so far as money could do it, to put the injured party in the same position as if the contract had been performed. I entirely agree with the method suggested by the learned master as a convenient guide to the figure that one is seeking to find. It is not a question of exact calculation."[225]

Although the passage quoted above shows that the assessment of rebate is "a matter of impression to be fixed by the court on a broad view and not by precise mathematical computation"[226], nevertheless the tendency of the courts in both cases mentioned above was to assess the amount of rebate by reference to the percentage return, i.e. the rate upon which the creditor himself had computed the finance charge when entering into the

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[222] The reason for this simply is that the financier, by recovery of loss of bargain in the event of termination would be able to receive future payments immediately rather than within a specified contractual period of time. Therefore, a proper rebate should be given as to the interest element in future instalments which has been added to the capital outlay because of the contractual provision for its periodic repayment by instalments. Among the authorities which support this, the observations of Pearce L.J. in *Overstone, Ltd v. Shipway* [1962] 1 All ER 52, might deserve mention; the Lord Justice, in assessing the financier's loss resulting from the premature termination of the contract, relying on the decision of Jenkins L.J. in *Interoffice Telephones, Ltd. v. Robert Freeman Co. Ltd.* [1957] 3 All ER at p. 482, [1958] 1 QB at p. 195, stated: "Some discount should be allowed on the ground that the plaintiffs had received back their money earlier than they would have done if the contract had been fulfilled." *Ibid.*, at p. 57

[223] [1962] 1 WLR 131

[224] [1962] 1 All ER 52

[225] *Ibid.*, at pp. 57-58

[226] Goode R.M., Hire-Purchase Law and Practice, 2nd ed., 1970, p. 400

agreement.

5.091 This view seems to be subject to a serious objection: The purpose of providing for the creditor's right to recover his loss of bargain is to put him in a place in which he would have been had the contract been performed. As a result, even though by interest rates remaining in a steady status, the assessment of the discount by a reference to the percentage return may result in fair consequences, nonetheless if the interest rates changed between the times of assessing the finance charge and the discount, referring to the percentage return, in order to compute the discount rate, would not do justice either to the creditor or the debtor. This is because, where the usual interest rate was much lower than the rate by which the finance charge had been computed, the creditor would get an amount of the future instalments which even by reinvesting them for the remaining period of time at the usual interest rate, he would not be able to get the expected value of the former contract; in other words, he would not be in a position in which he would have been had the debtor performed his agreement. On the other hand, if the usual interest rate was higher than the percentage return, then the creditor would be in a much better position than a situation where the debtor had completed his contract. This criticism leads us to the second view in assessing the discount.

Second, the creditor should be given the right to recover the present value of the future instalments.[227] The discount rate, therefore, need not necessarily eliminate the whole interest element in the future instalments, even though it might do that where the usual interest rate at the time of termination is equal to the percentage return. According to this view, in assessing the discount rate, the usual interest rate at the time of termination should be taken into account. By using this rate, in fact, the creditor will get the present value of the future instalments which by reinvesting them for the remaining contractual period, he could be presumed to be at a position in which he would have been if the main contract had been completed by the debtor. There still, however, remains another problem: the creditor, by getting the present value of the future instalments, is deprived of the interest he would have supposed he would acquire had the contract run its full course.

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[227] Meagher R P, Penalties in Chattel Leases (Chapter 3 of "Essays in Equity, by Finn, P D"), 1985, at p. 54

He may not immediately be able to invest his money in other transactions, and thus he may lose the contractually stipulated interest for a period of time in which he is unable to reinvest. This is, it appears, a relevant factor which should be taken into account in calculating the creditor's loss, and the parties, especially the creditor, should be allowed to provide for precautions to avoid such a loss when they enter into the contract. In practice, the creditor is stipulated to be entitled for the interest for a certain period of time, e.g. three months, in which he would reasonably be able to reinvest his money.

5.092 Two small points need to be made here: I) In agreeing as to the minimum payment clause, the contracting parties might refer to the usual interest rate as the discount rate at the time of termination; or to be precise, they might relate the discount rate to a suitable objective list such as a specific bank interest rate or the rate of a particular financial institution. II) It should be noted that in order to determine the nature of an agreed damages clause, the test is whether the parties' pre-estimation is ***excessively*** large in comparison with the actual loss resulting from breach.[228] Therefore, even where the discount rate in the minimum payment clause is not a precisely specific rate, it should not, it is submitted, affect the validity of the minimum payment clause if the clause does not amount to an excessively large sum in comparison with the creditor's actual loss resulting from termination.

5.3. Giving Credit for the Increased Value to the Creditor Resulting from Repossession

5.093 For a minimum payment clause to be valid, a proper allowance for the increased value to the creditor resulting from repossession and disposing of the subject-matter should be given. This allowance is rather differently achieved in different financing transactions: In some financing contracts, like hire-purchase agreements, the subject-matter is provided to be purchased by the hirer at the end of the contractual period by exercising his option. In such agreements, the assumption is that the subject-matter does not come back to the owner's possession, except where the contract is prematurely terminated and the owner exercises his contractual right of repossession. Therefore, there is no residual value provided for in the agreement. On the other hand, in some

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[228] See *supra.*, paras. 2.26-2.27, 2.35

financing transactions, like leases, in which the subject-matter of the agreement is normally provided to come back to the lessor's possession at the natural termination of the agreement, a residual value, which reflects the expected value of the subject-matter at the end of the contract, is provided for.

5.094 In contracts of hire-purchase nature, the allowance should be given to the realisable value of the subject-matter at the time of repossession. This value is normally determined either by the resale value of the subject-matter where the owner sells it after repossession in a properly conducted sale, or by the price fixed in the certificate of an independent valuer if he does not.[229] However, in agreements like leases, where the realisable value of the subject-matter, which is determined as above, exceeds the residual value as provided for in the contract [or its true value at the end of the lease if the residual value is not provided for in the agreement], an allowance should be given for the difference between the realisable value and the residual value of the subject-matter. Clearly, the parties may provide for the difference between these two values to be taken into account as a part of minimum payment, where the realisable value of the subject-matter is less than its residual value.

5.095 It should be noted that in either case, the cost of repossession and any sums which are normally necessary to be spent to put the subject-matter in a resaleable condition[230] may be provided for to be taken away from the realisable value of the subject-matter.

5.4. The Creditor's Duty to Mitigate his Loss

5.096 Generally, the innocent party who has suffered loss for the other party's breach has the duty to take reasonable steps to mitigate his loss. His failure in this relation would confine him to recover his damages only to the extent that he would have been entitled to had he taken such reasonable measures to minimize his loss. This general rule seems to apply with equal force to a situation where the parties have stipulated for a minimum payment clause providing for the promisee's loss of bargain resulting from termination for the promisor's breach. In financing transactions, where the repossession and resale of the

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[229] See Meagher R P, Penalties in Chattel Leases (Chapter 3 of "Essays in Equity, by Finn, P D"), 1985, at p. 55

subject-matter is provided for as a right of the creditor in the event of default by the other party, the duty of mitigation mainly arises in relation to taking reasonable measures in disposing of the repossessed subject-matter by the creditor. In fact, one of the criticisms which is frequently open to the finance companies is their manner of disposing of the repossessed goods. Such companies, relying on their contractual right under the minimum payment clause to recover their loss of bargain damages, normally dispose of the repossessed subject-matter at low prices. That is why it has been sometimes suggested that the minimum payment clauses encourage either the creditor to be careless in his way of disposing of the repossessed goods[231]; or the hirers/lessees to dispute the sum for which the repossessed subject-matter could have been disposed of by the creditor.[232]

5.097 In any event, the duty of the creditor to minimize his loss by taking reasonable measures in disposing of the repossessed goods would seem to be beyond doubt[233], even though there are some suggestions[234] that in computing the creditor's loss of bargain no allowance for any mitigation of damages should be made. In fact, suggestions of this kind imply the duty of mitigation where a chattel leased is truly unique; in other situations, however- considering that after repossession, the creditor is left with one less leased chattel than would be the case if there were no breach[235]- the duty of mitigation has been denied. It would seem that the measures which the creditor should take to

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[230] See in general Meagher, *ibid.*, at p. 54

[231] See Ziegel, Jacob S., The Minimum Payment Clause Muddle [1964] C.L.J. 108, p. 110

[232] Molony Committee on Consumer Protection, 1962 report, Cmnd. 1781, para. 548 (cited also in *ibid.*, p. 128); One can see here the advantage of a suggestion (see *supra.*, para. 41) that the creditor can leave the subject-matter in the hirer/lessee's possession and claim for the arrears of rent and all future instalments, giving credit to the accelerated receipt of them, under a minimum payment clause which provides so.

[233] See e.g. *Bridge v. Campbell Discount Co. Ltd.* [1962] AC 600, in which, on remission of the case to the County Court to assess the owners' loss, the question was whether the owners had acted reasonably in mitigating their loss by trying to obtain the best price available in the resale of the repossessed vehicle. The County Court judge, considering the facts of the case and all surrounding circumstances concluded that the owners, by resale for cash, had not disposed of the vehicle in the best possible way, and had they done so, their loss would have been confined to £26, not the £303 that they had actually claimed. See also Fridman G H L, The Decline of a Claim for Damages: A Moral Tale (1963) 26 M.L.R. 198, at p. 202

[234] Meagher R P, Penalties in Chattel Leases (Chapter 3 of "Essays in Equity, by Finn, P D"), 1985, p. 55

[235] *Ibid.*

minimize his loss depends on the terms of the contract and all surrounding circumstances.[236] The creditor is not necessarily supposed to lease the repossessed goods for the remaining contractual period to be taken as relieved from his duty of mitigation. His manner in disposing of the goods would be reasonable if, considering the terms of the agreement and all circumstances, he, objectively, chose the best way in this regard. Therefore, he may sell the repossessed goods, as it is the situation in so many cases, for cash and there is no doubt, even from the writers who suggested the negation of the duty of mitigation, that in such a situation, the goods should be sold "at a properly conducted sale."[237] The duty to sell the goods "at a properly conducted sale" is not anything but taking reasonable steps to mitigate the loss. It would, therefore, seem that, despite the objections which have been apparently raised, the creditor's duty of mitigation is an accepted principle.

5.098 As it was referred to, the terms of the contract and all surrounding circumstances should be taken into consideration in determining whether the creditor has taken reasonable steps to mitigate his loss. The realities of commercial life also should not be ignored.[238] In particular, as it was pointed out by Professor Goode, the following should be borne in mind:

> "(a) finance houses do not have facilities for selling direct to the public ... so that they are obliged to sell to dealers either at auction or by private treaty thus obtaining at best the trade price not the retail price; (b) it is commercially desirable for the finance house to sell repossessed goods as rapidly as possible rather than seeking to hold out for a higher price which they might not obtain, since the value of the goods will depreciate with the passage of time and storage and insurance are expensive; (c) dealers are well aware of these difficulties and are thus in a position to drive a hard bargain; (d) in a great many cases repossessed goods have been neglected and misused in the hands of the hirer and come back to the finance house in a deplorable condition; and (e) the briskness of trade, for resale purposes, is very much dependent on the stringency of terms control, and in a period of high deposit requirements dealers may be reluctant to add to

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[236] See Goode R.M., Hire-Purchase Law and Practice, 2nd ed., 1970, p. 403: "What is reasonable depends on the circumstances and no dogmatic rule can be laid down."

[237] Meagher R P, Penalties in Chattel Leases (Chapter 3 of "Essays in Equity, by Finn, P D"), 1985, at p. 55

[238] Goode R.M., Hire-Purchase Law and Practice, 2nd ed., 1970, at p. 403

existing stock."[239]

5.099 It might be suggested that re-letting the repossessed goods in the form of hire-purchase or lease, is what a reasonable creditor should do rather than disposing of the goods in a resale for cash.[240] Although in some rare situations this proposition might be practical, nonetheless in most financing transactions where a finance house is involved, this view does not conform with the realities of commercial life. That is because; **first**, the finance house is not commercially in the trade of selling or letting goods to public but its trade is to extend finance to customers through dealers; **second**, even where the creditor can find a retail purchaser rather than a dealer to dispose of the goods, it is difficult for him to turn down a cash offer merely to preserve an opportunity to dispose of the goods in the form of hire-purchase or lease elsewhere[241]; **third**, assuming that he is able to re-let the repossessed goods, then the main difficulty is that, until the end of the new agreement, it is not possible to determine the amount realised from disposing of the goods to credit that amount to the old hirer/lessee in assessing the recoverable damages.[242]

6. Australian Law

6.1. General Remarks

5.100 The law, as to the application of the penalty doctrine to minimum payments provided to be paid upon termination of the contract for breach, in Australia, is moving towards a more satisfactory position. The distinction between repudiatory and non-repudiatory breaches upon which the termination of an agreement may be based, in determining the nature of a minimum payment clause, by the recent decisions of the High Court of Australia in *AMEV-UDC Finance Ltd. v. Austin*[243] and *Esanda Finance Corporation Ltd. v. Plessnig*[244] has now been to a large extent eliminated and a single

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[239] Goode, loc. cit., at p. 403, note 5

[240] See *Bentworth Finance, Ltd. v. Jennings* (1961) 111 L. Jo 488

[241] Goode R.M., Hire-Purchase Law and Practice, 2nd ed., 1970, p. 404

[242] See *ibid.*

[243] (1986) 162 C.L.R. 170

[244] (1988-89) 166 C.L.R. 131

unique approach is apparently applied irrespective of the fact whether termination has been based on a repudiatory or non-repudiatory breach. Such an approach which is in line with giving effect to the express intention of the parties should be welcomed. There are, however, still some uncertainties about determining the unliquidated damages of the innocent party where the agreement of the parties as to the minimum payment, for any reason, constitutes a penalty, though there are some judicial statements[245] to the effect that the innocent party's actual loss resulting from termination should be recoverable even where the minimum payment clause is held to be a penalty, regardless of the kind of breach upon which the termination has been based. It should be hoped that in completing this welcome move, such judicial statements will be given legal force, by reconsidering the subject in future cases. This section will thus be devoted to exploring the position of the Australian law as to the application of the penalty doctrine to minimum payments provided to be paid in the event of termination for breach in some detail, and will also deal with the prospect of the movement started in Australian courts as to this issue.

6.2. Measure of Damages Recoverable: Loss up to the Date of Termination in the Event of a Non-repudiatory Breach

5.101 Like English law, the damages which were recoverable for termination of the agreement following a breach by the promisor, *prima facie* was loss of bargain.[246] This principle, before the decision of the High Court in *Shevill v. The Builders' Licensing Board*[247], was applicable to commercial contracts. As a result, a minimum payment clause which provided for the actual loss resulting from termination to be recoverable by the innocent party upon termination of the agreement by him for the other party's breach was *prima facie* a valid stipulation, regardless of whether the breach upon which the termination was based was a repudiatory breach or not.[248] A shift towards the principles laid down by the decision of the English Court of Appeal in *Financings Ltd. v.*

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[245] See the judgements of Deane and Dawson JJ. in *AMEV-UDC Finance Ltd. v. Austin* (1986) 162 C.L.R. 170: *infra.*, paras. 5.111-5.113

[246] Carter J W, Termination Clauses (1990) 3 JCL 90, at p. 111

[247] (1982) 56 A.L.J.R. 793, (1982) 149 C.L.R. 620

[248] See e.g. *I.A.C. (Leasing) Ltd. v. Humphrey* (1972) 126 C.L.R. 131, It should be noted that in our discussion the phrase "repudiatory breach" refers to breach of a fundamental term, fundamental breach of the contract and repudiation; and therefore the breach of a minor term which does not result in any of the above consequences is referred to by a "non-repudiatory breach".

Baldock[249], appeared in Australia by *Shevill v. The Builders' Licensing Board*[250], which to some extent can be referred to as the Australian copy of *Baldock*'s case. As a result of this case, recovery of loss of bargain damages was confined to cases in which termination had been based on a repudiatory breach. Where, therefore, the promisee exercised his contractual option to terminate the contract for a breach of a minor term by the promisor (i.e. a non-repudiatory breach), the recoverable amount was limited to the loss up to the date of termination. The reasoning behind this decision was the known argument that in the event of a termination for a non-repudiatory breach, the loss flowing from termination results from the promisee's own act in exercising his option to terminate the contract and cannot be attributed to the breach.

5.102 In this case, in a contract for the lease of land, it was provided that in the event of, among other events, the lessee's default in punctual payment and the rent remaining unpaid for 14 days, the lessor had the right to re-enter the land. The right of re-entry, it was stipulated, was without any prejudice to the lessor's action for damages. The lessee having defaulted in the payment, the lessor claimed repossession and sued the defendants, the guarantors of the lessee, for damages. The judge at first instance awarded damages amounting to the outstanding balance of the instalments. An appeal to the Court of Appeal being dismissed, the guarantors appealed to the High Court. The High Court, allowing the appeal, held the guarantors liable only for nominal damages, arguing that the lessee's breach in punctual payment was not a repudiatory breach: Loss of bargain, therefore, was caused by the lessor's own act in determining the contract and could not be attributed to the lessee's breach. Thus, the lessors were entitled only to damages up to the date of termination, i.e. the unpaid instalments up to the date of repossession together with the cost of repossession and interest. Although the decision of the High Court in this case was contrary to some Australian authorities, like *Larratt v. Bankers and Traders Insurance Co. Ltd.*[251], and some English cases, like *The Solholt*[252], it was nonetheless

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[249] [1963] 2 QB 104, [1963] 1 All ER 443

[250] *Shevill v. The Builders' Licensing Board* (1982) 56 A.L.J.R. 793, (1982) 149 C.L.R. 620

[251] (1941) 41 S.R.(N.S.W.) 215, in which Sir Frederick Jordan stated: "Where [an agreement] is avoided by virtue of an express right of avoidance, the consequences which flow from an avoidance depend on the intention of the parties, actual or imputed, and in the absence of some express or implied indication of intention to the contrary, are governed by the ordinary law applicable to the avoidance of contracts for

applied in subsequent cases.[253]

6.3. The Effect of Elevating a Term into the Category of Conditions

5.103 In the *Shevill*'s case[254] itself, *though* conferring the right of termination was not considered as sufficiently indicating the implied intention of the parties as to the recoverability of the actual loss resulting from termination for breach, *yet* the power of the contracting parties to promote an apparently minor term into the category of conditions, so that the breach of which would entitle the promisee to recover his loss of bargain, was recognized. Gibbs C.J., having considered that a covenant to pay rent at specified times would not clearly constitute a fundamental or essential term with the effect that any failure, even minor, would entitle the lessor to terminate the agreement at common law, stated:

> "However, the parties to a contract may stipulate that a term will be treated as having a fundamental character although in itself it may seem of little importance, and effect must be given to any such agreement."[255]

The chief justice, however, thought that a contractual right to terminate upon breach was not enough in itself to show the common intention of the parties for the recoverability of loss of bargain upon such a termination. He said:

> "... it would require very clear words to bring about the result ... that whenever a lessor could exercise the right given by the clause to re-enter, he could also recover damages for the loss resulting from the failure of the lessee to carry out all the covenants of the lease- covenants which, in some cases, the lessee might have been both willing and able to perform had it not been for the re-entry."[256]

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breaches of essential promises." at pp. 225-226

[252] *Sotiros Shipping Inc v. Sameiet Solholt* [1983] 1 Lloyd's Rep. 605

[253] See e.g. *Austin v. United Dominions Corporation Ltd.* [1984] 2 N.S.W.L.R. 612 ; *Progressive Mailing House Pty. Ltd. v. Tabali Pty. Ltd.* (1985) 157 C.L.R. 17, in which, upon the authority of the *Shevill* case, it was held that where the exercise of the power to terminate was based upon a repudiatory breach, the party in default would be liable for loss of bargain damages. ; The same reasoning on which the *Shevill* case was based was followed in *Lessors (Aus) Pty v. Westley* [1964-5] N.S.W.R. 2091, and it was also mentioned without disapproval in *O'Dea v. Allstates Leasing System (WA) Pty. Ltd.* (1983) 57 A.L.J.R. 172, (1983) 45 A.L.R. 632; see also the application of this principle in *AMEV-UDC Finance Ltd. v. Austin* (1986) 162 C.L.R. 170: *infra.*, paras. 5.107 *et seq.*

[254] *Shevill v. The Builders' Licensing Board* (1982) 56 A.L.J.R. 793, (1982) 149 C.L.R. 620

[255] *Ibid.*, at p. 627

[256] *Ibid.*, at p. 628

5.104 In *Citicorp Australia Ltd. v. Hendry*[257], in a contract for the lease of three cranes, a clause to the effect of elevating every term into the category of conditions, by stipulating for the time of the lessee's performance of his contractual obligations to be of the essence, was provided for. (cl. 9.19) The parties also agreed that in the event of the lessee's breach in punctual payment and continuance of the default for 7 days, the whole unpaid balance of the rent ("less a rebate in respect of the rent instalments not then accrued due to be ascertained by applying the rate of ten (10) per centum per annum...") would become due and the lessors would have the right to retake possession of the goods. (cl. 10.0) Upon retaking the possession of the subject-matter, it was provided that the goods should be disposed of by the lessors at the best price which reasonably could be obtained: if the realisable value was less than the residual value, as stipulated in the contract, the lessee was liable to pay the difference and if it was more than the residual value, the excess was to be set off against any unpaid rent for the unexpired portion of the lease. (cl. 11.2)

The lessee having failed to pay instalments, the lessors claimed from the defendants, the guarantors of the lessee, the amount provided for in the minimum payment clause. The New South Wales Court of Appeal held that the stipulated sum amounted to a penalty. The judgment was mainly based on the two following grounds: **First**, the rebate stipulated to be given as to the future instalments of rent, considering the percentage return which the lessor expected to receive, was too small so that the minimum payment could not be regarded as a genuine pre-estimate of the lessor's actual loss. **Second**, the parties, entering into the contract, were supposed to pre-estimate the legally recoverable loss resulting from breach; since this loss- considering that the lessee's breach in the punctual payment of the rental instalment could not be regarded as a repudiatory breach- was the loss up to the date of repossession, the minimum payment providing for the actual loss resulting from termination would not have a chance of being upheld as liquidated damages. Mahoney J.A., relying on the latter argument, rejected the lessor's contention that the agreed damages clause had been provided for the actual loss rather than the legally recoverable loss, arguing that "the law of penalties is based upon a policy

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[257] (1985) 4 N.S.W.L.R. 1

of limiting recovery to the damages recoverable at law"[258].

5.105 As to the effect of the "time of the essence" clause, Mahoney J.A. thought that cl. 9.19 could not sufficiently indicate that the parties had intended the obligation as to the punctual payment to be a condition, because the clause related to all obligations of the lessee, some of which were to be performed within a *reasonable* time. Furthermore, under clause 10.0 the lessor had the right to terminate the agreement only where the payments were in arrear for at least 7 days and this, in Mahoney J's view, made it difficult to infer that the time of performance was fundamental for the lessors. He, accordingly, held that although the parties had the right to elevate every term into the category of conditions, nonetheless it is difficult to conclude that the "time of the essence" provision in this case "... indicates an intention that timeous performance of all the lessee's obligations is at the heart of the lease agreement."[259]

5.106 This conclusion seems to be subject to a serious objection: Where the parties provide for the time of performance to be of the essence, they, in fact, regard the performance of the promisor's obligations at any stipulated time to be of this character; in other words, even where an obligation is provided to be performed within a reasonable time, the parties may agree that performing in a reasonable time is to be of the essence. The policy behind such a provision is that first, the parties intend to show their true intention as to the nature of the term; and second, the promisee, regarding the performance of the obligation as an essential and vital factor, might have some plans like reinvesting the sums he expects to receive in a reasonable time, in some other projects. It, therefore, seems that the "time of the essence" provision in the *Citicorp*'s case should have been taken as a clear indication of intention to elevate the terms regarding the lessee's obligations into the category of conditions. Assuming the correctness of this conclusion, even in Mahoney J.A.'s view, the lessor would have been entitled to recover his loss of bargain and so the minimum payment clause providing for such a loss would have been a valid stipulation. The result, therefore, would have been rather like what had

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[258] *Ibid.*, at pp. 13-14

[259] *Ibid.*, at p. 10

been achieved in the English case of *Lombard North Central Plc. v. Butterworth*[260]. All the criticisms made to that case as to the preference of the form over substance[261] would have therefore been relevant here.

6.4. Recoverability of loss of bargain Damages

6.4.1. Starting Point: the *AMEV-UDC* case

5.107 The shift towards the recoverability of loss of bargain damages under the minimum payment clause, regardless of the nature of the term breached by the promisor, started by the important decision of the High Court of Australia in *AMEV-UDC Finance Ltd. v. Austin*[262]. In this case, in two similar agreements for the lease of certain printing equipment, it was provided *that* the entire rents were due and payable upon the execution of the contract, but the lessor would agree to receive the rentals by instalments, provided the lessee made instalment payments punctually or within seven days of their due date; *that* upon the lessee's breach in the punctual payment of instalments and upon the default continuing for 14 days, the lessor might call up the entire rent and thus the whole balance of unpaid rents would become payable forthwith (cl. 1(b)); *that* upon the failure to pay any instalment within 7 days of its due date, or committing any breach of the provisions of the agreement, or happening of some other specified events, the lessor would be entitled to repossess the goods and terminate the agreement whereupon the whole unpaid balance of the total rent would immediately become payable (cl. 7); *that* the lessor would have the right to sell the repossessed equipment and if the net proceeds of resale were less than the residual value, as provided in the contractual schedule, the lessee would be liable to pay forthwith the deficiency (cl. 10); and *that* the whole residual value would become payable if the lessee failed to return the equipment within 7 days of the expiration of the contractual period or its prior termination, together with the whole unpaid balance of the total rents plus interest (cl. 12).

The lessee defaulted in payment of one instalment in each lease. The default having been

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[260] [1987] 1 QB 527

[261] *Supra.*, para. 5.067

[262] *AMEV-UDC Finance Ltd. v. Austin* (1986) 162 C.L.R. 170

continued for seven days, the lessor exercised his right to terminate the agreements, repossessed the goods and called up the outstanding balance of the rent. He sold the equipment, the subject-matter of one of the agreements, well in excess of the expected residual value but was unable to sell the other. The lessee, having gone into liquidation, the lessor instituted proceeding against the defendants, the guarantors of the lessee, claiming payment of $291857.40 representing the arrears of rent as at the time of repossession, the outstanding balance of the future instalments and the residual value of the equipment less the net proceeds of the resale of the equipment which had been sold plus interest.

5.108 The precise nature of the claim was unclear from the statements but obviously the accelerated payment of the total rentals could not have been claimed, since, as pointed out in *O'Dea v. Allstates Leasing System (WA) Pty. Ltd.*[263], the clause providing for the entire rentals to be due in advance was inconsistent with another clause providing for the liability of the lessee to pay the whole outstanding balance of rentals upon termination for his default.[264] Hence, considering the contract as a whole, there could not be a present debt which, by indulgence on the part of the lessor, had been provided to be paid by instalments. The claim, therefore, inevitably was for the damages resulting from termination for the lessee's breach under the agreed damages clause provided for in the agreements.

The judge, at first instance, applying the decision of the High Court in the *O'Dea* case[265], held the agreed damages clause to be a penalty since the clause allowed neither any rebate for the accelerated receipt of the future instalments nor any credit for a probable excess in the realisable value of the repossessed goods over the residual value. He, however, arguing that the equity relieves a party from a penalty on the condition that the other party would be compensated for his actual loss, did not disregard the penalty clause and enforced it up to the lessor's actual loss resulting from termination amounting to arrears of rent, future rentals less a discount for the accelerated receipt of them, and the residual

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[263] (1983) 45 A.L.R. 632, (1983) 57 A.L.J.R. 172, at p. 175 per Gibbs C.J.

[264] see *supra.*, paras. 3.40, 3.47-3.48

[265] *O'Dea v. Allstates Leasing System(W.A.) Pty. Ltd.* (1983) 57 A.L.J.R. 172

value of the resold equipment less the realisable value of the resale.

5.109 The majority of the Court of Appeal, holding the clause to be a penalty, disagreed with the judge at first instance and held that, even applying the equitable principles, the lessor would be entitled to recover his loss up to the date of termination, i.e. the arrears of rent plus interest. On appeal, the majority of the High Court of Australia affirmed the decision of the Court of Appeal arguing that with the development of the penalty doctrine by the common law, there was no room for the old equitable jurisdiction to grant relief in this area. Holding the agreed damages clause to be a penalty, the majority emphasized the principle that upon termination of the agreement for the lessee's non-repudiatory breach, the lessor would be entitled to recover merely his loss resulting from breach; the actual loss flowing from termination was caused by the lessor himself in exercising his option to terminate the contract and could not be attributed to the breach. Thus, they confined the lessor's damages to arrears of rent with interest. This was clearly stated in the judgment of Gibbs C.J. where he, discussing as to the recoverable damage by the lessor where the agreed damages clause was held to be a penalty, pointed out:

> "It is true to say, as Roger J. said, that the lessor is entitled to recover its actual damage. However, it is the actual damage which flowed from the breach which alone can be recovered. ... It is well established in the modern law that the liability of a party who has broken a contract which contains a penalty clause is to pay the damages that have resulted from the breach. In the present case, the additional damage in respect of which the appellant seeks to recover did not result from the breach; it resulted from the determination of the hiring which the appellant itself chose to bring about."[266]

5.110 The apparent result achieved in this case seems to be in line with the principle laid down by the English Court of Appeal in the *Baldock*'s case[267] and accepted in the decision of the High Court in the *Shevill*'s case[268]; but further consideration shows that the majority believed the law as representing and supporting another view: Mason & Wilson JJ, reviewing the law as to penalties, suggested that the courts should give the parties greater latitude to determine the terms of their contract. They, having referred to

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[266] *AMEV-UDC Finance Ltd. v. Austin* (1986) 162 C.L.R. 170, at pp. 175,176

[267] *Financings Ltd. v. Baldock* [1963] 2 QB 104, [1963] 1 All ER 443

[268] *Shevill v. The Builders' Licensing Board* (1982) 56 A.L.J.R. 793, (1982) 149 C.L.R. 620

the advantages of such a latitude as to the provisions for agreed damages and emphasizing on the "supervisory jurisdiction" of the courts to relieve against provisions which are so extravagant and unconscionable that are penal in nature and not compensatory, proposed some tests in drawing a distinction between penalties and liquidated damages[269], and added:

> "Our rejection of the appellant's arguments should not be taken as throwing any doubt on the right of the owner or the lessor to recover his actual loss on his early termination of a hire-purchase agreement or chattel lease, pursuant to a contractual right, for the hirer's non-fundamental breach, under a correctly drawn indemnity provision ... there is no reason to suppose that a provision which gives the lessor an indemnity, on his early termination for the lessee's breach, in the form of all unpaid instalments of rent, suitably discounted for early receipt, plus the residual value of the goods adjusted so as to reflect their actual value at the relevant time, would constitute a penalty."[270]

As it appears from the passage quoted above, the learned judges, though holding the agreed damages clause in this case to be a penalty, proposed the view that the creditor's actual loss resulting from termination, if inserted properly in a minimum payment clause, would be recoverable under that clause, even where termination of the agreement was triggered off by the exercise of the creditor's contractual right for a non-repudiatory breach. However, they considered that where the parties' pre-estimation of the actual loss went beyond the correct formula and turned to be penal in nature, the courts could not undertake the "unfamiliar role" to rewrite the parties' agreement so as to confine it to the actual loss which the lessor had sustained.[271] In such a case, therefore, the creditor would only be able to recover his damages to the extent which is recoverable at common law, and in a case where termination was based on a non-repudiatory breach, it would be confined to the loss resulting from breach, i.e. the arrears of rent with interest.

5.111 The dissenting judgments were delivered by Deane and Dawson JJ. Deane J., accepting apparently the proposal laid down in the joint judgment of Mason and Wilson JJ. as to the recoverability of loss of bargain damages where it has been inserted in a "correctly drawn indemnity provision" even where termination is triggered off by a non-

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[269] *Supra.*, para. 2.52

[270] *AMEV-UDC Finance Ltd. v. Austin* (1986) 162 C.L.R. 170, at p. 194

[271] *Ibid.*, at pp. 192-193

repudiatory breach, considered that even the agreed damages clause being a penalty, the actual loss resulting from termination should be recoverable. He based his judgment mainly on the ground that a penalty clause is not void at common law and it is not even completely unenforceable. "Common law unenforceability", he said, "while ab initio,..., is limited to the extent to which liability under the clause exceeds the true damnification."[272] Put another way, the learned judge held the penalty clause to be enforceable up to the amount of actual loss resulting from termination.

5.112 Dawson J., agreeing in effect with the conclusion achieved by Deane J, based his judgment on the following grounds:

I) There is inconsistency in the idea that loss of bargain damages resulting from termination can be recovered under a contractual provision to that effect, while if the provision is held to be a penalty, the lessor will be restricted to the loss flowing from breach, disregarding the legitimate termination based on that breach.

II) There is no justification for the view that in order to determine the nature of an agreed damages clause, the stipulated payment (i.e. loss of bargain) should be regarded as payable upon breach rather than upon termination of the agreement, while the clause being characterized as a penalty, the recoverable amount should be confined to that which results from breach and not loss of bargain which results from termination (where there is a non-repudiatory breach).

III) The agreed damages clause, even where it is held to be a penalty, can clearly indicate the intention of the parties to provide for compensation to the lessor in respect of damages which result from termination pursuant to a contractual right, and there is no reason why the law should not give effect to such intention: "If it cannot do so by reference to the stipulated amounts because they are penalties, there is no reason why it should not do so by way of unliquidated damages."[273]

IV) The parties may admittedly agree that a minor term to be treated as a condition and thus give effect to the breach of that term to be regarded as a repudiatory breach giving rise to the right of recovery of loss of bargain damages. There is no reason why, just like

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[272] *Ibid.*, at p. 203

[273] *Ibid.*, at p. 216

such an agreement, the parties should not be able "to prescribe the measure of compensation payable upon termination for breach of an inessential term"[274].

5.113 The intention of the parties extracted from their agreement as to the recoverability of the actual loss resulting from termination was the very core of Dawson J's arguments. The learned judge, relying on the observations of Deane J. in *Progressive Mailing House Pty. Ltd. v. Tabali Pty. Ltd.*[275] and also the English case of *the Solholt*[276] stated:

> "... where a contractual power to terminate an agreement is exercised upon breach, damages for loss of the bargain should be recoverable, not only where the breach amounts to repudiation or is fundamental, but also where it is intended by the parties that such loss should be recoverable. And if it is the intention of the parties, it will not be correct to say that the loss was due solely to the act of the party terminating the agreement. It will be attributable also to the breach because it was contemplated by the parties as something for which damages should be recoverable."[277]

5.114 The reasons given for the recoverability of loss of bargain damages in the event of termination for a non-repudiatory breach, where the agreed damages clause is held to be a penalty seem to be convincing. The proposition is also supported by the arguments discussed in the earlier part of this chapter[278] and we do not need to repeat them again. It is, therefore, fitting to suggest here that the intention theory gives the best justification for determining the loss which the creditor is entitled to recover where he terminates the contract exercising his option to do so. According to this theory, the recoverable damage should be the actual loss resulting from termination, i.e. loss of bargain, even where the minimum payment (or agreed damages) clause is held to be a penalty regardless of the nature of breach upon that the termination of the agreement has been based.

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[274] *Ibid.*, at p. 217

[275] (1985) 157 C.L.R. 17

[276] *Sotiros Shipping Inc. v. Sameiet Solholt* [1983] 1 Lloyd's Rep. 605 at p. 607

[277] *AMEV-UDC Finance Ltd. v. Austin* (1986) 162 C.L.R. 170, at pp. 218-219

[278] Where we discussed the issue that the recoverable loss at common law should be loss of bargain if the parties have agreed for the promisee's right to terminate the contract upon the promisor's breach. see *supra.*, paras. 5.080 *et seq.*

6.4.2. Adoption of the Recoverability of loss of bargain under a Minimum Payment Clause

5.115 The dicta of Mason and Wilson JJ. in *AMEV-UDC Finance Ltd. v. Austin*[279]- as to the entitlement of the lessor to recover his loss of bargain damages resulting from termination for a non-repudiatory breach, under a "correctly drawn indemnity provision"- were applied by the High Court of Australia in *Esanda Finance Corporation Ltd. v. Plessnig*[280]: In an agreement for the hire-purchase of a truck made between the appellant (finance company) and the respondents, Mr and Mrs Plessnig (the hirers), it was provided that upon the hirers' default in any payment under the agreement, the owner would be entitled to repossess the vehicle whereupon the hiring would terminate, and the hirers would be under the liability to pay the "recoverable amount" as liquidated damages to the owner. The "recoverable amount" was agreed to be calculated as thus: the total rent and all other moneys payable for the entire period of the agreement (including all costs of repossession, maintenance and resale) less deposit, all rentals paid before retaking possession, the realisable value of the goods being the best wholesale price reasonably obtainable for them at the time of repossession and a rebate of charges. The hirers making default in payment of three monthly instalments, the owner repossessed the vehicle (according to the findings of the courts below[281]) and claimed for the moneys due under the contract (i.e. the recoverable amount). The judge at first instance, accepting the claim, entered judgement for the hirers' liability to pay the "recoverable amount" claimed.

5.116 In the Full Court of South Australia, the majority (Von Doussa J. dissenting), allowing the appeal, considered the agreed damages provision to be a penalty. They based their judgment mainly on the ground that first, the criteria approved in *I.A.C. (Leasing) Ltd. v. Humphrey*[282] and by Mason and Wilson JJ in the *AMEV-UDC* case[283], as to agreed damages clause was in relation to leases with no option to purchase, while

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[279] (1986) 162 C.L.R. 170

[280] (1988-89) 166 C.L.R. 131; see Carter J. W., Liquidated Damages and Penalties: The Saga Continues (1989-90) 2 JCL 78

[281] *Ibid.*, per Wilson & Toohey JJ at p. 136

[282] (1972) 126 C.L.R. 131

[283] *AMEV-UDC Finance Ltd. v. Austin* (1986) 162 C.L.R. 170

here the agreement was one of hire-purchase; second, the clause did not provide for any credit to be given to the hirers where the realisable value of the subject-matter happened to exceed the amount owing to the owner.[284]

5.117 On appeal, the High Court of Australia, unanimously held that the clause providing for the owner's actual loss resulting from termination for the hirer's breach would not be a penalty. Wilson and Toohey JJ., having emphasized on the test laid down by Mason and Wilson JJ. in the *AMEV-UDC* case in determining the nature of agreed damages clause and repeating the principle that the agreed sum is a penalty only where it is "out of all proportions", "extravagant", "exorbitant or unconscionable" in comparison with the likely actual loss resulting from breach, pointed out:

> "As *O'Dea* and *AMEV-UDC* show, the fact that the "recoverable amount" payable by the respondents under cl.6 is payable upon termination of the agreement consequent upon breach, rather than in respect of the breach alone, does not mean that the clause escapes the scrutiny of the law relating to penalties. But it does mean that in determining whether the "recoverable amount" is a genuine pre-estimate of loss or a penalty, "relevant loss" is not restricted to the loss flowing immediately and merely from the actual breach of contract; it includes the loss of the benefit of the contract resulting from the election to terminate for breach..."[285]

They also considered that the agreement being one of hire-purchase, and not merely hire, should not be regarded as a material element, since until the hirer had not exercised his option to purchase, he was only a bailee and should have no property in the subject-matter. Other members of the High Court, in effect, agreed with these arguments.[286] Brennan J. held that, for the moment, he accepted the view that in determining the nature of the "recoverable amount" prescribed by the contract, the owner's loss resulting from termination for the hirer's non-repudiatory breach should be taken into account.[287] However, he considered that the law, in holding the owner to be restricted to the loss resulting from breach, in the event of termination by the exercise of a contractual right, for a non-repudiatory breach, and at the same time allowing him to recover his actual loss resulting from termination under a "correctly drawn indemnity provision", accepted an

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[284] See Wilkin J., Penalties and the Financial Contract [1990] L.M.C.L.Q. 16, at p. 25

[285] *Esanda Finance Corporation Ltd. v. Plessnig* (1988-89) 166 C.L.R. 131, at p. 140

[286] See *Ibid.*, at p. 153 per Deane J., p. 157 per Gaudrin J., and p. 147 per Brennan J.

[287] *Ibid.*, at p. 147

incongruity. He then added:

> "It may be appropriate to reconsider this incongruity in some later case and, if that is done, it may well be necessary to canvass the correctness of some earlier decisions of this court."[288]

5.118 The decision of the High Court in *Esanda Finance Corporation Ltd. v. Plessnig*[289] should be welcomed. It is in conformity with the true nature of financing agreements and avoids the problems which the financiers might face in drafting such contracts. It also eliminates, to some extent, the problems like the preference of form over substance introduced by some authorities, like the English case of *Lombard North Central Plc. v. Butterworth*[290]. More importantly, the decision is in line with the principle of freedom of contract and the necessity of respect to the true intention of the parties, for it recognizes the latitude of the contracting parties to determine the terms of their agreement including the consequences of the breach of any contractual undertaking. However, ***though*** to a great extent it reflects the realities of commercial life by allowing the creditor to recover his actual loss resulting from termination for a non-repudiatory breach under a "correctly drawn indemnity provision", ***yet*** in the absence of such a provision or where the provision is held to be a penalty, the law still restricts the creditor to his loss resulting from breach and denies his entitlement to recover his actual loss flowing from termination for the other party's non-repudiatory breach. Many arguments were adduced, in the earlier part of this chapter[291], in favour of the view that providing for the right of termination for the promisee to be exercised in the event of the promisor's breach should be regarded as sufficiently indicating the common intention that the contracting parties have contemplated the actual loss resulting from termination to be the recoverable damage where the agreement is terminated by the innocent party for the other party's breach. This indication is even stronger where the parties have expressly provided for loss of bargain [or greater than that in case of the clause being penal] to be recoverable in the event of termination for the promisor's non-repudiatory breach.[292] Accordingly, if the

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[288] *Ibid.*, at p. 147

[289] (1988-89) 166 C.L.R. 131

[290] [1987] 1 QB 527

[291] *Supra.*, paras. 5.080 *et seq.*

[292] Cornwell P, Commentary on "Termination Clauses by Carter" (1990) 3 JCL 126, at p. 128

agreed damages clause providing for loss of bargain to be recoverable upon termination is held to be a penalty, the actual loss resulting from termination should be recoverable under the general rules at common law. The arguments raised in the judgments of Deane and Dawson JJ. in the *AMEV-UDC* case[293] do clearly support this view.

5.119 From the above observations, it could be inferred that the present status of the Australian law as to this issue- i.e. denying the entitlement of the creditor to recover his actual loss resulting from termination where the agreed damages clause providing for loss of bargain is held to be a penalty, and restricting him to the loss flowing merely from breach- seems unsatisfactory and it should be hoped that, considering the arguments of Deane and Dawson JJ., the present position will, in future cases, be reconsidered so that the promisee will be able to recover his actual loss resulting from termination for breach where the express, implied or imputed intention of the parties indicates so. Thus, the creditor in financing transactions will have the right to recover his loss of bargain for a non-repudiatory breach, even where the agreed damages clause is held to be a penalty.

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[293] *AMEV-UDC Finance Ltd. v. Austin* (1986) 162 C.L.R. 170

Part Two

Relief Against Forfeiture

Introduction

The parties to a contract, instead of providing for the agreed damages to be paid upon breach, may stipulate for the forfeiture of advance payments on the occurrence of a default by the payer in performing his contractual undertakings. In a contract for the sale of land by instalments, for example, the vendor may ask for a deposit, and the contract may contain a stipulation providing for the right of the vendor to repossess the land and retain the deposit and all other payments made by the purchaser in case of any default by the purchaser of his contractual obligations. Such a provision is referred to as a "forfeiture clause" and may be considered as a good alternative to providing for agreed damages. The term "forfeiture" in this context, as it is clear from the example, refers to two different, but related, concepts: **First**, losing some interest in the subject-matter of the agreement as a result of a default in performing contractual duties. **Second**, losing the moneys paid before termination in consequence of that default. Thus, in the example given above, if the vendor wishes to enforce his contractual right, the purchaser will forfeit both his equitable interest in the land and also the deposit and the instalments paid before termination. It is why the decided cases, as it will be seen, discuss the availability of relief against forfeiture of both the payer's interest in the subject-matter and the moneys already paid.

The right to repossess the subject-matter and to retain all payments made by the contract breaker may act as a security for the creditor against the debtor's default[1]: The debtor is prevented from breaking his contractual obligation, because as a result he might lose the possession and the payments made; the creditor also may look at the clause as a means of preventing the debtor from any default and compelling him to perform his promises punctually. Accordingly, upon any default, the creditor may be willing to negotiate and reschedule the performance of the debtor's undertakings; but his right to repossess and retain payments will provide him with a strong bargaining power. As a result, he might be able to impose any harsh terms and conditions, even at the negotiation stage.

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[1] See Collins H., The Law of Contract, (2nd ed., 1993), p. 354

Furthermore, upon the premature termination of the agreement, the creditor who repossesses the subject-matter is very unlikely to wish to retain the property for himself. He will normally try to retransfer it as soon as it is practicable. On the other hand, the debtor is interested in maintaining possession. The creditor, therefore, needs to be certain of the due performance of the debtor's contractual duty, *i.e.* the payment and completion of the agreement. It is, thus, provided in the contract that, upon termination for the debtor's default, the creditor would have the right to retake possession of the subject-matter and retain the payments already made. In most cases, therefore, such a provision does normally act as a guarantee for the creditor against any probable default by the debtor in the punctual payment and due performance of the contract.

Providing for the forfeiture of advance payments upon default is very similar in effect to an agreed damages clause: the parties, instead of providing for a large sum of money to be paid upon breach, stipulate for the forfeiture of a large amount of money already paid upon the payer's default. In principle, therefore, there might be good reasons for the application of the rules against penalties to forfeiture provisions; in other words, such a forfeiture provision should, it may be said, simply be regarded as subject to the rules against penalties, and the courts should relieve the payer from the consequences of his breach to the extent that the forfeited sum exceeds the actual loss of the payee resulting from breach. As we shall see, however, the rules relating to relief against forfeiture and the rules against penalties, though having a common origin in equity, have developed differently. They, therefore, are, to some extent, different from each other.

As a general principle, common law respects the right of parties to provide for a forfeiture clause. Thus, upon termination of a contract for the payer's default, the advance payments may be forfeited by the payee if there is a contractual term to that effect[2], or, even in the absence of a forfeiture provision, where the right of the payee to

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[2] McGregor on Damages, 15th ed., 1988, para. 505; Ogus, The Law of Damages, p. 53; Treitel, Remedies for Breach of contract, 1988, p.235; Pawlowski, Relief Against Forfeiture of Instalments (1993) Estate Gazette, p. 122; For the best judicial discussion on the subject see *Stockloser v. Johnson* [1954] 1 Q.B. 476; The Australian approach appears to be the same: see, e.g., Greig & Davis, The Law of Contract (Australia), p. 1279; Carter, Breach of Contract, 2nd ed., 1991, para. 1259

the prepayments is unconditional[3]; but, at the same time, the courts of equity, having recognized the realistic purpose of a forfeiture clause and that the creditor is not usually interested in possession of the property, and having considered that, in some cases, the clause may act as a penalty[4], have established certain rules to protect the proprietary or possessory interest of the debtor, and also to relieve him against forfeiture of the advance payments. Some statutory measures have also been provided for to protect the possessory interest of the debtor.[5]

Although, in general, there is no doubt about the existence of a jurisdiction to relieve against forfeiture of the payer's possessory or proprietary interest and also the moneys already paid[6], the scope of this jurisdiction, its boundaries and the circumstances upon which the jurisdiction might be exercised are not very clear[7]. The equitable jurisdiction to relieve against the payer's interest in the subject-matter should not be regarded as distinct from the jurisdiction to relieve against moneys already paid. Although with regard to the applicable rules and principles, they might seem different, nonetheless, in effect, they are closely related to each other: Where a court relieves the payer from the forfeiture of his equitable interest in the property, it, in fact, also prevents the vendor from retaining the moneys already paid for his own benefit. Put another way, the court normally grants such

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[3] See *infra.*, para. 6.20

[4] This is the case, for instance, where the amount of damages resulting from the payer's breach is considerably less than the advance payment which is subject to forfeiture.

[5] See, e.g., as to forfeiture of leases for breach of covenants other than payment of rent, Law of Property Act 1925, sec. 146 ; as to consumer credit transactions, Consumer Credit Act 1974 ss. 87-89 requiring the creditor to give a special notice that the default in payment risks the repossession of the goods by him. see also s. 129 empowering the court to allow time for payment if it regards it just to do so. There are also some statutory measures to empower the court to order repayment of the advance payments: see, e.g., as to the land transactions sec. 49(2) of the Law of Property Act 1925 (for a detailed discussion of this section see *infra.*, paras. 9.10 *et seq.*); as to "consumer hiring agreements" see sec. 132, Consumer Credit Act 1974

[6] Furmston M P, Cheshire, Fifoot & Furmston's Law of Contract, 13th ed., p. 942; Chitty on Contracts, 27th ed., vol. 1, 1994, para. 20-070; Treitel, The Law of Contract, 9th ed., pp. 908-910; McGregor on Damages, 15th ed., para. 506; Ogus, The Law of Damages, 1973, pp. 54-56; Collins, The Law of Contract, (2nd ed., 1993), p. 354; Downes, Textbook on Contract, 3rd. ed., 1993, p. 334; Guest A G, Anson's Law of Contract, 26th ed., 1984, p. 513-514; Harpum, Relief Against Forfeiture and the Purchaser of Land [1984] CLJ 134, at p. 136; Pawlowski, Relief Against Forfeiture of Instalments, Estate Gazette, issue 9312, 27 March 1993, 122; Law Commission, Working Paper, No. 61, Penalty Clauses and Forfeiture of Monies Paid, 1975, paras. 54-56

[7] See, e.g., *Sport International Bussum BV v. Inter-Footwear Ltd* [1984] 2 All ER 321, [1984] 1 WLR 776; Law Commission, Working Paper, No. 61, *ibid.*

relief by giving the payer extra time to complete his part of bargain. By granting such relief, the payer's default is in fact ignored and the moneys already paid are, upon completion of the agreement, taken into account as the purchase price. Moreover, the court may grant relief against forfeiture of moneys already paid by granting the payer extra time within which the contract is to be completed. Granting relief in such a way does, in effect, also relieve the payer from forfeiture of his equitable interest in the property.

Considering the rules and principles relating to relief against forfeiture, examining the scope of this equitable jurisdiction, and determining the relationship between these principles and the rules against penalties are the main aims towards which this part will be directed. However, before discussing the jurisdiction of courts to relieve against forfeiture, it is appropriate to consider, rather briefly, two preliminary issues: first, the rules regarding the recoverability of advance payments by the contract breaker at common law, and second, a historical review of the equitable jurisdiction of courts to relieve against forfeiture. This part, therefore, will be structured as follows: Consideration is given first to the preliminary issues, as referred to above. (Ch. 6) This will be followed by a detailed analysis of the equitable rules for relief against forfeiture of the payer's interest in the subject-matter (Ch. 7), and the rules relating to relief against forfeiture of moneys already paid (Ch. 8). Though the equitable jurisdictions as to these two heads of relief are closely related to each other, it seems preferable to discuss them separately; for the rules applicable to each of them and their interrelationship with the penalty doctrine are, as it will be seen, to some extent different. The consideration will also be given to the interrelationship between each head of relief and the rules against penalties. Finally some important statutory jurisdictions to relieve against forfeiture will be given a close analysis (Ch. 9).

Chapter 6

Some Preliminary Issues

6.01 To discuss the availability of relief in equity against forfeiture of advance payments and its relationship with the penalty doctrine, it should first be seen to what extent these payments, after a premature termination of a contract for the promisor's default, could be recovered by the breacher in an action at common law. It is also preferable to review briefly the historical evolution of the doctrine of relief against forfeiture. This chapter will be responsible for illuminating these two preliminary issues.

1. Recoverability of Advance Payments at Common Law

1.1. General Considerations

6.02 Upon termination of a contract, in which some advance payments have been made for the payer's breach, one of the main questions which may arise is whether the payments made are recoverable by the contract breaker. The issue gains practical importance where the amount of prepayments is more than damages suffered by the innocent party as the result of breach: If there is no right for the contract breaker to recover the advance payments to the extent that it exceeds the damages suffered by the innocent party, this may result in an unjust enrichment and injustice.

6.03 Discussing the principles of common law in this regard, the issue should be limited to a situation in which no forfeiture clause has been provided for, since where the parties have stipulated for the forfeiture of advance payments upon termination for the payer's default, there is no right at common law for the contract breaker to recover the prepayments[1], even if they are out of all proportion to the actual or probable damages

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[1] *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 Q.B. 476, specially at p. 490 per Denning L.J. ; see also McGregor on Damages, 15th ed., 1988, para. 505 ; Ogus, The Law of Damages, 1973, p. 53 ; Treitel, Remedies for Breach of Contract, 1988, p. 240 ; Pawlowski, Relief Against Forfeiture of Instalments, Estate Gazette, March 27 1993, p. 122; This is also the case where there is an implied intention as to the non-recoverability of an advance payment by the contract breaker, like the case in deposits: see, e.g., *Stockloser v. Johnson*, *ibid.*, where Denning L.J. at p. 637 stated: "Where there is a forfeiture clause or the money is expressly paid as a deposit (which is equivalent to a forfeiture clause), then the buyer who is in default cannot recover the money at law at all." The position is the same in Australia: see, e.g., Greig & Davis, The Law of Contract, 1987 (with fourth cumulative supplement, 1992), p. 1279 ; Carter, Breach of Contract, 2nd ed., 1991, para. 1259

which may flow from the breach. The question, therefore, is, whether, in the absence of any forfeiture provision, there is any right for the defaulting party to recover his prepayments.

6.04 The relevant principle is that the discharge of a contract has no retrospective effect[2]. This principle has been affirmed by the House of Lords[3] after years of controversy on the issue of the effect of termination. On a simple analysis of the principle, it might be argued that where the right to payments has accrued before discharge, then the party in default remains liable, and if there has been a payment, there will be no right for its recovery by the contract breaker[4]. It should, however, be noted that such an analysis is an oversimplification of the issue and where the damages are less than the amount of advance payments, it may lead to an unjust enrichment. As we shall see, the position at common law depends on the construction of the clause requiring the advance payments and the object with which the payments have been made. To start with, it is necessary to consider the traditional approach to the subject. Then some important cases which may clarify the issue should be examined.

1.2. Traditional Approach

6.05 For many years, it was thought that, in the absence of an express or implied forfeiture provision, upon the premature termination of a contract for the payer's breach, all advance payments, even deposits, were recoverable.[5] In *Hinton v. Sparkes*[6], on the

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[2] *Hirji Mulji v. Cheong Yue SS Co. Ltd.* [1925] AC 497, per Lord Sumner at p. 510; see also Furmston M P, Cheshire, Fifoot & Furmston's Law of Contract, 13th ed., p. 640; Beatson J, Discharge for Breach: The Position of Instalments, Deposits, and Other Payments Due Before Completion (1981) 97 LQR 389 (Reproduced with revision in J. Beatson, The Use and Abuse of Unjust Enrichment (Essays on the Law of Restitution), (Oxford: Clarendon Press, 1991), p. 45)

[3] *Johnson v. Agnew* [1980] AC 367, overruling *Horsler v. Zorro* [1975] Ch. 302 ; see also *Colonial Bank v. European Grain & Shipping Ltd. (The Dominique)* [1987] 1 Lloyd's Rep. 239, at p. 248 per Hobhouse J., affirmed on this aspect by both the Court of Appeal and the House of Lords: [1989] AC 1056

[4] Duncan Wallace I.N., Hudson's Building and Engineering Contracts, 11th ed., vol. 1, para. 4.025 at p. 489, citing *Taylor v. Laird* (1856) 25 L J Ex. 329, and Salmond and Winfield on the Law of Contract (1927 ed.), p. 286

[5] See, e.g., *Hinton v. Sparkes* (1868) LR 3 CP 161; *Casson v. Roberts* (1862) 31 Beav. 613, 54 ER 1277, 32 L.J. 105, Ch., where Sir John Romilly, M.R. held: "An agreement certainly might be made that the deposit should be forfeited in case the purchase should not be completed, but this must either be expressed or clearly implied from the contract itself. ... There is ... no authority which holds that the deposit must be considered as forfeited in the absence of any agreement whatever, or one which could neither be enforced at law nor in equity." at p. 106; The judgment of the Court of Queens Bench,

question of the recoverability of a deposit, Bovill C.J. held:

> "In *Casson v. Roberts*, 32 L.J. 105, Ch., it was held that there must be an agreement express or implied, for the purpose of working a forfeiture of a deposit, and that there was no authority to show that it would be forfeited without an agreement to that effect. With that case I entirely concur, and therefore it is only necessary to see if in this case there is an agreement express or implied that the deposit should be forfeited. ..."[7]

This was the case until a series of decisions[8] in which a sharp distinction was made between deposits and other part payments: In *Howe v. Smith*[9], in a contract for the sale of a certain freehold land, a deposit of £500 was paid by the purchaser. The contract contained no provision at all as to what should be done with the deposit if the contract was not completed[10]. Due to the purchaser's default, the contract was practically brought to an end by the vendor. In an action for, *inter alia*, the recovery of deposit, it was held that the purchaser having failed to perform his contractual undertaking, had no right to the return of the deposit. The members of the court mainly based their judgment on the nature of the advance payment. They held that a deposit, in addition to being a part of the purchase money if the contract was completed, was a guarantee of performance, and therefore the defaulting purchaser could have no right to recover it. In the course of his judgment, Cotton L.J. said:

> "The deposit, as I understand it, and using the words of Lord Justice James is a guarantee that the contract shall be performed. If the sale goes on, of course, not only in accordance with the words of the contract, but in accordance with the intention of the parties in making the contract, it goes in part payment of the purchase money for which it is deposited; but if on the default of the purchaser the contract goes off, that is to say, if he repudiates the contract, then, according to Lord Justice James, he can

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delivered by Lord Denman C.J., in *Palmer v. Temple* (1839) 9 Ad. & El. 508, 112 ER 1304 could also be read in this way: "The ground on which we rest this opinion is, that, in the absence of any specific provision, the question, whether the deposit is forfeited, depends on the intent of the parties to be collected from the whole instrument ..." at pp. 520, 1309 respectively..

[6] [1868] L.T. 600

[7] *Ibid.*, at p. 601

[8] See, e.g., *Ex parte Barrell* (1875) 10 L.R. Ch. App. 512, in which Sir George Mellish L.J. held: "... it appears to me clear that, even where there is no clause in the contract as to the forfeiture of the deposit, if the purchaser repudiates the contract he cannot have back the money, as the contract has gone off through his default." at p. 514 ; *Collins v. Stimson* 11 Q.B.D. 142 per Baron Pollock J. at p. 143 ; *Howe v. Smith* (1884) 27 Ch. D. 89

[9] (1884) 27 Ch. D. 89

[10] The contract only provided: "£500 part of the purchase money of £12500 has been paid as a deposit and in part payment of the purchase money."

have no right to recover the deposit."[11]

6.06 On the other hand, advance payments other than deposits, in the absence of an express or implied forfeiture provision, were recoverable by the defaulting payer.[12] The core of such a distinction lay on the point that, having regard to the nature of deposits, there should always be an implied term to the effect that, upon a premature termination of the contract for the payer's breach, the deposit would be forfeited by the payee. Such an implication can clearly be inferred from the words of Fry L.J. in *Howe v. Smith*[13]:

> "Money paid as a deposit must, I conceive, be paid on some terms implied or expressed. ... The terms most naturally to be implied appear to me in the case of money paid on the signing of a contract to be that in the event of the contract being performed it shall be brought into account, but if the contract is not performed by the payer it shall remain the property of the payee."

6.07 A simple analysis of the distinction made between deposits and other prepayments would show that the recoverability of advance payments depended on the nature of payments and the purpose for which they were required. If the payment could be described as a "guarantee of performance" or as an "earnest to bind the bargain", then an implied term requiring the forfeiture of such an advance payment in the event of termination for the payer's default would be inferred from the contract. If, however, the payment was only a part of the purchase money, it was then recoverable where the contract was prematurely brought to an end for the payer's breach, unless the contract provided otherwise.

6.08 The most important authority for the recoverability of part payments is provided by *Dies v. British and International Mining and Finance Co. Ltd.*[14]. In this case, the

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[11] *Howe v. Smith* (1884) 27 Ch. D. 89, at p. 95

[12] See, e.g., *Mayson v. Clouet* [1924] AC 980, where Lord Dunedin convincingly argued that all the arguments about the forfeitability of the deposit in *Howe v. Smith*, *ibid.*, would have been unnecessary if the case could have been solved by the simple proposition that, upon termination for the payer's breach, the innocent party "may keep anything that he has got from the partial fulfilment of the contract." at p. 986 ; *Palmer v. Temple* (1839) 9 A. & E. 508, 112 ER 1304; *Dies v. British and International Mining and Finance Co. Ltd.* [1939] 1 KB 724 ; *Stockloser v. Johnson* [1954] 1 Q.B. 476, at pp. 483, 489-490

[13] (1884) 27 Ch. D. 89, at p. 101

[14] [1939] 1 KB 724, This case was followed in *Rover International Ltd. v. Cannon Film Sales Ltd. (No.*

plaintiffs entered into a contract to buy some rifles and ammunition for a total sum of £270,000. In breach of the contract, the buyers, having paid £100,000 of the purchase price, refused to pay the balance and also to take delivery of the goods. The defendants elected to bring the contract to an end. In an action by the buyers for the recovery of the part payment less the agreed damages, it was held that the purchasers were entitled to recover the sum of £100,000 which had been paid in part payment of the price, subject to the sellers' claim for damages resulting from the purchasers' breach. In the course of his judgement, Stable J.- having discussed the nature of the advance payment, and concluding that the payment was a part payment of the price and not a deposit- held:

> "... Where the language used in a contract is neutral, the general rule is that the law confers on the purchaser the right to recover his money, and that to enable the seller to keep it he must be able to point to some language in the contract from which the inference to be drawn is that the parties intended and agreed that he should."[15]

He also rejected the contention that the foundation of such a right to recover the part payment was a total failure of consideration. "In my judgement", he said, "the real foundation of the right... is not a total failure of consideration but the right of the purchaser, derived from the terms of the contract and the principle of law applicable, to recover back his money."[16]

6.09 This case clearly showed that part payments would generally be recoverable if there was no reason to suggest that it was an earnest to bind the bargain or a guarantee for due performance. The argument in *Dies*[17] also implied that where a prepayment could be classified as a deposit, there should be an implied intention of the parties to the effect that such a prepayment would not be recoverable if the contract was terminated for the

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3) [1989] 1 W.L.R. 912, [1989] 3 All ER 423

[15] *Ibid.*, at p. 743

[16] *Ibid.*, at p. 744; The judgment could also well be justified on the basis of total failure of consideration. Upon the facts, there was no doubt that the advance payment had been paid for a consideration which had totally failed. The reason why Stable J. did not ground his judgment on this restitutionary basis may, it has been suggested, be that the case was decided before the decision of the House of Lords in *Fibrosa Spolka Akcyjna v. Fairbairn Lawson Combe Barbour Ltd* [1943] AC 32, overruling the unjustified decision in *Chandler v. Webster* [1904] 1 KB 493 to the effect that to claim an amount on the basis of total failure of consideration, the contract must be void *ab initio*. In fact, Stable J. might have probably followed the latter case as he was bound to do so. see Burrows A., The Law of Restitution, (Butterworths, 1993), p. 274

[17] *Ibid.*

payer's breach. The traditional approach, therefore, was generally the recoverability of part payments and the forfeitability of deposits upon the premature termination of the agreement for the payer's breach.

1.3. Recent Developments

1.3.1. Apparent Inconsistency of the Traditional Approach with Principle

6.10 The decision in *Dies*, at first glance, looks inconsistent with the principle regarding the non-retrospective effect of discharge.[18] The principle requires that the property transferred before discharge should remain the property of the party to whom it has been transferred, and the fact that the contract has been terminated afterwards should not affect the existent rights of the parties before discharge. Accordingly, the advance payments should remain the property of the payee and there should be no right for the payer to recover them after termination. Such a view, however, is not compatible with the traditional approach. Nor can it be reconciled with the case law as to the recoverability of part payments, and, as it has been argued by Lord Dunedin in *Mayson v. Clouet*[19], it negates the elaborate arguments in cases which distinguish deposits from other advance payments. It has also been suggested that the simple analysis of this principle would increase the danger of unjust enrichment[20], because it would allow the payee to keep all advance payments which may considerably exceed his actual loss resulting from breach.[21] It would also increase the extent of claims for the recovery of payments which were due before discharge but the debtor has refused to pay them. Having considered these issues, it should however be conceded that the points made, though correct, do not by themselves remove the apparent inconsistency between the decision in *Dies* and the principle requiring the non-retrospective effect of discharge.

1.3.2. Hyundai Cases

6.11 In addition to this inconsistency, much confusion has been added to the issue by the

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[18] See Beatson, loc. cit., no. 2, pp. 393-394

[19] [1924] AC 980, at p. 986

[20] Beatson, loc. cit., no. 2, pp. 393-394

[21] It is to be remembered that, as it will be seen, there is an equitable jurisdiction empowering the court to grant relief against forfeiture of advance payments, but the scope of such a discretionary jurisdiction is

rather recent decisions of the Court of Appeal in *Hyundai Shipbuilding & Heavy Industries Co. Ltd. v. Pournaras*[22] and the House of Lords in *Hyundai Heavy Industries Co. Ltd. v. Papadopoulos*[23]. The facts of both cases were rather similar: In two contracts for the construction and sale of ships to certain companies, the payment of the contractual price, which had been provided to be by certain instalments, was guaranteed by the defendant. The buyers having failed in the payment of the second instalment, the plaintiffs, *i.e.* the shipbuilders, elected to bring the contract to an end and brought an action against the guarantors claiming the unpaid instalment. It was held in both cases that the guarantor was liable to pay the instalment of price which was due before termination, but had remained unpaid. In the *Pournaras* case[24], Roskill L.J., delivering the main judgment of the Court of Appeal, based his judgment mainly on the nature of the surety agreement[25]. He also emphasized the point that the accrued liabilities of the original debtor to pay the instalment has remained unaffected by termination, and the buyers being liable, the guarantors would also, according to the terms of surety, be under the liability to pay the unpaid instalment. He stated:

> "To my mind, the fact that these contracts came to an end on Oct. 21, 1976, did not free the buyers from their respective obligation to pay the various instalments, liability for which had already accrued, and accordingly ... the guarantors' several liabilities under the respective guarantees remained wholly unaffected."[26]

The words of Roskill L.J. in this case cast a shadow of doubt on the correctness of the decision in *Dies*[27], though it was decided that, even assuming the correctness of *Dies*, the guarantors were not able to take advantage of the right which the principal buyers might have, to recover the part payments less damages resulting from breach.

6.12 Also in the *Papadopoulos* case[28], the House of Lords unanimously held the

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to a large extent controversial. See *infra.*, chapter 8

[22] [1978] 2 Lloyd's L.R. 502

[23] [1980] 2 All ER 29

[24] [1978] 2 Lloyd's L.R. 502

[25] The arguments relating to the nature and construction of the surety agreement are not material here.

[26] *Ibid.*, at p. 507

[27] [1939] 1 KB 724

[28] [1980] 2 All ER 29

guarantor liable to pay the accrued instalment. The majority of their Lordships[29] based their judgment mainly on the ground that the cancellation of the agreement by the builders had no effect on their accrued right to recover the unpaid instalment from the buyers, and since the letter of guarantee had provided for the liability of the guarantors to pay "all sums due or to become due by the Buyer" to the shipbuilder, the defendants were under the liability to pay the unpaid instalment. Two of their lordships, Viscount Dilhorne and Lord Fraser of Tullybelton, distinguished *Dies* on the basis that it was a case just for sale, while here the contract was a contract to "build, launch, equip and complete" a vessel and "to deliver and sell" her to the buyers. In fact, in this case the shipbuilders had to spend expenses to construct the ship. Put another way, it was a contract for work and materials, not merely a contract for sale.

6.13 Viscount Dilhorne- assimilating the contract in the instant case to a building contract, and citing some parts of the statements of Hudson on Building Contracts, under the heading "Express terms for payment by instalments", to the effect that the contractor, after abandonment or repudiation of the contract, has the right to sue the employer for any accrued instalment- stated:

> "... save in the case of sales of land and goods and where there has been a total failure of consideration, it was the law prior to the decision in *Moschi v. Lep Air Services Ltd.* [1972] 2 All ER 393, [1973] AC 331 that cancellation or rescission of a contract in consequence of repudiation did not affect accrued rights to the payment of instalments of the contract price unless the contract provided that it was to do so."[30]

His lordship, then, convincingly argued that there was nothing in the speeches in the *Moschi* case to show any change in the law with regard to the recoverability of accrued instalments which had remained unpaid.

6.14 Lord Fraser rejected the contention that if the buyer in *Dies* was entitled to recover his advance payment, *a fortiori*, the shipbuilder in this case would have no right to recover an unpaid instalment, since had the buyers paid it before termination, they would have been entitled to recover it. He distinguished the *Dies* case on the ground that in that

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[29] Lord Russell and Lord Keith, though dissenting on this ground, held the guarantor liable to pay the instalment under the terms of guarantee.

[30] *Ibid.*, at p. 35

case the contract was simply a contract of sale which "did not require the vendor to perform any work or incur any expense on the subjects of sale. But the contract in the instant case [was] not of that comparatively simple character. The obligations of the buyer were not confined to selling the vessel but included designing and building it... "[31] His lordship, then, explained that the contract price in this case was not simply a purchase price, and on this basis concluded that a shipbuilding contract had little similarity with a contract of sale: it was in fact similar to a contract "in which the party entitled to be paid had either performed work or provided services for which payment [was] due by the date of cancellation".[32] This conclusion led his lordship to the view that in contracts of this nature, the builder or the provider of services would not be deprived of his accrued rights under the contract because of any premature termination of the agreement.

6.15 Lord Edmund Davies- though being, in effect, of the same opinion- appeared to have based his judgement generally on the non-retrospective effect of discharge.[33] Citing a description of the *Dies* case as an uneasy decision to be reconciled with earlier authority from Goff and Jones's Law of Restitution[34], his lordship, like Roskill L.J. in the *Pournaras* case, seemed, at least in effect, to cast some doubt on the correctness of the decision in *Dies*.[35]

6.16 The decisions in the two *Hyundai* cases, at first sight, seem to be in line with the principle regarding the non-retrospective effect of discharge. At the same time, it might appear that these decisions are inconsistent with the traditional approach which allows the recovery of part payments by the payer: According to this view, as contended by the

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[31] *Ibid.*, at p. 44

[32] *Ibid.*, at p. 45

[33] In his Lordship's opinion, the assertion that termination of a contract for the other party's breach renders the right to a payment which has already accrued due (*i.e.*, before termination) as no longer effective is "an irrational assumption unsupported by any direct authority". In his view, on the contrary, "there are sound commercial reasons for holding that a vested and indubitable right to prompt payment on a specified date of a specified sum, expressly provided for in the contract, should not be supplanted by or merged in or substituted by a right to recover at some future date such indefinite sum by way of damages as, on balance and on proof, might be awarded to the builders, following on a scrutiny of the parties' respective rights and obligations under the contract as a whole." *Ibid.*, at p. 39

[34] 2nd ed., 1978, p. 381

[35] See *Hyundai Heavy Industries Co. Ltd. v. Papadopoulos* [1980] 2 All ER 29, at p. 40

guarantors' counsels in both *Hyundai* cases, *a fortiori*, an unpaid part payment could not be recovered by the prospective payee, since had it been paid, it would have been recoverable by the payer. Despite this analysis, in both *Hyundai* cases, the unpaid instalment was held to be recoverable by the shipbuilder. Now, analysing the position on the whole, the question is whether the *Dies* case is actually against the principle of non-retrospective effect of discharge? Is the decision in *Dies* a wrong decision or is it somehow reconcilable with the principle and the decisions in the two *Hyundai* cases? And finally, does the traditional approach need to be modified according to the *Hyundai* cases?

1.3.3. The relationship between Dies and Hyundai Cases

1.3.3.1. General Proposition

6.17 Considering the relationship between the *Dies* and the *Hyundai* cases, it has been suggested[36] that either *Dies* was a wrong decision or the rule in *Dies* is only applicable to contracts of sale and not to a shipbuilding contract where in addition to transferring the ownership of the vessel to the buyers, a great deal of work is also involved[37] or in the *Hyundai* cases, despite *Dies*, there was no total failure of consideration, because the buyers there had taken advantage of the work which the shipbuilder had done before termination. It would be suggested that the first of these proposals could not be a correct approach to the issue; the other two, which are very similar in nature, however, are the right analyses which could be put in some general terms.

6.18 There are two different, but closely related, analyses to explain the relationship between these cases: First, an analysis based on the construction of the contract: this analysis, as we shall see, gains its credibility from construing the intention of the parties through a thorough consideration of the terms of the contract and all surrounding circumstances. Second, the analysis based on the restitutionary approach: according to this view, the basis for the recovery of money paid before termination is an action in restitution for money had and received. Thus, if it can be established that the money was

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[36] Furmston M P, Cheshire, Fifoot & Furmston's Law of Contract, 13th ed., 1996, p. 641

[37] See also McKendrick E, Contract Law, (2nd ed., 1994), p. 334

paid for a consideration which has totally failed, the payer would be entitled to recover it in a restitutionary action. In case of instalments accrued due before termination, but remained unpaid, the argument runs on the basis of the necessity of a symmetry between the position of paid and unpaid sums: If the unpaid sum could not have been recovered by the payer had it been paid, the prospective payee should logically have the right to recover it.

6.19 As far as the recovery of part payments in contractual relations is concerned, these two views are closely related to each other. In most cases, as we shall see, the recoverability of an advance payment could be explained on both bases, but the restitutionary approach, mainly because of the requirement of the *total* failure of consideration, is, it is submitted, unable to explain the recoverability of some advance payments. In fact, in contractual relations, the restitutionary approach is reduced to a species of the construction approach[38], for to determine the total failure of consideration, as a requirement for the action in restitution, regard should be had to the construction of the contract and determining what the parties have bargained for.[39] We shall now proceed with individually considering each of these bases.

1.3.3.2. Construction Approach

6.20 The issue of the recoverability of an advance payment upon the premature termination of the contract for the payer's breach could well be explained by construction of the contract to determine the nature of the payee's right to the part payment[40]: this right might be conditional or without any condition.[41] The right of the owner to an

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[38] See Beatson, loc. cit., no. 2, pp. 74-75

[39] For the concept of a "bargained for performance" as the only consideration which might prevent the failure of consideration from being total see *Rover International Ltd. v. Cannon Film Sales Ltd. (No. 3)* [1989] 1 W.L.R. 912, [1989] 3 All ER 423

[40] See Chitty on Contracts, 27th ed., vol. 1, 1994, para. 20-070 ; Beatson, loc. cit., no. 2, pp. 397-398 ; Harpum C., Relief Against Forfeiture and the Purchaser of Land [1984] C.L.J. 134, at pp. 135-136 ; Greig & Davis, The Law of Contract (Australia), 1987, pp. 1288-1289

[41] The distinction between conditionally and unconditionally acquired rights has also been recognized in the Australian case of *McDonald v. Dennys Lascelles Ltd.* (1933) 48 C.L.R. 457 (High Court of Australia) where Dixon J., in the course of his leading judgment, said: "When a party to a simple contract upon breach by the other contracting party of a condition of the contract elects to treat the contract as no longer binding upon him, the contract is not rescinded from the beginning. Both parties are discharged from further performance of the contract, but rights are not divested or discharged which

advance payment in a hire-purchase agreement, for example, is an unconditional right. That is why there has been no doubt that upon termination of a hire-purchase agreement for the hirer's default, the instalments paid are retainable.[42] As it has been argued by Lord Denning in *Kelly v. Lombard Banking Co. Ltd.*[43], with regard to the retainability of an initial payment, the hirer who pays the initial payment in consideration of the option to purchase, gets what he has paid for from the moment of payment. In other words, the owner's right to that payment is not conditioned upon anything else. If, on the other hand, the construction of the parties' agreement shows that the parties have intended the payee's right to part payments to be conditional on partial or complete performance, then there will rationally be no right for the payee to retain the payments unless the condition has been fulfilled. This analysis would seem to explain the relationship between the *Dies*[44] and the *Hyundai*[45] cases. In *Dies*, the right of the seller to the instalments of price, though it was an existing right which had accrued before termination, was conditional

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have already been *unconditionally* acquired." at p. 477 (emphasis added) ; see also the observations of Lord Wright in *Fibrosa Spolka Akcyjna v. Fairbairn Lawson Combe Barbour Ltd.* [1943] AC 32, where he stated: "The condition of retaining it [the part payment] is eventual performance. Accordingly when that condition fails, the right to retain the money simultaneously fail." at p. 65

[42] See, for example, *Brooks v. Beirnstein* [1909] 1 KB 98, where upon the hirer's default in payment of instalments, the owner retook possession of the subject-matter under the contract and claimed for the instalments which had accrued due before discharge. It was held that the owner was entitled to recover those instalments. Bigham J. said: "The agreement, in so conferring the right to retake possession on a breach by the hirer, does not take away any other rights which the law gives to the owners, among which rights is that of suing for the monthly rent which had already accrued." at p. 102; see also *Kelly v. Lombard Banking Co. Ltd.* [1959] 1 WLR 41, [1958] 3 All ER 713, 103 Sol. Jo. 34; *Chatterton v. Maclean* [1951] 1 All ER 761; *Belsize Motor Supply Co. v. Cox* [1914] KB 244; *South Bedfordshire Electrical Finance Ltd. v. Bryant* [1938] 3 All ER 580; *Overstone Ltd. v. Shipway* [1962] 1 W.L.R. 117 ; and the Canadian case of *Pacific Leasing Corporation Ltd. v. Fire Valley Land & Cattle Co. Ltd. and Jordan* (1969) 68 WWR 411; see further Chitty on Contracts, 27th ed., vol. 2, 1994, para. 36-274; Goode, Hire-Purchase Law and Practice, 2nd ed., p. 359; Guest, The Law of Hire-Purchase, 1966, para. 592-596. It should be noted that in certain circumstances an equitable relief against forfeiture of instalments might be available, but at common law the instalments paid could not be recovered by the defaulting hirer.

[43] [1959] 1 WLR 41, [1958] 3 All ER 713, 103 Sol. Jo. 34; In this case as to the hirer's claim to recover his initial payment which had been paid in consideration of granting him the option to purchase, it was held that the hirer had no right to that advance payment. Lord Denning, in the course of his judgement, argued: "The option to purchase is an existing right as from the moment of signing the contract and the payment of money. So [the hirer] has got what he has paid for. He has to fulfil the condition in order to exercise the option. But he has paid for an option which he has got." at p. 44

[44] [1939] 1 KB 724

[45] *Hyundai Shipbuilding & Heavy Industries Co. Ltd. v. Pournaras* [1978] 2 Lloyd's L.R. 502 (C.A.) ; *Hyundai Heavy Industries Co. Ltd. v. Papadopoulos* [1980] 2 All ER 29 (H.L.)

upon the complete performance of the agreement.[46] That this is clear, it has been suggested[47], is shown by Stable J's extensive quotation from *Palmer v. Temple*[48] where a distinction was made between deposits which were forfeitable upon the buyer's default on the one hand and simple part payments of price "the right to which depended on the performance of the contract"[49] on the other. The decision in *Dies*, therefore, should not be considered as a wrong decision or inconsistent with the principle of non-retrospective effect of discharge. It was a right decision because the right to retain the instalments being conditional and the condition having failed, there is no ground for justifying the entitlement of the seller to keep the instalments. The decision is also not inconsistent with the principle: The principle requires that the discharge should not have any retrospective effect; put another way, any existing right before discharge should remain unaffected. It is suggested that this was the case in *Dies*. The existing right of the seller was, in fact, unaffected, but this right itself was a conditional right, and the condition having failed, the seller lost his right to retain the instalments. In other words, as it has neatly been put by a learned writer[50], "it is not the discharge qua discharge that affects the right but discharge as the product of the initial contractual specification of the extent of the right".

6.21 In the *Hyundai* cases, on the other hand, the contract was, in fact, for work and material. The shipbuilders had to incur expenses from the beginning of the contract to provide materials and to build the ship. In fact, they needed instalments to spend on the work they had to do under the contract. In such a contract, in the absence of any express provision with regard to the recoverability or forfeitability of instalments upon the

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[46] In *McDonald v. Dennys Lascelles Ltd.* (1933) 48 C.L.R. 457 (High Court of Australia), in a contract to guarantee the payment of the outstanding instalments under a contract for the sale of land, Dixon J. expressly recognized the conditional nature of the payee's right to the instalments paid. The learned judge said: "When a contract stipulates for payment of part of the purchase money in advance, the purchaser relying only on the vendor's promise to give him a conveyance, the vendor is entitled to enforce payment before the time has arrived for conveying the land; yet his title to retain the money has been considered not to be absolute but conditional upon the subsequent completion of the contract." at p. 477

[47] Beatson, loc. cit., no. 2, p. 398

[48] (1839) 9 Ad & El 508, 112 ER 1304

[49] Beatson, *ibid.*

[50] Beatson, *ibid.*, p. 398

premature termination of the contract, the reasonable construction of the agreement requires that the right of the builders to instalments should be unconditional. This clearly was the ground upon which Lord Fraser based his judgment in *Papadopoulos*[51]. The way his lordship distinguished cases like *Dies* and *Palmer v. Temple*- as cases in which "the contracts were simply contracts of sale which did not require the vendor to perform any work or incur any expense on the subjects of sale"[52]- clearly support this.

6.22 This analysis also explains the non-recoverability of a deposit by the payer, upon the premature termination of the contract. A deposit, as it has been emphasized, is a guarantee of performance and an earnest to bind the bargain. The nature of such a payment requires its forfeitability upon any failure by the payer. The right of the payee to such a payment, therefore, is an unconditional right. That is why a deposit is not recoverable by the payer upon termination of the agreement for his default.

1.3.3.3. Restitutionary Approach

6.23 It can, alternatively, be argued that in *Dies*, there was a total failure of consideration[53]: the buyers received nothing from what they had bargained for. In the *Hyundai* cases, on the other hand, the buyers received part of the consideration for which they had contracted: the contract was to build, launch, equip and complete a vessel and to deliver and sell her to the buyers and the assumption in the case, as it was explained by Lord Fraser[54], was that the shipbuilders had performed their contractual duty up to the date of termination. Therefore, there being no total failure of consideration, the shipbuilders were entitled to retain the instalments, and in case of the instalments which had accrued due and remained unpaid, they had the right to sue the buyers for their recovery.

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[51] *Hyundai Heavy Industries Co. Ltd. v. Papadopoulos* [1980] 2 All ER 29

[52] *Ibid.*, at p. 44

[53] This has sometimes been accepted as a general principle in the context of the recoverability of moneys already paid: see, e.g., Goff & Jones, The Law of Restitution, 4th ed., 1993, pp. 428-429 ; Halsbury's Law's of England, 4th ed., vol. 9, para. 672

[54] Lord Fraser stated: "There was no evidence either way whether the builders had in fact carried out their obligations to start designing and building the vessel, but in my opinion we must assume, in the absence of evidence or even averment to the contrary, that they had carried out their part of the bargain up till the date of cancellation." at p. 45

It appears that Viscount Dilhorne in *Papadopoulos* reasoned his decision on this basis. In his view, except "in the case of sales of land and goods and where there has been a total failure of consideration"[55], the payee's accrued rights to part payments remains unaffected. The exception of sales of land and goods could, it has been suggested[56], only be justified on the ground that in such cases there is normally a total failure of consideration where the contract is prematurely brought to an end.

6.24 The relationship between *Dies* and *Hyundai* cases could, as it appears, be explained on both construction and restitutionary bases. The issue however is which of these bases could provide a generally acceptable ground for the recoverability of advance payments at common law. To approach this point, it is appropriate to consider analytically the merits of both bases.

6.25 Several reasons have been suggested to show that the restitutionary approach, though intellectually attractive, cannot provide a general rule in this context: **First**, the concept of total failure of consideration, as the main requirement for an action in restitution, is based on "arbitrary and uncertain" concepts.[57] This has been illustrated by the different treatments of the court in the cases of *Papadopoulos*[58] and *Fibrosa*[59]. The latter case was concerned with an agreement to purchase certain textile machinery for £4,800. The buyers made an advance payment of £1,000, but before delivery, the contract came to an end by reason of frustration due to the outbreak of the Second World War. The House of Lords found in favour of the buyers in their action to recover the advance payment. The expenses which the sellers had incurred in manufacturing the machines did not prevent the House from holding that there was a total failure of consideration. The relevant facts of this case was similar to those of *Papadopoulos*. In both the sellers had to incur expenses in order to perform their contractual obligations, whereas the House rejected the existence of the total failure of consideration in the latter

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[55] *Hyundai Heavy Industries Co. Ltd. v. Papadopoulos* [1980] 2 All ER 29, at p. 35

[56] Beatson, loc. cit., no 2, pp. 58-59

[57] Beatson, loc. cit., no 2, p. 64

[58] *Hyundai Heavy Industries Co. Ltd. v. Papadopoulos* [1980] 2 All ER 29

case. This portrays, it is thought, the arbitrariness of the concept of total failure of consideration.

An important distinction which might explain the different treatments of the House in these cases is the consideration for which the parties had bargained for: In *Papadopoulos*, the contract was for building, launching, equipping the vessel and delivering and selling her to the buyers, while in *Fibrosa*, the substance of the agreement was to sell the machines to the buyers. The apparent intention of the parties, derived from the words used by them, was that in *Fibrosa*, the parties had bargained for the transfer of the end product, and the expenses incurred by the seller in manufacturing the machines were not a part of the parties contract. In the former case, however, the bargain clearly included designing and building, as well as delivering and selling. From the time that the process of designing the vessel started, the buyers had been getting a part of consideration for which they had bargained, while in *Fibrosa* this was not the case.[60] This analysis does also gain support from the decision of the Court of Appeal in *Rover International Ltd v. Cannon Film Sales Ltd*[61] where the court expressly recognized the concept of the "bargained-for performance" as the criteria for determining whether the failure of consideration had been total. In this case, Kerr LJ, describing the test to determine the existence of a total failure of consideration, held:

> "The test is whether or not the party claiming total failure of consideration has in fact received any part of *the benefit bargained for under the contract or purported contract.*"[62]

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[59] *Fibrosa Spolka Akcyjna v. Fairbairn Lawson Combe Barbour Ltd* [1943] AC 32

[60] It has also been argued that the contract in *Papadopoulos* was a severable contract, *i.e.* "the obligation to design and build the vessel was severable from the obligation to deliver and sell her"- or alternatively assuming the contract as an entire contract, the buyers' default prevented them from arguing that the acceptance of services provided by the seller was not proratable-, while in *Fibrosa* the contract was an entire contract. The result is that the sellers in *Papadopoulos* were entitled to a recompense for services provided by them, whereas in *Fibrosa* the sellers could not make such a claim. Now, since in a sense the services constituting performance of consideration (and preventing the failure of consideration from being total) on the one hand and services which generate a restitutionary claim by themselves on the other are the two sides of the same coin, it could be concluded that in *Fibrosa* there was a total failure of consideration, while such a failure could not be established in *Papadopoulos*. For a detailed analysis see Beatson, loc. cit., no 2, pp. 65-71

[61] [1989] 1 WLR 912, [1989] 3 All ER 423

[62] *Ibid.*, at p. 923 [emphasis added]

6.26 **Second**, it might further be argued that the unevenness[63] of the concept of total failure of consideration could be considered as a barrier in developing a general rule for the recoverability of advance payments based on the restitutionary approach. The argument runs as follows: As to entire contracts, rendering part of services provided for in the contract would not normally entitle the provider of services to recompense.[64] One exception to this rule is where the recipient of services is in breach of the contract, because in such a case, his own failure will prevent him from contending that his acceptance of services was with the expectation of receiving the full performance. Thus, the concept of *quantum meruit* would, as it appears, be an uneven concept because it "draws a sharp distinction between the position of a contract-breaker and an innocent party"[65]. This unevenness, though not unreasonable in itself, is not quite consistent with the principle regarding the non-retrospective effect of discharge. Now, since it may be argued that services generating a restitutionary claim on the one hand, and services constituting a part performance which prevents the failure of consideration from being total on the other should be considered as the two sides of the same coin[66], the result of this argument would be that in entire contracts, the breacher would not be able to claim

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[63] By "unevenness" I mean the existence of asymmetry between the position of either paid and unpaid sums (see *infra*., note 66) or breacher and non-breacher.

[64] Unless of course the services provided could amount to an "incontrovertible benefit" (*i.e.*, an "*immediate and realizable* gain to the defendant" or "saving him an *inevitable* expense") which in contractual relations is very difficult to be established. The reason for the rule in the text is that a claim for a recompense for those services may face an immediate defence that the services were accepted "in the context of the contractual performance as an entity", *i.e.*, with the expectation that the full performance, as provided by the contract, will follow. See Beatson, loc. cit., no 2, p. 69

[65] Beatson, loc. cit., no 2, p. 71

[66] Though the separate development of the claims for the recovery of moneys paid on the one hand, and claims for the recovery of a recompense for services suggests to the contrary: see Beatson, loc. cit., no 2, p. 70; Thus, in entire contracts, a clear asymmetry between the position of paid and unpaid sums could be seen: A part performer who cannot claim for a recompense for services rendered, where the contract is prematurely discharged for his breach, will not normally be liable to return the part payments made by the other party on the ground that there was no total failure of consideration. (see Law Commission, Working Paper No 65, Pecuniary Restitution on Breach of Contract, 1975, para. 20; see also *Baltic Shipping Co. v. Dillon (The Mikhail Lermontov)* (1993) 176 CLR 344, where a passenger on a cruise ship, after the ship being sunk, was held not to be entitled to recover the fare paid- on the ground that there was no total failure of consideration- whereas had the fare become due on completion of the voyage, it would not have been recoverable.) The Law Commission, though suggesting in general the entitlement of the payer to claim, in restitution, for the difference between moneys paid by him and the value of services rendered by the payee in the Working Paper, did not recommend, in its subsequent report, any change in the existing rule under which the payer's only remedy in the above-mentioned situation is in a claim for damages. (see Law Commission's Report, No 121, Pecuniary Restitution on Breach of Contract, 1983, part III, especially para. 3.11)

for the recovery of his part payments, because the provider of services being entitled to a recompense for services provided, the recipient has received part of consideration which will prevent the failure of consideration from being total. While if the discharge of the contract is not for the recipient's breach, the provided services will not entitle the provider to a recompense, and thus there should be taken to be a total failure of consideration which should allow the recipient to recover his part payments.[67] Such an outcome would obviously be unsatisfactory, because it would be in apparent inconsistency with the principle regarding the non-retrospective of discharge: if there is an unconditionally accrued right for the payer before discharge, it should remain unaffected regardless of whether he was the breacher or not.

6.27 **Third**, the major problem with the restitutionary approach in this context, is, it seems, the requirement that the failure of consideration should be *total*. This, it has been suggested, has led the courts to find, in some cases, the existence of the total failure of consideration in an artificial way.[68] For instance, in the cases of sales of cars by non-owners[69], despite the use of the car by the buyer for long periods of time, the court has decided that there was a total failure of consideration, and has ordered the seller to return the price on this basis. Here, it has been argued, the failure of consideration could not be regarded as total, for the buyer has had the benefit of using the car for a certain period of time, but due to the non-recognition of the concept of *partial* failure of consideration, and thus the impossibility of the apportionment of the price, taking into account the

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[67] Under the existing law, however, such a payment may not be recoverable; the payer's only remedy is in damages. see Law Commission's Report no 121, part III

[68] See Burrows A., The Law of Restitution, (Butterworths, 1993), p. 255; Beatson, loc. cit., no 2, p. 71

[69] See, for example, *Rowland v. Divall* [1923] 2 KB 500, where despite the fact that the car was used by the buyer for two months, the Court of Appeal held that there was a total failure of consideration because the buyer had not been given what he had bargained for. (see *ibid*, per Atkin LJ at p. 506); *Butterworth v. Kingsway Motors Ltd.* [1954] 1 WLR 1286; see also *Rover International Ltd. v. Cannon Film Sales Ltd. (No. 3)* [1989] 1 W.L.R. 912, [1989] 3 All ER 423, where in a film distributorship agreement, incurring certain expenses by Cannon in delivering the films to Rover, and also the possession and use of the films by Rover were not regarded as a consideration which had been bargained for. Kerr LJ held: "... delivery and possession were not what Rover had bargained for. The relevant bargain, at any rate for present purposes, was the opportunity to earn a substantial share of the gross receipts pursuant to clause 6 of the schedule, with the certainty of at least breaking even by recouping their advance. Due to the invalidity of the agreement Rover got nothing of what they had bargained for, and there was clearly a total failure of consideration." at pp. 924-925; see also Birks P, An Introduction to the Law of Restitution, (Oxford: Clarendon Press, 1989), note 17 at p. 465 & note 30 at p. 476

benefit received by the buyer[70], the courts have tried to artificially find the existence of the *total* failure of consideration.

6.28 Both restitutionary and construction approaches do, it appears, come to the same point where the payee's right to the part payment, according to the intention of the parties derived from the terms of the contract and surrounding circumstances, is conditional either on the beginning of the contractual performance by the payee, or on the provision of the end-product. In the first case, as in *Papadopoulos*, by the payee starting to perform his contractual obligations, his right to the part payments becomes unconditional; or on the alternative approach, consideration which prevents the failure from being total is provided. Thus, the payer will not be entitled to recover the instalments already paid, and will be under the liability to pay the instalments which have accrued due before discharge, but remained unpaid. In the second case, like most cases of sales of goods or land, unless the end product is transferred, the payee's right remains conditional; and on the restitutionary approach, there will be a total failure of consideration unless the payee performs his contractual obligation fully, *i.e.* transfers the end-product.

6.29 Where, however, the payee's right is conditional upon partial or full performance of services[71], then based on the construction approach, the payee's right will not be unconditional unless the services bargained for are provided. Whereas on the basis of the restitutionary approach, by the payee starting to perform his contractual obligations, it may be argued that no *total* failure of consideration could be established, although the bargained for services have not yet been provided.[72] The result would be that the part

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[70] In the car cases, of course, the seller's lack of title to the car would negate any possibility of his entitlement to a restitutionary claim on the basis of *quantum valebat* (see Burrows A., The Law of Restitution, (Butterworths, 1993), pp. 255-256; Birks P, An Introduction to the Law of Restitution, (Oxford: Clarendon Press, 1989), note 30 at p. 476, and note 17 at p. 465), but as to the *Rover International* case, it has been suggested (see Birks, loc. cit., p. 476) that "the value of the use of the films should have been taken into account in calculating Rover's *quantum meruit*."

[71] Where, for example, the payee's right to each instalment of payment is conditional upon provision of a specific part of services provided for in the contract, or where it is conditional on the provision of full services.

[72] Because the actual beneficial enjoyment of the payer from services has already been started, so it is difficult to argue that the failure of consideration is total. For the concept of "actual beneficial

payments may be recoverable on the construction approach, while they are not on the restitutionary approach. This limitation on the restitutionary approach may, to some extend, be removed by accepting the concept of *partial* failure of consideration[73], though such a change, it has been submitted[74], could not be achieved on the basis of the existing case law. Therefore, the restitutionary approach, in its present form, in the context of the recoverability of advance payments, is, it appears, reduced to a species of the construction approach: In addition to the fact that to determine the "bargained for consideration" for the purpose of deciding whether there has been a total failure of consideration, the intention of the parties, having regard to the terms of the contract and surrounding circumstances, should be construed[75], the recoverability of advance payments based on the restitutionary approach could well be explained on the construction approach as well; while, as it was seen, the recovery of part payments on the construction approach, might sometimes not be explainable on the basis of the restitutionary approach.

For these reasons, it seems that the construction approach, in the context of the recoverability of advance payments at common law, should prevail. This approach, in addition to being capable of protecting both reliance and restitutionary interests of the payee, can provide a general principle as to the recoverability of advance payments, regardless of whether or not the payer is in breach of contract.[76] Thus, determining the nature of the payee's right to the advance payments by properly construing the intention of the parties will generally provide the answer to the issue of the recoverability of part payments, upon the premature termination of the contract, at common law. Such a solution is, as it was seen, completely consistent with the principle regarding the non-retrospective effect of discharge.

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enjoyment" as a determinative factor in determining the total failure of consideration see Burrows A., The Law of Restitution, (Butterworths, 1993), pp. 253 *et seq*.

[73] Such a change was provisionally proposed by the Law Commission in its Working Paper No. 65, though in its subsequent report, the Commission suggested the necessity of adhering to the concept of *total* failure of consideration. Law Commission's Report No. 121, Pecuniary Restitution on Breach of Contract, part III. This has sometimes been described as "a major disappointment". see Burrows A., The Law of Restitution, (Butterworths, 1993), p. 261

[74] Beatson, loc. cit., no 2, p. 75, where he suggests: "Common law development ... cannot remove the requirement that the failure of consideration be total ..."

[75] In other words, such a "bargained for performance" is "a product of contractual specification". see Beatson, loc. cit., no 2, pp. 74-75

[76] See Beatson, loc. cit., no 2, pp. 59-60; Chitty on Contracts, 27th ed., vol. 1, 1994, para. 26-071

1.4. The Criteria for Deciding the Nature of the Payee's Right to Prepayments

1.4.1. Express or Implied Intention of the Parties

6.30 Whether the right of the payee to advance payments is conditional or unconditional would seem to depend on the intention of the parties which should be ascertained by the interpretation of the contract according to its terms and all surrounding circumstances.[77] Where, therefore, the parties have expressly or implicitly provided for the forfeitability of the payment upon termination of the contract for the payer's default, the right to advance payment would be unconditional.[78] If, on the other hand, the express or implied intention of the parties is that, upon termination, the advance payment would be recoverable by the payer, the right of the payee to that payment would undoubtedly be a conditional one.

1.4.2. Imputed Intention of the Parties

6.31 Where no express or implied intention could be discovered from the contract, then the imputed intention of the parties would clarify the situation:

First, if the advance payment is a deposit and is paid to guarantee the performance of the contract, then, in the absence of any express or implied intention of the parties, the imputed intention would be that the right to the deposit is unconditional; and therefore the payee has the right to retain it.

6.32 **Second**, where the payment is only a part payment of the price, then if the payee has to incur expenses in performing his contractual promise, his right to the part payment will, *prima facie*, be unconditional.[79] It does, however, appear that a distinction should

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[77] See Goff & Jones, The Law of Restitution, 4th ed., 1993, p. 430

[78] See, e.g., *Colonial Bank v. European Grain & Shipping Ltd.* [1987] 1 Lloyd's Rep. 239, In this case, as to a charterparty providing for the advance payment of the freight and the owner's entitlement to that regardless of any subsequent events, it was held that the owner's right to the freight was unconditional. Mr Justice Hobhouse, in the course of his judgment, relying on the *Papadopoulos* case, said: "If on a true construction of the contract the creditor has done all that is required of him to earn the entitlement to the relevant payment or payments by the debtor then in principle, and in justice, the creditor should continue to be entitled to those payments regardless of subsequent events which occur before the time or times at which those sums have actually to be paid and regardless of the failure of the creditor to perform subsequent obligations under the contract." at p. 248 (The case has been affirmed on this aspect by both the Court of Appeal and the House of Lords: [1989] AC 1056, at pp. 1098-99 per Lord Brandon)

[79] See Goff & Jones, The Law of Restitution, 4th ed., p. 431; McKendrick E, Contract Law, (2nd ed., 1994), p. 334; Beatson, loc. cit., no. 2, p. 401 ; Harpum, loc. cit., no. 46, p. 136 ; Greig & Davis, The

be made between the following situations: if the parties have agreed for the end-product (*i.e.* only the final result has been bargained for), there should be no unconditional right in the payee to instalments before the completion of the performance.[80] A clear example is a case where a famous painter undertakes to paint a certain picture in consideration of a price provided to be paid by instalments. He will obviously have to incur expenses, and spend considerable time to produce the final product. But if for any reason the contract is prematurely brought to an end, the painter will not be entitled to retain the instalments, for his right to part payments- according to the apparent construction put on the contract, in the absence of any intention to the contrary- is conditional upon the provision of the final product, as has contractually been bargained for.[81] If, however, there is no hint that

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Law of Contract (Australia), 1987, p. 1280

[80] See, e.g., *Fibrosa Spolka Akcyjna v. Fairbairn Lawson Combe Barbour Ltd* [1943] AC 32, where the parties' contract was for the purchase of certain machines which also involved incurring expenses in manufacturing them by the sellers. The apparent construction of such an agreement was that the parties had bargained for the end-product. Thus, expenses incurred by the payee in performing his obligation did not turn his right to advance payments to an unconditional right.

[81] There is no doubt that in case of a discharge for the payer's breach, the painter will have a remedy in damages. He might alternatively, it may be argued, be able to sue the other party, on the basis of *quantum meruit*, to recover a reasonable remuneration for the work already done. See, e.g., *Planché v. Colburn* (1831) 8 Bing. 14, where the plaintiff was engaged in writing a volume of a certain series of books which was to be published by the defendants. Upon the abandonment of the publication by the defendants, it was held that the plaintiff might be entitled to recover the value of the work he had already done on the basis of *quantum meruit*. It should, however, be mentioned that this case which has, for long, been regarded as an authority for the plaintiff's right to elect between damages and restitution [see, e.g., *De Bernardy v. Harding* (1853) 8 Ex. 822; *Lodder v. Slowey* [1904] AC 442 (PC); *Hoenig v. Isaacs* [1952] 2 All ER 176, at p. 180 per Somervell LJ; *Renard Construction (ME) Pty Ltd v. Minister of Public Works* [1992] A.C.L. Rep. 325 (Court of Appeal, N.S.W.)], is a controversial decision and not immune from strong criticism: **First**, the case was decided at a time when the rules as to discharge for breach had not yet been developed. Thus, the decision, as it appears from the report and also from the consequent authorities considering the case, was based on the ground that the contract had been rescinded *ab initio*. **Second**, though the first criticism has been overcome by the further development of the concept of repudiatory breach and discharge for that (see, e.g., *Renard* case, *ibid.*), it might still be argued that the desirable consequences could be achieved by an action for damages. Put another way, the plaintiff could *either* carry on with the contract, and upon the defendant's actual failure to perform his contractual obligation, bring an action for damages [In such a case, he would be limited to the recovery of the contract price, (see Goff & Jones, The Law of Restitution, 3rd ed., p. 424) and damages resulting from breach if he can prove them (see *ibid*, at p. 428)], *or*, because of the repudiation of the contract by the defendant due to his anticipatory breach, treat the contract as discharged, and immediately bring an action for damages. The whole argument is that in cases like *Planché v. Colburn*, the plaintiff should not have the right to elect between damages and restitution: **First**, generally speaking, damages and restitution are not mutually exclusive remedies. **Second**, one of the elements/bases for a restitutionary action is enrichment. That is, there must exist a benefit which unjustly enriches the defendant at the plaintiff's expense. In *Planché v. Colburn*, the existence of such a benefit could not be proved, because the plaintiff had only incurred reliance expenditure in performing his part of the bargain: that was in fact not a benefit to the defendant, but a reliance loss to the plaintiff . [for the concept of benefit constituting enrichment see Goff & Jones, loc. cit., p. 426 (objective, "bargained-for" benefit); Burrows A. S., Free

the contract- *i.e.* what has been bargained for- is *only* for the end-product and the payee has to incur expenses to perform his contractual duty[82], then it is *presumed* that the parties have intended that the payee will have the right to retain the instalments.

6.33 It would seem that such an intention is ascribable to the parties where the performance has commenced, and in fact the payer has started to benefit from the agreement.[83] This view is supported by the assumption made by Lord Fraser in the *Papadopoulos* case[84] to the effect that the shipbuilders had carried out their obligations

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Acceptance and the Law of Restitution (1988) 104 LQR 576, at pp. 586-587 (*either* incontrovertible *or* "bargained-for" benefit, but generally the latter)] In cases like *Planché v. Colburn*, where the contract is for the production of the end-result, it is difficult to discern any benefit conferred on the defendant being capable of a ground for a restitutionary claim. The works done by the plaintiff is, in fact, in the nature of preparatory work for the purpose of performance, which should certainly entitle him to compensation in an action for damages. Thus, it has sometimes been suggested that "the case is best viewed as awarding the equivalent of contractual expectation damages and not restitution". [Burrows, loc. cit., at p. 589; *cf.* Peter Birks, An Introduction to the Law of Restitution, (Oxford: Clarendon Press, 1985), p. 127, who tries to justify the decision using the concept of "limited acceptance": the defendant by entering into the contract should be deemed to have accepted to pay for the preparatory expenses incurred by the plaintiff in performing his contractual obligation. This has been considered as a benefit to the defendant enough to give rise to a claim in restitution.] Third, the most important issue is, in such cases, the recovery of a possible claim based on restitution could not, in principle, exceed the contractual price. [*cf. Lodder v. Slowey* [1904] AC 442 (affirming (1900) 20 N.Z.L.R. 321); See also the California case of *Boomer v. Muir* 24 P. 2d 570 (1933); For more American authorities see George E. Palmer, The Law of Restitution, vol. 1, (Little, Brown and Company, 1978), s. 4.4 esp. cases cited in note 1] Although the restitutionary claim is regarded as independent from contract, based on the concept of unjust enrichment, nonetheless the benefit rendered to the defendant is determined by reference to the terms of the contract. Further, the acceptance of this benefit by the defendant is also analysed as a matter of obligation: The defendant by his breach of contract is estopped from denying that he has accepted the benefit rendered by the plaintiff. That being so, how at the valuation stage, an independent basis for the claim can be assumed. The inevitable conclusion should be that, the benefit and its acceptance being determined by the terms of the contract, which also include the contractual price, the remuneration also should not exceed the contract price. [see *Noyes v. Pugin*, 27 P. 548 (1891), at p. 549 per Anders C.J (State of Washington); *Wuchter v. Fitzgerald*, 163 P. 819 (1917) (State of Oregon); see also Goff & Jones, The Law of Restitution, p. 427; Burrows distinguishes incontrovertible benefits from benefits deriving merely from bargained-for performance: in case of the former, the plaintiff is not, in his view, restricted to the contract price, while as to the latter, he cannot recover more than the contract ceiling. See Burrows, *ibid.*, at p. 587; see also Garner M., The Role of Subjective benefit in the Law of Unjust Enrichment (1990) 10 O.J.L.S. 42, at p. 55; For the same view but on slightly different arguments see Birks P., In Defence of Free Acceptance, [Published in: Essays on the Law of Restitution, ed. Andrew Burrows], (Oxford: Clarendon Press, 1991), p.136]

[82] Like the facts in the cases of *Pournaras* and *Papadopoulos*

[83] Benefiting from the agreement by the payer is not necessarily the *actual* enjoyment, but getting the bargained for performance from the payee. see *infra.*, para. 6.34

[84] [1980] 2 All ER 29, where he says: "... in my opinion we must assume, in the absence of evidence or even averment to the contrary, that they [*i.e.* the builders] had carried out their part of the bargain up till the date of cancellation." (at p. 45); *cf.* Beatson, loc. cit., no 2, pp. 60-61, Professor Beatson, though suggesting a modification of taking the actual, rather than the likelihood of, reliance into account, thinks

up to the date of termination. It is therefore suggested that, in the absence of any contrary intention, it is the fact of partial performance and incurring expenses by the payee, and not merely being bound to incur expenses according to the contractual terms, which entitles the payee to retain the instalments.

6.34 This proposition might be criticized by saying that according to that, the payee's right should be regarded as unconditional, regardless of whether the commencement of performance by him has actually conferred any benefit upon the payer. Furthermore, there might be cases in which the benefit enjoyed by the payer as a result of the partial performance is considerably less in value than the instalments retained or sued for by the payee. It would appear that the "*actual* enjoyment" of the payer is not a determinative factor in this regard; it is enough that the payer has started to get what he has bargained for, though it may not necessarily amount to "actual enjoyment". In *Papadopoulos*, for

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that, according to Lord Fraser in *Papadopoulos*, merely being bound to incur reliance expenditure by the payee will give him an unconditional right to the part payments. He refers to this as a disadvantage of the construction approach, because it may leave open the possibility of unjust enrichment where the payee, though being contractually bound to incur expenses, had not in fact incurred any reliance expenditure. (see *ibid.*, at p. 60) With all due respect, however, it appears that Lord Fraser's judgment in *Papadopoulos* may have an indication to the contrary: In addition to the assumption made by his lordship, as referred to above, he states in another part of his judgment: "... I think it is clear that the shipbuilding contract has little similarity with a contract of sale and much more similarity, so far as the present issues are concerned, with contracts in which the party entitled to be paid had either performed work or provided services for which payment is due by the date of cancellation." (at p. 45) He also repeats the assumption made above as a basis for his judgment: "In the instant case the buyers have not actually enjoyed any benefit from the work which the builders have performed, but it had been performed (or at least we must so assume, in the absence of evidence to the contrary) on the faith of the buyer's promise to pay the instalments on the due dates. (at p. 46) On the other hand, his statement to the effect that "[i]t is enough that the builders were bound to incur considerable expenses in carrying out their part of the contract long before the actual sale could take place" (at p. 44) might be taken as a support for the view that merely being bound to incur expenditure makes the payee's right to advance payments unconditional. It should however be noted that such a statement was made in the context of distinguishing a shipbuilding contract from a contract of sale, like contracts in *Dies* or *Palmer v. Temple*. To make such a distinction, it was enough to see that the builders were bound to incur reliance expenditure "long before the actual sale could take place". It does not, it seems, show that, in his view, merely being bound to incur expenses makes the payee's right to the payments an unconditional right. Furthermore, turning to the restitutionary approach, it is obvious that merely a promise to perform, though constituting enough consideration as far as the formation of contract is concerned, cannot amount to a consideration which prevents the failure of consideration from being total. It is the actual performance which may amount to that: see *Fibrosa Spolka Akcyjna v. Fairbairn Lawson Combe Barbour Ltd* [1943] AC 32, per Lord Simon, at p. 48; see also *Rover International Ltd. v. Cannon Film Sales Ltd. (No. 3)* [1989] 1 W.L.R. 912, [1989] 3 All ER 423, where Kerr LJ observed: "When referring to the provision of consideration in this context, ..., one is not referring to the *original promise to perform* the contract. The question is whether there was any consideration *in the nature of part performance* for which the instalment was payable ..." (at p. 932, emphasis added); see also p. 923 per Kerr LJ

instance, though "the buyers [had] not actually enjoyed any benefit from the work which the builders [had] performed"[85], they had started (or, at least, in the words of Lord Fraser, it had to be *assumed* so in the absence of any evidence to the contrary) to get the bargained for performance from the sellers.

6.35 It is however difficult, it seems, to ascribe to the parties the intention that the payee has the right to retain all the instalments paid regardless of the expenses incurred by the payee or the value of benefits conferred upon the payer by the partial performance. For example, in a contract to build and sell a ship, there might be different stages in the process of performing the contractual undertakings by the shipbuilder, like getting an export licence, planning the vessel, building the structure, constructing other different parts, equipping the ship, launching and delivering her to the buyers. In such a contract, if the parties provide for the payment to be made by certain instalments, then, in the absence of any express or implied intention as to the forfeitability of instalments, allowing the shipbuilder to retain all the instalments paid by the buyers for the mere reason that the payee has commenced performing his undertaking, without any regard to the expenses incurred by him and/or the benefits conferred on the buyers through partial performance might unjustly enrich the shipbuilder: He, for instance, might be at the first stage of the process of performing his undertaking, while the buyer has made an advance payment for the half of the price. In a well-planned contract, of course, this is less likely to happen, because most probably the parties provide for the payment of the instalments in proportion to the progress of the work undertaken by the payee.[86] But where this is the case, it would seem that the parties would hardly be likely to intend that the payee be entitled to keep the instalments paid before termination, regardless of the expenses incurred by the payee and the benefit conferred upon the payer through the partial performance.

In the course of his judgement in the *Papadopoulos* case[87], Lord Fraser referred to the

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[85] *Hyundai Heavy Industries Co. Ltd. v. Papadopoulos* [1980] 2 All ER 29, per Lord Fraser at p. 46

[86] As it is the case in most modern construction contracts

[87] [1980] 2 All ER 29

possibility of a proportion between the instalments paid by the payer and the expenses incurred by the payee in the following terms:

> "It seems very likely that the increasing proportions of the contract price represented by the five instalments bore some relation to the anticipated rate of expenditure, but we have no information on which to make any nice comparison between the amount of expenses ... and the amount of instalments payable by the buyers."[88]

But, then, his lordship negated the necessity of such a comparison and added:

> "It is enough that the builders were bound to incur considerable expense in carrying out their part of the contract long before the actual sale could take place."[89]

The question which may arise is whether the outcome of the case would be the same if the buyer had paid a considerable part of the price, say three quarters, as the instalments, and the builders were only at the stage of planning the structure of the ship. It seems unlikely that, in the absence of an express or implied term, the intention of the forfeitability of such instalments could be ascribed to the parties relying on the facts that the builders have to incur expenses to perform their part of the contract, and they have commenced to perform it.

6.36 A distinction, it appears, should be made between entire and severable covenants: Where the covenant of the payee, though consisting of many parts, form the parts of one whole which may not be considered as separable, then merely having to incur expenses by the payee in fulfilling his obligations and the fact of starting to perform those undertakings will entitle him to retain the instalments paid upon the premature termination of the contract for the payer's default.[90] If, however, the covenants of the payee are severable, he should be entitled, it is submitted, to retain the instalments only in proportion to each severable covenant.[91] That seems to be the reasonable intention

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[88] *Ibid.*, at p. 44

[89] *Ibid.*

[90] It may well be argued that in *Papadopoulos*, the payee's covenant was an entire obligation, and since the payer had to incur expenses in performing his obligations (and he has actually, or at least presumably, started to perform), therefore his right to advance payments was unconditional.

[91] In a well planned contract the instalments relating to each severable covenant will certainly have a relation to the expenses incurred by the payee and the benefit conferred upon the payer from the fulfilment of that severable covenant. The possibility of the apportionment of the consideration has been recognized in *The Government of Newfoundland v. Newfoundland Railway Co.* (1888) 13 App. Cas. 199, where the plaintiff company entered into an agreement with the Government to construct and maintain a

which could be ascribed to the parties in the absence of any express or implied term. Thus, in severable contracts the commencement of performance by the payee of each severable covenant will make his right to the instalment proportionate to that covenant as an unconditional right.[92] Therefore, though the payer might have paid a considerable part of the whole price in the form of instalments, upon the premature termination of the contract for his default, he may be entitled to recover those instalments the severable covenant relating to which has not yet been commenced to be performed.

6.37 **Third**, in all other cases, the right of the payee to the part payment would, it seems, be conditional upon performance of the contract. Therefore, the payer would be entitled to recover the advance payment if the contract was prematurely terminated.[93] The right of the payee might be conditional upon complete performance or the commencement of performance which should also be determined by construing the contract according to its terms and all surrounding circumstances.

1.5. The Criteria for Distinguishing Deposits from Part Payments

6.38 Having concluded that the issue of the recoverability of an advance payment by the payer upon the premature termination of the contract for his default is a matter of construction to discover the express, implied or imputed intention of the parties with regard to the right of the payee to the advance payment, it is now appropriate to discuss the criteria for determining whether an advance payment is a deposit or a mere part

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railway in consideration of, *inter alia*, an annual subsidy for thirty-five years. Upon breach of the contract by the company after completion of a portion of the railway, the company claimed, *inter alia*, a certain amount of subsidy for the completed portion of the railway. The Privy Council answered the question "[w]hether by the non-completion of the whole railway within the time stipulated, the company forfeit their right to the payment of the subsidy in respect of so much of the line as is complete and operated" in favour of the plaintiffs. In the Board's view, upon the true construction of the contract, on the completion of each severable section of the line, a proportionate part of the whole subsidy "became payable as a separate subsidy, beginning at the next day of payment and continuing for thirty-five years". see at pp. 208-209 per Lord Hobhouse

[92] This is the case in most building contracts: In these contracts, the instalments of the contract price are determined and paid according to the progress of the work. Such a contract may, it seems, be said to be severable which consists of several separable entire obligations. The right to each instalment will be unconditional as the payee starts performing the relevant severable covenant.

[93] See, e.g., *Dies v. British and International Mining and Finance Corporation Ltd.* [1939] 1 KB 724 ; *Reid Motors Ltd. v. Wood* [1978] 1 N.Z.L.R. 319 ; *Stevenson v. Colonial Homes Ltd.* (1961) 27 D.L.R. (2nd) 698 ; *Terrex Resources N.L. v. Magnet Petroleum Ply Ltd.* (1988) 1 W.A.R. 144

payment. This is particularly important because, as it was pointed out[94], the advance payment being recognized as a deposit is undoubtedly forfeitable by the payee upon termination of the contract for the payer's default.

1.5.1. Functions of a Deposit

6.39 The attention should be paid, first and foremost, to the functions of a deposit which would help in recognizing the nature of an advance payment. Fry L.J. in *Howe v. Smith*[95] explained these functions in the following terms:

> " Money paid as a deposit must, I conceive, be paid on some terms implied or expressed. In this case no terms are expressed, and we must therefore inquire what terms are to be implied. The terms most naturally to be implied appear to me in the case of money paid on the signing of a contract to be that in the event of the contract being performed it shall be brought into account, but if the contract is not performed by the payer it shall remain the property of the payee. It is not merely a part payment, but is then also an earnest to bind the bargain so entered into, and creates by the fear of its forfeiture a motive in the payer to perform the rest of the contract."[96]

This passage clearly shows that a deposit is (a) a part of the purchase price if the contract is completed, and (b) an earnest to bind the bargain: it shows the fact that the payer means business. In other words, it constitutes a guarantee for the performance and completion of the contract by the payer.[97] If, therefore, the *construction of the contract*[98] showed that the advance payment had been paid to fulfil these functions, it should be recognized as a deposit.

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[94] *Supra.*, para. 6.31

[95] (1884) 27 Ch.D. 89

[96] *Ibid.*, at p. 101; also see *Soper v. Arnold* (1889) 14 App. Cas. 492 at 433, 435 ; *Levy v. Stogdon* [1898] 1 Ch. 478, 485 (affirmed by the Court of Appeal: [1899]1 Ch. 5) ; *Hall v. Burnell* [1911] 2 Ch. 551; *Lowe v. Hope* [1970] Ch. 94, at pp. 97, 98 ; *Re A Solicitor* [1966] 3 All ER 52, 57

[97] It has been doubted that deposits can still be a guarantee of performance. The reason, as it has been pointed out by the Conveyancing Standing Committee of the Law Commission and the Law Society in a report published in February 1988, is that the old practice of keeping the deposit by the vendors' solicitors as stakeholders has been replaced by the practice of allowing the vendor to use the deposit in his own purchase. Consequently "only the vendor at the top of the chain has money in his hands to forfeit in the event of the chain collapsing." It has been argued that the new practice of permitting "travelling deposits" questions the justification given for the payment of a deposit as providing a security for the vendor against the purchaser's default. See Oakley A J, Deposits: still a guarantee of performance?, part I, The Conveyancer and Property Lawyer, Jan-Feb 1994, pp. 45-49

[98] See McKendrick E, Contract Law, (2nd ed., 1994), p. 332; Pawlowski, Relief Against Forfeiture of Deposits, Estate Gazette, Nov 21, 1992, p. 76

1.5.2. The Language Used by the Parties

6.40 The language used by the parties to describe the payment is also material.[99] Although the use of the term "deposit" is not conclusive[100], nonetheless it, *prima facie*, shows that the parties have truly intended the advance payment to be a deposit. In *Howe v. Smith*[101], Bowen J., discussing the meaning which a businessman attaches to the term "deposit", observed:

> "... a deposit, if nothing more is said about it, is, according to the ordinary interpretation of business men, a security for the completion of the purchase."[102]

It was, furthermore, held in *Elson (Inspector of Taxes) v. Prices Tailors Ltd.*[103] that using the term "deposit" would normally imply that the prepayment was a security for the performance of agreement:

> ""Deposit" bears a perfectly well and commonly known meaning of security for completion of the purchase."[104]

It may, therefore, be concluded that using the term "deposit" raises a *presumption* that the prepayment is intended to be a deposit.[105] Needless to say that such a presumption could, by evincing enough evidence to the contrary, be rebutted. This can clearly be inferred from the observations of Lord Hailsham of St. Marylebone L.C. in *Linggi Plantations Ltd. v. Jagatheesan*[106] where he stated:

> "It is also no doubt possible that in a particular contract the parties may use language normally appropriate to deposits properly so called even to forfeiture which turn out on investigation to be purely colourable and that in such a case the real nature of the transaction might turn out to be the

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[99] See Furmston M P, Cheshire, Fifoot & Furmston's Law of Contract, 13th ed., 1996, p. 640; Furmston M P, Contract Planning: Liquidated Damages, Deposits and the Foreseeability Rule (1991) 4 JCL 1, at p. 3; Harris, Remedies in Contract and Tort, 1988, p. 27; Pawlowski, loc. cit., no. 98, p. 76

[100] See, e.g., *Reid Motors v. Wood* [1978] 1 N.Z.L.R. 319 where despite the use of the word "deposit", the advance payment, considering the circumstances in which the contract was made and the reasons for stipulating for such a large amount, was regarded as a part payment. at pp. 326-327 ; see also McGregor on Damages, 15th ed., 1988, para. 503; Carter, Breach of Contract, 2nd ed., 1991, para. 1252, no. 294

[101] (1884) 27 Ch.D. 89

[102] *Ibid.*, at p. 98

[103] [1963] 1 W.L.R. 287; see also *Soper v. Arnold* (1889) 14 App. Cas. 429, at p. 435 per Lord Macnaghten; *Gallagher v. Shilcock* [1949] 2 KB 765, at p. 768; *Stockloser v. Johnson* [1954] 1 Q.B. 476, at p. 490

[104] *Ibid.*, at p. 292

[105] See Goff & Jones, The Law of Restitution, 4th ed., p. 432, *cf. Smyth v. Jessup* [1956] V.L.R. 230

[106] [1972] 1 M.L.J. 89

> imposition of a penalty, by purporting to render forfeit something which is in truth part payment."[107]

1.5.3. The Circumstances of Each Particular Case

6.41 In determining the nature of an advance payment and deciding whether it is a deposit or a part payment, regard should also be had to the circumstances of each particular case.[108] Put another way, the court, considering the terms of the agreement, all circumstances surrounding it and the words used by the parties should determine whether the advance payment is a deposit or merely a part payment. This has been emphasized by Finnemore J. in *Gallagher v. Shilcock*[109] where he said:

> "As I understand the position, in each case the question is whether the payment was in fact intended by the parties to be a deposit in the strict sense or no more than a part payment: and, in deciding this question, regard may be had to the circumstances of the case, to the actual words of the contract, and to the evidence of what was said."[110]

6.42 Where the language of the contract is neutral and there is no evidence to show whether the payment is a deposit or a part payment, then the prepayment will be considered as a part payment.[111] That is because the money paid following the signing of the contract is supposed to be a part of the contractual price unless the contractual terms or any other evidence show that it is a deposit to bind the bargain or guarantee the performance of the agreement. The proposition is supported by the judgement in *Dies*[112] in which there being no evidence to indicate that the payment was a deposit, it was held that the money advanced was a mere part payment of purchase price. Stable J. stated:

> "In the present case, neither by the use of the word "deposit" or otherwise, is there anything to indicate that the payment of £100,000 was intended or was believed by either party to be in the nature of a guarantee or earnest for the due performance of the contract. It was a part payment of the

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[107] *Ibid.*, at p. 94

[108] Halsbury's Laws of England, 4th ed., vol. 41, para. 811, no. 1

[109] [1949] 2 KB 765; [1949] 1 All ER 921

[110] *Ibid.*, at p. 769 ; see also *Elson (Inspector of Taxes) v. Prices Tailors Ltd.* [1963] 1 W.L.R. 287, at pp. 291-292 per Ungoed-Thomas J.

[111] See Goff & Jones, The Law of Restitution, 4th ed., pp. 430, 432; McKendrick E, Contract Law, (2nd ed., 1994), p. 332; Downes, Textbook on Contract, 3rd ed., 1993, p. 333 ; see also *McDonald v. Dennys Lascelles Ltd.* (1933) 48 C.L.R. 457, at pp. 478-479 per Dixon J.

[112] [1939] 1 KB 724

price of the goods sold and was so described."[113]

2. A Historical Review of the Jurisdiction to Relieve Against Forfeiture

6.43 The other preliminary issue which, before discussing the equitable jurisdiction to grant relief against forfeiture, should be given a consideration is a review of the historical development of the equitable intervention of courts to grant relief against forfeiture. The penalty doctrine and the rules relating to the equitable relief against forfeitures- though they, in the course of time, appeared to have developed along independent lines- have the same origin. The main areas in which a court of chancery granted relief were those of mortgages, leases and bonds.[114] The history of the Chancellor's intervention to grant relief against forfeiture of mortgages and leases originally follows that of bonds.[115] Relief against satisfied mortgages in the early fourteenth century[116] was probably a special form of relief against bonds which, despite the actual payment, had not been cancelled nor there was any formal acquittance or release[117]. Turner dates the first relief afforded to a mortgagor who had failed to pay the debt on the specified day back to the reign of Elizabeth (1558-1603)[118], and speculates that such a relief had seemingly arisen out of the Chancellor's intervention to give relief against forfeiture of bonds of all kind in the sixteenth century.[119] It is in this time that some cases of relief against forfeiture of leases for non-payment of rent could also be found.[120]

6.44 Sir George Cary, speaking of the position as to relief against penalties and forfeitures by the beginning of the seventeenth century, explains the established

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[113] *Ibid.*, at p. 742

[114] Simpson A W B, A History of the Common Law of Contract, 1975, p. 118

[115] For the history of penalties, see *supra.*, chapter 1, section 1

[116] A reference to some recognized equitable jurisdiction over satisfied mortgages could be found in the Year Book of 9 Ed. IV. See Turner R.W., The Equity of Redemption, 1931, pp. 21-22

[117] St. German's Doctor and Student, edited by: Plucknett T.F.T & Barton J.L. (Sel. Soc., vol. 91, 1974), First Dialogue, ch. XII, pp. 77-79; see *supra.*, para. 1.07

[118] Turner R.W., The Equity of Redemption, 1931, p. 24; see also *supra.*, para. 1.08

[119] See *ibid.*

[120] See, e.g., *Browne v. Wentworth*, Monro (*Acta Cancellariae*) 638 (cited by Turner, loc. cit., pp. 24-25)

jurisdiction of the Courts of Chancery to grant relief against forfeiture of bonds in special circumstances where the exaction of penalties would result in hardship.[121] He, then, adds:

> "The like favour is extendable against them that will take advantage upon any strict condition, for undoing the estate of another in lands, upon a small or trifling default."[122]

This shows both the established jurisdiction of the Courts of Chancery to relieve against forfeiture and the fact that this jurisdiction had the same origin and basis as the jurisdiction to relieve against penalty of bonds. Turner refers to some cases decided in the close of the sixteenth century[123] and the early seventeenth century[124] where the Chancellor granted relief to a mortgagor who had failed to comply with the condition and suffered a forfeiture, though the reports, according to him, have not normally stated the basis upon which these decisions were grounded. He concludes that the Chancellor during this period intervened to relieve "where it seemed to be equitable".[125]

6.45 Although the jurisdiction was first limited to cases of hardship, its scope was gradually widened in the course of time so that the Chancellor started to grant relief as of course. There was, therefore, no need for the mortgagors to show special circumstances to be able to get relief. A judicial statement in 1639 shows how far the Chancellor had extended his jurisdiction by this time:

> "[The court] will relieve a mortgage to the tenth generation, though the purchaser had no notice, because it is supposed that he cannot purchase, but it must be derived from the mortgage, and in some cases, where the mortgagee will suddenly bestow unnecessary costs upon the mortgaged lands, of purpose to clogg the lands, to prevent the mortgagor's redemption."[126]

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[121] Cary 1 (cited by Simpson, loc. cit., no 114, p. 119; Turner R.W., The Equity of Redemption, 1931, p.25); see *supra.*, para. 1.09

[122] Cary 2 (cited by Turner, loc. cit., *ibid.*)

[123] *Langford v. Barnard* (1594) Tothill 134; *Sedgwick v. Evan* (1582) Choyce Cases 167 (relief refused because the defendant was in possession for forty years)

[124] *Courtman v. Convers* (1601) Monro 764; *Wilkey v. Dagge* (1608) Monro 107 where Sir John Tyndal observed: "I find him [*i.e.*, the mortgagor] a very poor man, and am very creditably informed that the defendants be hard-dealing men"; *Hanmer v. Lochard* (1612) Tothill 132; *Holman v. Vaux* (1616) Tothill 133

[125] Turner R.W., The Equity of Redemption, 1931, p. 26

[126] *Bacon v. Bacon* (1639) Tothill 133 (cited by Turner, loc. cit., p. 29)

6.46 By the middle of the seventeenth century, there seems to be no doubt that the jurisdiction to relieve against forfeiture had, together with the jurisdiction as to relief against penal bonds, well been developed.[127] This jurisdiction mainly derived from the wide and established jurisdiction of equity to relieve against the unconscionable use of legal rights. A bill, passed by Cromwell in 1654 as an Ordinance, limiting the redemption of mortgages to one year after the entry of the mortgagee for the condition breached, shows the extensive relief afforded by the Courts of Chancery against forfeiture of mortgages. This bill, however, was repeatedly ignored by the Commissioners in Chancery, and was finally thrown over by the legislature of the Restoration.[128]

6.47 Although the practice of granting relief against penal bonds, as we have already seen[129], was adopted by the Common Law Courts towards the middle of the seventeenth century, and although the relief against mortgages and bonds had originally developed in the same line, yet the Common Law Courts did not appear to make the same attempt to recover their power with regard to mortgages. The reason, according to Coke[130], was that "in a mortgage the ownership in the thing pledged had already been transferred, whereas in a bond the sum forfeited had not yet been paid over to the obligee."

6.48 The basis for the intervention, as emphasized earlier[131] was that the exaction of penalties and forfeitures would be inequitable where the obligee could be compensated for the loss suffered from the breach.[132] The notion of a forfeiture provision being in the nature of a security for the production of a stated result did, it appears, considerably help the Chancellor to formulate and extend his jurisdiction to grant relief, though it is a

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[127] See Yale D.E.C., An Essay on Mortgages and Trusts and Allied Topics in Equity (An Introduction to "Lord Nottingham's Chancery Cases, vol. II, 1961"), Sel. Soc., vol. 79, 1, at p. 15; Turner R.W., The Equity of Redemption, 1931, p. 30

[128] Spence, Mortgages, vol. 1, 602 *et seq.* (cited by Turner, loc. cit., p. 30)

[129] See *supra.*, paras. 1.20 *et seq.*

[130] Co. Litt., para. 334 (cited by Turner, loc. cit., pp. 33-34)

[131] See *supra.*, para. 1.13

[132] Simpson, loc. cit., no. 114, pp. 120-121

matter of discussion[133] whether it was the very first basis upon which the jurisdiction was grounded. In *Emanuel College v. Evans*[134], as to a lease of a certain property for 500 years, the court "conceived the said Lease being but a Security, and that Money paid, the said Lease had been void, as well against the said College, as against any other; and though the Money not paid at the Day, but afterwards, the said Lease ought to be void in Equity, as well as on a legal Payment, it had been void in Law against them."[135] This is apparently the only case before the Restoration where the Court of Chancery has referred to the concept of a mortgage being a security for a debt. However, this conception has frequently been used after the Restoration as a ground for relief against forfeiture afforded to mortgagors.[136]

6.49 The twelfth maxim of equity stated by Francis in the early eighteenth century shows the well established jurisdiction of equity to relieve against penalties and forfeitures:

> "Equity suffers not advantage to be taken of a penalty or forfeiture, where compensation can be made."[137]

By this time, the equitable rules for distinguishing penalties and forfeitures had been evolved; and the courts of equity had begun to settle some meaningful rules with regard to the notion of proprietary interests. A series of significant discussions regarding the equitable relief against forfeiture in a number of cases[138] shows the origin and the evolution of the doctrine in this century: The established rule was that where a party to a contract had been prevented from the literal enforcement of the agreement through unavoidable accident, fraud, surprise or ignorance, which was not wilful, the courts of equity would intervene and grant relief against forfeiture. Among these discussions, the remarks of Sir Richard Pepper Arden M.R. in *Eaton v. Lyon*[139] are worth mentioning. He

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[133] See Turner R.W., The Equity of Redemption, 1931, pp. 36 *et seq.*

[134] (1625) 1 Chan. Rep. 18, 21 ER 494

[135] *Ibid.*, at pp. 20, 495 respectively

[136] See, e.g., *Thornbrough v. Baker* (1676) 3 Swans. 628, 36 ER 1000, Lord Nottingham in this case refers to this concept as one of "natural justice and equity". See also *supra.*, para. 1.14

[137] Ed. princ. 1728 (cited by Simpson A.W.B., A History of the Common Law of Contract: The Rise of the Action of Assumpsit, 1975, p. 121)

[138] See, e.g., *Hardy v. Martin* (1783) 1 Cox 26, 29 ER 1046; *Sloman v. Walter* (1783) 1 Bro. c.c. 419, 28 ER 1213

[139] (1798) 3 Ves Jun 690, 30 ER 1223

pointed out:

> "At Law a covenant must be strictly and literally performed: in Equity it must be really and substantially performed according to the true intent and meaning of the parties, so far as circumstances will admit: but if by unavoidable accident, if by fraud, by surprise, or ignorance not wilful, parties may have been prevented from executing it literally, a court of Equity will intervene: and upon compensation being made, the party having done everything in his power, and being prevented by the means, I have alluded to, will give relief."[140]

It appears that in this period, the relief was limited to the heads of accidents, fraud, surprise and ignorance, and had not been extended to wilful breaches.

6.50 By the beginning of the nineteenth century, a judicial disagreement can be seen regarding the exercise of the equitable power to relieve against forfeitures: The settled point was granting relief against penalties in the shape of forfeiture where it was possible accurately to compensate the other party for the loss suffered. Lord Nottingham's observations in *Cage v. Russel*[141] can clearly illustrate this:

> "... it is a standing rule of the Court that a forfeiture should not bind where a thing may be done afterwards, or any compensation made for it- as where the condition was to pay money or the like."

As it also appears from the judgment, equity did always assume the compensation possible where the penalty of forfeiture had been inserted for non-payment of a sum of money.[142] It was, for instance, the established rule of the Court to grant relief against forfeiture of leases for non-payment of rent[143], but there was also a tendency to extend this jurisdiction to the breach of other covenants. In *Wadman v. Calcraft*[144], Sir William Grant, the Master of the Rolls, made some observations in the following terms:

> "The plaintiff seeks to be relieved against a forfeiture of this lease; which he states to have been incurred solely by non-payment of rent; and if that is the ground of this ejectment, there is no doubt equity will relieve against the forfeiture; considering the purpose of the clause of re-entry to be only

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[140] *Ibid.*, at pp. 692-693 and p. 1224 respectively

[141] 2 Ventris 352, 86 ER 481

[142] See, e.g., *Davis v. Thomas* (1830) 1 Russ. and My. 506, 36 ER 195

[143] This old equitable jurisdiction still survives (see, e.g., *Howard v. Fanshawe* [1895] 2 Ch. 581; *Lovelock v. Margo* [1963] 2 QB 786; *Thatcher v. CH Pearce & Sons (Contractors) Ltd.* [1968] 1 WLR 748; *Abbey National Building Society v. Maybeech Ltd.* [1984] 3 WLR 793), though subsequent statutes have modified it or extended its scope in certain circumstances.

[144] (1804) 10 Ves Jun 66 , 32 ER 768

> to secure the payment of rent; and that, when the rent is paid, the end is obtained; ... . But in this lease [there] are several other covenants; and it seems admitted, that relief is not to be given in equity against a forfeiture, occasioned by the breach of those covenants."[145]

In this case, Lord Chancellor Eldon, who heard the case upon appeal, clearly confined the jurisdiction to the breaches of covenants for payment of rent. Lord Erskine, on the other hand, two years later, in *Sanders v. Pope*[146], relieved the lessee from the consequences of his breach of a covenant to lay out a specific sum in repair in a given time. His lordship pointed out:

> "There is no branch of the jurisdiction of this court more delicate than that, which goes to restrain the exercise of a legal right. That jurisdiction rests only upon this principle; that one party is taking advantage of a forfeiture; and as a rigid exercise of the legal right would produce a hardship, a great loss and injury on the one hand arising from going to the full extent of the right, while on the other the party may have the full benefit of the contract, as originally framed, the Court will interfere; where a mode of compensation can be discovered."[147]

The Lord Chancellor, then, citing the observations of Lord Nottingham in *Cage v. Russel*[148], emphasized the importance of the rule of compensation; and subject to the possibility of full compensation, extended the jurisdiction to wilful breaches:

> "Undoubtedly, unless it is plain, that full compensation can be given, so as to put the other party in the same situation precisely, a Court of Equity ought not to act; ... If the covenant is broken with the consciousness, that it is broken, that is, if it is wilful, not by surprise, accident, or ignorance, still if it is a case, where full compensation can be made, these authorities say, not that it is imperative upon the court to give relief, but that there is a discretion."[149]

6.51 This expansive view was followed in *Davis v. West*[150]. However, it was soon much

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[145] *Ibid.*, at pp. 68-69 and p. 769 respectively

[146] 12 Ves Jun 282, 2 Ves Jun Supp 298, 33 ER 108, 34 ER 1103

[147] *Ibid.*, at pp. 289, 110 respectively

[148] 2 Ventris 352, 86 ER 481

[149] *Sanders v. Pope* 12 Ves Jun 282, 33 ER 108, at pp. 291-293 and pp. 111-112 respectively

[150] (1806) 12 Ves Jun 476, 33 ER 180 where it was held: "Where covenants are broken, and there is no fraud, and the party is capable of giving complete compensation, it is the province of a Court of Equity to interfere, and give the relief against the forfeiture for breach of other covenants, as well as that for payment of rent; and the only distinction is, that in the latter case it is considered so clear, that the object of the clause for re-entry is only to secure the payment of the rent, that the legislature interposed; and made it unnecessary to come into Equity; ..."

questioned: In *Hill v. Barclay*[151] and *Reynolds v. Pitt*[152], Lord Eldon refused to grant relief for breach of covenants to repair and to insure against fire.[153] The restricted approach towards the equitable relief against forfeiture appears to have been applied for quite a long time. Thus, in *Barrow v. Isaacs & Son*[154] the court refused to grant relief for breach of a covenant not to underlet the premises without the consent of the lessor. The remarks of Kay L.J. in this case, neatly summarises the position and clearly illustrates the lack of any "central concept"[155] for the equitable jurisdiction of relief against forfeiture:

> "Long ago Courts of Equity assumed jurisdiction to relieve against forfeitures and penalties where the only object was to secure payment of a definite sum of money, even though there was no fraud, accident, surprise, or mistake. ... At first there seems to have been some hesitation whether this relief [*i.e.* relief against forfeiture for non-payment of rent] might not be extended to other cases of forfeiture for breach of covenants such as to repair, to insure, and the like, where compensation could be made; but it was soon recognised that there would be great difficulty in estimating the proper amount of compensation; and, since the decision of Lord Eldon in *Hill v. Barclay* (18 Ves. 56), it has always been held that equity would not relieve, merely on the ground that it could give compensation, upon breach of any covenant in a lease except the covenant for payment of rent. But of course this left unaffected the undoubted jurisdiction to relieve in case of breach occasioned by fraud, accident, surprise, or mistake."[156]

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[151] (1811) 16 Ves Jun 402, 18 Ves. 56, 34 ER 1200

[152] (1812) 19 Ves Jun 134, 34 ER 468

[153] See also *Lovat v. Lord Ranelagh*, 3 Ves & Bea 24, 35 ER 388; *Bracebridge v. Buckley*, 2 Price 200, 146 ER 68; *Rolfe v. Harris*, 2 Price 206, 146 ER 71; *White v. Warner*, 2 Mer. 459, 35 ER 1016; *Hannam v. South London Water Works Company*, 2 Mer. 61, 35 ER 863

[154] [1891] 1 QB 417

[155] See Lang, A.G., Forfeiture of Interests in Land (1984) 100 LQR 427, at p. 429

[156] [1891] 1 QB 417, at p. 425 ; see also *Matthews v. Smallwood* [1910] 1 Ch. 777, at p. 792 per Parker J.

Chapter 7

Relief Against Forfeiture of the Payer's Interest in the Subject-matter

1. Introduction

7.01 Upon entering into a contract, the payer may acquire an interest in the subject-matter.[1] In an agreement for the sale of land by instalments, for instance, the purchaser obtains an equitable interest in the property on exchange of contracts[2]; and if he has taken possession of the land, there will also be a possessory interest for the purchaser.[3] Now, if such a contract provides for the right of the vendor to terminate the agreement, retake possession of the land and retain the moneys already paid upon the purchaser's breach, the payer will forfeit his equitable interest in the subject-matter, as well as the moneys already paid following his default and the exercise of the right to terminate by the vendor.

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[1] This may be a legal interest where a right over an identifiable asset (which is referred to as a "real right" or a right *in rem*) is acquired by the party to a contract. Such a right may result from ownership, possession or equitable charge. It may also be an equitable interest: This happens where a party acquires a personal right to have a real right (which is referred to as *ad rem* or a right *in personam* and *rem*). For instance, the right of a buyer to whom the asset has not been transferred nor delivered is a right in *ad rem*. Such a right is not regarded as a mere personal right (*in personam*) in Equity, but the buyer, it is said, has a proprietary interest in the subject-matter, provided that the contract is capable of being specifically performed. The important difference between legal and equitable rights, in this context, is that an equitable right is enforceable against anyone *except* a *bona fide* purchaser who takes the asset for value, without notice of the existence of the equitable right. See, generally, Goode R., Commercial Law, 2nd ed., (Penguin Books, 1995), pp. 28-31; Megarry, Sir Robert & Thompson M.P., Megarry's Manual of the Law of Real Property, 7th ed., (London: Sweet & Maxwell, 1993), pp. 56-69

[2] See, e.g., *Shaw v. Foster* (1872) 27 LT 281, LR 5 HL 321 where Lord Cairns said: "... there cannot be the slightest doubt of the relation subsisting in the eyes of a court of equity between the vendor and the purchaser. The vendor was a trustee of the property for the purchaser; the purchaser was the real beneficial owner in the eye of a court of equity of the property, subject only to this observation, that the vendor, whom I have called the trustee, was not a mere dormant trustee, he was a trustee having a personal and substantial interest in the property..." at p. 283 ; *Lysaght v. Edwards* (1876) 2 Ch.D. 499 ; *Lake v. Bayliss* [1974] 2 All ER 1114, [1974] 1 WLR 1073; For a short historical account on the evolution of equitable interests see *Swiss Bank Corporation v. Lloyds Bank Ltd* [1979] Ch. 548, at pp. 565-566 per Browne-Wilkinson J. (reversed on a different point: [1982] AC 584); see also Gibson's Conveyancing, 21st ed., 1980, p. 178; Megarry, Sir Robert & Thompson M.P., Megarry's Manual of the Law of Real Property, 7th ed., (London: Sweet & Maxwell, 1993), p. 66; Carter J W, Breach of Contract, 2nd ed., 1991, para. 1067

[3] Also a lessee in possession, for example, has a possessory interest in the subject-matter for the period of lease. Such an interest is also a real right (*in rem*).

7.02 This, of course, is the position at common law. The purchaser, however, might, in certain circumstances, be relieved from the consequences of his breach, *i.e.* the forfeiture of his equitable interest and moneys already paid, in equity. Though the equitable jurisdictions to relieve against forfeiture of the payer's interest in the subject-matter on the one hand and moneys already paid on the other have the same origin, due to different principles which are applicable to each of them, it is appropriate to discuss them separately. It should, however, be born in mind that these two heads of the equitable jurisdiction are closely related to each other: The purchaser, being relieved against forfeiture of his equitable interest in the subject-matter, is also, in effect, relieved against forfeiture of moneys already paid.[4]

2. Development of the Jurisdiction

7.03 Though the jurisdiction to relieve against forfeiture of an interest in the property has not been limited to any particular case[5], the development of the jurisdiction, nonetheless, has been mainly taken place through the cases of leases[6] and sale of land by instalments. The principles regarding the exercise of the jurisdiction, however, as it will be suggested, seem to apply to any other similar case.

7.04 As the historical review of the subject shows, the courts of equity, looking at the substance of the parties' agreement, granted relief against forfeiture where the object of the forfeiture clause was "to secure the payment of money"[7] provided that the innocent party could fully be compensated.[8] In an instalment contract, the power of forfeiture is normally stipulated for the failure in the payment of instalments. In such cases, it has clearly been established that if the debtor is willing, ready and able to perform his

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[4] See *supra.*, pp. 258-259

[5] Meagher, R. P., Gummow, W. M. C., Lehane, J. R. F., Equity Doctrines & Remedies, 3rd ed, 1992, para. 1805 at p. 439

[6] The jurisdiction with regard to leases is now mainly governed by statute. (see, for example, sec. 146, Law of Property Act 1925) The other instances for the exercise of the equitable jurisdiction were mortgages, and copyhold tenure. see Meagher, Gummow & Lehane, loc. cit., *ibid.*

[7] See *Shiloh Spinners Ltd. v. Harding* [1973] AC 691, at p.722 per Lord Wilberforce ; *Davis v. Thomas* (1830) 1 Russ & M 506, at p. 507 per Leach M.R.; *Re Dixon* [1900] 2 Ch. 561, at p. 576 per Rigby LJ

[8] See, in addition to the historical account on the subject (*supra.*, paras. 1.18-1.19, 1.28), *Reynolds v. Pitt* (1812) 19 Ves. Jun. 133, 34 ER 468 per Lord Eldon at p. 140; *Binks v. Lord Rokeby* (1818) 2 Swans. 222, per Lord Eldon at p. 226

obligation, *i.e.* to pay the instalments due with interest and the creditor's costs, the court may grant relief against forfeiture of the payer's interest in the subject-matter by decreeing specific performance or granting him one or more[9] extensions of time to perform his obligation.[10]

7.05 The foundation of such a relief could be found in the decision of the Court of Appeal in Chancery in *Re Dagenham (Thames) Dock Co., ex parte Hulse*[11]. The Company, which had been incorporated by Act of Parliament, agreed to purchase land from Hulse to build a dock on the north bank of the Thames. Half of the price was paid on the execution of the contract, and the other half, plus interest, was, after some changes in the date of payment by the parties' agreement, eventually agreed to be paid on a certain date. Time of the payment was expressly made of the essence. It was also provided that upon the company's failure on the payment of the balance, the vendors would be entitled to repossess the land and retain all moneys already paid. The company went into possession and carried out some work on the dock, but failed to pay the balance of the purchase price on time. Shortly afterwards the company went into liquidation. The vendors brought an action for ejectment. Lord Romilly M.R. was only prepared to offer them an order for the sale of the land in order to enable the vendors to enforce their lien for the balance outstanding. The vendors did not accept this offer and appealed. The Court of Appeal in Chancery, having upheld the decision of Lord Romilly M.R., granted the company relief against forfeiture of their interest in the land upon payment of the balance of the purchase price with interest.

Sir W.M. James L.J., in the course of his judgement, stated:

> "It would be a strong thing to hold that a company authorized to buy land for purposes beneficial to the public could enter into a bargain with a landowner that if ever so small a portion of the purchase money which the company is to pay him remains unpaid on a particular day, he shall be entitled to take back the land with all the works which have been executed

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[9] See *Starside Properties Ltd. v. Mustapha* [1974] 1 WLR 816

[10] See Furmston M P, Cheshire, Fifoot & Furmston's Law of Contract, 13th ed., p. 642; Goff & Jones, The Law of Restitution, 4th ed., 1993, p. 437 ; Beale H, Unreasonable Deposits (1993) 109 LQR 526 ; Harpum C, Relief Against Forfeiture and the Purchaser of Land [1974] CLJ 134, at p. 142 ; Lang A G, Forfeiture of Interests in Land (1984) 100 LQR 427, at p. 447

[11] (1873) LR 8 Ch App 1022

upon it by the company."[12]

It appears from this passage that the court considered the vendor's conduct in bringing an action to retake possession of the land with all the work which had been carried out on it and to retain all moneys paid as unconscionable. The forfeiture clause was also regarded as penal in nature[13], because it had provided for the forfeiture of both the company's interest in the property and the moneys already paid on the purchaser's failure to pay the balance on the specified date without any regard to the loss actually suffered as the result of breach. The case provides a clear authority for the availability of relief against forfeiture of the purchaser's interest in land where the forfeiture clause is in the nature of penalty and also where, probably, the vendor's conduct in exercising his right of forfeiture is unconscionable.

7.06 It is not clear whether the vendors in *Re Dagenham* had terminated the contract for the purchaser's default. There is some tendency in the subsequent authorities considering the case to construe that the contract there had not been terminated: In *Stockloser v. Johnson*[14], Romer L.J., analysing the case, favoured this view arguing that the decision of the court in granting relief, despite the provision that time was to be of the essence, was only justifiable "by reason of the fact that the plaintiff, themselves had twice postponed the date which had been originally agreed for the payment"[15]. This argument implies that the parties, having twice postponed the date of payment, had, in fact, waived the stipulation making time of the essence. The plaintiffs, therefore, were not entitled to terminate the agreement, since there was no contractual right to terminate, and the defendant's breach could not be regarded as a repudiatory breach. It has, on the other hand, been suggested that the vendor's action for ejectment cannot be consistent with the continued performance of the contract, and therefore the contract was terminated when "the writ in the ejectment proceeding was served"[16].

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[12] *Ibid.*, at p. 1025

[13] Sir G. Mellish L.J. stated: "I have always understood that where there is a stipulation that if, on a certain day, an agreement remains either wholly or in any part unperformed- in which case the real damage may be either very large or very trifling- there is to be a certain forfeiture incurred, that stipulation is to be treated as in the nature of a penalty." *Ibid.*, at p. 1025

[14] [1954] 1 QB 476, at pp. 496-497

[15] *Ibid.*, at p. 497

[16] Harpum C, Relief Against Forfeiture and the Purchaser of Land, loc. cit., no. 10, at p. 148, citing *Car*

7.07 There is much to be said in favour of the view that the mere extensions of time should not be regarded as a waiver of the "time of the essence" stipulation. Where the parties agree about a certain date for payment, and also make the time of the essence, their agreement, in fact, has two parts: first, determining a certain date as the date of payment; and second, agreeing that the time of payment shall be of the essence. Where an extension of time is given, the parties alter the first limb of their agreement, but the second part, in principle, remains unaffected by a mere change in the date of payment; and unless there is enough evidence that the parties, extending the date for payment, have also waived the "time of the essence" stipulation, the latter stipulation should, in principle, remain on foot.

Enough support for this proposition might be found in the authorities: In *Buckland v. Farmer & Moody*[17], there was no doubt that "if a vendor ha[d] once made time of the essence of the contract and then allow[ed] a further extension to a fixed date, the time remain[ed] essential."[18] The issue was also dealt with in detail in *Barclay v. Messenger*[19] where Jessel M.R. concluded:

> "It appears to me plain that a mere extension of time, and nothing more, is only a waiver to the extent of substituting the extended time for the original time, and not an utter destruction of the essential character of the time."[20]

It could also be argued that any extension of time is an indulgence granted by the creditor, and such an indulgence should not put the debtor in a better position than the one in which he would have been had the time not been extended.

7.08 Having said that, it could be argued that in the *Dagenham* case, the time stipulation retained its essential character despite the extensions agreed by the parties. Thus, the purchaser's failure was a breach of a payment stipulation time of which was of the essence, and it would entitle the vendors to bring the contract to an end. The vendor's

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and Universal Finance Co. Ltd. v. Caldwell [1956] 1 QB 525, 556 per Upjohn L.J., and *Garnac Grain Co. Inc. v. H.M.F. Faur & Fairclough Ltd.* [1966] 1 QB 650, 675 per Sellers L.J. for the support of the proposition.

[17] [1979] 1 WLR 221

[18] *Ibid.*, at p. 231, per Buckley L.J.

[19] (1874) 43 L.J. Ch. 449

action for ejection, as it was already argued[21], was a clear indication that the vendors had exercised their right to terminate. The contract, thus, had been brought to an end when the writ for the ejectment proceeding had been served to the purchasers.

The decision in this case, therefore, might be treated as an authority for the view that, even after termination for the purchaser's breach of an essential time stipulation, the court may grant relief against forfeiture of the purchaser's interest in the property, by decreeing specific performance or giving the purchaser extra time to perform his contractual obligation.[22]

7.09 The decision of the Court of Appeal in the *Re Dagenham* case[23] was followed by the Privy Council in *Kilmer v. British Columbia Orchard Lands Ltd.*[24] in which in an agreement for the sale of land by instalments, it was provided that if the purchaser made default in the punctual payment of any one instalment, the contract would be null and void, and the vendors would be entitled to re-sell the land and retain all payments already made. Time of the payments was expressly declared to be of the essence. There was an extension of time by mutual agreement for the payment of the second instalment. The purchasers having made default in the payment of this instalment, the vendors declared the contract to be of no effect and brought an action to enforce their right of forfeiture. The purchaser counterclaimed for specific performance and obtained leave to pay into the court the instalments due. The trial judge dismissed the action and gave judgment for the purchaser, relieving him from any forfeiture incurred, on the ground, apparently[25], that the vendor's conduct in exercising its strict legal rights was harsh and unconscionable. The company, therefore, was not regarded as entitled to terminate the agreement. The interesting point, however, is that, in his view, even if the vendor had been able to terminate the contract by relying on its strict legal rights, there was enough authority to

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[20] *Ibid.*, at p. 456

[21] See *supra.*, para. 7.06

[22] The point will also be discussed later: *infra.*, paras. 7.48 *et seq.*

[23] *Re Dagenham (Thames) Dock Co., ex parte Hulse* (1873) LR 8 Ch App 1022

[24] [1913] AC 319

[25] As it appears from the report (pp. 319-320, 322) and the full description of the case by Harpum, loc. cit., no. 10, at pp. 148-149

relieve the purchaser from forfeiture.

An appeal to the Court of Appeal of British Columbia was allowed. The court by the majority held that the vendor, being able to take advantage of the term making time of the essence, could terminate the contract. Furthermore, there was nothing in the vendor's conduct to preclude it from relying on its strict legal rights. There, therefore, being no ground for granting relief against forfeiture, the appeal should be allowed. However, the Privy Council, allowing the appeal, held that the forfeiture clause was in the nature of penalty, and the purchasers were entitled to be relieved against that. The short reasoning of the Board in their judgment, delivered by Lord Moulton, was, in part, in the following terms:

> "The circumstances of this case seems to bring it entirely within the ruling of the *Dagenham Dock* case. It seems to be even stronger case, for the penalty, if enforced according to the letter of the agreement, becomes more and more severe as the agreement approaches completion, and the money liable to confiscation becomes larger."[26]

7.10 The counsel for the both parties mainly concentrated their arguments on the provision making time of the essence. On behalf of the vendors, it was agreed that the time of payment was still of the essence, despite the extension agreed by the parties. The counsel for the purchasers, on the other hand, argued:

> "As they [the vendors] had submitted to postpone the day of the enforcing payment they were no longer entitled to say that time was of the essence of the contract. The rigid date having been altered they were not entitled to say the substituted date was rigid to the extent of being unalterable."[27]

Despite these arguments, the Board in its judgment did not refer at all to the "time of the essence" provision. They said that there were other points raised in the course of the argument, but they did not think it necessary to refer to them.[28] The logical inference to be drawn from this, it has been suggested[29], is that the Privy Council did not see it relevant to consider the "time of the essence" provision for the purpose of making a decision with regard to the grant of relief against forfeiture. This, in fact, is an obvious

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[26] [1913] AC 319, at p. 325

[27] *Ibid.*, at p. 320

[28] *Ibid.*, at p. 325

[29] Harpum C., Relief Against Forfeiture and the Purchaser of Land, loc. cit., no. 10, at p. at p. 150

inference: if the Board had thought it relevant to decide first with regard to the waiver of the provision making time of the essence to enable it to make a decision on granting relief against forfeiture, it should have referred to the arguments and made its position clear, especially where the point was so controversial between the parties and it had been referred to and dealt with by the trial judge and the Court of Appeal.

This being so, the case might, it seems, provide another authority for the view that relief against forfeiture may be granted irrespective of the termination of the agreement for the purchaser's breach of an essential time stipulation.

7.11 A shadow of doubt was cast on the development of the jurisdiction to relieve against forfeiture of the payer's interest in the property by the decisions of the Privy Council in *Steedman v. Drinkle*[30] and *Brickles v. Snell*[31], in which relief by decreeing specific performance was denied for the purchasers who had defaulted in payment of an instalment on the due date, time having been expressly made of the essence. In *Steedman v. Drinkle*[32], in an agreement for the sale of land by instalments, it was, *inter alia*, provided that if the purchaser made default in punctual payment of any one instalment, the vendor would be entitled to terminate the contract, keep all payments already made, as liquidated damages, and retain all improvements made on the premises. Default having been made in the payment of the first instalment, the vendors cancelled the contract. The respondent, who was the purchaser's assignee, tendered the instalment due by the time he received the notice of cancellation; but the appellant, who was the administer of the vendor's estate, refused to accept it. Drinkle, the respondent, then, brought an action claiming specific performance of the contract. The statement of claim, as it appears from the report, was as follows:

> "(1) Specific performance, or alternatively damages; (2) in the alternative that they should be relieved from the forfeiture (if any) of their rights and interests under the agreement, and of their equitable rights or interests in the land, upon terms."[33]

The appellant, Steedman, counterclaimed for a declaration that the agreement had been

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[30] [1916] 1 AC 275

[31] [1916] 2 AC 599

[32] [1916] 1 AC 275

[33] *Ibid.*, at p. 276

validly terminated. Newlands J., the judge at first instance, thought that, the time of payments being expressly made of the essence, he could not decree specific performance. He, however, offered the respondent an amendment of claim, so as to relieve him against forfeiture of moneys already paid. Drinkle, refusing this offer, successfully appealed to the Supreme Court of Saskatchewan which, reversing the decision of Newlands J., decreed specific performance, upon the authority of *Kilmer v. British Columbia*[34], on the term that the respondent should pay the amount due. The Privy Council held that the respondent should be relieved against forfeiture of moneys already paid, but he was not entitled to specific performance. The reason was that, though the forfeiture clause was in the nature of penalty against which the purchaser was entitled to be relieved, the Courts of Equity never granted specific performance where the parties have expressly made time of the essence. Viscount Haldane, delivering the judgment of the Board, stated:

> "Courts of Equity, which look at the substance as distinguished from the letter of agreements, no doubt exercise an extensive jurisdiction which enables them to decree specific performance ... . But they never exercise this jurisdiction where the parties have expressly intimated in their agreement that it is not to apply by providing that time is to be of the essence of their bargain."[35]

The Board explained *Kilmer v. British Columbia*[36] on the ground that in that case the Board was of the view that the "time of the essence" provision had been waived, because the date of payment had once been extended which showed that, the Board said, "the stipulation had not been insisted on by the company".[37]

7.12 This case, and *Brickles v. Snell*[38] in which the principle stated in *Steedman v. Drinkle*[39] was followed, might be regarded as authorities for the proposition that relief against forfeiture of the purchaser's interest in property could not be granted where the purchaser's breach is of a stipulation time of which has expressly been made of the

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[34] *Kilmer v. British Columbia Orchard Lands Ltd.* [1913] AC 319

[35] [1916] 1 AC 275, at p. 279

[36] [1913] AC 319

[37] [1916] 1 AC 275, at p. 279

[38] [1916] 2 AC 599

[39] [1916] 1 AC 275

essence.[40] If this proposition is correct, then a payer may only be relieved against forfeiture of his interest in the subject-matter, where the contract has not been terminated for his default of an essential time stipulation. It is, however, suggested that this view should not be maintained[41]: Much was said[42] about the point that the explanation of *Kilmer v. British Columbia*[43] as a case in which the "time of the essence" stipulation had been waived could not be correct. Both the principle and the authorities support the view that the mere extension of time does not indicate the waiver of the essential character of the time. Furthermore, the facts of the case and the judgment of the Board do not in any way show that the parties had, expressly or implicitly, intended that the essential character of the time should cease to be applicable by an indulgence given by the vendor. It may, therefore, be suggested that the *Kilmer* case[44] was wrongly explained in *Steedman v. Drinkle*[45]; and the facts of the latter case falling within the principle stated in *Kilmer*, the Board could, and should, have granted relief by decreeing specific performance.

7.13 In principle, furthermore, if it is accepted that there is an equitable jurisdiction to relieve the purchaser against forfeiture of his interest in the property where the forfeiture

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[40] See also *Hedworth v. Jenwise Ltd.* [1994] EGCS 133 where the Court of Appeal, relying on *Steedman v. Drinkle* (*ibid.*), refused to extend the jurisdiction to relieve against forfeiture of the purchaser's interest in property to a case where the purchaser was in default of an essential contractual stipulation, though it assumed for the purpose of this case (but not deciding the point) the existence of the jurisdiction. see *infra.*, para. 7.58; see also Collins H., The Law of Contract, (2nd ed., 1993), pp. 354-355 ; Pawlowski M., Relief Against Forfeiture: Contracts for the Sale of Land (1995) 14 Litigation 135; Hoggett B. M., Houses on the Never-Never (1975) 39 The Conveyancer and the Property Lawyer 343, at pp. 348-349

[41] See also Beale H., Unreasonable Deposits (1993) 109 LQR 524, at p. 526 ; Harpum C, Relief Against Forfeiture and the Purchaser of Land [1984] CLJ 134, at pp. 143-144, 156 ; Hodkinson K., Specific Performance and Deposits (1984) 4 Oxford Journal of Legal Studies 137, at pp. 140-141; Pawlowski, loc. cit., no. 40, p. 144 ; Goode R. M., Hire Purchase Law and Practice, 2nd ed., 1970, p. 383. In *Hedworth v. Jenwise Ltd.* [1994] EGCS 133, the Court of Appeal was prepared to assume the existence of the jurisdiction. see *infra.*, para. 7.58; see also the important decision of the High Court of Australia in *Legione v. Hateley* (1983) 152 CLR 406. In Australia, before this decision the prevailing view, relying mainly on *Steedman v. Drinkle*, was that courts had no power to grant relief against forfeiture of the payer's interest in the subject-matter resulting from termination for the payer's breach of an essential stipulation: see, e.g., *Hoad v. Swan* (1920) 28 CLR 258, at p. 264 ; *Real Estate Securities Ltd. v. Kew Golf Links Estate Pty. Ltd.* [1935] VLR 114 ; *Bull v. Gaul* [1950] VLR 377, at p. 379 ; *Petrie v. Dwyer* (1954) 91 CLR 99, at p. 105 ; see also Lang A., Forfeiture of Interests in Land, loc. cit., no. 10, p. 440

[42] *Supra.*, paras. 7.07, 7.10

[43] [1913] AC 319

[44] *Kilmer v. British Columbia Orchard Lands Ltd.* [1913] AC 319

[45] [1916] 1 AC 275

clause is penal and/or the vendor's conduct in exercising his strict legal rights is harsh, vindictive and unconscionable, there should not be an open gate for the creditors to circumvent this equitable principle, by stipulating simply for the time of payments to be of the essence. Put another way, a vendor by making time of the essence, which may easily be attained in contracts between parties of unequal bargaining power, and by avoiding any indulgence which might be interpreted as the waiver of the essential character of time, could prevent the equitable principle of relief against forfeiture of the payer's interest in the subject-matter from being enforced. This could ruin the whole purpose behind the equitable jurisdiction of relief. Considering the policy reasons behind the jurisdiction, therefore, there seems to be no justification for refusing relief against forfeiture of an interest in the subject-matter where the contract is terminated for the payer's breach of an essential time stipulation.

7.14 There have been some attempts to explain *Steedman v. Drinkle*[46] and *Brickles v. Snell*[47] as cases dealing with the issue of relief against forfeiture of moneys already paid. It has been suggested[48] that the purchasers in both cases claimed "relief against the forfeiture of instalments of purchase money". Thus, the decisions were not relevant to the different issue of the purchaser's right to be relieved against forfeiture of his interest in the property. Therefore, upon the authority of *Kilmer v. British Columbia*[49] and *Re Dagenham*[50] cases, the court would be able to grant relief against forfeiture of the purchaser's equitable interest in the property, even if the contract was terminated for the purchasers breach of an essential time stipulation. This explanation, however, runs counter to the facts of the case, as it has been reported. The claim, as quoted before[51], was expressly, *inter alia*, for specific performance. Furthermore, the judgments delivered in both cases show that the Board expressly refused to grant specific performance on the ground that such relief could not be granted after termination for the purchaser's breach

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[46] [1916] 1 AC 275

[47] [1916] 2 AC 599

[48] Mason and Deane JJ. in the Australian case of *Legione v. Hateley* (1983) 152 CLR 406, at p. 445

[49] [1913] AC 319

[50] *Re Dagenham (Thames) Dock Co., ex parte Hulse* (1873) LR 8 Ch App 1022

[51] See *supra.*, para. 7.11

of an essential time stipulation. The only possible view, it seems, is that these cases, as far as they decide that specific performance could not be decreed after breach of a stipulation of which time is of the essence, have wrongly been decided and should not be followed.[52]

7.15 There appears, however, to be a problem which might seem difficult to be explained in principle: Where the agreement is terminated by the vendor for the purchaser's breach of an essential time stipulation, there, then, is no contract; *i.e.* the contractual relations of the parties, by the exercise of the right to terminate, have been brought to an end. The contract being at an end, how could the court grant specific performance or give extra time in order to enable the purchaser to perform his obligation? There, in fact, is no contractual obligation to be performed in the extra time given by the vendor. One possible answer is that the purchaser, asking to be relieved against forfeiture of his interest in the property, in fact, asks to be excused for his default. If the court grants such a request, *i.e.* excuses the purchaser for his breach, then the termination of the contract could not be valid, and there could be no objection to the decree of specific performance.[53] This view, though it explains the problem raised above, may itself be subject to an objection: If, by granting relief against forfeiture of an interest in the property, the purchaser is excused for his breach, then there should be no consequence for the default, while in all cases regarding the issue, relief is given, in proper circumstances, upon terms that compensation should be made by the purchaser for the damages caused by the breach. The problem may, it appears, be explained in the following terms: where the "time of the essence" provision is attached to a forfeiture clause which amounts to a penalty, then the court by relieving against forfeiture, in fact, declares the "time of the essence" provision to be of no effect. Because just as the forfeiture clause cannot be enforceable in equity, the "time of the essence" provision attached to it, also, could not be relied upon by the vendor. Therefore, granting relief against forfeiture would mean that the "time of the essence" provision, as a part of the forfeiture clause is of no effect; and therefore the vendor, relying on that, could not

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[52] See Harpum C., Relief Against Forfeiture and the Purchaser of Land, loc. cit., no. 10, at p. 151

[53] Harpum, *ibid.*

validly terminate the agreement. The contract remaining on foot, there would be no objection to the decree of specific performance; and the default having been made by the purchaser, this should be conditioned upon the compensation being made by the purchaser.

7.16 There is at least one more case which supports the existence of a wider jurisdiction to relieve against forfeiture of property. In *Starside Properties Ltd. v. Mustapha* [54], in an agreement for the sale of a house by instalments, it was provided that if the purchaser was in arrears with her payments for more than 14 days, the vendors would be entitled to terminate the contract and forfeit all the sums paid by the purchaser, and she would also have to vacate the property. The purchaser falling into arrears, the vendors terminated the contract and brought an action against her in the County Court claiming possession, a declaration that the contract had been validly terminated, and that they had the right to retain all moneys paid by the purchaser. The judge at first instance held that the forfeiture clause was in the nature of penalty. Making an order for possession, therefore, he postponed his order for three months in order to give the purchaser time to raise money and buy the property at the contracted price. Three days before the expiry of this time, the purchaser applied for an order requesting an extension of her time for eight more weeks. The judge refused the application on the ground that he had no jurisdiction to extend the granted time by revising his previous order. On appeal, the Court of Appeal held that in a proper case and where the justice of the case required, the court had jurisdiction to extend the time first granted to relieve the purchaser from forfeiture. The case indirectly illustrates that, even after termination, the court has the power to grant relief against forfeiture of property. It is not clear from the reports whether the time of payment stipulation which was breached by the purchaser was of the essence, though it has been suggested that it almost certainly was.[55] However, the contract had clearly been terminated for the purchaser's breach. The case, therefore, provides an authority for the view that relief against forfeiture of an interest in property could be granted even after the contract had validly been terminated for the purchaser's breach.

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[54] [1974] 1 WLR 816, [1974] 2 All ER 567; see Fairest P B, Equitable Relief Against Penalties [1974] CLJ 12

[55] Harpum C., Relief Against Forfeiture and the Purchaser of Land, loc. cit., no. 10, at p. 155, citing

3. The Scope of the Jurisdiction

3.1. General Considerations

7.17 A review of cases relevant to the issue shows much controversy with regard to the scope of the jurisdiction to relieve against forfeiture of property. Whether the jurisdiction is limited to the special type of cases, whether it is available after breach of covenants other than payment of a certain sum of money, and, on the whole, whether the jurisdiction is an unlimited and unfettered jurisdiction or there are some limitations, and also the issue of the existence of the jurisdiction in cases not concerning an interest in land are the issues which have often been discussed in cases, and will be dealt with in this section. It will be shown that although the jurisdiction cannot be regarded as an unlimited and unfettered power for the courts, it should not yet be considered as limited to the breach of covenants concerning only with payment of money. It may also be invoked and applied where the forfeiture in question is not a forfeiture of an interest in land, but a forfeiture of the payer's interest in personal property. A good and comprehensive consideration of the subject has been provided by the House of Lords in the leading and important case of *Shiloh Spinners Ltd. v. Harding*[56]. We will proceed with a careful consideration of the principles laid down in this case.

3.2. Availability of Relief after Breach of Covenants other than Payment of Money

7.18 In the *Shiloh Spinners* case, it was expressly emphasized that the jurisdiction had not been confined to the special type of cases, though, in practice, it had been commonly exercised with regard to cases of mortgages and leases. Lord Wilberforce[57], in the course of his judgment, stated:

> "There cannot be any doubt that from the earliest times courts of equity have asserted the right to relieve against the forfeiture of property. The jurisdiction has not been confined to any particular type of case. The commonest instances concerned mortgages, giving rise to the equity of redemption, and leases, which commonly contained re-entry clauses; but other instances are found in relation to copyholds, or where the forfeiture

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Harold Wood Brick Co. Ltd. v. Ferris [1935] 2 KB 198, in which there was a similar provision.

[56] [1973] AC 691

[57] With whom Viscount Dilhorne, Lord Pearson and Lord Kilbrandon concurred.

was in the nature of a penalty."[58]

Referring to the fluctuation of authority regarding the self-limitation on this equitable power, his lordship added:

> "There has not been much difficulty as regards two heads of jurisdiction. First, where it is possible to state that the object of the transaction and of the insertion of the right to forfeit is essentially to secure the payment of money, equity has been willing to relieve on terms that the payment is made with interest, if appropriate, and also costs. ... Secondly, there were the heads of fraud, accident, mistake or surprise, always a ground for equity's intervention, the inclusion of which entailed the exclusion of mere inadvertence and *a fortiori* of wilful defaults."[59]

As it appears from the passage quoted above, other than the heads of fraud, accident, mistake or surprise, the jurisdiction was widely exercised where the forfeiture was occasioned by the breach of a covenant for the payment of a sum of money.

7.19 The prevailing view was that relief could not be granted for breach of covenants other than payment of a certain sum of money.[60] The reason for this view was that relief should be granted upon compensation being made by the contract-breaker, and since in breach of covenants for payment of money, the liability of the party in breach was readily calculable, the compensation could easily be made and the relief, therefore, was available; while in case of other breaches of covenants, damages could not easily be computed and the supervision of court for the steps to be taken for compensation was also practically impossible.[61]

Lord Wilberforce, however, reviewing the previous authorities, argued that the denial of relief in the previous cases, such as *Hill v. Barclay*[62], was because the breach there was a

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[58] *Shiloh Spinners Ltd. v. Harding* [1973] AC 691, at p. 722

[59] *Ibid.*

[60] See, e.g., *Wadman v. Calcraft* (1804) 10 Ves 67, 32 ER 768; *Hill v. Barclay* (1811) 18 Ves 56, 34 ER 238; *Bracebridge v. Buckley* (1816) 2 Price 200 ; *Barrow v. Isaacs & Son* [1891] 1 QB 417; see also Baker P V, Snell's Equity, 29th ed., 1990, p. 542; Meagher, Gummow & Lehane, loc. cit., no. 5, para. 1805

[61] Key L.J. in *Barrow v. Isaacs & Son* [1891] 1 QB 417 favoured this reasoning in the following terms: "... it was soon recognized that there would be great difficulty in estimating the proper amount of compensation; and, since the decision of Lord Eldon L.C. in *Hill v. Barclay* it has always been held that equity would not relieve, merely on the ground that it could give compensation, upon breach of any covenant in a lease except the covenant for payment of rent." at p. 425; see also Meagher, Gummow & Lehane, loc. cit., no. 5, para. 1805

[62] (1811) 18 Ves 56, 34 ER 238

wilful breach.[63] He also rejected, as a reason for denying relief, the impossibility for the courts of supervising the work which should be done as compensation, "for" he argued "what the court has to do is to satisfy itself, ex post facto, that the covenanted work has been done, and it has ample machinery, through certificates, or by enquiry, to do precisely this".[64] His lordship concluded:

> "I would fully endorse this: it remains true today that equity expects men to carry out their bargains and will not let them buy their way out by uncovenanted payment. But it is consistent with the principle that we should reaffirm the right of courts of equity in appropriate and limited cases to relieve against forfeiture for breach of covenant or condition where the primary object of the bargain is to secure a stated result which can effectively be attained when the matter comes before the court, and where the forfeiture provision is added by way of security for the production of that result."[65]

This clearly shows that, regardless of whether the covenant breached by the payee is for the payment of money, courts may have jurisdiction to relieve against forfeiture of property provided that the forfeiture provision had been inserted to secure a stated result which can effectively be attained when the matter comes before the court.[66]

7.20 One important prerequisite for the existence of the jurisdiction, therefore, is that the forfeiture clause must be added to secure a stated result, and this result must be attainable if the matter comes before the court. The recent decision of the Court of Chancery Division in *Nutting v. Baldwin*[67] is a good illustration of a case not falling within the test provided by Lord Wilberforce, for the object of the forfeiture provision, though it was to secure a stated result, was not subsequently attainable: Under the rules of an association of individuals formed to co-ordinate and finance certain legal proceedings, the committee

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[63] *Shiloh Spinners Ltd. v. Harding* [1973] AC 691, at pp. 722-723

[64] *Ibid.*, at p. 724

[65] *Ibid.*

[66] It should be born in mind that, even in the 19th century when the jurisdiction was narrowly exercised, there were some statutory provisions which empowered the courts to grant relief against forfeiture of leases for breach of covenants and conditions (Section 146, Law of Property Act 1925 now contains the important part of those provisions), but until the decision of the House of Lords in the *Shiloh Spinner* case, the existence of the equitable jurisdiction to grant relief against forfeiture of leases for breach of covenants other than payment of a certain sum of money was doubtful. Thus, the cases not falling within the statutory jurisdiction will now remain subject to the equitable jurisdiction. (see Meagher, Gummow & Lehane, loc. cit., no. 5, para. 1808 ; Baker, Snell's Equity, 29th ed., 1990, p. 543)

[67] [1995] 1 WLR 201

of the association had the power to declare any member to be a defaulting member if he/she failed, *inter alia*, to pay any additional subscription fees which had been levied by the committee and supported by a resolution of the majority of two-thirds of members present at the general meeting. The effect of such a declaration, under rule 9, was to deprive a defaulting member of any share in recoveries, *i.e.* the fruits of any proceedings brought in the names of members. The defendants, having failed to pay the additional subscription fees, were declared to be defaulting members. Subsequently two actions, brought by the association, were compromised by an agreement under which the association was agreed to be paid a sum of £116m. In an action by the committee, seeking declarations that the defendants had been defaulting members and the association had the right and power to distribute the recoveries between the members other than the defaulting members, the court was asked to determine, *inter alia*, whether it had jurisdiction to relieve the defaulting members against forfeiture of their rights to share in the proceeds of actions brought by the association. Rattee J.- arguing that a member's interest, by virtue of rule 9, to share in the benefits of recoveries is a proprietary interest, and depriving him from this interest as the result of his failure to pay the subscription fees on time is a forfeiture- held that the court had no jurisdiction to relieve the defaulting members from such a forfeiture: The forfeiture provision had been inserted to secure a stated result, but that result was impossible to be attained when the matter came before the court. Rattee J. stated:

> "... the object of the rules of the association was to achieve a situation in which the rights of action of all the members against the Lloyd's agents were enforced together for the benefit of all the members at the shared risk of all the members .... To allow a member who has not undertaken his share of the risk by paying his subscriptions on time to come in after the litigation has been successfully concluded, so that there is no longer any risk, and still share in the fruits of the litigation on payment of his overdue subscription would, in my judgment, undermine rather than attain the object of the forfeiture provision against which relief is sought ..."[68]

3.3. Unlimited or Unfettered Jurisdiction?

7.21 The decision of the House of Lords in the *Shiloh Spinners* case demonstrates the existence of the equitable jurisdiction to relieve against forfeiture of property for breach of covenant or condition in "appropriate and limited" cases. There was, however, a more

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[68] *Ibid.*, at p. 210

liberal view expressed by Lord Simon of Glaisdale who held:

> "... equity has an unlimited and unfettered jurisdiction to relieve against contractual forfeitures and penalties."[69]

His lordship regarded the limitations to the jurisdiction as considerations which the court should weigh in order to decide whether it should exercise its unfettered jurisdiction. He called them as internal considerations, rather than any external limits on the jurisdiction. Though this view is, in effect, close to the approach taken by the majority, his theoretical approach towards the scope of the jurisdiction has not been followed by any other judges in subsequent cases.

3.4. Availability of the jurisdiction in cases not concerning land

7.22 The jurisdiction has not been confined to the cases concerning land, and it might be exercisable with regard to hiring or lease of chattels.[70] In *Barton Thompson and Co. Ltd. v. Stapling Machines Co.*[71], in a contract for the lease of certain machines, it was provided that in case of breach of any term of the agreement, the lessors were entitled to terminate the contract if the lessees had failed to remedy the breach within 30 days of the service of a notice requiring that. The lessees having failed to make payments due under the contract, and to comply with a notice requiring payment, the lessors terminated the agreement. On the same day the lessees issued an originating summons seeking relief from forfeiture. Pennycuick J., having considered the arguments of the parties, held:

> "I am not prepared to hold that it is plain and obvious as a matter of law that in the absence of unconscionable behaviour the court has in no circumstances power to relieve against forfeiture under any conceivable lease of a chattel. This is, I think, a point which the plaintiff should be allowed to argue if his case is otherwise maintainable."[72]

This view which implies the existence of the jurisdiction to relieve against forfeiture of property other than an interest in land relied upon and apparently approved by Edmund Davies L.J. in *Starside Properties Ltd. v. Mustapha*[73].

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[69] *Shiloh Spinners Ltd. v. Harding* [1973] AC 691, at p. 726

[70] See Meagher, Gummow & Lehane, Equity Doctrines & Remedies, loc. cit., no. 5, p. 421; Keeton G W, Equity, 2nd. ed., 1976, p. 316; Baker, Snell's Equity, 29th ed., 1990, p. 542 ; Lang A G, loc. cit., no. 10, p. 431; Clarke M J R, Commentary on "Contract Planning: Liquidated Damages, Deposits and Foreseeability Rule, by Prof. Furmston" (1991) 4 JCL 11, at p. 14

[71] [1966] 1 Ch. 499

[72] *Ibid.*, at p. 509

[73] [1974] 2 All ER 567, [1974] 1 WLR 816, at p. 822

7.23 In *Stockloser v. Johnson* [74], Romer L.J., considering the hypothetical case of a purchaser who buys a necklace by instalments on terms that if he defaults in the payment of a single instalment, he has to return the necklace and forfeit all the instalments paid, said:

> "It would certainly seem hard that the purchaser should lose both the necklace and all previous instalments owing to his inability to pay the last one. ... The court would, doubtless, ... give him further time to find the money if he could establish some probability of his being able to do so ..."[75]

This hypothetical example, though it has no authoritative force, shows the tendency that relief against forfeiture of property should be available in case of sale of chattels by instalments.

7.24 The position has neatly been summarized by Dillon L.J. in the rather recent case of *BICC Plc. v. Burndy Corp.*[76], where he, considering the previous cases, said:

> "There is no clear authority, but for my part I find it difficult to see why the jurisdiction of equity to grant relief against forfeiture should only be available where what is liable to forfeiture is an interest in land and not an interest in personal property. Relief is only available where what is in question is forfeiture of proprietary or possessory rights, but I see no reason in principle for drawing a distinction as to the type of property in which the rights subsist."[77]

This passage was relied upon and described as the "underlying principle" in the recent case of *Transag Haulage Ltd. v. Leyland DAF Finance Plc.*[78]. In this case, in three hire-purchase agreements for the hire of three vehicles, it was provided by the clause 13(f) that if a receiver should be appointed for the hirer's assets, the owner would be entitled to terminate the contracts; and upon termination, retake the possession of the vehicles. The hirer, in such a case, was also obliged to pay the whole instalments remaining unpaid less the value of the repossessed vehicles. The hirer, having gone into administrative receivership, the owner terminated the agreements. The hirer brought an action seeking

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[74] [1954] 1 QB 476, [1954] 1 All ER 630, at pp. 644-645

[75] *Ibid.*, at p. 644

[76] [1985] 1 All ER 417, [1985] Ch. 232

[77] *Ibid.*, at pp. 427-428 and p. 251 respectively

[78] [1994] 2 BCLC 88

either a declaration that clause 13(f) was void as a penalty or relief from forfeiture of his interest in the agreements. Knox J. held that the right to repossess the vehicles upon termination did not constitute a penalty. However, he considered the loss of the hirer's probable right to buy the vehicles under the agreements as the forfeiture of a proprietary right and held that the court had jurisdiction to relieve against such a forfeiture. Considering the conditions to exercise such a jurisdiction, the learned judge found the case as a suitable one for granting relief; and therefore relieved the hirer from forfeiture of his interest in the subject-matter on condition that the outstanding instalments should be paid to the owners within seven days. The decision in this case is important from different aspects which will be considered in its place; but for the time being, it is sufficient to be noted that the case does clearly confirm the existence of the jurisdiction to relieve against forfeiture in cases concerning an interest in personal property.

4. The Limits of the Jurisdiction[79]

7.25 Though the jurisdiction of courts to grant relief against forfeiture of property has not been confined to any special type of case[80], considering the purpose and nature of relief available, the courts have set a series of limitations on their equitable power. Although the principle as to the *existence* of the jurisdiction is a well-established one, "there has", in the words of Lord Wilberforce, "undoubtedly been some fluctuation of authority as to the self-limitation to be imposed or accepted on this power."[81] The reason behind these self-limitations would seem to be that the exercise of the jurisdiction runs counter to the principle of freedom of contract: A court by granting relief against forfeiture, in fact, prevents the enforcement of an express contractual term. The courts, therefore, have tried to step within the boundaries of a well-defined equity, and confine themselves to these boundaries. That is why it has sometimes been suggested that the

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[79] Drawing a definite line between the scope and the limits of the jurisdiction is extremely difficult: one view may be that any point relating to the existence of the jurisdiction should be discussed as an issue relating to the scope of the jurisdiction, whereas points regarding the exercise of an existent jurisdiction should be considered as a relevant issue in the "limits of the jurisdiction". In this sense, the scope of the jurisdiction will be responsible for the jurisdictionary points, while the limits of the jurisdiction will focus on the discretionary points. In this study, I have tried to discuss any point which could incontrovertibly be regarded as a jurisdictionary point in the "scope of the jurisdiction", and left the matters which may be controversial from the point of view of being jurisdictionary or discretionary to "the limits of the jurisdiction".

[80] *Shiloh Spinners Ltd. v. Harding* [1973] AC 691, per Lord Wilberforce at p. 722, see *supra.*, para. 7.18

court should not make, in the words of Lawton L.J., "its decision by what it considers to be the length of the chancellor's foot, nor by taking on the role of a fussing judicial nanny seeking to protect the improvident from their folly by entering into disadvantageous contracts."[82]

7.26 The limits to the jurisdiction will be discussed by reference to the following criteria: First, the nature of the debtor's interest in the subject-matter; second, availability of relief after termination for breach of an essential time stipulation; third, availability of relief in commercial contracts.

4.1. The Debtor's Proprietary or Possessory Interest

7.27 Relief against forfeiture of property is normally, in a proper case, granted by decreeing specific performance or giving the contract-breaker extra time to remedy his breach. It can, therefore, be possible in a contract which could specifically be performed. If, therefore, a contract is not capable of specific performance, the court will normally not be prepared to extend the jurisdiction to such an agreement. A contract for services, for example, which does not transfer any proprietary or possessory right to the debtor is a contract in respect of which the courts have always disclaimed any jurisdiction to decree specific performance.[83] With regard to such a contract, thus, if a contractual term provides for the withdrawal of services in case of breach of any contractual stipulation by the debtor, the court will have no jurisdiction to grant relief from forfeiture.[84]

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[81] *Ibid.*

[82] *Starside Properties Ltd. v. Mustapha* [1974] 1 WLR 816, at p. 826

[83] See the speech of Lord Diplock in *Scandinavian Trading Co. v. Flota Petrolera Ecuatoriana (The Scaptrade)* [1983] 2 AC 694, at pp. 700-701, citing *Clarke v. Price* (1819) 2 Wils. 157 ; *Lumley v. Wagner* (1852) 1 De G.M. & G. 604. The absolute emphasize in Lord Diplock's words has been slightly criticized by some writers: "It is perhaps putting it too high that the courts have always disclaimed jurisdiction to grant order for specific performance of contracts involving the rendering of services: see the comments of Megarry J. in *C.H. Giles & Co. Ltd. v. Morris* [1972] 1 WLR 307, 318-319. There is no doubt, however, that as a general rule no order for specific performance of a contract to render services, e.g. the supply of a ship and its crew, can be obtained." Thompson, J. M. (1983) 99 LQR 489

[84] See Furmston M P, Cheshire, Fifoot & Furmston's Law of Contract, 13th ed., 1996, p. 643; Chitty on Contracts, 27th ed., vol. 1, 1994, para. 20-070; Guest A G, Benjamin's Sale of Goods, 4th ed., 1992, p. 795; Downes T A, Textbook on Contract, 3rd ed., 1993, p. 334; Collins H., The Law of Contract, 2nd ed., 1993, p. 355; Harpum C., loc. cit., no. 10, at pp. 167-169; Thompson, J. M. (1983) 99 LQR 489; Carter J W, Breach of Contract, 2nd ed., 1991, para. 1065; Lang A, loc. cit., no. 10, at pp. 431-433

4.1.1. Development of the Limitation: Time Charterparty Cases

7.28 This limitation to the jurisdiction has developed through time charterparty cases, otherwise than by demise. A time charterparty is a contract to render services which confers no proprietary or possessory interest upon the charterer. In the words of Lord Diplock, "A time charter, unless it is a charter by demise, ... transfers to the charterer no interest in or right to possession of the vessel; it is a contract for services to be rendered to the charterer by the shipowner through the use of the vessel by the shipowner's own servants, the master and the crew, acting in accordance with such directions as to the cargoes to be loaded and the voyages to be undertaken as by the terms of the charterparty the charterer is entitled to give to them."[85]

It is common for these charterparties to contain a withdrawal clause which provides for the right of the owner to withdraw the vessel from the charterer's service, if he defaults in the punctual payment of the hiring charge. A clause, called as an "anti-technicality clause", also sometimes appears in these contracts. This clause provides for the necessity of the service of a notice before the shipowner can exercise his right under the withdrawal clause. Until the decision of the House of Lords in *The Scaptrade*[86], it was controversial whether the court had jurisdiction to grant relief against the operation of a withdrawal clause in a time charterparty. The *obiter dicta* of Lord Simon of Glaisdale in *The Laconia*[87] lent support to the view that the court had such a jurisdiction, though in the case itself, the House did not accept the point to be taken in the appeal, since it had not been raised in the courts below. He arrived at this conclusion mainly by an analogy between the possibility of relief in respect of the operation of a withdrawal clause in a time charterparty and the relief against forfeiture of leases for non-payment of rent.

7.29 In *The Afovos*[88], Lloyd J., who had been counsel for the charterers in *The*

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[85] *Scandinavian Trading Tanker Co. v. Flota Petrolera Ecuatoriana (The Scaptrade)* [1983] 2 AC 694, at p. 700

[86] *Scandinavian Trading Tanker Co. v. Flota Petrolera Ecuatoriana (The Scaptrade)* [1983] 2 AC 694

[87] *Mardof Peach & Co. Ltd. v. Attica Sea Carriers Corporation of Liberia* [1977] AC 850, at pp. 873-874

[88] *Afovos Shipping Co. SA v. Pagnan and Lli, (The Afovos)* [1980] 2 Lloyd's Rep. 469

Laconia[89], was the judge of the commercial court, and held that such a jurisdiction did exist. On appeal[90], the House of Lords decided the case on the ground that the withdrawal notice, upon the true interpretation of the "anti-technicality clause", was invalid, and the question of availability of the jurisdiction to grant relief was not, therefore, discussed.

7.30 However, in *The Scaptrade*[91], the House expressly disclaimed any jurisdiction to grant relief against forfeiture with regard to the operation of a withdrawal clause in a time charterparty. In fact, though the word "forfeiture" was sometimes used to describe the withdrawal of services from the charterer[92], it could not be a precise description; for such a contract did not transfer any proprietary or possessory interest in the vessel to the charterer. Therefore, upon termination of the agreement, there was no conceivable interest for the charterer to be forfeited by the shipowner. Put another way, there was no "forfeiture" relief from which could be discussed.[93]

Lord Diplock, delivering the main judgment of the House, argued that a time charterparty could not be analogous to a lease, for a time charter is only a contract for providing services, and transfers no interest in the vessel to the charterers. He, then, added:

> "To grant an injunction restraining the shipowner from exercising his right of withdrawal of the vessel from the service of the charterer, though negative in form, is pregnant with an affirmative order to the shipowner to perform the contract; juristically it is indistinguishable from a decree for specific performance of a contract to render services; and in respect of that category of contracts, even in the event of breach, this is a remedy that English courts have always disclaimed any jurisdiction to grant."[94]

7.31 The counsel for the charterers had relied upon the principle, stated by Lord

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[89] [1977] AC 850

[90] [1983] 1 All ER 449

[91] *Scandinavian Trading Tanker Co. v. Flota Petrolera Ecuatoriana (The Scaptrade)* [1983] 2 AC 694

[92] See, e.g., *Tankexpress Als v. Compagnie Finan Ciere Belge des Petroles S.A. [The Petrofina]* [1949] AC 76, at p. 99 ; *Mardorf Peach & Co. Ltd. v. Attica Sea Carriers Corporation of Liberia [The Laconia]* [1977] AC 850, at p. 874

[93] It may also be noted that in the *Scaptrade* and other litigated time charterparty cases, no forfeiture of money was also involved, because no money had in fact been paid by the charterer.

[94] *Scandinavian Trading Tanker Co. v. Flota Petrolera Ecuatoriana (The Scaptrade)* [1983] 2 AC 694, at p. 701

Wilberforce in *Shiloh*[95], that where the withdrawal clause had been inserted to secure a stated result which could effectively be attained when the matter came before the court, the jurisdiction to relieve against forfeiture would, in "appropriate" circumstances, exist. Lord Diplock, citing Lord Wilberforce's speech in *The Laconia*[96] where he had pointed out the difference between a time charter and a lease of land, considered that this principle had no application to a contract for the provision of services which transfers no proprietary or possessory right. His lordship also argued that the purpose of a withdrawal clause in a time charterparty was not to secure the payment of hire. The payment of hire is a means to provide a fund for running and manning the vessel[97] without which the provision of the proposed services to the charterer will practically be impossible.

7.32 Moreover, Lord Diplock referred to some policy reasons for refusing to create such a jurisdiction. Approving the observations of Robert Goff L.J. in the Court of Appeal[98], his lordship referred to the availability of legal advice to the parties in such contracts, and the necessity of speed and certainty in commercial transactions. He, then, pointed out that the creation of any jurisdiction to grant relief would require the detailed examination of all facts and surrounding circumstances which would be against the requirements of speed and certainty.

The case is an authority for the view that the jurisdiction to relieve against forfeiture of property can exist only in contracts which involve the transfer of proprietary or possessory rights. More recently Rattee J. in *Nutting v. Baldwin*[99] was in no doubt that the jurisdiction should be limited to cases which involved forfeiture of a proprietary or possessory interest. In his view, however, the "beneficial interest" of each member of a certain association to share the proceeds of certain claims brought on behalf of the

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[95] *Shiloh Spinners Ltd. v. Harding* [1973] AC 691, at p. 724

[96] [1977] AC 850

[97] *Scandinavian Trading Tanker Co. v. Flota Petrolera Ecuatoriana (The Scaptrade)* [1983] 2 AC 694, at p. 702

[98] [1983] QB 529, at pp. 540-541

[99] [1995] 1 WLR 201, the facts of the case have already been given: *supra.*, para. 7.20

members could be regarded as a proprietary interest.[100] Therefore, in any contract for the provision of services, e.g. a time charterparty otherwise than by demise, such a jurisdiction would not be available.

4.1.2. Hirer's proprietary interest in a hire-purchase agreement: availability of relief

7.33 Although an option to purchase had long ago been regarded as a proprietary interest[101], the issue of the availability of relief against forfeiture of the hirer's interest in the subject-matter was not quite clear. The situation can be summarized as follows: In a hire-purchase agreement, it is commonly provided that upon the failure of the hirer to make payments punctually, or to observe his other undertakings, the owner would, *inter alia*, be entitled to terminate the contract, retake possession of the subject-matter, and retain all the instalments already paid. Now, if the hirer is ready, able and willing to pay the outstanding balance of the instalments with interest, is there any case for him to be relieved against forfeiture of his interest in the subject-matter?

7.34 Until the recent decision of the Chancery Division in *Transag Haulage Ltd. v. Leyland DAF Finance Plc.*[102], the point was subject to a large controversy.[103] On the

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[100] *Ibid.*, at p. 209, where Rattee J. held: "... by virtue of rule 9 each member was left with a proprietary interest in the form of his beneficial interest under the trust declared by that rule."

[101] See *London and South Western Railway Co. v. Gomm* (1881) 20 Ch. D. 562, where Jessel M.R. stated: "The right to call for a conveyance of the land is an equitable interest or equitable estate. In the ordinary case of a contract for purchase there is no doubt about this, and an option for purchase is not different in its nature. A person exercising the option has to do two things, he has to give notice of his intention to purchase, and to pay the purchase money; but as far as the man who is liable to convey is concerned, his estate or interest is taken away from him without his consent, and the right to take it away being vested in another, the covenant giving the option must give that other an interest in the land." at p. 581; see also *Mackay v. Wilson* (1947) 47 S.R. (N.S.W.) 315, at p. 325 per Street J.; *Imperial Chemical Industries Ltd. v. Sussman* (Unreported) May 28, 1976 per Oliver J. (cited in *Pritchard v. Briggs* [1980] 1 Ch. 338, at p. 391); *Pritchard v. Briggs*, *ibid.*, per Goff LJ at pp. 388-389. A right of pre-emption (often called a right of first refusal) is not, on the contrary, regarded as a proprietary interest: see *Pritchard v. Briggs*, *ibid.*, per Goff LJ at pp. 389, 394, 399, and per Templeman LJ at p. 418; see also Megarry, Sir Robert & Thompson M.P., Megarry's Manual of the Law of Real Property, 7th ed., (London: Sweet & Maxwell, 1993), p. 66

[102] [1994] 2 BCLC 88

[103] See Chitty on Contracts, 27th ed., vol. 2, 1994, para. 36-273 at pp. 637-638 ; Goode R. M., Hire-Purchase Law and Practice, 2nd ed., 1970, pp. 382-383 ; Diamond A L, Equitable Relief for the Purchaser of Hire-Purchase Goods (1956) 19 MLR 498 ; Prince E J, Equitable Relief in the Law of Hire-Purchase (1957) 20 MLR 620 ; Diamond, Equitable Relief in Hire-Purchase: A Rejoinder (1958) 21 MLR 199

one hand, some cases[104]- which, without any reference to the equitable relief, had approved the right of the owner to retake possession of the subject-matter and retain moneys already paid- were cited as supporting the view that such a jurisdiction did not exist. It was, on the other hand, argued[105] that these cases provided no authority for the view, for they all had been decided purely on common law principles, and without any reference to the equitable power of the courts. Furthermore, considering the economic realities of the hire-purchase agreements, and the real object for these contracts, there was no reason to differentiate between them and contracts for sale of goods, so far as the equitable power of the court to grant relief against forfeiture was concerned[106].

7.35 In the recent case, the facts of which have previously been given[107], Knox J., discussing the general issues about the equitable jurisdiction of relief against forfeiture of property and its availability as to the forfeiture of an interest in personal chattels, reaffirmed that the probable right of the hirer to buy the subject-matter as the final process of the contract in a hire-purchase agreement is, in fact, a proprietary right which against its forfeiture, in proper circumstances, the hirer may be relieved. The learned judge said:

> "The only forfeiture that I can discern in the case before me where no claim is being made in respect of past payments by company is the loss of the contingent right to buy the goods for £5 under cl. 24. ... In my view, although that right was then subject to that contingency, it can nevertheless be truthfully said that there was a forfeiture of proprietary or possessory rights and not merely contractual rights. Even a contingent

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[104] See, e.g., *Cramer v. Giles* (1883) Cab. & Ell. 151 ; *Brooks v. Beirnstein* [1909] 1 KB 98 ; *South Bedfordshire Electrical Finance, Ltd. v. Bryant* [1938] 3 All ER 580 ; *Campbell v. The Official Assignee of Buckman* (1909) 28 NZLR 875 ; *cf. Wheeler & Wilson Manufacturing Co. v. Charters* (1882) 21 NBR 480 where in an agreement for the hire-purchase of a sewing machine, after the hirer's default in paying the monthly instalments and upon tendering the payments due by the hirer before any action on behalf of the owner, it was held that even though the property in goods did not vest in the hirer before the payment of the whole instalments, the tender of the unpaid instalments before action would prevent the owner from repossession.

[105] Diamond, Equitable Relief in Hire-purchase (1958) 21 MLR 199, at p. 200

[106] Diamond, Equitable Relief for the Purchaser of Hire-purchase Goods (1956) 19 MLR 498, where he said: "... although a true hire purchase agreement is not a contract of sale, it does contain an element of sale imported by the option to purchase. It is therefore submitted that for this purpose the difference between a hire-purchase agreement and a contract for the sale of goods is not of importance. There is, it is suggested, a tendency for the courts to apply similar rules wherever possible." at p. 504 ; see also Diamond (1958) 21 MLR 199

[107] See *supra.*, para. 7.24

right to exercise an option appears to me to be properly described as a 'proprietary right'."[108]

The case, therefore, can be considered as a reconfirmation of and an authority for the view that the hirer's contingent interest in the subject-matter is a proprietary interest, and that the courts can, in proper circumstances, assume jurisdiction to relieve the hirer against forfeiture of that interest, on the condition, of course, that the hirer would be ready, able and willing to pay the outstanding balance of the instalments with interest and costs.

4.1.3. The trend to extend the scope of the limitation

7.36 A tendency to confine further the scope of the jurisdiction to relieve against forfeiture of property does clearly appear from the decision of the House of Lords in *Sport International Bussum VI v. Inter-Footwear Ltd.*[109]. The case concerned an agreement embodied in a consent order under which the licences to use certain names and trademarks were granted to the defendant. The defendant agreed to pay certain sum of money in three instalments, and to furnish guarantees for the second and third instalments immediately upon the payment of each previous instalment. It was also provided that upon any failure by the defendant to pay on the due date or to provide guarantees, the whole outstanding balance would become due; and the licences would terminate. The defendant having failed in furnishing the second guarantee, the plaintiffs brought an action claiming the whole outstanding balance and seeking a declaration that the licence had been terminated. The judge at first instance, accepting the claim, rejected any jurisdiction to relieve against forfeiture. The Court of Appeal dismissed the appeal. On appeal to the House of Lords, dismissing the appeal, the House held that the case was not a suitable one in which to define the boundaries of the equitable relief against forfeiture, and since the facts of the case did not fall within the recognized boundaries, so the equitable jurisdiction could not be applied in this case.

7.37 The only judgment, given by Lord Templeman, is rather ambiguous: It is not clear whether his lordship disclaims the jurisdiction or does not see the case as an appropriate one to exercise the jurisdiction. In the course of his judgment, he relied on the

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[108] *Transag Haulage Ltd. v. Leyland DAF Finance Plc.* [1994] 2 BCLC 88, at p. 99

[109] [1984] 1 WLR 776, [1984] 2 All ER 321

observations of Oliver L.J. in the Court of Appeal[110] with regard to the importance of certainty in such commercial agreements[111], and argued that the conduct of the plaintiffs in terminating the agreement could not be considered as unconscionable or oppressive.[112] These might be taken as indications that the House did not find the case as an appropriate one to *exercise* the jurisdiction. On the other hand, his lordship rejected the reliance placed by the counsel for the defendants on the famous principle stated by Lord Wilberforce in the *Shiloh Spinners* case[113], holding that this principle had been confined by the House in *The Scaptrade*[114] to contracts concerning transfer of proprietary or possessory rights. This might imply that, in his lordship's view, the licences to use certain trade marks and names did not create proprietary or possessory right, though he did not expressly mention this point, and merely declared his reluctance to extend the equitable jurisdiction of relief beyond the recognized boundaries.[115] When the case was considered in the subsequent case of *BICC plc v. Burndy Corp.*[116], Dillon L.J. appeared to have understood it as a case not concerning proprietary or possessory rights.[117] Some commentators also interpreted the decision of the House to refuse the equitable relief to be "on the ground", *inter alia*, "that the contractual licence to use a trade mark was not the kind of possessory interest for which relief from forfeiture would be given".[118]

7.38 The decision of the House, in addition to its ambiguity, seems to be subject to a

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[110] [1984] 1 All ER 376, at p. 384

[111] [1984] 2 All ER 321, at p. 325

[112] "The inclusion of cl 13 in the contract and the reliance of SI [the plaintiffs] on that clause do not constitute conduct which can be stigmatised as oppressive or unconscionable" *ibid.*, at p. 324

[113] *Shiloh Spinners Ltd. v. Harding* [1973] AC 691, where he pointed out that the courts may relieve against forfeiture where the forfeiture clause had been inserted to secure a stated result which could effectively be attained when the matter comes before the court. at p. 724; see *supra.*, para. 7.19

[114] *Scandinavian Trading Tanker Co. v. Flota Petrolera Ecuatoriana (The Scaptrade)* [1983] 2 AC 694

[115] [1984] 2 All ER 321, at p. 325 where his lordship said: "Counsel submitted that in the present case the licences to use the trademarks and names created proprietary rights in intellectual property. He admits, however, that so to hold would be to extend the boundaries of the authorities dealing with relief against forfeiture. I do not believe that the present case is a suitable case in which to define the boundaries of the equitable doctrine of relief against forfeiture."

[116] [1985] 1 All ER 417

[117] *Ibid.*, at p. 427

[118] Collins H, The Law of Contract, 2nd ed., 1993, p. 355

serious objection: There can be less doubt that a contract granting licence to one party to use certain trade marks and names creates proprietary and possessory interest in intellectual property which is of great commercial interest.[119] Since the contractual clause permitting forfeiture of this interest had been inserted to secure the payment of certain instalments, there was, it is submitted, the jurisdiction for the court to relieve the defendant from forfeiture of his interest. It should, however, be noted that, considering the facts of the case and circumstances in which the agreement had been entered into[120], and in view of the availability of legal advice to both parties which were dealing at arm's length and also the great importance of certainty in such a commercial compromise, the case was not an appropriate one to exercise the existent jurisdiction.

7.39 This criticism is supported by the subsequent decision of the Court of Appeal in *BICC plc v. Burndy* [121], in which a clause providing for the assignment of the defendant's half shares in certain patents and other joint rights to the plaintiff upon the defendant's failure to pay his share of costs within 30 days was considered as the forfeiture of proprietary and possessory right against which the court had the equitable jurisdiction to relieve the defendant.[122] There are, of course, some differences between a contractual licence and a joint ownership of certain patents, but as far as the creation of proprietary and possessory rights is concerned, in both agreements, one party has the right to use a

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[119] See Collins, *ibid.*

[120] The agreement was a part of a consent order bringing an end to all hostilities between the parties. The consideration provided to be paid by the defendant was not, in fact, only the purchase price of the licences: "it was", in the words of Lord Templeman, "a sum payable by the appellant in part consideration for all the benefits provided by SI [*i.e.* the respondents] as consideration for the consent order, including the abandonment of all claims for injunctions, damages, interest and costs and a grant of two-year licences subject to termination under cl. 13." see *Sport International Bussum B.V. v. Inter-Footwear Ltd.* [1984] 2 All ER 321, at p. 324

[121] [1985] 1 All ER 417

[122] The court, in fact, was prepared to exercise its jurisdiction to grant relief by allowing the defendant a further time in which to perform his obligation. Dillon L.J., considering the authorities and concluding that he had jurisdiction, analysed the facts of the case and said: "In my judgment, the case for relief is made out and, if I had not taken the view that Burndy had a good defence to the action on the ground of set-off, I would grant Burndy relief, by way of an extension of time, against forfeiture of its rights under cl 10(iii)." (at p. 428) Kerr L.J., the dissenting judge, also held: "... for the reasons stated by Dillon L.J., I also agree that this is a case where the court's equitable jurisdiction goes further. It entitles the court to grant an extension of time to Burndy to comply with cl 10(iii) in order to relieve them from forfeiture of their proprietary share in 'the joint rights'." (at p. 429)

certain kind of intellectual property for a period of time[123], and from this point of view such agreements can be assimilated to a contract for the lease of a property.

7.40 It can, on the whole, be concluded that the equitable jurisdiction of relief against forfeiture of property has not been confined to any special type of case, it can be extended to contracts concerning personal chattels, and even intellectual property. It would, however, be limited to cases concerning transfer of proprietary or possessory rights.[124] Where, therefore, the forfeiture is purely contractual (as opposed to the forfeiture of proprietary or possessory rights), the mere fact that the forfeiture clause has been inserted to secure a stated result, which can effectively be attained when the matter comes before the court[125], would not be enough to attract the jurisdiction.

4.2. Availability of Relief in Commercial Contracts

7.41 The important issue which needs to be considered here is whether the court has jurisdiction to relieve against forfeiture in commercial agreements. There is at least one case which clearly suggests that there is no equitable jurisdiction for the courts to intervene for relief against forfeiture in commercial contracts where the parties are dealing at arm's length. Oliver L.J., giving the judgment of himself and Ackner L.J. in the Court of Appeal, in *Sport International Bussum B.V. v. Inter-Footwear Ltd* [126] referred to this issue and held that the equitable jurisdiction of courts to relieve against forfeiture had historically been confined to cases concerning land and there was no reason to extend this jurisdiction to commercial agreements. He, relying on the observations of Robert Goff L.J. in the Court of Appeal in *The Scaptrade*[127], based his judgment on the ground of

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[123] Some writers have described them as "more or less identical" and the distinct decisions in the two relevant cases as "difficult to justify" or "not justifiable in commercial terms": see Chitty on Contracts, 27th ed., vol. 1, para. 26-070, no. 92 ; Collins H, The Law of Contract, 2nd ed., 1993, pp. 355-356 ; Downes T A, Textbook on Contract, 3rd ed., 1993, pp. 334-335 ; Professor Atiyah in his interesting essay entitled "Freedom of Contract and the New Right" referred to the distinction between patent rights and commercial licensing agreements as an "absurd distinction". Essays on Contract, 1990, p. 372

[124] See also *Nutting v. Baldwin* [1995] 1 WLR 201, where the right to share in the benefits of recoveries from actions brought by a certain association was regarded as a proprietary interest.

[125] *Shiloh Spinners Ltd. v. Harding* [1973] AC 691, at p. 724 per Lord Wilberforce

[126] [1984] 1 All ER 376. The case has been affirmed in the House of Lords on narrower grounds: [1984] 1 WLR 776, [1984] 2 All ER 321

[127] *Scandinavian Trading Tanker Co. v. Flota Petrolera Ecuatoriana (The Scaptrade)* [1983] 2 AC 694, [1983] QB 529, at pp. 538-541

policy considerations. The importance and necessity of speed and certainty in commercial contracts contrasts, he pointed out, sharply with the equitable intervention which requires a detailed examination of relevant facts and other circumstances. Furthermore, in such agreements, parties are normally at arm's length, any legal advice is available to them, and they take advantage of an equal bargaining power. They, therefore, should be able to look after their own interests when entering into contracts. The Lord Justice, then, referred to the special facts of the case and rejected any possibility of equitable intervention for relief in the instant case.

7.42 Though the policy considerations, referred to in the judgment, should be given importance, and though in commercial contracts the parties are more concerned about certainty and speed than any other point, nonetheless these considerations do not necessarily negate the existence of the jurisdiction in commercial dealings. A review of the cases concerning the jurisdiction reveals the fact that the equitable intervention, though it has normally been exercised as regards contracts concerning land, has not been confined to any special type of cases. The introductory observations of Lord Wilberforce in the *Shiloh Spinners* case, referred to before[128], the points made by Pennycuick J. in *Barton Thompson and Co. Ltd. v. Stapling Machines Co.*[129] which cast a serious doubt on the non-availability of the equitable power to relieve against forfeiture with regard to a lease of chattel in the absence of unconscionable behaviour[130], the observations of Edmund Davies L.J. in *Starside Properties Ltd. v. Mustapha* [131] and Romer L.J. in *Stockloser v. Johnson*[132] all show the possibility of relief against forfeiture in commercial agreements. Furthermore, the policy reasons behind the equitable intervention, particularly preventing a party having a legal right to exercise it in an unconscionable and oppressive way, is a common consideration between the commercial and non-commercial agreements. There may be a case where a commercial party exercises his legal right unconscionably which will certainly make the equitable intervention desirable. It is,

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[128] *Shiloh Spinners Ltd. v. Harding* [1973] AC 691, at p. 722; *supra.*, para. 7.18

[129] [1966] 1 Ch. 499; see also Keeton G W, Equity, 2nd ed., p. 316

[130] *Ibid.*, at p. 509 ; see *supra.*, para. 7.22

[131] *Starside Properties Ltd. v. Mustapha* [1974] 1 WLR 816

[132] [1954] 1 All ER 630, [1954] 1 QB 476

therefore, suggested that there is no compelling reason to deny the jurisdiction of courts to relieve against forfeiture in cases concerning commercial agreements.

7.43 This jurisdiction should, of course, be exercised in an appropriate case where the facts and circumstances of the case require such an intervention. There is no doubt that the jurisdiction exists *only* where the transfer of proprietary or possessory right is in issue and the contract is specifically enforceable. Since the payee's interest in commercial agreements is normally of a non-proprietary nature and the contract is not capable of specific performance, the equitable relief from forfeiture in such agreements, as it has been pointed out by some writers[133], will not be a frequent occurrence. It should also be noted that even where the equitable jurisdiction exists, the exercise of this jurisdiction, considering the equal bargaining power of the parties in most commercial dealings and the importance of certainty and speed in these contracts, will be very exceptional.[134] It is because, where the parties are dealing at arm's length, proving the unconscionability and oppressiveness of the party's conduct who exercises his legal right will be extremely difficult.

7.44 The decision of the Court of Appeal in the *Sport International* case[135] should not, for the following reasons, be considered as a bar to assume the existence of the jurisdiction for relief against forfeiture in commercial agreements: **First**, this decision was affirmed in the House of Lords on some narrower grounds. The House did not apparently approve the general proposition that the jurisdiction of relief against forfeiture had been confined to cases concerning land, and could not be extended to commercial agreements.

7.45 **Second**, the Court of Appeal, shortly after the decision in the *Sport International* case, in a welcomed decision adopted and affirmed its jurisdiction to relieve against

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[133] Carter J W, Breach of Contract, 2nd ed., 1991, para. 1066; Harpum, Relief Against Forfeiture in Commercial Cases (1984) 100 LQR 369, at pp. 371-372, and Harpum, loc. cit., no. 10, at pp. 166-169

[134] See McKendrick E., Contract Law, 1990, p. 265; Goff & Jones, The Law of Restitution, 4th ed., 1993, pp. 437-438; Harpum, loc. cit., no. 10, at p. 169

[135] *Sport International Bussum B.V. v. Inter-Footwear Ltd.* [1984] 1 All ER 376

forfeiture in a commercial contract: In *BICC plc v. Burndy Corp* [136], in a series of agreements following the dissolution of a partnership, a commercial agreement was also entered into which provided that any joint rights (such as patent rights) were to be vested in the parties jointly so that each of them had the right to exploit them. It was also provided that the plaintiff was primarily responsible for maintaining and paying the costs relating to the joint rights, and the defendants were obliged to pay their share of the costs within 30 days of the plaintiff's written request to do so. Upon the defendant's failure to comply with the notice, it was provided, the plaintiff was entitled to require the defendant to assign to the plaintiff his interests in the patent rights concerned. The defendants made default at a time when they were under the impression that there was no urgency in the payment, and also the amount of the plaintiff's indebtedness under the agreement was well in excess of the amount due to him as the half of the costs. The plaintiff immediately exercised his contractual right and brought an action to require the defendants to assign their interest in the relevant patents to him. The defendants contended, *inter alia*, that (1) because of their right to set-off, there was no breach of contract to attract the exercise of the plaintiff's contractual right; (2) they were entitled to be relieved against forfeiture of their interest in the patent rights.

The Court of Appeal, by majority, accepted the first limb of the defendant's defence and refused the plaintiff's claim for specific performance. All members of the court, however, were prepared, without any doubt, to relieve the defendants against forfeiture of their interest in the patent rights. Dillon L.J., considering the previous authorities, argued that there was no reason to disclaim the jurisdiction to relieve against forfeiture with regard to commercial contracts, and in fact he found the facts of the case appropriate to exercise the jurisdiction. He, after expressing the view that the jurisdiction should be extended to cases where the forfeiture of proprietary or possessory rights in personal property is in question, said:

> "The fact that the right to forfeiture arises under a commercial agreement is highly relevant to the question whether relief against forfeiture should be granted, but I do not see that it can preclude the existence of the jurisdiction to grant relief, if forfeiture of proprietary or possessory rights,

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[136] [1985] 1 All ER 417, see also Harpum C, Set Off, Specific Performance, and Relief Against Forfeiture (1985) 44 CLJ 204

as opposed to merely contractual rights, is in question."[137]

7.46 **Third**, the observations of Dillon L.J. were cited and followed by Knox J. in the recent case of *Transag Haulage Ltd. v. Leyland DAF Finance plc.*[138], where the learned judge, assuming the jurisdiction to relieve the hirer from forfeiture of his interests in three vehicles, which were the subject-matters of three hire-purchase agreements, found the facts of the case suitable to exercise the jurisdiction. This case can also provide an authority for the view that there is, in appropriate cases, an equitable jurisdiction for the courts to relieve against forfeiture in cases concerning commercial agreements.

7.47 It can, to sum up, be said that the jurisdiction to relieve against forfeiture should not be confined to non-commercial contracts, and the courts, in appropriate commercial cases, have such a jurisdiction, though considering the specific nature and particular requirements of commercial transactions, this jurisdiction will only be exercised in exceptional cases.

4.3. Relief After Termination for Breach of an Essential Time Stipulation

7.48 The availability of relief against forfeiture of the debtor's proprietary or possessory interest in the subject-matter, where the contract has been terminated by the creditor for the debtor's breach of an essential time stipulation, is not yet settled in England.[139] On the one hand, it is argued that in such a case where the parties have expressly made the time of the essence, the contract is not specifically enforceable, and therefore relief from forfeiture of property by decreeing specific performance or granting the debtor extra time to perform his obligations will not be possible, though another form of relief, in appropriate circumstances, may be available.[140] On the other hand, it has been suggested

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[137] *Ibid.*, at p. 428

[138] [1994] 2 BCLC 88, for the facts of the case see *supra.*, para. 7.24

[139] Some writers support the existence of such a jurisdiction: see, e.g., Beale, Unreasonable Deposits, loc. cit., no. 10, at p. 526 ; Harpum, Relief Against Forfeiture and the Purchaser of Land, loc. cit., no. 10, at pp. 143-144; Keith Hodkinson, Specific Performance and Deposits, loc. cit., no. 41, at p. 140 ; Pawlowski, Relief Against Forfeiture: Contracts for the Sale of Land (1995) 14 Litigation 135, at p. 144 ; Goode, Hire-Purchase Law and Practice, 2nd ed., p. 383 ; For the opposite view see Hugh Collins, The Law of Contract, 2nd ed., pp. 354-355; Hoggett, Houses on the Never-Never, loc. cit., no. 40, at pp. 348-349

[140] See *Steedman v. Drinkle* [1916] 1 AC 275 ; see *infra.*, para. 8.09

that where the debtor claims for relief from forfeiture, he, in fact, asks to be relieved from the consequences of his breach; and if the court grants such relief, there will be no effective termination of the contract. Put another way, granting relief against forfeiture would be a preliminary to the decree of specific performance, and there would be no bar for the court to decree specific performance or give the debtor extra time to perform his obligation.

7.49 It was argued, in the early part of this chapter[141], that, in principle, there seems to be no compelling reason to negate the jurisdiction of courts to relieve against forfeiture of property, even where the contract has been terminated for the debtor's breach of a provision time of which has expressly been made of the essence. The main reason which justifies the existence of the jurisdiction is that the courts of equity should not allow a contracting party to exercise his legal rights in an oppressive and unconscionable way. A creditor, after the debtor's breach of an essential time stipulation, may exercise his right to terminate the contract unconscionably, e.g. to gain a windfall. In such circumstances, there should be a ground for equity to intervene and prevent the creditor from such unconscionable conduct. If the debtor is relieved from this unconscionability, there will, then, be no effective termination of the agreement; and the court will be able to decree specific performance or grant the debtor extra time to perform his contractual obligation. Furthermore, where the time of the essence provision attaches to a forfeiture clause which amounts to a penalty, the court, by relieving the debtor from forfeiture, in fact, declares the "time of the essence" provision, as a part of a penal forfeiture provision, of no effect. There, therefore, remains no bar for relief by decreeing specific performance or granting extra time. Thus, it does seem that, in principle, the courts should have jurisdiction to relieve from forfeiture of property even after the contract has been terminated for the debtor's breach of an essential time stipulation.

7.50 Some policy reasons, referred to before[142], also support this proposition. It should, however, be borne in mind that this jurisdiction should be exercised in exceptional

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[141] See *supra.*, para. 7.15

[142] See *supra.*, para. 7.13

cases[143] where the penal nature of the forfeiture clause with the essential time stipulation attached to it, or the unconscionability of the vendor's conduct in exercising his strict legal rights is clear. This is because the exercise of the jurisdiction in such cases is an obvious departure of the contractual terms agreed between the contracting parties, especially the term which makes the time of the debtor's performance of the essence.

7.51 Despite the reasons referred to above, the weight of English authority seems to be against the existence of such a jurisdiction.[144] The relevant authorities were previously discussed[145], and it was suggested that *Steedman v. Drinkle*[146] and *Brickles v. Snell*[147], as far as they decide that the courts have no jurisdiction to relieve against forfeiture of property after termination for breach of an essential time stipulation, had wrongly been decided and should not be followed.[148]

7.52 The decision of the House of Lords in *The Scaptrade* [149] is sometimes relied upon to show that the courts have no such a jurisdiction.[150] In this case, as to a time charterparty, the House refused to grant relief against the operation of a withdrawal clause to a charterer who had failed to pay the instalment of hire on time. Lord Diplock, in the course of his judgement, also referred to the point that the parties when entering into the agreement, have expressly made the time of payments of the essence. He, then, added:

> "When time is made of the essence of a primary obligation, failure to perform it punctually is a breach of a condition of the contract which

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[143] See *infra.*, paras. 7.73 *et seq.*

[144] The law has more recently been stated in *Hedworth v. Jenwise* [1994] EGCS 133 where, relying on *Steedman v. Drinkle* [1916] 1 AC 275, the availability of relief by way of an order for specific performance after breach of an essential stipulation was denied.

[145] *Supra.*, paras. 7.05 *et seq.*; Other than the authorities discussed, the early decision in *Vernon v. Stephens* (1722) 2 P. Wms. 66, 24 ER 642 should also be mentioned in which, in a contract for the sale of a manor, Lord Macclesfield L.C. relieved the purchaser from forfeiture of his interest in the property by decreeing specific performance, even though the contract had already been terminated for the purchaser's default of a payment stipulation time of which was of the essence.

[146] [1916] 1 AC 275

[147] [1916] 2 AC 599

[148] See *supra.*, para. 7.14

[149] *Scandinavian Trading Tanker Co. v. Flota Petrolera Ecuatoriana (The Scaptrade)* [1983] 2 AC 694

[150] Collins H., The Law of Contract, 2nd ed., 1993, pp. 354-355

> entitles the party not in breach to elect to treat the breach as putting an end to all primary obligations under the contract that have not already been performed."[151]

The point made by Lord Diplock is undoubtedly correct; but there is no reason to suggest that his lordship relied on this point to refuse the availability of the jurisdiction to grant relief. It seems that the reference to this point was for an emphasis on the legal right of the shipowner to terminate the contract when the charterer had failed to make instalment payments punctually, the obligation of which time was of the essence. It should not, however, it is respectfully suggested, be considered as a ground for refusing relief against the operation of the withdrawal clause.[152] This case, therefore, could not be regarded as an authority for the view that the courts have no jurisdiction to relieve against forfeiture of some interest in real or personal property following termination of a contract for breach of an essential stipulation.

7.53 In Australia, there is now no doubt about the existence of the jurisdiction to relieve against forfeiture of property where the contract has been terminated for the purchaser's breach of an essential stipulation[153], though the scope of such a jurisdiction is, to a large extent, controversial. The leading Australian case is the decision of the High Court of Australia in *Legione v. Hateley*[154]. There the majority of the Court[155], holding the traditional view to be wrong, was in no doubt to grant relief by decreeing specific performance to a purchaser who was in default of a payment stipulation time of which had contractually been made of the essence. On the facts, the purchaser had built a house on the land which had significantly improved the value of the property, and if the

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[151] *Scandinavian Trading Tanker Co. v. Flota Petrolera Ecuatoriana (The Scaptrade)* [1983] 2 AC 694, at p. 703

[152] It has also been suggested that if Lord Diplock intended this statement to be a ground for refusing relief, "it is made *obiter* in the context of the issues in *The Scaptrade* and that the English appellate courts are free to consider that issue when it arises". see Lang, Forfeiture of Interests in Land, loc. cit., no. 10, at p. 433

[153] Regardless of whether the parties have initially made the time for the performance of the purchaser's obligations of the essence, (see, e.g., *Legione v. Hateley* (1983) 152 CLR 406; *Berry v. Hodsdon* [1989] 1 Qd R 361) or this has been done by serving a notice to complete by the vendor making time of the essence, and the contract has been terminated for the purchaser's non-compliance with that notice (see, e.g., *Stern v. McArthur* (1988) 62 ALJR 588; *Tang v. Chong* (Unreported) 1 December 1988, Supreme Court of N.S.W, Young J)

[154] *Legione v. Hateley* (1983) 152 CLR 406

[155] Consisting of Gibbs CJ and Murphy J, and Mason and Deane JJ who delivered two joint judgments.

forfeiture were to stand, the vendor could gain a great windfall. As it appears from the judgments, such a jurisdiction should, however, be exercised sparingly where the intervention of courts to prevent unjust results is necessary. It is not clear whether there is a divergence of opinion in the reasonings provided by the majority's two joint judgments. Gibbs CJ and Murphy J had argued that relief against forfeiture could be granted "if there is nothing to render such an order inequitable", though they agreed that a time of the essence stipulation would generally make such relief inequitable.[156] Mason and Deane JJ, on the other hand, basically believed that the jurisdiction to relieve against forfeiture could be exercised even where the forfeiture clause was not in the nature of penalty. Such a jurisdiction, however, in their view, should be limited to exceptional circumstances where the vendor's conduct in insisting on the exercise of his legal rights amounts to unconscionability.[157]

7.54 In the subsequent authorities considering the case, there is a tendency to construe the two joint judgments as suggesting two divergent reasonings: In *Stern v. McArthur*[158], for example, Brennan J described the approach taken by Gibbs CJ and Murphy J as a somewhat broader approach, and declined to accept it. He thought the view suggesting the exercise of the jurisdiction where it would prevent *injustice* is not adequately specific to be accepted.[159] Also Gaudron J described the difference between the two reasonings as being "manifest": In her view, Mason and Deane JJ, by concentrating on the existence of the unconscionable conduct, took "the quality of the vendor's action" into consideration, while Gibbs CJ and Murphy J were only concerned about the consequences of the vendor's conduct as being in the nature of penalty.[160] On the other hand, in the same case, Deane and Dawson JJ were of the view that they had understood

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Brennan J delivered the dissenting judgment.

[156] *Legione v. Hateley* (1983) 152 CLR 406, at p. 429; Their Honours also made it clear that "where the parties have chosen to make time of the essence of the contract the grant of relief against forfeiture as a preliminary to an order for specific performance will be exceptional". (*ibid*)

[157] *Ibid.*, at p. 444

[158] *Stern v. McArthur* (1988) 62 ALJR 588; see Nicholson K., Relief Against Forfeiture in Australia (1990) 106 LQR 39

[159] *Ibid.*, at p. 598

[160] *Ibid.*, at p. 609

no "significant difference" between the two approaches.[161] In their view, "in referring to unconscionable conduct, Mason and Deane JJ were not saying that there must be unconscionable conduct of an exceptional kind before a case for relief can be made out. Rather, what being said was that a court will be reluctant to interfere with the contractual rights of parties who have chosen to make time of the essence of the contract. The circumstances must be such as to make it plain that it is necessary to intervene to avoid injustice or, what is the same thing, to relieve against unconscionable- or, more accurately, unconscientious- conduct."[162] To depart from the parties' bargain by equitable intervention, therefore, "a strong case" must be made out, and it is in this sense that the existence of exceptional circumstances has been required. Such circumstances would normally be shown if there were "something such as fraud, mistake, accident or surprise before relief [is] granted", but- and this is the important feature of the judgment- "[t]hese elements do not ... exhaust the scope of unconscionable or unconscientious behaviour; they are referred to in this context to emphasise that a strong case must be made out to warrant departure from the general approach".[163] In the case itself the High Court, by a majority[164], granted relief to a purchaser of a certain piece of land who had defaulted in the punctual payment of instalments. The contract had been terminated by the vendor after the purchaser's non-compliance with a notice to complete. The purchasers had gone into possession with the vendors knowledge, though contrary to the contractual terms, and had erected a house on the land. For this reason, and also considering the fact that the contract was a long term contract and had been terminated after nine years, the value of the property had been significantly increased. The dissenting judges, though accepting the existence of the jurisdiction, thought that the exceptional circumstances justifying its exercise, could not be proven upon the facts of the case: No unconscionable conduct could be ascribed to the vendor, and in the words of Mason CJ:

> "to extend relief against forfeiture to instances in which no exceptional circumstances are established would be to eviscerate unconscionability of its meaning."[165]

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[161] *Ibid.*, at p. 603

[162] *Ibid.*

[163] *Ibid.*, at p. 604

[164] Deane and Dawson JJ and Gaudron J (Mason CJ and Brennan J dissenting)

[165] *Ibid.*, at p. 593

7.55 From the majority, Deane and Dawson JJ considered the situation as analogous to a case where a forfeiture clause had been inserted to secure the payment of money.[166] The object of the provision capable of being achieved in the long term, it, the judges held, would be unconscientious for the vendor to take advantage of the forfeiture. They said:

> "The circumstance in the present case which warrants relief being granted is not only that the forfeiture provision was by way of security for the payment of the purchase money, but also that the contract as it was carried into effect was essentially an arrangement whereby the appellants [*i.e.*, the vendors] undertook to finance the respondent's purchase upon the security of the land. In other words, there was a close and obvious parallel between it and a purchase with the aid of a mortgage ... and the parties acted on that basis."[167]

In their Honours' view, the security nature of the forfeiture in the special circumstances of the case would well justify the exercise of the jurisdiction, but as a further justification, the windfall gained by the vendors as a result of the forfeiture[168] would bring about the circumstances in which the intervention of the court would be desirable. Gaudron J., on the other hand, held that the conduct of the vendors in insisting on the strict exercise of their rights amounted to unconscionability which justified the exercise of the jurisdiction to grant relief.[169]

7.56 Though the cases show some sort of uncertainty as to the exercise of the jurisdiction to grant relief against forfeiture of property after termination for breach of an essential term, they, no doubt, leave no room for any argument against the existence of such jurisdiction. We will deal with the issues relating to the exercise of the jurisdiction in the next section, but for the time being, it suffices to point out that the jurisdiction of courts to relieve against forfeiture of property in circumstances where parties have

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[166] *Ibid.*, at pp. 604-605

[167] *Ibid.*, at p. 604

[168] Their Honours observed: "The forfeiture of the respondent's interest in the land would truly result in a windfall to the appellants whereas relief against forfeiture would not result in a gain to the respondents properly described as a windfall." *Ibid.*, at p. 605

[169] *Ibid.*, at p. 610; In her view, "[i]nsistence on those rights, involving the loss to Mrs Bates of her house, the loss to the respondents of their interest under the contract, the forfeiture of the deposit and the indefinite retention of the instalments already paid, so long as an action for damages was commenced within 12 months of termination, when a decree of specific performance would secure all that the appellants had contracted for was ... unconscionable". Her Honour also believed that the purchasers' conduct was not such as to disentitle them from relief against forfeiture. (*ibid.*, at pp. 610-611)

expressly showed their intention as to the essential character of the term breached by the debtor should not open a floodgate to debtors to abuse the court's equitable power. It should, therefore, as it has already been suggested[170], be exercised in exceptional circumstances where it is clear that the creditor's insistence on the exercise of his legal rights would amount to unconscionability.

7.57 There are two recent English cases which show the tendency of the courts to relieve the debtor against forfeiture of his interest in the subject-matter in such circumstances. **First**, in *Transag Haulage Ltd. v. Leyland DAF Finance plc.*[171], the Court of Chancery Division was in no doubt to relieve the hirer from forfeiture of his interest in the subject-matter of three hire-purchase agreements, even though the contracts, by the exercise of the owner's contractual right, had been terminated. Though the termination of the agreements in this case was due to the appointment of an administrative receiver, nonetheless the case clearly illustrates the availability of relief against forfeiture of the debtor's proprietary or possessory interest after termination; and that the determination of the agreement should not be regarded as an obstruct to attract the jurisdiction.

7.58 **Second**, in *Hedworth v. Jenwise Ltd.*[172], the Court of Appeal was prepared to assume, for the purpose of this case, the existence of the jurisdiction to relieve from forfeiture of the purchaser's proprietary interest after termination for breach of an essential stipulation: In a contract for the sale of a freehold property, the purchaser failed to complete the contract on the contractually provided completion date, and also on the dates which had later been fixed by the mutual agreement subject to the purchaser paying compensation to the vendor. The vendor, then, purported to terminate the contract. The purchaser brought an action seeking relief from forfeiture by decreeing specific performance. The Court of Appeal, relying on *Steedman v. Drinkle*[173], held that the equitable doctrine of relief against forfeiture of the purchaser's interest in property in English law did not extend to a case where the purchaser was in default of an essential

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[170] *Supra.*, para. 7.50; see also *infra.*, paras. 7.73 *et seq.*

[171] [1994] 2 BCLC 88, for the facts of the case see *supra.*, para. 7.24

[172] [1994] EGCS 133

[173] [1916] 1 AC 275

contractual term. The court, however, referring to the leading decision of the High Court of Australia in *Legione v. Hateley* [174] assumed for the purpose of this case (though not deciding the point) the jurisdiction to grant relief by decreeing specific performance after breach of an essential stipulation, although it did not find the circumstances of the case suitable to exercise the jurisdiction. The decision, which shows the tendency to accept the jurisdiction to relieve against forfeiture of proprietary or possessory interest following termination for breach of an essential contractual term, should be welcomed. It should be hoped that in future the courts would consider the decision of the Privy Council in *Steedman v. Drinkle*[175], and would hold that they have the jurisdiction to relieve against forfeiture by decreeing specific performance or granting extra time after termination for breach of an essential stipulation.

5. The relevant circumstances for the exercise of the jurisdiction

7.59 Having discussed the scope of the jurisdiction to relieve against forfeiture of the debtor's proprietary or possessory interest and the limits of this jurisdiction, it is now appropriate to consider the conditions for the exercise of the jurisdiction and the circumstances upon which relief may be granted. It should, first and foremost, be noted that the power to grant such a relief is a discretionary jurisdiction[176], and its exercise to a large extent depends on the judge's discretion. There are, however, some indications in cases which suggest the circumstances in which the discretion should be exercised.

5.1. A Contrast: "Contractual Forfeiture" and "Legal Forfeiture"

7.60 In order to discuss these circumstances, a distinction should, it seems, be drawn between relief against "the contractual forfeiture" and relief from a forfeiture which is the creditor's common law right[177]:

(1) The parties to a contract sometimes stipulate for a clause which provides, *inter alia*, for the forfeiture of the debtor's interest in the subject-matter, upon his default in

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[174] (1983) 46 ALR 1

[175] [1916] 1 AC 275

[176] *Shiloh Spinners Ltd. v. Harding* [1973] AC 691, at p. 727 per Lord Simon

[177] See *Legione v. Hateley* (1983) 152 CLR 406, per Mason & Deane JJ at p. 445; *Stern v. McArthur* (1988) 62 ALJR 588, at p. 609 per Gaudron J; see also Thompson, J. M. (1983) 99 LQR 489, at pp. 491-492

performing certain contractual obligations. Such a clause is a "contractual forfeiture clause", and in certain proper circumstances relief against such a forfeiture may be granted.

(2) The forfeiture is sometimes the creditor's legal, as opposed to the contractual, right. The debtor breaches an essential contractual condition which is regarded as a repudiatory breach, and entitles the creditor to bring the contract to an end. Upon termination, the debtor forfeits his interest in the subject-matter. In fact, the forfeiture in such a case is the consequence of the creditor's termination for breach of an essential stipulation which is the creditor's common law right. Even if the parties have inserted such a legal consequence as a contractual clause in their agreement, this does not alter the legal nature of such a forfeiture, and is merely an emphasis on the creditor's common law right.[178]

5.2. The Relevant Circumstances for Relief Against "Contractual Forfeiture"

7.61 A contractual forfeiture provision may be inserted to secure the performance of a principal obligation. It was discussed before that against such a forfeiture, courts have jurisdiction to grant relief, if the clause amounts to the forfeiture of the debtor's proprietary or possessory interest. It also appears that Lord Wilberforce's famous statement in the *Shiloh Spinners* case[179] with regard to the availability of the relief against forfeiture of the debtor's interest for his breach of covenant or condition- "where the primary object of the bargain is to secure a stated result which can effectively be attained when the matter comes before the court, and where the forfeiture provision is added by way of security for the production of that result"[180]- refers to a contractual forfeiture provision. There is, therefore, no doubt that the courts, subject to the limitations discussed, have jurisdiction to relieve against the exercise of such a contractual forfeiture provision.

7.62 The circumstances in which this jurisdiction may be exercised have been considered by Lord Wilberforce in the *Shiloh Spinner* case. His lordship confines the availability of relief against a contractual forfeiture to "appropriate and limited cases"; and then explains

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[178] See *Legione v. Hateley* (1983) 152 CLR 406, per Mason & Deane JJ, *ibid.*

[179] *Shiloh Spinners Ltd. v. Harding* [1973] AC 691

the word "appropriate" in the following terms:

> "The word 'appropriate' involves consideration of the conduct of the applicant for relief, in particular whether his default was wilful, of the gravity of the breaches, and of the disparity between the value of the property of which forfeiture is claimed as compared with the damage caused by the breach."[181]

In the case itself, his lordship, considering the clear and wilful breaches of the assignee of more than one covenant, the continuous disregard of the assignor's rights over a period of time, the lack of enough evidence to show the assignee's ability to remedy speedily and adequately his defaults, and finally the failure to show any disproportion between the damages suffered by the assignor resulting from the breaches and the value of the interest which was subject to forfeiture, did not find the case as an appropriate one to exercise the jurisdiction. Two important points need more emphasis and consideration here: **First**, the penal nature of a contractual forfeiture provision which may reveal the relationship between the penalty doctrine and relief against forfeiture of a proprietary or possessory interest in the subject-matter. **Second**, the relevance of the unconscionable conduct of the creditor in exercising his legal rights to the exercise of the court's jurisdiction to relieve against forfeiture.

5.2.1. The penal nature of a contractual forfeiture provision

7.63 The disproportion between the damages suffered by the creditor as a result of the breach and the value of the interest which is subject to forfeiture under the contractual forfeiture provision is one of the issues which the court should review when it considers the exercise of its jurisdiction to grant relief. This is what which is normally done as regards an agreed damages clause to determine whether it is a penalty or liquidated damages: As it was previously discussed[182], if there is a gross disproportion between the actual damages which are likely to be suffered by the innocent party as a result of the breach and the amount which has been agreed to be paid under the agreed damages clause, the clause is normally considered as a penalty.

7.64 In a sense, a contractual forfeiture provision is very similar to an agreed damages

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[180] *Ibid.*, at p. 723

[181] *Ibid.*, at pp. 723-724

[182] *Supra.*, paras. 2.26-2.27

clause. The only difference is that, instead of providing for a certain sum of money to be paid or a certain act to be done by the contract-breaker in the event of breach, the forfeiture of the debtor's interest in the subject-matter in the event of his breach of a certain contractual undertaking is provided for. There is much to be said in favour of the view that the courts should have the same attitude towards these two clauses. It does, however, seem that the courts exercise their jurisdiction to relieve against forfeiture of the debtor's proprietary or possessory interest in a wider extent than they normally exercise their power to strike out penalties. Other than being penal or in the nature of penalty- in a sense that there is a clear disparity between the actual likely damages suffered by the creditor and the value of the interest which is subject to forfeiture- there are, as it appears from the judgment of Lord Wilberforce, some other considerations- such as the conduct of the applicant for relief and the gravity of breaches in question- which should be pondered when the court considers the exercise of its jurisdiction to grant relief against forfeiture.

7.65 It is, however, suggested that where the forfeiture clause is penal or in the nature of penalty, in the sense explained above, the court should have no doubt to exercise its jurisdiction to relieve the debtor from the forfeiture of his proprietary or possessory interest. This approach is in line with the view that the courts should adopt the same policy in respect of contractual forfeiture provisions and agreed damages clauses. It is also supported by some authorities in which the court relieved the debtor from forfeiture of his interest in the property on the ground that the forfeiture clause amounted to a penalty.[183]

In *Re Dagenham*[184], a case which was considered before[185], Mellish LJ stated:

> "... where there is a stipulation that if, on a certain day, an agreement remains either wholly or in any part unperformed- in which case the real damage may be either very large or very trifling- there is to be a certain forfeiture incurred, that stipulation is to be treated as in the nature of a

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[183] Though the forfeiture provision, it seems, was regarded as in the nature of penalty on the technical ground that a certain forfeiture was to be incurred for different breaches of varying importance.

[184] *Re Dagenham (Thames) Dock Co., ex parte Hulse* (1873) LR 8 Ch App 1022

[185] *Supra.*, para. 7.05

penalty."[186]

James LJ also seems to be of the same opinion where he says:

> "In my opinion, this is an extremely clear case of a mere penalty for non-payment of the purchase money."[187]

He concludes that against such a penalty, the purchaser should be relieved on the payment of the residue of the purchase price with interest.

Kilmer v. British Columbia[188] also was a similar case in which the Privy Council, applying the decision in *Re Dagenham*, said:

> "It seems to be even a stronger case, for the penalty, if enforced according to the letter of the agreement, becomes more and more severe as the agreement approaches completion, and the money liable to confiscation becomes larger."[189]

5.2.2. The Unconscionable Conduct of the Creditor

7.66 Despite the similarity between contractual forfeiture provisions and agreed damages clauses, being penal has not, it appears, been the only ground for the exercise of the jurisdiction to relieve against forfeiture of property. From the early times, the courts of equity, granted relief against forfeiture of leases for the non-payment of rent by the lessee, even though there was no penalty involved.[190] The observations of Lord Wilberforce in the *Shiloh Spinners* case[191] also show that there may be some grounds, other than being penal, upon which the jurisdiction to grant relief from forfeiture of property should be exercised. It does, therefore, seem that, even where the forfeiture provision has no penal element, the courts may exercise their jurisdiction to grant relief.[192] Now, the question which arises is upon what ground or grounds the equitable intervention of courts to grant relief in such circumstances may be justified? To answer this question, it is perhaps appropriate to refer to some relevant judicial statements.

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[186] *Ibid.*, at p. 1025

[187] *Ibid.*

[188] *Kilmer v. British Columbia Orchard Lands Ltd.* [1913] AC 319

[189] *Ibid.*, at p. 325

[190] See the observations of Gibbs C.J. and Murphy J. in the Australian case of *Legione v. Hateley* (1983) 152 CLR 406, at p. 425

[191] *Shiloh Spinners Ltd. v. Harding* [1973] AC 691, at pp. 723-724

[192] See Lang, Forfeiture of Interests in Land, loc. cit., no. 10, at pp. 443, 447 ; Carter, Breach of Contract, 2nd ed., 1991, para. 1070 ; Harpum, Relief Against Forfeiture and the Purchaser of Land, loc.

7.67 In *Mussen v. Van Diemen's Land Co.*[193], Farwell J., discussing the availability of specific performance to a purchaser who had failed to pay the instalments of the purchase price on time, stated:

> "There are no doubt cases where there has been a failure to pay the instalments and to complete the contract, and the purchaser has then come forward and said: 'I am here and now ready and willing to complete the contract and to pay the price originally stipulated by the contract and to carry out its terms', and then the court has said that it is inequitable and against conscience that the vendor should refuse specific performance and claim to retain the money already paid. That is because the court has said that if the plaintiff is willing and able to carry out his contract, notwithstanding the fact that temporarily at any rate he was unable to do so, if he is willing and able to carry out his contract, it being the primary intention of the parties that the sale should take place, it would be against conscience for the defendant to say: 'I will not give effect to the primary intention of the parties, but I will refuse to complete, and I will retain the money which has been paid to me'."[194]

It appears from this quotation that in Farwell J.'s view, the court should grant relief against forfeiture by decreeing specific performance where the vendor's refusal from specific performance, or in fact the vendor's emphasis on the exercise of his strict legal rights, is "inequitable or against conscience".

7.68 In the Australian case of *Legione v. Hateley* [195], Gibbs C.J. and Murphy J. said:

> "A court of equity will grant specific performance notwithstanding a failure to make a payment within the time specified by the contract if there is nothing to render such an order inequitable."[196]

In the same case, Mason & Deane JJ stated:

> "There is more to be said for the view that when the equitable jurisdiction is invoked to relieve against a forfeiture which is not in the nature of a penalty, equity looks to unconscionable conduct, ... especially when unconscionable conduct is associated with fraud, mistake, accident or surprise."[197]

7.69 It does appear from the above statements that since one of the main reasons for the

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cit., no. 10, at p. 154

[193] [1938] Ch. 253

[194] *Ibid.*, at pp. 263-264

[195] *Legione v. Hateley* (1983) 152 CLR 406

[196] *Ibid.*, at p. 429

[197] *Ibid.*, at p. 444

equitable intervention is to prevent a party who emphasizes on the exercise of his legal rights in an unconscionable and oppressive way, the unconscionable conduct of the creditor in exercising his contractual rights should be regarded as the main ground, other than the forfeiture clause being penal, for the exercise of the jurisdiction to relieve against forfeiture of the debtor's proprietary or possessory interest.[198] It is not, however, easy to determine whether the creditor's conduct in the forfeiture of the debtor's interest in property for his breach is unconscionable. We will discuss this issue in the following section when considering the grounds for the exercise of the jurisdiction to relieve against forfeiture following termination for breach of an essential term, which is the creditor's common law right. It is, for the time being, to be noted that considerations like the conduct of the applicant for relief, especially whether his default was wilful, and the gravity of breaches in the words of Lord Wilberforce[199] can be regarded as some guidance to show whether the creditor's emphasis on the exercise of his strict legal right amounts to an unconscionable conduct.

5.3. The Relevant Circumstances for Relief Against "Legal Forfeiture"

7.70 Relief may sometimes be sought against forfeiture of the debtor's interest in property following termination for his breach of an essential stipulation which is the creditor's common law, as opposed to the contractual, right. It was argued[200] that, in such a case, the courts should have jurisdiction to grant relief, though the weight of English authority is, it appears, against the existence of such a jurisdiction. Now, assuming that the jurisdiction exists, what are the circumstances in which this jurisdiction should be exercised?

5.3.1. Reference to "Legal Forfeiture" as a Penalty: is it right?

7.71 It should first be noted that such a forfeiture could not be regarded as a penalty.[201] A penalty, in its strict sense[202], is the *agreement* of the parties, about a payment which

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[198] See Goff & Jones, The Law of Restitution, 4th ed., 1993, p. 437 ; Greig & Davis, The Law of Contract, 1987, p. 1295

[199] *Shiloh Spinners Ltd. v. Harding* [1973] AC 691, at pp. 723-724

[200] *Supra.*, paras. 7.48 *et seq.*

[201] See *Legione v. Hateley* (1983) 152 CLR 406, per Mason & Deane JJ at p. 445; *Stern v. McArthur* (1988) 62 ALJR 588, at p. 609 per Gaudron J.

[202] As opposed to liquidated damages; see *supra.*, para. 2.03

should be made or an act which should be done in the event of breach, which acts "*in terrorem*" of the defaulting party, while such a forfeiture is essentially the consequence of something (*i.e.* termination) which is the common law right of the creditor. Therefore, despite the contractual forfeiture provision which is merely the agreement of the parties as to the rights of the creditor upon breach, the legal forfeiture[203] is not rightly to be regarded as a penalty.

7.72 Two small points need to be made here: a) Reference to such a forfeiture as a penalty, in the general sense that it is a punishment for the breach of the contract, may be made to show the disparity between the actual damages suffered as the result of breach and the value of interest which is subject to forfeiture under the creditor's common law right.[204] b) If there is a provision in the contract restating the common law right of the creditor to terminate and retake possession of the subject-matter in the event of an essential breach, it does not, as it was pointed out[205], alter the essential character of the forfeiture, and merely regulates the creditor's common law right.[206] However, where such a clause provides for an additional liability to be imposed on the debtor for his breach of an essential stipulation, like the retention of moneys already paid or making some additional payments, the clause may be regarded as a penalty, in its strict sense. Reference to the forfeiture provision as a penalty in the cases of *In re Dagenham*[207] and *Kilmer v. British Columbia*[208] seems to be in this sense.

5.3.2. The Exercise of the Jurisdiction in Exceptional Circumstances

7.73 The jurisdiction to relieve against such a legal forfeiture, as it was suggested[209], should be exercised in exceptional circumstances. These circumstances have well been defined in the joint judgment of Mason & Deane JJ in the Australian case of *Legione v.*

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[203] As opposed to the contractual forfeiture.

[204] In this sense, in the previous parts of this work, such a forfeiture has been referred to as a penalty. See, e.g., *supra.*, paras. 7.15, 7.50

[205] *Supra.*, para. 7.60

[206] See the judgment of Mason & Deane JJ in *Legione v. Hateley* (1983) 152 CLR 406, at p. 445

[207] *Re Dagenham (Thames) Dock Co., ex parte Hulse* (1873) LR 8 Ch App 1022

[208] *Kilmer v. British Columbia Orchard Lands Ltd.* [1913] AC 319

[209] *Supra.*, paras. 7.50, 7.56

Hateley[210]. "Whether the exceptional circumstances exist in a given case", the learned judges stated, "hinges on the existence of unconscionable conduct."[211] They, then, expressing the impossibility of defining all the situations which may amount to unconscionable conduct on the part of a creditor in emphasising on the exercise of his strict legal rights, referred to some situations: If the conduct of the creditor has contributed to the debtor's breach, or where the object of the creditor in exercising his legal rights is merely "to take unconscionable advantage of the breach which will fortuitously accrue to him on forfeiture of the purchaser's interest under the contract", there will be a ground for the jurisdiction to be exercised.[212]

7.74 As it was already discussed, there are some judicial statements suggesting a divergence of approaches in the reasonings of the majority in *Legione v. Hateley*.[213] The approach taken by Gibbs CJ and Murphy J, it has been argued, suggests a somewhat broader view in the exercise of the jurisdiction, mainly in line with the principle laid down by Lord Wilberforce in *Shiloh Spinners*[214] case. Accordingly, the courts could exercise their jurisdiction if the forfeiture provision is only in the nature of a security for the production of a stated result which can effectively be attained when the matter comes before the court, and no circumstances of an exceptional kind need to be shown.[215]

It would appear that the judgments of the majority in *Legione v. Hateley* could be construed as suggesting a single approach: though Gibbs CJ and Murphy J argued, in general terms, in favour of the exercise of the jurisdiction where "there is nothing to

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[210] *Legione v. Hateley* (1983) 152 CLR 406; see also Harpum, loc. cit., no. 10, at pp. 155-156 ; Carter, Breach of Contract, 2nd ed., para. 1069 ; Lang, loc. cit., no. 10, at pp. 444-445

[211] *Legione v. Hateley, ibid.*, at p. 449

[212] *Legione v. Hateley, Ibid.*, see also Meagher, Gummow & Lehane, Equity Doctrines and Remedies, 2nd ed., 1984, para. 1827

[213] (1983) 152 CLR 406; see *supra.*, para. 7.54

[214] *Shiloh Spinners Ltd. v. Harding* [1973] AC 691, at p. 722

[215] This was in fact the way Deane and Dawson JJ proceeded in their joint judgment in *Stern v. McArthur* (1988) 62 ALJR 588, though they provided some further justifications showing, in effect, the unconscionability of the vendors' insistence on the exercise of their legal rights. Their Honours had already acknowledged that they had understood no "significant difference" between the approaches taken by the majority in *Legione v. Hateley.*

render such an order inequitable"[216], they pointed out that in most cases where the parties have expressly made time of the essence, the exercise of the jurisdiction would be inequitable.[217] This in fact implies that the jurisdiction would be exercised in exceptional cases where the intervention of courts, despite the existence of a "time of the essence" provision, could not be regarded as "inequitable". The existence of these exceptional circumstances, it is submitted, could only be justified where a degree of unconscionability could be shown in the vendor's conduct to insist on the exercise of his legal rights, and this in fact was what emphasized on by Mason & Deane JJ.[218] It does therefore seem that the construction of Deane & Dawson JJ in *Stern v. McArthur*, as far as it proposes the lack of "any significant difference" in the approaches taken by the majority in *Legione v. Hateley*, is a right approach, though it is difficult to say that the judgments there did not require the proof of the existence of exceptional circumstances which renders the insistence of the vendor on the forfeiture as unconscionable.

7.75 It is therefore suggested that to exercise the jurisdiction there should exist exceptional circumstances showing that the vendor's insistence on the exercise of his legal right of forfeiture amounts to unconscionability. Both in principle and also relying on some authorities this view may be supported: **First**, in principle, the right of forfeiture in such circumstances is basically, as it was already argued[219], the vendor's common law right. To put somewhat differently, it is not a contractual right of forfeiture which could be categorized as being in the nature of security for the production of a stated result. It could not, therefore, it appears, be regarded as falling within the principle stated by Lord Wilberforce in *Shiloh Spinners*[220] case. Neither could it, as it was suggested[221], be considered as being in the nature of penalty, in its strict sense. Any attempt, therefore, to apply the principle laid down in the *Shiloh Spinners* case, and to derive a general rule applicable to both legal and contractual forfeitures from that will ignore the analysis put

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[216] *Legione v. Hateley* (1983) 152 CLR 406, at p. 429

[217] *Ibid.*

[218] See *Ibid.*, at p. 444

[219] See *supra.*, para. 7.60

[220] *Shiloh Spinners Ltd. v. Harding* [1973] AC 691, at p. 723

[221] See *supra.*, para. 7.71

forward above. Furthermore, even assuming the incorrectness of the above analysis, Lord Wilberforce, dealing with a situation involving an expressly contractual forfeiture provision, considered that the jurisdiction should be exercised in "appropriate and limited"[222] cases, giving some general guidelines for ascertaining those appropriate circumstances.[223]

7.76 **Second**, some Australian authorities show the necessity of the existence of "exceptional circumstances" for the exercise of the courts' jurisdiction: In *Ciavarella v. Balmer*[224], the High Court, in a single joint judgment[225], was in no doubt to limit the exercise of the jurisdiction to exceptional circumstances which involved unconscionable conduct on the part of vendor. Two factors in *Legione* were referred to as the central points in finding the unconscionability on the part of the vendor in *Ciavarella*: the windfall which the vendor would have stood to gain had the forfeiture not been relieved against, and the vendor's solicitors' misleading conduct which had contributed to the purchaser's breach.[226] In *Tang v. Chong*[227], Young J relieved a purchaser against forfeiture of his interest in property after termination for his failure to comply with a notice to complete. He based his judgment on the ground that it was "unconscionable" for the vendor to gain a windfall as a result of the purchaser's default where the purchaser's breach had been caused by the illness of his solicitor. In *Berry v. Hodsdon*[228] the need for the existence of exceptional circumstances was expressly emphasized by Derrington J who refused to grant relief to a purchaser who had defaulted in the payment of the balance of the deposit, time being expressly made of the essence, after the contract had been brought to an end by the vendor. The learned judge, relying on *Legione v. Hateley*, limited the exercise of the jurisdiction to "exceptional circumstances" the

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[222] *Shiloh Spinners Ltd. v. Harding* [1973] AC 691, at pp. 723- 724

[223] See *supra.*, para. 7.62

[224] (1983) 153 CLR 438; this case was referred to in the judgment of Mason CJ in *Stern v. McArthur* to show the necessity of the existence of unconscionable conduct for the exercise of the jurisdiction, but it was not discussed in any other judgment delivered.

[225] Which included Mason and Deane JJ. and Gibbs CJ

[226] (1983) 153 CLR 438, at p. 453

[227] (Unreported) 1 December 1988, Supreme Court of N.S.W (briefly considered in: Butt Peter, Relief Against Forfeiture- High Court of Australia (1989) 63 ALJ 346, at p. 349)

[228] [1989] 1 Qd R 361

existence of which "depend[ed] upon the existence of unconscionable conduct".[229] No circumstances of this character could be shown in the instant case, because, in the words of the learned judge:

> "the position of the plaintiffs [*i.e.* the purchasers] is quite commonplace in such circumstances. Indeed, it is if anything better than usual by reason of the defendants' recent abandonment of the forfeiture of the deposit. It may be contrasted with the factual situation in *Legione v. Hateley* where the parties seeking relief had constructed a building upon the subject land which would have amounted to a substantial windfall to the vendor and a substantial loss to them had the relief been refused."[230]

Finally, in *T M Burke Estates Pty Ltd v. P J Constructions (Vic) Pty Ltd (In Liq)*[231] the Appeal Division of the Supreme Court of Victoria, relying on *Legione v. Hateley*, favoured the view that relief after termination for breach of an essential term could be granted "if there are exceptional circumstances" which "may include unconscionable conduct on the part of the vendor who rescinded the contract".[232] The relatively large windfall which the vendor stood to gain, the improvements made by the purchasers with the vendors' consent, by building a display home on the land, which resulted in the considerable increase in the value of the property, and the vendor's refusal to make any allowance to the purchasers for the improvements were regarded as the relevant factors in finding out the unconscionability of the vendors' conduct.[233]

7.77 It could thus be concluded that the jurisdiction of courts to relieve against forfeiture of property after termination for breach of an essential stipulation should only be exercised in exceptional circumstances where the insistence of the creditor on the exercise of his strict legal rights amounts to unconscionability. Some useful guidelines have been suggested by Mason and Deane JJ in the form of some questions which should be answered to find out whether the exercise of his legal rights by the creditor amounts to unconscionable conduct:

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[229] *Ibid.*, at pp. 366-367

[230] *Ibid.*, at pp. 367-368

[231] [1991] 1 VR 610 (Victorian Supreme Court, Appeal Division; Young CJ, Kaye and Murphy JJ)

[232] *Ibid.*, at p. 620

[233] The case is interesting from another point of view: the vendors had already, upon termination, resold the property. The equitable relief granted to the purchasers was by way of ordering the vendors to pay the value of improvements to the purchasers.

> "(1) Did the conduct of the vendor contribute to the purchaser's breach? (2) Was the purchaser's breach (a) trivial or slight, and (b) inadvertent and not wilful? (3) What damage or other adverse consequences did the vendor suffer by reason of the purchaser's breach? (4) What is the magnitude of the purchaser's loss and the vendor's gain if the forfeiture is to stand? (5) Is specific performance with or without compensation an adequate safeguard for the vendor?"[234]

The resolution of these questions- which, in most cases relating to the subject, may arise- will determine whether the creditor's conduct in rescinding the agreement and forfeiture of the debtor's interest gives rise to unconscionable conduct.

7.78 The second of the above questions may, in fact, be resolved by a detailed examination of the facts regarding the conduct of the applicant for relief and the gravity of breaches involved, the factors which were referred to in the judgment of Lord Wilberforce in the *Shiloh Spinner* case[235]. In most cases in which relief was granted the breach was trivial, and it was remedied by the debtor in a short period after the breach.[236]

The answer to the first question, *i.e.* whether the creditor's conduct has contributed to the breach, is also an important factor in deciding whether the debtor's breach was wilful. If the creditor's conduct created the reasonable impression in the debtor's mind that the creditor would not emphasize on the exercise of his legal rights, then the breach might be regarded as inadvertent. This was, in fact, the case in *Legione v. Hateley*[237] where Mason & Deane JJ held:

> "We have already found that Mr. Gardiner (the purchaser's solicitor) acted in reliance on the statement made by Miss Williams (the secretary of the vendor's solicitor) as he understood it. The consequence is that the

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[234] *Legione v. Hateley* (1983) 152 CLR 406, at p. 449

[235] *Shiloh Spinners Ltd. v. Harding* [1973] AC 691, at pp. 723-724

[236] In *Kilmer v. British Columbia* [1913] AC 319, for example, the purchaser, failing to pay on the 7th of July, promised to pay without any failure on the 12th; and after the vendor terminated the contract and brought an action to enforce his legal rights under the contract, the purchaser counter-claimed seeking specific performance and paid the outstanding money into the court. In *Legione v. Hateley* (1983) 152 CLR 406, the purchaser tendered the outstanding purchase money only four days after the notice, required by the agreement, expired. Also in *Stern v. McArthur* (1988) 62 ALJR 588, in a long term contract for the sale of land, the purchaser had regularly paid the instalments for about eight years, then there were some defaults in payment between March 1977 and May 1978, but afterwards the instalments were again regularly paid. After termination of the contract by the vendors in February 1979, the purchasers in May 1979 deposited the whole sum which was outstanding under the contract of sale.

[237] *Legione v. Hateley* (1983) 152 CLR 406

purchaser's breach was inadvertent and not wilful."[238]

The answer to the third and fourth questions will, indeed, reveal any disparity between the actual damages suffered by the creditor as the result of breach and the value of property which is subject to forfeiture.[239] This has been considered as an extremely important factor in deciding whether the court should exercise its jurisdiction to grant relief[240]; and it is the element which has been referred to as the penal nature of the forfeiture provision in cases.[241]

Relief against forfeiture by decreeing specific performance should also be an adequate safeguard for the creditor. This is so if the forfeiture provision has merely been inserted to secure the performance of a principal obligation. Also where the forfeiture is the consequence of a termination which is the creditor's common law right, if the creditor enforces his legal right not in order to protect himself "from adverse consequences which he may suffer as a result of the contract remaining on foot"[242], but to take unconscionable advantage of the benefits which may accrue to him as the result of the forfeiture, the specific performance would, as far as the creditor is concerned, be an appropriate remedy to be decreed.

7.79 In cases where the jurisdiction should exceptionally be exercised- like commercial agreements where the parties are of equal bargaining power, or cases where the forfeiture has occurred following termination for breach of an essential term- the exercise of the jurisdiction will only be possible if the unconscionability of the vendor's conduct in stressing on the exercise of his legal rights is adequately evident and obvious.

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[238] *Ibid.*, at p. 450

[239] This includes the value of the debtor's interest in the property, the improvements which he may have made to the property, the instalments which he may forfeit under the forfeiture clause and so on.

[240] See, e.g., *Re Dagenham (Thames) Dock Co., ex parte Hulse* (1873) LR 8 Ch App 1022 ; *Kilmer v. British Columbia Orchard Lands Ltd.* [1913] AC 319 ; *Starside Properties Ltd. v. Mustapha* [1974] 1 WLR 816

[241] See cases cited above: note 240

[242] *Legione v. Hateley* (1983) 152 CLR 406, per Mason & Deane JJ at p. 449

5.4. Being Ready, Able and Willing to Perform: A General Condition to Exercise the Jurisdiction

7.80 Relief against forfeiture of the debtor's proprietary or possessory interest would not obviously be granted unless the debtor is able, willing and ready to perform his contractual obligation. Since the relief given, in these cases, is normally a decree of specific performance or granting the debtor extra time to perform his contract, there would be no case for granting such relief where the debtor has not shown his readiness, ability and willingness to perform his obligation. In *Barton, Thompson v. Stapling Machines*[243], Pennycuick J., in respect of relief against forfeiture of leases for non-payment of rent, referred to this requirement saying:

> "It is an invariable condition of relief from forfeiture for non-payment of rent that the arrears, if not already available to the lessor, shall be paid within a time specified by the court. The precise length of time is a matter of discretion and the time may be extended on subsequent application, but the imposition of the condition is not a matter of discretion; it is a requirement of law rooted in the principle on which relief is granted. It follows that readiness to pay arrears within such time as the court shall think fit is a necessary condition of the tenant's claim for relief."[244]

7.81 Being able, ready and willing to perform does not mean that the debtor must be able to perform his contractual obligation immediately.[245] It seems that if the court can be convinced that there is a "reasonable prospect"[246] of the debtor being able to perform the contract in a reasonable period of time, then the relief may be granted.

6. Forms of Relief

7.82 The most usual form of relief against forfeiture of the debtor's interest in the

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[243][1966] 2 All ER 222, Pennycuick J.

[244] *Ibid.*, at p. 225

[245] *Starside Properties Ltd. v. Mustapha* [1974] 1 WLR 816, where Carins L.J., at p. 825, said: "... I do not consider that the expression 'able, ready and willing to perform' means 'able to perform on that very day'. ... in *Chandless- Chandless v. Nicholson* [1942] 2 KB 321 ... the original order for relief was on condition that payment of arrears was made within three months, and I believe it to be common for time to pay to be given, which would never be appropriate if it were a condition of relief that the applicant for relief should be able to pay immediately." See also Hoggett, Houses on the Never-Never, loc. cit., no. 40, at p. 348 ; Keeton, Equity, 2nd ed., 1976, p. 314

[246] *Stockloser v. Johnson* [1954] 1 QB 476, in which Romer L.J., considering the *In re Dagenham* case said that "presumably the court", in that case, "was satisfied that there was a reasonable prospect of the company being able to satisfy the vendors, if extra time were given, for otherwise there was no object in allowing them a further chance of completing the contract." see also Pawlowski, Relief Against Forfeiture of Instalments , Estate Gazette, 27 March 1993, Issue 9312, 122, at p. 123

subject-matter is, as it was probably noticed when discussing the relevant cases, decreeing specific performance or giving the contract-breaker further time to perform his contractual obligation. In unusual circumstances, however, there might be a case where the court is unable to grant this form of relief. In such a case, would the court have to enforce the forfeiture provision which might also be penal in nature, or should there be another form to relieve the debtor from the consequences of his breach?

7.83 The question was considered in the rather recent case of *Jobson v. Johnson* [247]: The defendant agreed to purchase 62,566 shares in a football club for a total purchase price of £351,688 which was payable by an initial payment of £40,000 and six half-yearly instalments of £51,948. Upon his default in the payment of the second or any subsequent instalment, the defendant, under cl 6(6) of the agreement, had to retransfer the same amount of shares (though not necessarily the shares purchased) to the vendors for the sum of £40,000. Default having been made in the payment of the first instalment, a further variation agreement was entered into by the parties which changed slightly the date and amount of the instalments. The defendant paid a further £100,000, but failed to make any payment in respect of the balance. The plaintiff, as the assignee of the vendors, brought an action seeking specific performance of the retransfer agreement. The defendant claimed that the retransfer agreement was a penalty clause and unenforceable. He also counterclaimed for relief against forfeiture of his shares.

At the trial, the counterclaim was struck out because the defendant had failed to comply with an undertaking to disclose certain documents relating to his recent financial circumstances.[248] Harman J. held that, though the clause was a penalty, it was nonetheless enforceable unless the court, in its discretion, can grant the purchaser relief against forfeiture. Since such relief, because of the striking out of the defendant's counterclaim, was impossible, so the judge ordered specific performance of the retransfer agreement.

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[247] *Jobson v. Johnson* [1989] 1 All ER 621

[248] There was no appeal against this decision. That meant that it was not open for the appellate court to consider granting relief against forfeiture.

7.84 On appeal, the court was in no doubt that cl 6(6) was a penalty clause since it subjected the defendant to the same liability regardless of the gravity, nature and consequences of the breach.[249] The court was also unanimous[250] as to the point that it should not allow the clause, with its apparent penal nature, to be enforced.[251] All the judges were of the opinion that in the ordinary course of events, relief by giving the defendant a further opportunity to pay the outstanding balance of the instalments with interest would have been considered had the defendant's counterclaim for relief against forfeiture not been struck out.[252]

In Nichols LJ's view, cl 6(6), in addition to being penal, had features which resembled those of forfeiture clauses. He pointed out:

> "In substance cl 6(6) is equivalent to a right to retake the property being sold in default of payment of the full price. Clause 6(6) was inserted as an attempt to give the vendors some "security" over the property being sold if the purchaser failed to pay in full."[253]

Kerr LJ was in agreement with Nichols LJ as to this point and held that in his view the clause was "much closer to what [was] commonly referred to as a 'forfeiture' than a 'penalty' clause".[254]

7.85 It would seem clear that the clause had a hybrid nature: It was an agreed damages clause under which the defendant, instead of making a specific payment, had to transfer a certain property to the plaintiff if he defaulted in punctual payment of instalments. The clause, no doubt, was not a genuine pre-estimate of the plaintiff's likely losses, and so

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[249] *Jobson v. Johnson* [1989] 1 All ER 621, at p. 625 per Dillon LJ, p. 634 per Nichols LJ, and p. 638 per Kerr LJ

[250] Kerr LJ with considerable reluctance

[251] *Jobson v. Johnson* [1989] 1 All ER 621, at p. 629 per Dillon LJ, p. 634 per Nichols LJ, and p. 639 per Kerr LJ

[252] *Jobson v. Johnson* [1989] 1 All ER 621, at p. 629 per Dillon LJ, pp. 635-636 per Nichols LJ, and p. 638 per Kerr LJ

[253] *Ibid.*, at p. 635. There were, of course, some problems with regard to such a construction: for instance, no property in the shares had been retained by the vendor; and the purchaser, under cl 6(6), did not have to transfer the identical shares which he had purchased. (See p. 635 per Nichols LJ, and p. 638 per Kerr LJ) Nonetheless, taking into account the other provisions of the contract, they could not undermine the fact that the real purpose for the insertion of the clause was to provide a form of security over the property for the payment of the instalments. (See *ibid.*, per Nichols LJ and Kerr LJ)

[254] *Ibid.*, at p. 638

was a penalty. Being penal, it could not be enforced beyond the actual losses which the plaintiff had suffered as the result of breach.[255] On the other hand, it was a forfeiture clause which had been inserted to provide a form of security over the shares for payment. There was no doubt that, even in the absence of a counterclaim for relief against forfeiture, the clause could not be enforced. The plaintiff, however, had to be adequately compensated, but how?

7.86 Relief by granting the defendant an extra time to perform was impossible because of the striking out of the counterclaim. One possibility was to order the transfer of a reduced number of shares to the plaintiff so that it would cover his actual loss resulting from breach. The court, however, considered it as making a new contract for the parties, and therefore rejected this possibility.[256] The other possibility was simply to refuse to enforce the clause, and to enter a judgment for the plaintiff for actual damages he had suffered as the result of breach. But this was disclaimed by the plaintiff.[257]

The majority of the Court of Appeal[258] proposed the plaintiff two options: **First**, an order for the sale of the shares by the court, and payment of the outstanding balance of the instalments plus interest out of the proceeds. **Second**, an order for the specific performance of the retransfer agreement if the present value of the shares, according to an enquiry ordered by the court, did not exceed, by more than £40,000, the actual losses of the vendor as the result of breach.[259] If neither of these alternatives was acceptable by the plaintiff, then he would be left to sue for the unpaid instalments in a fresh action and the order for specific performance would be discharged.[260]

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[255] *Ibid.*, at p. 627 per Dillon LJ, pp. 632-633 per Nichols LJ ; Kerr LJ thought that penalty clauses were not simply unenforceable. "In my view" he said "the combined effect of law and equity on penalty clauses is simply that they will not be enforced in favour of a plaintiff without first giving to the defendant a proper opportunity to obtain relief against their penal consequences." (at p. 638) This view, with all respect, does not seem to be in line with the previous authorities which clearly establish that penalty clauses are unenforceable. To see some of these authorities see *supra.*, chapter one ; see also Harpum, Equitable Relief: Penalties and Forfeitures (1989) 48 CLJ 370, at p. 372

[256] *Jobson v. Johnson* [1989] 1 All ER 621, at pp. 634, 637 per Nichols LJ

[257] *Ibid.*, at p. 630 per Dillon LJ

[258] Dillon and Nichols LJJ

[259] *Ibid.*, at p. 630 per Dillon LJ, and pp. 636-637 per Nichols LJ

[260] *Ibid.*, per Dillon LJ

7.87 The second of these alternatives was almost certainly not a real option, for the value of the shares, as appeared from both parties, had dramatically increased. The first option, in the words of Nichols LJ, was "equivalent in the different circumstances of this case to the automatic scaling-down of a (pecuniary) penalty clause".[261] It was also, it would seem, very similar to relief by granting the defendant an extension of time: The shares would belong to the defendant, but to pay the unpaid instalments, the court would order the sale of the shares to pay the arrears out of the proceeds. This was one of the reasons why Kerr LJ disagreed with this form of relief. His lordship said:

> "The first alternative differs little from simply granting relief to the defendant in the usual way, save that this would be accompanied by what would in effect be an auction of the shares, in which both parties as well as outsider could compete."[262]

7.88 Kerr LJ, therefore, offered another form of relief: *restitutio in integrum*. The fairer solution without contravening any principle of equity, in his view, was that the shares should be retransferred to the plaintiff (*i.e.* the specific performance of cl 6(6)) on condition that all the moneys paid by the defendant should be repaid to him, perhaps with interest, by the plaintiff.[263]

7.89 It has been suggested that the majority's view is the correct one, because, according to the both normal and equitable rules for damages, the plaintiff "must be placed in the same position as if the agreement had been performed".[264] Some writers, on the other hand, have favoured the minority's view.[265] It would seem that, in the unusual circumstances of the case, Kerr LJ's view has much to commend it: **First**, as pointed out by Professor Furmston, in the circumstances of the case where the value of the shares had increased and the issue between the parties was largely about the right to the shares, not money, "a solution which leaves the shares in the plaintiff's hands is likely to be fairer

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[261] *Ibid.*, at p. 637

[262] *Ibid.*, at p. 640

[263] *Ibid.*

[264] Harpum, Equitable Relief: Penalties and Forfeitures (1989) 48 CLJ 370, at p. 373

[265] Furmston M P, Contract Planning: Liquidated Damages, Deposits and Foreseeability Rule (1991) 4 JCL 1, at pp. 6-7 ; Clarke M J R, Commentary on "Contract Planning, by Prof. Furmston" (1991) 4 JCL 11, at p. 15

than a solution which leaves the shares in the defendant's hands."[266]

7.90 **Second**, it should not be doubted that the rights of the plaintiff should not be prejudiced by the form of relief which is offered by the court. If the defendant's counterclaim had not been struck out, the court might have granted relief by extending the time for payment. In such a case, if the defendant had failed to perform his contract within the specified time, the court, subject to any further extension of time, would have ordered the specific performance of cl 6(6), and the shares, accordingly, would have been retransferred to the plaintiff. Put another way, in the ordinary course of events, the plaintiff had the probable chance of getting the shares back. Now, the relief offered by the majority ignores this probable right of the plaintiff, especially in circumstances where, as it appears from the report, the defendant preferred to let his counterclaim be struck out. True that the plaintiff had the right to bid and buy the shares if there was a sale[267], but it was undoubtedly different from getting the shares back under cl 6(6).

7.91 **Third**, the relief offered by the majority was very close to the ordinary relief by the extension of time which, because of the striking out of the counterclaim, was not open for the court to consider and grant it.

7.92 **Fourth**, Kerr LJ's view was explainable in principle in the following terms: There was no objection if the parties had provided that upon any failure by the purchaser, the vendor would be entitled to retake possession of the subject-matter on terms that he should repay all moneys received under the agreement. Upon this analysis, cl 6(6) was of a penal nature because it did not take into account the moneys already received by the plaintiff, and to this extent, it was unenforceable.[268] Therefore, the counterclaim being struck out, there would be no objection to the enforcement of the clause if the plaintiff was ordered to return the instalments received under the agreement. Put another way, after the retransfer of shares to the plaintiff, the retention of the instalments already received by him would be in the nature of penalty against which the defendant was

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[266] Furmston, *ibid.*, at p. 7

[267] As it was suggested by Nichols LJ, *Jobson v. Johnson* [1989] 1 All ER 621, at p. 637

[268] See *Jobson v. Johnson* [1989] 1 All ER 621, at p. 640 per Kerr LJ

entitled to be relieved. This relief would take the form of ordering the plaintiff to repay those moneys to the defendant. Though this form of relief would return the parties to their pre-contractual position, it does not contravene the equitable principles relating to relief against forfeiture. For, as it will shortly be seen[269], relief against forfeiture of instalments already paid might, in certain circumstances, be restitutionary in nature.[270]

7.93 The case illustrates the possibility of some other forms of relief, where it is not, for any reason, open to the court to consider granting relief by extending the time of performance. It should, however, be noted that these are exceptional forms of relief, and could only be utilized in proper exceptional circumstances.

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[269] See *infra.*, chapter 8, section 2

[270] See, e.g., *Steedman v. Drinkle* [1916] 1 AC 275; *Workers Trust and Merchant Bank Ltd. v. Dojap Investment Ltd.* [1993] 2 All ER 370

Chapter 8

Relief Against Forfeiture of Moneys Already Paid

1. Introductory Remarks

8.01 A contractual forfeiture provision, besides the forfeiture of the debtor's interest in the subject-matter, may also provide for the creditor's right to retain moneys already paid by the debtor in case of his breach of a contractual obligation. In sale of land by instalments, for instance, the parties may provide that if the purchaser made default in the payment of any instalment, the vendor would be entitled to terminate the contract, retake possession of the land and retain the moneys already paid by the purchaser. This may also happen in commercial agreements where the debtor's interest in the subject-matter may not be a proprietary or possessory interest.

8.02 Granting relief against forfeiture of the creditor's interest in property in appropriate cases, the court also relieves the debtor from forfeiture of moneys already paid by him[1]; because where the court grants such relief by decreeing specific performance or giving the debtor extra time to perform the contract, the moneys paid by the debtor are taken into account as a part of his performance. If, however, relief from forfeiture of the debtor's interest in property was denied, or where the debtor was not ready and able to perform the contract and brought an action seeking only relief from forfeiture of moneys already paid, would there be a jurisdiction for the courts to grant such a relief? Assuming the existence of the jurisdiction, what are the circumstances upon which the jurisdiction should be exercised? And is there any relationship between the jurisdiction to strike out penalties and the doctrine of relief against forfeiture of moneys already paid. These are the questions with which this chapter will mainly be concerned.

8.03 It will be seen that there are both equitable and statutory jurisdictions to grant relief against forfeiture of moneys already paid. Though the statutory jurisdiction has mainly originated in equity, and our main concern also is the study of the equitable jurisdiction,

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[1] See *supra.*, pp. 258-259

nevertheless we will refer, briefly, to the statutory jurisdiction[2] after a rather detailed analysis of the equitable jurisdiction.

8.04 The moneys which may be forfeited as the result of the debtor's breach might be a deposit or instalments of the contractual price. It has sometimes been suggested[3] that the principles relating to relief against forfeiture of moneys already paid do not extend to deposits, and can only be applied to part payments (*i.e.* the instalments of purchase price). It might, on the other hand, appear from some judicial statements that the equitable jurisdiction is equally available as to relief against forfeiture of deposits and part payments.[4] With all respect, neither of these views, it seems, can precisely reflect the situation: As it will be argued[5], there is an equitable jurisdiction to relieve against forfeiture of deposits. The circumstances for the exercise of this jurisdiction, however, are, to some extent, different from those which are applied as to the relief from forfeiture of instalments. It is, therefore, appropriate to discuss separately the principles regarding relief from forfeiture of part payments and deposits. Thus, the second section of this chapter will deal with the equitable rules as to relief against forfeiture of instalments already paid, while the third section will be responsible for illuminating the jurisdiction of courts to relieve against forfeiture of deposits.

2. Equitable Relief Against Forfeiture of Part payments

2.1. Existence and Scope of the Jurisdiction

8.05 There is no doubt that, in certain circumstances, courts have equitable power to relieve a debtor from forfeiture of instalments already paid.[6] The scope of the

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[2] See *infra*., chapter 9

[3] Downes T. A., Textbook on Contract, 3rd ed., 1993, p. 334

[4] See, e.g., *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 QB 476, at pp. 637-638 per Denning LJ; see also McGregor on Damages, 15th ed., 1988, para. 503

[5] See *infra*., paras. 8.47 *et seq.*

[6] Furmston M P, Cheshire, Fifoot & Furmston's Law of Contract, 13th ed., 1996, p. 642; Treitel G.H., The Law of Contract, 9th ed., 1995, pp. 908-909 ; Chitty on Contracts, 27th ed., vol. 1, 1994, para. 26-070; Guest A.G., Anson's Law of Contract, 26th ed., 1984, p. 513 ; Ogus A I, The Law of Damages, 1973, p. 54 ; Downes T. A., Textbook on Contract, 3rd ed., 1993, pp. 333-334 ; Pawlowski M., Relief Against Forfeiture of Instalments (1993) Estate Gazette, 27 March 1993, issue 9312, 122

jurisdiction, however, is highly controversial. In principle, where the forfeiture provision is in the nature of penalty- where, that is, the sum forfeited is wholly disproportionate to the damages caused by the breach- there seems less reason to justify the enforcement of the clause and to reject the availability of relief. A review of cases, however, shows that the position is far from clear. Two different situations may need different treatments, on the basis of whether the debtor is able, ready and willing to perform his obligation.

2.1.1. The debtor able and willing to perform

2.1.1.1. Relief by granting extra time to complete the contract

8.06 It seems to be an unchallenged proposition that where the debtor is able, ready and willing to perform his part of the contract, the courts- subject to the limitations discussed in the preceding chapter[7]- could have jurisdiction to relieve him against forfeiture of instalments by granting him extra time to perform his contractual obligation.[8] In *Starside Properties Ltd. v. Mustapha*[9], the facts of which have already been given[10], Edmund Davies LJ, considering the judgment of the judge at the first instance, cited the following part of his judgment:

> "... one only has to consider the case where the defendant goes on paying regularly right up to a state where she has nearly accumulated a deposit of £1250 and then defaults. If she loses all her payments to date it can not be argued that this provision is not a penalty. It cannot be a penalty one year

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[7] *Supra.*, chapter 7

[8] *Re Dagenham (Thames) Dock Co., ex parte Hulse* (1873) LR 8 Ch App 1022 ; *Kilmer v. British Columbia Orchard Lands Ltd.* [1913] AC 319 ; *Starside Properties Ltd. v. Mustapha* [1974] 1 WLR 816 ; Though, it was suggested, these cases deal with the different, but related, question of relief against forfeiture of the payer's interest in property, nonetheless they can, it seems, be relied upon, to establish the existence of the jurisdiction to relieve from forfeiture of instalments; because firstly, in all these cases the purchaser was indirectly relieved from forfeiture of instalments already paid, and secondly, the argument of the court, particularly in *Kilmer v. British Colombia* and *Starside Properties Ltd v. Mustapha*, *inter alia*, was that the forfeiture provision empowering the vendor to retain the instalments already paid was in the nature of penalty against which the purchaser was entitled to be relieved. It, then, granted relief by giving the purchaser extra time to perform his contractual obligation. See also Furmston M P, Cheshire, Fifoot & Furmston's Law of Contract, 13th ed., 1996, p. 642; Guest A.G., Benjamin's Sale of Goods, 4th ed., 1992, para. 15-133; Treitel G.H., The Law of Contract, 9th ed., 1995, p. 908; Treitel G.H., Remedies for Breach of Contract, 1988, p. 242; Chitty on Contracts, 27th ed., vol. 1, 1994, para. 26-070 ; Ogus A I, The Law of Damages, 1973, p. 57 ; McGregor on Damages, 15th ed., 1988, para. 506 ; Guest A.G., Anson's Law of Contract, 26th ed., 1984, pp. 513-514; Downes T. A., Textbook on Contract, 3rd ed., 1993, p. 334 ; Pawlowski M., Relief Against Forfeiture of Instalments (1993) Estate Gazette, 27 March 1993, issue 9312, 122 ; Meagher R P, Equity Doctrines & Remedies, 3rd ed., 1992, para. 1827

[9] *Starside Properties Ltd. v. Mustapha* [1974] 1 WLR 816

[10] *Supra.*, para. 7.16

> and not the next and therefore I am in no doubt that this is a penal provision."[11]

The Lord Justice, then, referred to the relief given by the court by postponing the order for possession for three months to enable the purchaser to perform his part of the bargain, and added:

> "That the contract between the parties imposed a penalty is unchallenged, and that the nature or dimensions of the penalty were such as to satisfy the court that justice required that relief therefrom should be granted was demonstrated by the original order from which the plaintiffs did not appeal."[12]

8.07 Although this jurisdiction has mainly been developed in cases dealing with contracts for the sale or lease of land, there is, nonetheless, no reason to confine it to any special type of agreements.[13] The observations of Romer LJ- who, as it will be seen, took the narrowest possible view with regard to the scope of the jurisdiction in the important case of *Stockloser v. Johnson*[14], a case dealing with a forfeiture provision in a contract for the sale of plant and machinery- show the general availability of the jurisdiction to relieve from forfeiture of instalments by granting the debtor extra time to perform his obligation:

> "... it appears to me that the cases establish that, if a purchaser defaults in punctual payment of instalments of purchase money, the court will, in a proper case, relieve the purchaser from his contractual liability to forfeit instalments (apart from the deposit) already paid to the extent of giving him a further chance and further time to pay the money which is in arrears if he is able and willing to do so."[15]

Furthermore, regarding the hypothetical case of the purchase of a necklace by instalments, put by Denning LJ, on terms that upon default in punctual payment the purchaser would forfeit all instalments already paid, Romer LJ was in no doubt that the court would give the purchaser "further time to find the money if he could establish some probability of his being able to do so..."[16]

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[11] *Ibid.*, at p. 570

[12] *Ibid.*, at p. 571

[13] See, e.g., *Barton Thompson & Co., Ltd. v. Stapling Machines Co.* [1966] Ch. 499; *supra.*, para. 7.22; see also Greig & Davis, The Law of Contract, 1987 (With Fourth Cumulative Supplement, 1992), pp. 1458, 1460

[14] *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 QB 476

[15] *Ibid.*, at p. 643

[16] *Ibid.*, at p. 644

8.08 The scope of the jurisdiction, its limitations, and the circumstances upon which it should be exercised[17] have already been fully dealt with[18] and need not be repeated here.

2.1.1.2. Relief by ordering repayment of the forfeited instalments

8.09 The more important question is if, because of any limitations of the jurisdiction to relieve from forfeiture by granting extra time, the court does not grant the debtor more time to pay, whether it has power to grant relief by ordering repayment of the instalments which are subject to forfeiture? The position does not seem to be clear[19]: It has, relying on *Steedman v. Drinkle*[20], been suggested that the courts certainly have the jurisdiction to grant such a relief. In this case[21], the Privy Council refused to grant specific performance to a purchaser who had failed to pay the instalments of the purchase price on the due date, time having been expressly made of the essence. The Board, however, was in no doubt that the forfeiture provision empowering the vendor to retain the instalments paid by the purchaser was in the nature of penalty "against which", in the words of Viscount Haldane, "relief should be given on proper terms".[22] The form of relief which the Board suggested was that the purchasers should be relieved from forfeiture of the sums paid by them under the agreement, and for this purpose they should be at liberty to apply to the Court of the first instance.[23] The case clearly establishes the jurisdiction of courts to relieve against forfeiture of instalments already paid, where the forfeiture constitutes a penalty.

8.10 There is, on the other hand, the dicta of Romer LJ who, delivering his judgment in

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[17] See also Pawlowski M., Relief Against Forfeiture of Instalments (1993) Estate Gazette, 27 March 1993, issue 9312, 122, at p. 123

[18] *Supra.*, chapter 7

[19] See, e.g., Furmston M P, Cheshire, Fifoot & Furmston's Law of Contract, 13th ed., 1996, p. 642; Ogus A I, The Law of Damages, 1973, pp. 54-56; Treitel G.H., The Law of Contract, 9th ed., 1995, p. 908; McGregor on Damages, 15th ed., 1988, paras. 506-507; Pawlowski M., Relief Against Forfeiture of Instalments (1993) Estate Gazette, 27 March 1993, issue 9312, 122, at p. 123; Chitty on Contracts, 27th ed., vol. 1, 1994, para. 26-070 at p. 1264

[20] *Steedman v. Drinkle* [1916] 1 AC 275

[21] For the facts of the case see *supra.*, para. 7.11

[22] *Ibid.*, at p. 280

[23] *Ibid.*

Stockloser v. Johnson[24], considered the cases regarding the issue, and took a view which has been described as "the narrowest view of the court's powers"[25]. His lordship concluded:

> "In my judgment, there is no sufficient ground for interfering with the contractual rights of a vendor under forfeiture clauses of the nature which are now under consideration, while the contract is still subsisting, beyond giving a purchaser who is in default, but who is able and willing to proceed with the contract, a further opportunity of doing so; and no relief of any other nature can properly be given, in the absence of some special circumstances such as fraud, sharp practice, or other unconscionable conduct of the vendor, to a purchaser after the vendor has rescinded the contract."[26]

As it appears from this passage, in Romer LJ's view, the only relief which may be available from forfeiture of instalments already paid, where the contract has not been terminated for the debtor's default, is granting the contract breaker extra time in which to remedy his breach. After termination, however, in the absence of special circumstances, there is no jurisdiction to relieve from forfeiture.[27] Accordingly, the court would, in no case, in the absence of special circumstances, have power to grant relief by ordering the repayment of the instalments already paid.

8.11 It will shortly be considered[28] that the dicta of Romer LJ have been based on an unconvincing explanation of the previous cases which do not justify such a conclusion. Furthermore, the premises relied upon by his lordship, though correct in themselves, do not lead to such a result. It is, therefore, submitted that the first view is correct and the courts, in proper circumstances, have power to grant relief against forfeiture of instalments already paid by ordering the creditor to return the forfeited sums.

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[24] *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 QB 476

[25] Waddams, The Law of Contracts, 2nd ed., 1984, p. 343

[26] *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 QB 476, at p. 644

[27] It was fully discussed and submitted before that after termination, even where the contract has been terminated for breach of an essential stipulation, the courts should have power to grant relief by granting the defaulting party a further time to remedy his breach. See *supra.*, paras. 7.48 *et seq.*

[28] *Infra.*, paras. 8.21 *et seq.*

2.1.2. The debtor unable or unwilling to perform

2.1.2.1. Availability of Relief: Generally

8.12 Where the defaulting party is either unable or unwilling to perform his contractual obligation, no question of granting relief against forfeiture of instalments paid by giving him an extra time to remedy his breach would arise, because, as it was argued before[29], being able, ready and willing to perform is a necessary condition for decreeing specific performance or granting the debtor extra time to perform his part of the bargain. Now the question in such a case is whether courts have jurisdiction to grant relief by ordering repayment of the instalments to the debtor?[30] It would seem that the decision of the Privy Council in *Steedman v. Drinkle*[31] establishes the existence of such a jurisdiction. The logical inference to be drawn from the case is that where the forfeiture provision is in the nature of penalty and the court is, for any reason, barred from affording relief by granting an extra time, the debtor may be relieved by the court ordering the creditor to return the forfeited instalments.

2.1.2.2. Availability of Relief: opposing views

2.1.2.2.1. Farwell J in Mussen's case

8.13 The decision in *Steedman v. Drinkle* has been narrowly interpreted by Farwell J in *Mussen v. Van Diemen's Land Co.*[32]: In an agreement for the sale of land by instalments, it was provided that in proportion to the amounts paid by instalments, the purchaser would be let into possession of certain parts of the land, and that upon default in punctual payment, the vendor would be entitled to rescind the contract and retain the instalments already paid. Default having been made, the vendor terminated the agreement and retained about £40,200 which was the sum paid by the purchaser in excess of the price of the land which had been conveyed to him. After about six years, the purchaser brought an action claiming the return of the forfeited sum on the ground, *inter alia*, that the

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[29] *Supra.*, paras. 7.80-7.81

[30] See Treitel G.H., The Law of Contract, 9th ed., 1995, p. 908 ; Chitty on Contracts, 27th ed., vol. 2., 1994, para. 36-273 at pp. 637-638 ; McGregor on Damages, 15th ed., 1988, para. 506 ; Ogus A I, The Law of Damages, 1973, pp. 55-56 ; Diamond A.L., Sutton & Shannon on Contracts ; 7th ed., 1970, pp. 423-424 ; Meagher R P, Equity Doctrines & Remedies, 3rd ed., 1992, para. 1827; Beale H., Unreasonable Deposits (1993) 109 LQR 524, at p. 526

[31] *Steedman v. Drinkle* [1916] 1 AC 275

[32] *Mussen v. Van Diemen's Land Co.* [1938] 1 All ER 210, [1938] Ch. 253

forfeiture provision was in the nature of penalty against which he was entitled to be relieved by ordering the vendor to return some part, if not the whole, of the moneys already paid under the agreement.

8.14 Farwell J was in no doubt that there were cases in which equity would relieve against penalties. The basis for such an intervention, in his view, was that it was "against conscience for a party who had the money to retain it".[33] His lordship stated:

> "To entitle a plaintiff to relief from a penalty, it is necessary, in my judgment, for him to show that there is some ground or another on which it would be unconscionable for the defendants to retain the money, or the whole of the money."[34]

On the facts of the case, however, he concluded that there was nothing unconscionable to justify the existence of the jurisdiction to grant relief from forfeiture.[35] He confined the cases in which relief had been granted, with the exception of one case, to cases where the court was able to decree specific performance. Then he explained *Steedman v. Drinkle*[36] as an exceptional case, concluding that the reason for the relief in that case was that the purchaser was able, ready and willing to perform the contract, and the vendors were refusing to permit specific performance. His lordship pointed out:

> "In my judgment, the whole basis of that decision turns on the fact that the appellant was willing to perform the contract, and the only reason why performance was impossible was that the respondents refused to agree to specific performance and the terms of the contract made it impossible for the court to decree specific performance. The Board thereupon thought that it was unconscionable for the respondents to take up the attitude of saying: "We will not complete but we will retain the money," and on that ground the Board granted relief."[37]

The judge, therefore, thought that *Steedman v. Drinkle* turned on its particular facts and had no general application. Thus, since the purchaser, in the present case, was not ready and willing to perform, there was no ground for the court to grant relief from forfeiture.[38]

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[33] *Ibid.*, at pp. 215-216

[34] *Ibid.*, at p. 217

[35] *Ibid.*

[36] *Steedman v. Drinkle* [1916] 1 AC 275

[37] *Ibid.*, at p. 219

[38] The court also relied on two other factors: first, even if the purchaser were ready and willing to perform, his delay in bringing the action would make it impossible for the court to consider specific performance. Further, in the circumstances of the case where the purchaser had stood by for six years

According to Farwell J., therefore, the court would have no jurisdiction to relieve against forfeiture by ordering repayment of the instalments, which are subject to forfeiture, to the payer, where he is not able, willing and ready to perform his part of the bargain.

8.15 Farwell J's view, so far as it recognises unconscionability as the basis for the equitable intervention to relieve from forfeiture, should be supported.[39] His narrow interpretation of *Steedman v. Drinkle*[40] does, however, seem to be subject to a number of serious objections[41]:

First, in that case, the Board emphasised the penal nature of the forfeiture provision, and realised the necessity of relief against such a penalty.[42] The Board did not put any emphasis on the vendor's conduct and did not even mention that the vendor's conduct- in not allowing the specific performance, though the purchaser was ready, able and willing to perform, and at the same time insisting on his contractual right to retain moneys already paid- amounted to unconscionability. It should, no doubt, be accepted that the purchaser's readiness and ability to complete the contract was a relevant factor in deciding whether relief should be given[43], but the judgment by no means shows that willingness and ability were the necessary prerequisites to any relief which may be given against forfeiture.

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and had not made the smallest attempt to complete the contract, it was not unconscionable for the vendor to insist on the performance of the contractual term. Second, the purchaser had received a part of what he had bargained for. Therefore, it would not be unconscionable for the vendor to retain, under the contractual provision, the moneys already paid. See *ibid.*, pp. 219-220; see also Harpum C., Relief Against Forfeiture and the Purchaser of Land [1984] CLJ 134, at p. 158

[39] See Harpum C., Relief Against Forfeiture and the Purchaser of Land [1984] CLJ 134, *ibid.*

[40] *Steedman v. Drinkle* [1916] 1 AC 275

[41] Farwell J's narrow explanation was also criticized by Denning LJ in *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 QB 476, at p. 639. In his lordship's view, "the court was much influenced by the fact that the purchaser had allowed nearly six years to elapse before claiming restitution. He had already had a good deal of land conveyed to him and, during his six years' delay, values had so greatly changed that it may be that he had his money's worth. At any rate, it was not unconscionable for the defendant to retain the money."

[42] It is helpful to recite the relevant words of the judgment: "... the stipulation in question was one for a penalty against which relief should be given on proper terms." *Steedman v. Drinkle* [1916] 1 AC 275, at p. 280

[43] See the judgment of Somervell LJ in *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 QB 476, at pp. 635-636

Second, in principle, there could be no justification for the view requiring readiness and ability as conditions precedent for relief from forfeiture by ordering repayment of the forfeited instalments. Where the forfeiture provision amounts to a penalty, *i.e.* where the amount which is subject to forfeiture greatly exceeds the actual loss suffered by the creditor, there should, in principle, be an equitable jurisdiction to relieve the debtor from forfeiture on terms that the creditor should be fully compensated for losses caused by the breach.

Third, accepting the readiness and ability as preconditions for relief would lead to an unjustifiable distinction between penalty clauses and forfeiture provisions which are of penal nature. As to the former, relief would be given regardless of the debtor's readiness and willingness to perform. With regard to the latter, however, the provision would be enforced where the purchaser is not able, ready and willing to complete his contract.[44]

Fourth, the view might also lead to an important practical problem which has well been put by a learned writer in the following terms:

> "If a vendor terminated a contract because a purchaser failed to pay on time, then as a result of the decision in *Steedman v. Drinkle*, that purchaser would know that he would not thereafter obtain a decree of specific performance. It would be an exercise in futility to require the purchaser to have gone through the ritual of indicating his readiness to perform the contract."[45]

In view of the above observations, it would seem that Farwell J's narrow interpretation of *Steedman v. Drinkle* is, with respect, not correct and should not be followed.[46]

2.1.2.2.2. Conflicting dicta in Stockloser v Johnson

8.16 A narrow version of Farwell J's views, however, was expressed in *obiter dicta* by Romer LJ in *Stockloser v. Johnson*[47]. The case was concerned with the purchase of certain plant and machinery- which had been hired out on the royalty basis- by the

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[44] See Ogus A I, The Law of Damages, 1973, p. 56 ; Harpum C., Relief Against Forfeiture and the Purchaser of Land [1984] CLJ 134, at p. 158

[45] Harpum C., Relief Against Forfeiture and the Purchaser of Land [1984] CLJ 134, at pp. 158-159

[46] See also Pawlowski M., Relief Against Forfeiture of Instalments (1993) Estate Gazette, 27 March 1993, issue 9312, 122, at p. 123 where he observed : "In essence, Farwell J's judgment ignores the *restitutionary* nature of the form of equitable relief now under discussion."

[47] *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 QB 476

plaintiff and taking over the benefits of the hiring agreements. The contracts provided that the purchase price should be paid by certain instalments; and that upon default in payment of any instalment for a period exceeding 28 days, the seller would be entitled, on giving a fourteen-day notice, to rescind the agreement, retake possession of the plant and machinery and retain all instalments already paid. Due to the bad weather, the amount of royalties received by the buyer was not as much as he had expected, and apparently this resulted in the buyer's failure to pay the instalments due. Default having been made, the seller gave notice rescinding the agreements, retook possession of the subject-matters and retained the moneys paid by the buyer. The buyer never expressed his willingness and ability to perform the contracts.

In an action by the buyer for the recovery of the forfeited instalments on the ground that the forfeiture provision amounted to a penalty, the Court of Appeal was of the unanimous opinion that the plaintiff was not entitled to relief. According to the facts, the instalments of the purchase price should have been of the same value as the royalties anticipated from the hiring agreements. There, therefore, was nothing unconscionable for the seller to retain the instalments paid, because they were the least that he would have expected even if the contracts had not been entered into.

8.17 There was, however, a sharp distinction of opinion on the question whether the court had jurisdiction to relieve from forfeiture by ordering repayment of instalments already paid. Somervell and Denning LJJ took a wider view of the equitable jurisdiction of courts. Holding that the cases establish a wider power for courts to give relief against forfeiture even though there is no sharp practice by the creditor, and even though the vendor is not able to perform his contractual obligation, Somervell LJ emphasised on unconscionability as the basis for the equitable intervention.[48] He pointed out:

> "All I am concerned to say is that, in my opinion, the cases do not establish (i) that relief could never be given unless the plaintiff could show that he is financially in a position to complete and would be willing to do so if the defendant were himself prepared to waive the breach and complete the contract, or (ii) that after rescission no relief can be given unless there is fraud or sharp practice. ... As the basis of the plaintiff's right if he has one, is the unconscionability of the defendant's retaining

[48] *Ibid.*, at p. 634

> sums which have been paid to him as instalments, ... the circumstances of the particular case should be looked at and the question is not one to be decided by looking only at the contract."[49]

His lordship's views were shared by Denning LJ who rejected the debtor's ability and willingness to complete the contract as conditions for giving relief by ordering repayment of the forfeited sums. Emphasising on the fact that readiness and willingness are conditions for granting relief by decreeing specific performance, the learned Lord Justice said:

> "... the plaintiff's object here is not to re-establish the contract. It is to get his money back: and to do this; I do not think it is necessary for him to go so far as to show he is ready and willing to perform the contract."[50]

He, then, referred to *Steedman v. Drinkle*[51] as a clear authority which shows the equitable jurisdiction of courts to relieve the buyer from forfeiture of moneys already paid by ordering the seller to repay them on terms which court may think fit.[52] As to the circumstances in which such a power should be exercised, Denning LJ, expressing his total agreement with Somervell LJ, said:

> "Two things are necessary: first, the forfeiture clause must be of a penal nature, in the sense that the sum forfeited must be out of all proportion to the damages; and, secondly, it must be unconscionable for the seller to retain the money."[53]

8.18 Romer LJ, on the other hand, held that before termination if the purchaser was able, ready and willing to perform, the only relief which might be available was giving the defaulting purchaser a further opportunity to perform his contractual obligation; and no relief would be granted, in the absence of special circumstances such as sharp practice, fraud, or other unconscionable conduct, after the vendor had terminated the contract for

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[49] *Ibid.*, at p. 636

[50] *Ibid.*, at p.637 ; see also his lordship's observations at pp. 638-639 where he concluded that the purchaser does not lose the equity of restitution simply because he is not able and willing to perform the contract. "Nay, that is", he continued, "the very reason he needs the equity. The equity operates, not because of the plaintiff's default, but because it is, in the particular case, unconscionable for the seller to retain the money. In short, he ought not unjustly to enrich himself at the plaintiff's expense."

[51] *Steedman v. Drinkle* [1916] 1 AC 275

[52] *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 QB 476, at p. 637

[53] *Ibid.*, at p. 638

the purchaser's breach.[54] His lordship based his judgment on the following grounds:

1) In principle, people are expected to be bound by their bargains. Equity has never interfered with the contractual terms simply because they are improvident and turn to be hard on one side. Thus, in the circumstances where the parties are on terms of bargaining equality with each other, and there is no element of duress, pressure or acting under the stress of economic necessity, there seems no ground for equity to intervene if the terms of the agreement turns to operate hardly on either party.[55]

2) What cases, with the exception of one case, establish is that a purchaser, who has defaulted in the punctual payment of his instalments, may be relieved against forfeiture of the instalments already paid only by giving him a further chance and further time to pay the outstanding balance. His lordship referred to *Re Dagenham (Thames) Dock*[56] and *Kilmer v. British Colombia*[57] as cases in which relief was granted by giving the purchaser a further opportunity to pay the arrears and interest. He emphasised on the point that the court in these cases did not declare the forfeiture provision, which was in the nature of penalty, void. All it did, according to him, was to relieve the purchasers from its operation on payment of the residue with interest.[58] Reference had also been made to *Public Works Comr. v. Hills*[59] and *Mayson v. Clouet*[60] which admittedly did not have much bearing on the issue under discussion.[61]

3) *Steedman v. Drinkle*[62]- though it, at first sight, appeared to establish a wider

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[54] *Ibid.*, at p. 644

[55] *Ibid.*, at pp. 640-641

[56] *Re Dagenham (Thames) Dock Co., ex parte Hulse* (1873) LR 8 Ch App 1022

[57] *Kilmer v. British Columbia Orchard Lands Ltd.* [1913] AC 319

[58] He also pointed out that in the *Re Dagenham* case, it was not clear whether the company (*i.e.* the purchaser) had asked for a further time to perform the contract (though he gathered from the papers that it had not). *Ibid.*, at p. 641

[59] *Commissioner of Public Works v. Hills* [1906] AC 368

[60] *Mayson v. Clouet* [1924] AC 980

[61] *Mayson v. Clouet* was a case concerned with the recovery of instalments already paid in the absence of a provision entitling the vendor to retain them. The case did not deal with the question whether the court would have granted relief, had there been a forfeiture provision. In *Public Works Comr. v. Hills*, in Romer LJ's view, the only question was whether the forfeited sums were penalty (in the strict sense) or liquidated damages. The Privy Council held that it was the former. (at pp. 642-643) It will shortly be argued that this case could be relied upon to show that what Romer LJ concluded cannot be maintained. (See *infra.*, paras. 8.27-8.29)

[62] *Steedman v. Drinkle* [1916] 1 AC 275

jurisdiction- was a special case and cannot be regarded as of general application. The special aspects of the case were explained by his lordship and can be summarised in the following terms: First, relief against forfeiture by ordering repayment of the forfeited instalments did not seem to have been argued or introduced by the plaintiffs. Second, the vendors did not contest it. Third, the only sum subject to forfeiture was £1,000 which was a small sum compared to the purchase price. This may explain why neither party attached much importance to the issue. Fourth, it was not clear why the prepayment was not regarded as a deposit.[63] His lordship also referred to Farwell J's observations in *Mussen v. Van Diemen's*[64], and found himself in agreement with Farwell J in that the case could not be considered as of general application.[65]

2.1.2.2.3. Following Romer LJ's narrow view of the jurisdiction in some subsequent cases

8.19 Romer LJ's view was followed by Sachs J in *Galbraith v. Mitchenall Estates Ltd*[66] and by Oliver J in *Windsor Securities Ltd v. Loreldal* [67]. In the former case, Sachs J thought that Romer LJ's view had been supported by the Court of Appeal in *Campbell Discount Co. v. Bridge*[68]. He, therefore, chose to follow the narrower view saying:

> "It appears to my mind that the proper course for a court of first instance to adopt is to follow the line which appears most to accord with established authority. I have come to the conclusion that I ought to follow the view expressed in the judgment of Romer LJ, for the reasons which he there gave."[69]

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[63] *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 QB 476, at p. 644

[64] *Mussen v. Van Diemen's Land Co.* [1938] 1 All ER 210, [1938] Ch. 253

[65] *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 QB 476, at p. 644

[66] [1964] 2 All ER 653, [1965] 2 QB 473, for a consideration of the case see also Polack K., Equitable Relief in Contracts [1965] CLJ 17

[67] (1975) The Times, 10 September 1975. Oliver J., having discussed the views expressed in several authorities, held that if he had to choose between these conflicting views, "he would think it preferable, particularly in the Vacation Court, to adopt the more conservative view expressed by Lord Justice Romer in *Stockloser v. Johnson*." see also Wilkinson H. W., Relief Against Forfeiture in England and Australia (1989) 53 The Conveyancer and Property Lawyer 307

[68] [1961] 2 All ER 97, reversed in the House of Lords on another ground which did not involve the consideration of *Stockloser v. Johnson*: see [1962] AC 600, [1962] 1 All ER 385

[69] *Galbraith v. Mitchenall Estates Ltd.* [1965] 2 QB 473, [1964] 2 All ER 653, at p. 658

2.1.2.3. Analysing the Conflicting Views: Concluding Discussion

8.20 The narrow view of the court's jurisdiction, expressed by Farwell J in Mussen[70] and echoed by Romer LJ[71], and its subsequent support[72] have led some writers to suggest that the weight of English authority is against affording positive relief by ordering the vendor to return the forfeited instalments to the purchaser.[73] It would, however, seem that such an approach cannot be maintained. To argue for this view, it is necessary to consider analytically the basis for the narrow view, and see how far the reasons suggested for that approach actually support it. Furthermore, some cases which may support the availability of the positive relief against forfeiture of instalments should be discussed.

To start with, thus, the arguments of Romer LJ in *Stockloser v. Johnson*[74] would analytically be examined. This will follow a consideration of the support lent to the narrow view of the court's jurisdiction by subsequent authorities. It will, then, be observed whether the ability and willingness to perform should always be considered as a necessary prerequisite to grant any kind of relief, and whether there could be any basis for the view that after termination, in the absence of special circumstances, no relief of any kind against forfeiture of instalments could be available. The discussion will be concluded by a review of cases and judicial statements which may, directly or indirectly, support the broader view of the court's jurisdiction.

2.1.2.3.1. The analysis of Romer LJ's arguments in Stockloser v Johnson for the narrow view

8.21 Romer LJ's view has been based on premises which cannot, it seems, sustain the conclusion on which he arrived:

First, his lordship's reasoning, in principle, are arguments which are normally presented in favour of the principle of sanctity and freedom of contracts. This principle is always in conflict with the equitable doctrine of relief against penalties and forfeitures. Exactly the

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[70] *Mussen v. Van Diemen's Land Co.* [1938] 1 All ER 210, [1938] Ch. 253

[71] *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 QB 476, at p. 643

[72] See *Galbraith v. Mitchenall Estates Ltd.* [1965] 2 QB 473, [1964] 2 All ER 653 ; *Windsor Securities Ltd. v. Loreldal* (1975) The Times, 10 September 1975

[73] See, e.g., Pawlowski M., Relief Against Forfeiture of Instalments (1993) Estate Gazette, 27 March 1993, issue 9312, 122, at p. 124

[74] *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 QB 476

same arguments may be presented against the intervention of courts to strike out penalties, but no case suggests that as penalties are a part of the parties' agreement, they should literally be enforced.[75] True that the equitable doctrine of relief against penalties and forfeitures should be confined to situations where established authorities justify such an intervention, but it cannot be accepted that any argument in favour of the principle of sanctity of contracts may undermine the equitable doctrine of relief against penalties and forfeitures. In short, any reason which may, in principle, justify the court's intervention against penalties can be relied upon to explain it in the context of forfeitures of penal nature.[76]

8.22 **Second**, two of the cases relied upon by his lordship[77], as it was suggested before[78], are, in fact, concerned with the different, but related, question of relief against forfeiture of the purchaser's interest in property.[79] The court in those cases recognised the penal nature of the forfeiture provision and relieved the purchasers against it by decreeing specific performance which was what the purchasers had claimed for: In *Kilmer v. British Colombia*[80], the purchaser expressly counterclaimed for specific performance and paid the arrears of instalments with interest into the court. Also in the *Re Dagenham* case[81], though the report is not clear about the point, the extension of time granted by the court indicates that the purchasers had declared their readiness, ability and willingness to

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[75] As Somervell LJ in *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 QB 476, observed: "Any penalty provision is, of course, in one sense, a term of the contract, and all the plaintiff was seeking to do in the numerous cases in which equity gave relief was to enforce the bargain." at p. 636

[76] See also Treitel G.H., Remedies for Breach of Contract, 1988, p. 243 ; Pawlowski M., Relief Against Forfeiture of Instalments (1993) Estate Gazette, 27 March 1993, issue 9312, 122, at p. 124 ; *cf.* Polack K., Equitable Relief in Contracts [1965] CLJ 17, at pp. 20-21

[77] *Re Dagenham (Thames) Dock Co., ex parte Hulse* (1873) LR 8 Ch App 1022 ; *Kilmer v. British Columbia Orchard Lands Ltd.* [1913] AC 319

[78] *Supra.*, paras. 7.05 *et seq.*

[79] See also the judgment of Dixon J., with whom Rich and McTiernan JJ. concurred, in the Australian case of *McDonald v. Dennys Lascelles Ltd.* (1933) 48 CLR 457 where he observed that the view adopted in these cases "seem to have been that relief should be granted, not against the forfeiture of the instalments, but against the forfeiture of the estate under a contract which involved the retention of the purchase money" at p. 470 ; see, too, the observations of Gibbs C.J. and Murphy J. in *Legione v. Hateley* (1983) 152 CLR 406, at pp. 426-428

[80] *Kilmer v. British Columbia Orchard Lands Ltd.* [1913] AC 319

[81] *Re Dagenham (Thames) Dock Co., ex parte Hulse* (1873) LR 8 Ch App 1022

perform the agreement.[82] Furthermore, in the course of his judgment in the *Kilmer* case, Lord Moulton[83], explaining *Re Dagenham*, observed:

> "That was a case like this of forfeiture claimed under the letter of agreement and a cross action for specific performance."[84]

In such cases, the most proper relief which may be given is decreeing specific performance or granting the debtor an extra time to perform his contractual obligation. Thus, these cases, with respect, by no means show that giving a further opportunity to perform the contract is the *only* relief which may be granted against forfeiture of the instalments already paid.

8.23 **Third**, Romer LJ's explanation of *Steedman v. Drinkle*[85]- as a special case which cannot be regarded as of general application- was mainly based on the observations of Farwell J in *Mussen*[86], reasons against which have already been given.[87] His lordship's comments as to the case[88] to show its special aspect- and therefore to lessen its authority- in addition to not justifying the conclusion at which he reached, are open to a number of objections:

1) The points that the issue had not been argued or introduced by the plaintiffs and it was not contested by the defendants, if correct, show that the unconscionability of the court permitting the vendor to retain the instalments under a penal forfeiture provision was so obvious that the Board made it clear that, even at the latest stage, the plaintiffs were at liberty to apply to the court of first instance for relief against forfeiture of instalments. Put another way, the forfeiture provision being penal in nature, the Board had no doubt that the plaintiffs should be relieved against that by ordering the vendor to return the forfeited instalments. If the defendant's possible arguments against such a relief would make the situation different, the Board would certainly have made it clear that the

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[82] Had that not been the case, the court would not have granted any extension of time. See *Barton Thompson & Co., Ltd. v. Stapling Machines Co.* [1966] Ch. 499, at p. 510 per Pennycuick J.

[83] Delivering the judgment of the Board prepared by Lord Macnaghten

[84] *Kilmer v. British Columbia Orchard Lands Ltd.* [1913] AC 319, at p. 322

[85] *Steedman v. Drinkle* [1916] 1 AC 275

[86] *Mussen v. Van Diemen's Land Co.* [1938] 1 All ER 210, [1938] Ch. 253

[87] *Supra.*, para. 8.15

[88] See *supra.*, para. 8.18

plaintiffs, subject to the defendant's possible defences, were entitled to apply for relief. The Board, however, clearly held that the forfeiture provision was penal in nature against which relief should be given, and whether or not the defendants contested such a relief seemed immaterial.

2) Although the forfeited sum was a small amount in comparison with the purchase price, the Board was in no doubt that the plaintiffs should be relieved against its forfeiture. Granted that the parties did not attach much importance to the issue[89], the judicial Committee was not prepared to ignore it and let the penal forfeiture provision be enforced.

3) There is nothing in the report to suggest that the prepayment was a deposit: The parties did not call it a deposit in their agreement, and no evidence was presented by either party that they had, in fact, intended the advance payment to be a deposit. There, therefore, seems to be no supporting reason for the contention that the prepayment might have been forfeitable as a deposit.[90]

2.1.2.3.2. A consideration of the support lent to the narrow view by subsequent authorities

8.24 Though Romer LJ's view has been followed in a few subsequent cases[91], no original argument has been presented to support the narrow view of the court's jurisdiction. Only Sachs J referred to the support lent to this view by the decision of the Court of Appeal in *Campbell Discount Co. v. Bridge*[92]. In that case[93], the only judge who expressly referred to *Stockloser v. Johnson*[94] was Holroyd Pearce LJ. The Lord Justice cited certain parts of the judgement delivered in the case to show, apparently, that there should be an element of unconscionability to justify the equitable intervention of courts.[95] Then,

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[89] Though there is less evidence to support such a contention.

[90] Even if the prepayment was a deposit, there might be a possibility of intervening to relieve against its forfeiture. See *infra.*, paras. 8.48 *et seq.*

[91] *Galbraith v. Mitchenall Estates Ltd.* [1965] 2 QB 473, [1964] 2 All ER 653 ; *Windsor Securities Ltd. v. Loreldal* (1975) The Times, 10 September 1975, as to the latter case see Wilkinson H. W., Relief Against Forfeiture in England and Australia (1989) 53 The Conveyancer and Property Lawyer 307, at p. 308

[92] *Campbell Discount Co. v. Bridge* [1961] 2 All ER 97

[93] The case was very different from a case dealing with a forfeiture provision. For the facts of the case see *supra.*, para. 4.16

[94] *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 QB 476

[95] *Campbell Discount Co. v. Bridge* [1961] 2 All ER 97, at p. 102

without committing himself to any of the views, his lordship turned to the facts of the case before him, and discussed the point that there was no element of unconscionability in the instant case. Harman LJ expressed his disagreement with every attempt to extend the equitable jurisdiction to intervene in the contractual relations of the parties on the ground that the agreement had turned out to be harsh or disadvantageous to one of them.[96] He, however, did not refer to *Stockloser v. Johnson* at all. Davies LJ only agreed with both judgments and did not add anything to them.[97]

Referring to the facts of the case[98], it is quite understandable why their Honours disagreed with the extension of the equitable intervention. Granting equitable relief in the circumstances of that case, even accepting the majority's view in *Stockloser v. Johnson*[99], might have been regarded as "a novel extension"[100]. The case, therefore, it seems, did not lend any support to Romer LJ's view[101]; and without any authoritative support, Sachs J.- it is, with all respect, submitted- should have followed the majority's view.[102]

2.1.2.3.3. Ability and willingness to perform: is it a necessary condition for any kind of relief?

8.25 Being able, ready and willing to perform the contract cannot be regarded as a condition precedent for any relief against forfeiture of instalments. It is, of course, as it was discussed[103], a condition where the court considers granting relief by decreeing specific performance or giving the debtor extra time to remedy his breach. If, however,

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[96] *Ibid.*, at p. 103 where he said: "... I rather deprecate the attempt to urge the court on what are called equitable principles to dissolve contracts which are thought to be harsh, or which have turned out to be disadvantageous to one of the parties."

[97] *Ibid.*, at p. 104

[98] *Supra.*, para. 4.16

[99] *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 QB 476

[100] *Campbell Discount Co. v. Bridge* [1961] 2 All ER 97, per Holroyd Pearce LJ, at p. 103

[101] See also Ogus A I, The Law of Damages, 1973, p. 56 ; for the opposite view see Chitty on Contracts, 27th ed., vol. 2., 1994, para. 36-273 ; Professor McGregor thought that the case only lent indirect support to Romer LJ's view; he, however, was of the opinion that Sachs J should have followed the majority's view in *Stockloser*- for it was the *ratio decidendi* of the case- and should have decided for the plaintiff. McGregor on Damages, 15th ed., 1988, para. 510

[102] As his lordship himself said: "In *Stockloser v. Johnson* the first of the foregoing views was adopted by Somervell and Denning LJJ and, had the matter rested there [*i.e.* had there not been any authoritative support for the narrower view], it might well have been proper for a court of first instance simply to follow the majority view." at p. 657

relief by ordering repayment of the forfeited instalments is under consideration, there seems no reason to justify the contention that, as a prerequisite for relief, the debtor should be ready, able and willing to complete his contract. This was originally the view taken by Farwell J in *Mussen*[104] which has already been adequately considered.[105]

2.1.2.3.4. Availability of relief after termination

8.26 The view that after termination, in the absence of special circumstances such as fraud, accident and unconscionable conduct, no relief of any kind against forfeiture may be available has, for the following reasons, less to commend it:

1) There is no doubt that relief by ordering repayment of the forfeited instalments can be granted even where the contract has been terminated for the purchaser's breach of an essential time stipulation. *Steedman v. Drinkle*[106] is a clear authority which supports this view.[107]

2) There are also many cases[108] in which the courts have exercised their equitable power to relieve from forfeiture by decreeing specific performance or granting the debtor extra time to remedy his breach, even though the contract had been validly terminated. However, where the creditor exercises his right to terminate for the debtor's breach of an essential stipulation, the availability of such a relief is controversial: it was already discussed and suggested that, even in this situation, the courts should have jurisdiction to grant this form of relief.[109]

2.1.2.3.5. Direct or indirect support for the availability of positive relief in cases

8.27 There are a number of cases which, directly or indirectly, support the broader view. We briefly refer to these cases and judicial statements:

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[103] *Supra.*, paras. 7.80-7.81

[104] *Mussen v. Van Diemen's Land Co.* [1938] 1 All ER 210, [1938] Ch. 253

[105] *Supra.*, para. 8.15

[106] *Steedman v. Drinkle* [1916] 1 AC 275

[107] See also the observations of Denning LJ in *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 QB 476, at p. 637

[108] See, e.g., *Re Dagenham (Thames) Dock Co., ex parte Hulse* (1873) LR 8 Ch App 1022; *Kilmer v. British Columbia Orchard Lands Ltd.* [1913] AC 319; *Starside Properties Ltd. v. Mustapha* [1974] 1 WLR 816; *Transag Haulage Ltd. v. Leyland DAF Finance Plc.* [1994] 2 BCLC 88

[109] *Supra.*, paras. 7.48 *et seq.*

First, in *Public Works Commissioner v. Hills*[110], in a railway construction contract, it was provided that upon non-completion of the line within the specified period, the contractor would forfeit certain percentages of moneys payable to him, retained as a guarantee fund to answer for defective work, and also certain security money lodged with the employer's Agent-General. The Judicial committee of the Privy Council held that the forfeiture provision was not a genuine pre-estimate of damages; and therefore, the moneys cannot be retained by the employer as liquidated damages. The Privy Council, in fact, relieved the contractor from forfeiture of moneys which should have been paid (repaid in case of the security money) to the contractor upon termination of the contract for non-completion if there had not been a forfeiture provision.

8.28 In Romer LJ's view[111], this case was an irrelevant authority, and this also appears from Denning LJ's judgment[112]. There, however, seems to be no compelling reason to distinguish this case from the situation which is now under consideration. It may be said that in the *Hill's* case, the forfeiture of moneys which belonged to the plaintiff [*i.e.* the contractor, that is, the promisor] was in issue, but here we are concerned with a stipulation providing for the forfeiture of moneys which used to belong to the defendant [*i.e.* the promisee]. Such a difference may be true, but does it justify the different treatments as to the two kinds of forfeiture provisions?[113] True that in normal forfeiture cases, the moneys, which are now subject to forfeiture, used to belong to the promisee. However, in most cases[114], they become the property of the promisor, as soon as the contract is prematurely terminated; and unless there is a forfeiture provision, they should be returned to him. There seems, therefore, to be no convincing reason to regard the *Hill's* case as an irrelevant authority.

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[110] *Commissioner of Public Works v. Hills* [1906] AC 368

[111] *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 QB 476, at p. 642

[112] *Ibid.*, at p. 637, where he said: "There is, I think, a plain distinction between penalty cases, strictly so called, and cases like the present. It is this. When one party seeks to exact a penalty from the other, he is seeking to exact payment of an extravagant sum either by action at law or by appropriating to himself moneys belonging to the other party, as in *Hill's* case. ... In the present case, however, the defendant is not seeking to exact a penalty. He only wants to keep money which already belongs to him."

[113] See Law Commission, Penalty Clauses and Forfeiture of Monies Paid, Working Paper no. 61, 1975, para. 59 at pp. 44-45, see also *infra.*, para. 8.75

[114] Where, for example, the prepayment is a conditional payment. see *supra.*, paras. 6.20, 6.37

8.29 This proposition is supported by the recent judgment of the Privy Council in *Workers Trust and Merchant Bank Ltd. v. Dojap Investments Ltd.*[115] where the *Hills* case[116] was applied as an authority to hold that the forfeiture of an unreasonable deposit was in the nature of penalty against which relief should be given by ordering repayment of the forfeited sum. The Judicial Committee, referred to the *Hills* case as a "clear authority that in a case of a sum paid by one party to another under the contract as security for the performance of that contract, a provision for its forfeiture in the event of non-performance is a penalty from which the court will give relief by ordering repayment of the sum so paid, less any damage actually proved to have been suffered as a result of non-completion."[117] Despite the fact that in *Dojap* there was no doubt that the deposit was also a part payment, and belonged to the defendant as soon as it was paid, the Privy Council applied the *Hills* case as a clear authority to order the repayment of the penal deposit.

It is, therefore, suggested that the *Hills* case[118] can be relied upon to establish a wider jurisdiction for the courts to relieve, in a proper case, against forfeiture by ordering repayment of the sums which are subject to forfeiture.

8.30 **Second**, in *The Scaptrade*[119], Lord Diplock[120] was prepared to assume (without deciding the point) "that moneys already paid by one party to the other under a continuing contract prior to an event which under the terms of the contract entitled that other party to elect to rescind it and to retain the money already paid might be treated as money paid under a penalty clause, and recovered to the extent that it exceeded to an unconscionable extent the value of any consideration that had been given for it."[121] This, in his lordship's view, was regarded as the express opinion of the majority in *Stockloser v.*

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[115] *Workers Trust and Merchant Bank Ltd. v. Dojap Investments Ltd.* [1993] 2 All ER 370

[116] *Commissioner of Public Works v. Hills* [1906] AC 368

[117] *Workers Trust and Merchant Bank Ltd. v. Dojap Investments Ltd.* [1993] 2 All ER 370, at p. 376

[118] *Commissioner of Public Works v. Hills* [1906] AC 368

[119] *Scandinavian Trading Tanker Co. v. Flota Petrolera Ecuatoriana (The Scaptrade)* [1983] 2 AC 694

[120] With whom other members of the House agreed.

[121] *Ibid.*, at p. 702

Johnson[122].

8.31 **Third**, the conflicting opinions delivered in *Stockloser v. Johnson* were considered in the recent case of *Dojap*[123]. There, the Privy Council was in no doubt that it would not order the payment of a deposit which had been provided for, but not yet been paid, if the sum was a penalty.[124] But as to the question of the recoverability of such a deposit by the payer, where it has already been paid, the Board considered the dicta of Romer LJ and the majority in *Stockloser v. Johnson*[125]. Their lordships left open the question that which of the conflicting dicta was correct. They only distinguished the case from *Stockloser v. Johnson* on the ground that the latter case was concerned with a situation in which "a party [was] seeking relief from forfeiture for breach of contract to pay a price by instalments, the party in default having been let into possession in the meantime."[126] The Board, thus, under the authority of the *Hills* case[127], relieved the purchaser from forfeiture of his deposit by ordering the vendor to return it less damages actually suffered as the result of breach.[128]

8.32 It would seem that, in effect, the Privy Council's conclusion supports the broader view of the jurisdiction[129]: In both *Dojap* and *Stockloser* cases, the question was whether the court had jurisdiction to relieve the debtor/purchaser from a penal provision, which empowers the innocent party to retain an advance payment, by ordering the forfeited sum to be returned. The advance payments in *Stockloser v. Johnson* were the instalments of the purchase price, while in *Dojap*, it was called a deposit. Considering that a deposit is, in general, forfeitable at law when the contract goes off for the purchaser's default[130], if

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[122] *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 QB 476

[123] *Workers Trust and Merchant Bank Ltd. v. Dojap Investments Ltd.* [1993] 2 All ER 370

[124] *Ibid.*, at p. 375

[125] *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 QB 476

[126] *Workers Trust and Merchant Bank Ltd. v. Dojap Investments Ltd.* [1993] 2 All ER 370, at p. 376

[127] *Commissioner of Public Works v. Hills* [1906] AC 368

[128] See *Workers Trust and Merchant Bank Ltd. v. Dojap Investments Ltd.* [1993] 2 All ER 370, at pp. 376-377

[129] See also Beale H., Unreasonable Deposits (1993) 109 LQR 524, at p. 528

[130] See *supra.*, paras. 6.31, 6.38; *infra.*, para. 8.45

there is a jurisdiction to relieve the purchaser from forfeiture of his deposit by ordering its repayment, *a fortiori*, such a jurisdiction should be recognised with regard to the forfeiture of instalments.

8.33 Furthermore, the Board concluded that the deposit amounting to 25% of the purchase price, in the circumstances of the case, was not a true deposit by way of earnest, and the provision for its forfeiture, therefore, constituted a penalty.[131] Now, considering the different functions of a sum of money paid as a deposit[132], though the sum was not a true earnest money, it undoubtedly was a part payment of the price. The Privy Council held that the provision for the forfeiture of this money was a penalty and, in fact, relieved the purchaser from the forfeiture by ordering its repayment. This, it would seem, supports the view that courts, may, in proper circumstances, have jurisdiction to relieve the debtor from forfeiture of his instalments by ordering the creditor to return the forfeited sums less damages caused by the breach.[133]

2.1.2.3.6. Conclusion

8.34 The reasons given above all show that the majority's view in *Stockloser v. Johnson*[134] should prevail.[135] Put another way, the courts have jurisdiction to grant

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[131] *Workers Trust and Merchant Bank Ltd. v. Dojap Investments Ltd.* [1993] 2 All ER 370, at p. 376

[132] See *Howe v. Smith* (1884) 27 Ch D 89 ; see also *supra.*, para. 6.39, *infra.*, para. 8.45

[133] It may also be argued that the logical inference from the judgment of the Privy Council in *Dojap* is that any disguised penalty should not be enforced. The provision for forfeiture of instalments already paid also might, in some cases, be a disguised penalty and act *in terrorem*. It, therefore, seems that the decision could be regarded as a support for the availability of positive relief against forfeiture of instalments.

[134] *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 QB 476

[135] See also Guest A.G., Benjamin's Sale of Goods, 4th ed., 1992, p. 795; Goode R.M., Hire-Purchase Law and Practice, 2nd ed., 1970, p. 381; Goff & Jones, The Law of Restitution, 4th ed., 1993, pp. 437-438; Ogus A I, The Law of Damages, 1973, p. 56 ; Harpum C., Relief Against Forfeiture and the Purchaser of Land [1984] CLJ 134, p. 144; Carter J.W., Breach of Contract, 2nd ed., 1991, para. 1259 at p. 487; Pawlowski, though favouring the broader view, believes, relying on *Galbraith v. Mitchenall Estates Ltd.* [1965] 2 QB 473, [1964] 2 All ER 653, that the weight of English authority is "against affording positive relief to a purchaser in the form of a right of recovery of instalments already paid." Pawlowski M., Relief Against Forfeiture of Instalments (1993) Estate Gazette, 27 March 1993, issue 9312, 122, at p. 124; Some writers suggest that English law, as to this point, still appears to be undecided: see, e.g., Wilkinson H. W., Relief Against Forfeiture in England and Australia (1989) 53 The Conveyancer and Property Lawyer 307, at pp. 308-309; Meagher R P, Equity Doctrines & Remedies, 3rd ed., 1992, para. 1827

positive relief against forfeiture of instalments already paid.[136] This relief may be available, even after the contract has validly been terminated by the creditor for the debtor's breach, regardless of the debtor's ability and willingness to complete the contract.

2.2. Conditions for the Exercise of the Jurisdiction

8.35 Having considered the availability and the scope of the jurisdiction to relieve against forfeiture of instalments, and the forms of relief which may be available, it is now appropriate to discuss the circumstances upon which the jurisdiction should be exercised. Two situations- on the basis of the ability and willingness of the payer to perform, and the form of relief which may be afforded by courts- invite separate consideration: First, where the payer is able, willing and ready to complete and the court considers granting relief by extending the time of performance or decreeing specific performance. Second, where the court, for any reason, is unable to grant extension of time and is considering to order a positive relief.

2.2.1. Negative relief

8.36 Where the debtor is able, ready and willing to perform his contractual obligation, subject to the limitations discussed earlier[137], the form of relief will be decreeing specific performance, or giving the debtor a further opportunity to perform his part of the contract. In proper circumstances, the court has also jurisdiction to extend the time given.[138] The circumstances in which this form of relief may be granted have already been

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[136] Though the courts have, until the recent decision of the Privy Council in *Dojap*, been reluctant to grant this form of relief compared with the negative relief (*i.e.* extension of time) or striking penalties (in strict sense) out. See Guest A.G., Benjamin's Sale of Goods, 4th ed., 1992, p. 796; Chitty on Contracts, 27th ed., vol. 1, 1994, para. 20-070; Waddams S M, The Law of Damages, 1983, p. 540. As to hire-purchase agreements, it has been suggested that it is unlikely for the courts to grant any positive relief (see, e.g., Chitty on Contracts, 27th ed., vol. 2., 1994, para. 36-273). This may be justified on the ground that in hire-purchase agreements, it is extremely difficult to prove that the retention of instalments by the owner is unconscionable, because the hirer has had the benefit of using the subject-matter for the period he has paid the instalments for. (see Goode R.M., Hire-Purchase Law and Practice, 2nd ed., 1970, pp. 380,381); However, the existence of the jurisdiction to grant such a relief, in proper circumstances, should not be doubted. see, e.g., Diamond A.L., Equitable Relief for the Purchaser of Hire-Purchase Goods (1956) 19 MLR 498, p. 506 ; Diamond A.L., Equitable Relief in Hire-Purchase: A Rejoinder (1958) 21 MLR 199, p. 201; Goode, *ibid* ; see also the general observations of Knox J. in *Transag Haulage Ltd. v. Leyland DAF Finance Plc.* [1994] 2 BCLC 88, at p. 95; for the opposite view see Prince E.J., Equitable Relief in the Law of Hire-Purchase (1957) 20 MLR 620

[137] *Supra.*, chapter 7

[138] *Starside Properties Ltd. v. Mustapha* [1974] 1 WLR 816, at p. 824 per Edmund Davies LJ and p. 826 per Lawton LJ

discussed and need not be repeated here.[139]

2.2.2. Positive relief

8.37 If, due to any of the limitations of the jurisdiction, the court refused to grant negative relief (*i.e.* extension of time or specific performance), or where the debtor was unable or unwilling to complete the contract, the court might have jurisdiction to grant positive relief. In order to give such a relief, two conditions are necessary: first, the forfeiture provision should be of penal nature; second, it should be unconscionable for the creditor to retain the instalments.[140] Each of these requirements should briefly be considered.

2.2.2.1. Being penal in nature

8.38 Denning LJ, discussing the circumstances upon which the positive relief may be granted, said:

> "First, the forfeiture clause must be of a penal nature, in the sense that the sum forfeited must be out of all proportion to the damages ... "[141]

Thus, to meet the first requirement, it must be shown that there is a gross disproportion between the value of the sum or property to be forfeited and the actual losses which are likely to result from breach at the time when the contract is entered into.[142] The tests discussed earlier to distinguish liquidated damages from penalties[143] would seem to be applicable here to see whether or not the forfeiture clause is in the nature of penalty. The time for the application of the test would be the time when the contract was made[144], as it is the settled principle with regard to distinguishing liquidated damages from penalties.[145]

2.2.2.2. Unconscionability

8.39 To grant relief, besides the forfeiture clause being penal in nature, it must be

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[139] See *supra.*, paras. 7.59 *et seq.*

[140] *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 QB 476, per Denning LJ. See also McGregor on Damages, 15th ed., 1988, para. 508; It has sometimes been doubted whether these two conditions are distinct, or whether the first, being penal, is a "manifestation of unconscionable behaviour". see Goff & Jones, The Law of Restitution, 4th ed., 1993, pp. 433-434

[141] *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 QB 476, at p. 638 per Denning LJ

[142] See Pawlowski M., Relief Against Forfeiture of Instalments (1993) Estate Gazette, 27 March 1993, issue 9312, 122, at p. 123

[143] See *supra.*, paras. 2.24 *et seq.*

[144] See Pawlowski, *ibid.*

[145] See *supra.*, para. 2.20

unconscionable for the creditor to retain the money.[146] This requirement has much been emphasised by Somervell LJ in *Stockloser v. Johnson*[147]. His lordship, having concluded that the statements of law in cases indicate a wider jurisdiction, observed:

> "It would, of course, have to be shown that the retention of the instalments was unconscionable, in all the circumstances."[148]

To discern this requirement, all circumstances surrounding the contract, as well as the contractual terms, should, at the time when the jurisdiction is invoked, be examined. This can clearly be inferred from Somervell LJ's judgment where he said:

> "As the basis of the plaintiff's right, if he has one, is the unconscionability of the defendant's retaining sums which have been paid to him as instalments, I agree that the circumstances of the particular case should be looked at and the question is not one to be decided by looking only at the contract."[149]

In the words of Denning LJ, "[t]his equity of restitution is to be tested, not at the time of the contract, but by the conditions existing when it is invoked."[150]

8.40 The court would grant positive relief if it was convinced that, taking all the circumstances into account at the time when the jurisdiction is invoked, retaining the instalments already paid would unjustly enrich the defendant at the plaintiff's expense.[151] Put another way, having regard to the actual loss suffered by the creditor when he

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[146] See Guest A.G., Benjamin's Sale of Goods, 4th ed., 1992, p. 796 [Where the buyer had the benefit of the subject-matter, the court would not easily be satisfied as to this point.] see also Harpum C., Relief Against Forfeiture and the Purchaser of Land [1984] CLJ 134, at p. 144 ; Goode R.M., Hire-Purchase Law and Practice, 2nd ed., 1970, p. 381; Chitty on Contracts, 27th ed., vol. 1, 1994, para. 20-070 ; McGregor on Damages, 15th ed., 1988, para. 508; The requirement of "unconscionability" has sometimes been described as a "vague and woolly jurisprudence". see Goff & Jones, The Law of Restitution, 4th ed., 1993, p. 434

[147] *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 QB 476

[148] *Stockloser v. Johnson*, *ibid.*, at p. 634; see also per Denning LJ at p. 638; *Mussen v. Van Diemen's Land Co.* [1938] 1 All ER 210, [1938] Ch. 253, at p. 217 per Farwell J., see *supra.*, para. 8.14

[149] *Stockloser v. Johnson*, *ibid.*, at p. 636

[150] *Ibid.*, at p. 639; see also the decision of the Supreme Court of Canada in *Dimensional Investment Ltd. v. The Queen* (1967) 64 DLR (2nd) 632, where Ritchie J said: "Whether a provision in a contract is penal or not depends upon the construction of the contract but the question of unconscionability must depend upon the circumstances of each case at the time when the clause is invoked." at p. 638 ; see also McGregor on Damages, 15th ed., 1988, para. 508, no. 44

[151] Denning LJ said: "The equity operates, not because of the plaintiff's default, but because it is, in the particular case, unconscionable for the seller to retain the money. In short, he ought not unjustly to enrich himself at the plaintiff's expense." *Stockloser v. Johnson*, *ibid.*, at p. 639 ; see also McGregor on Damages, 15th ed., 1988, para. 508, no. 44 ; Pawlowski M., Relief Against Forfeiture of Instalments (1993) Estate Gazette, 27 March 1993, issue 9312, 122, at p. 124

exercised his right of forfeiture, the court would consider the point whether the forfeiture unconscionably overcompensated the creditor.[152] In this regard, different factors may be relevant: The most important among them is the actual loss suffered by the creditor as a result of the breach, taking into account the benefits which he may have received under the agreement, and also the amount of instalments paid[153] which are now subject to forfeiture. One nice illustration is the facts of *Stockloser v. Johnson*[154] itself. In this case, even if the forfeiture provision was in the nature of a penalty[155], it was not unconscionable for the seller to retain the instalments. That was because the buyer had the benefit of the hiring agreements, and thought that the royalties received under those contracts would be higher than they, in fact, were.[156] His position, in the words of the trial judge, which was cited with approval by Denning LJ, was like "a gambler who [had] lost his stake and [was] now saying that it [was] for the court of equity to get it back for him".[157]

8.41 The debtor's conduct may also be relevant. He may act in a way to disentitle himself to relief. The debtor, for example, may have considerably delayed in bringing his action to claim relief against forfeiture.[158] This might have some influence on the court to decide, considering all other factors, that it was conscionable for the creditor to retain the instalments.[159]

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[152] See Harpum C., Relief Against Forfeiture and the Purchaser of Land [1984] CLJ 134, at p. 144

[153] As Denning LJ suggested where the forfeited instalments was only five per cent. of the price, there would be no equity by which the contract-breaker could claim its repayment; but the situation would be very different after ninety per cent. of the price had been paid. *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 QB 476, at p. 639

[154] *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 QB 476

[155] Denning LJ was prepared to hold that the clause was in the nature of a penalty (see *ibid.*, p. 639), though Somervell and Romer LJJ had a different view.

[156] Owing to the bad weather, the royalties turned to be less than what the buyer had expected.

[157] *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 QB 476, at p. 629

[158] See Goode R.M., Hire-Purchase Law and Practice, 2nd ed., 1970, p. 381

[159] See, e.g., *Mussen v. Van Diemen's Land Co.* [1938] 1 All ER 210, [1938] Ch. 253, and Denning LJ's explanation with regard to this case in *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 QB 476, at p. 639 where he said: "... in *Mussen*'s case the court was much influenced by the fact that the purchaser had allowed nearly six years to elapse before claiming restitution."

8.42 It is not clear whether it is a relevant factor to inquire if the breach was wilful.[160] Undoubtedly it is relevant, as it was suggested[161], where the debtor seeks relief against forfeiture of his interest in the property.[162] In the context of relief against forfeiture of instalments already paid, however, the unconscionability of the creditor exercising his contractual right to retain the instalments would highly depend on the forfeited instalments being out of all proportions to the actual loss suffered by the creditor, taking all the above factors into account. Further, it has not been regarded as a relevant factor where the debtor seeks relief against a penalty, in its strict sense. It is, therefore, submitted that the wilfulness of the debtor's breach should not satisfy a court to hold that it is not unconscionable for the creditor to retain the instalments.

2.3. Terms of Relief

8.43 It cannot be doubted that the relief given by the court might be conditioned on certain terms. One main reason behind this probably is the famous maxim of equity to the effect that a person who seeks equitable relief must be prepared to do equity towards the other party.[163] Put another way, he must be ready to act justly, in its popular sense of doing "what is right and fair"[164] towards the defendant. It is, thus, obvious that the court should not grant relief to the defaulting debtor on an equitable basis while its order might create some unfairness to the innocent party.

8.44 Where the debtor is relieved from forfeiture by giving him a further time to perform his contract, the order is normally conditioned upon the payment of interest, as well as the outstanding instalments.[165] Thus, the creditor receives both what he had bargained

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[160] Some writers consider it as a relevant factor. see, e.g., Pawlowski M., Relief Against Forfeiture of Instalments (1993) Estate Gazette, 27 March 1993, issue 9312, 122, at p. 124 ; for the opposite view see Goff & Jones, The Law of Restitution, 4th ed., 1993, p. 438

[161] *Supra.*, paras. 7.69, 7.77 *et seq.*

[162] See, for instance, *Shiloh Spinners Ltd. v. Harding* [1973] AC 691, at pp. 723-724 per Lord Wilberforce; *Legione v. Hateley* (1983) 152 CLR 406, at p. 449 per Mason & Deane JJ.

[163] "He who seeks equity must do equity." see generally Martin J.E., Hanbury & Martin's Modern Equity, Fourth ed., 1993, p. 26; Baker P.V. and Langan P.St.J., Snell's Equity, 29th ed., 1990, p. 30. This has been described as a rule of "unquestionable justice". see *Neesom v. Clarkson* (1845) 4 Hare 97, at p. 101 per Wigram V.C.

[164] Baker P.V. and Langan P.St.J., Snell's Equity, 29th ed., 1990, p. 30

[165] *Re Dagenham (Thames) Dock Co., ex parte Hulse* (1873) LR 8 Ch App 1022, where the forfeiture provision was referred to as "a penalty from which the company [was] entitled to be relieved *on payment*

for, and also an interest for the period in which the payments remained outstanding. It is, however, far from clear[166] what the terms would be if the court relieved the debtor by ordering the creditor to return the forfeited instalments. The judgment of the Privy Council in *Steedman v. Drinkle*[167] refers to the necessity of granting relief on "proper terms"[168], but does not explain them. No other English court has, apparently, ever been reported to exercise the jurisdiction to grant positive relief from forfeiture of instalments. It would seem that the least term on which the relief should be conditioned is that the creditor must be fully compensated for damages he may suffer as a result of the breach.[169]

The following observations may support this proposition:

First, with regard to agreed damages clauses, the court strikes out penalties on condition that the defendant should compensate the plaintiff for losses caused by the breach. Refusing to enforce forfeiture clauses of penal nature- where it is unconscionable for the defendant to retain the money- is quite analogous to the unenforceability of penalties (in its strict sense). It would, therefore, seem that the positive relief should also be conditioned on the full compensation of the creditor for damages resulting from the debtor's breach.

Second, in *Dojap*[170], where relief against forfeiture of a penal deposit was given, it was expressly conditioned on the payment of damages actually proved to have been suffered by the vendor as a result of the breach.[171] This case is a good example of a positive relief[172], and it, therefore, could be a clear guide with regard to the terms on which the positive relief should be conditioned.

It is, therefore, submitted that the courts, exercising their jurisdiction to grant positive

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of the residue of the purchase-money with interest." at p. 1025 per James LJ (emphasis added); *Kilmer v. British Columbia Orchard Lands Ltd.* [1913] AC 319

[166] See the observations of Sachs J in *Galbraith v. Mitchenall Estates Ltd.* [1965] 2 QB 473, [1964] 2 All ER 653, at p. 658

[167] *Steedman v. Drinkle* [1916] 1 AC 275

[168] The judgment reads as follows: "... the stipulation in question was one for a penalty, against which relief should be given on proper terms." see *ibid.*, at p. 279

[169] See Greig & Davis, The Law of Contract, 1987 (With Fourth Cumulative Supplement, 1992), p. 1458

[170] *Workers Trust and Merchant Bank Ltd. v. Dojap Investments Ltd.* [1993] 2 All ER 370

[171] *Ibid.*, at pp. 376-377

[172] It was just argued that this case can be relied upon to show the wider jurisdiction of courts to relieve against forfeiture. *supra.*, paras. 8.31-8.33

relief, should order the repayment of the forfeited sums less damages actually suffered by the creditor resulting from breach.

3. Equitable Relief Against Forfeiture of Deposit

3.1. Introductory Remarks

8.45 A deposit, as it was discussed before[173], differs from a part-payment in that it is forfeitable at law, upon default being made by the payer in performing his contractual obligations where this results in termination of the agreement by the payee.[174] The reason for this lies in the purpose of making a payment as a deposit[175]: In addition to being a part of the contractual price if the contract is completed, a deposit is a guarantee for the completion of the agreement.[176] This has clearly been established by numerous cases.[177] In *Howe v. Smith*[178], Cotton LJ observed:

> "The deposit, as I understand it, ... is a guarantee that the contract shall be performed. If the sale goes on, of course, not only in accordance with the words of the contract, but in accordance with the intention of the parties in making the contract, it goes in part payment of the purchase-money for which it is deposited; but if, on the default of the purchaser the contract goes off, ..., he can have no right to recover the deposit."[179]

This function of a deposit confers on it a special characteristic which distinguishes it from

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[173] *Supra.*, paras. 6.09, 6.31

[174] It does not necessarily need to be a monetary sum. Other goods may also be "traded in" instead of the monetary deposit. see Guest A.G., Benjamin's Sale of Goods, 4th ed., 1992, para. 15-131, citing *Commission Car Sales (Hasting) Ltd. v. Saul* [1957] N.Z.L.R. 144

[175] See Atiyah, Introduction to the Law of Contract, 1995, p. 439; Farrand J T, Contract and Conveyance, 4th ed., 1983, p. 204

[176] See, e.g., *Howe v. Smith* (1884) 27 Ch D 89, at p. 101 per Fry LJ; see also *supra.*, para. 6.39

[177] *Lea v. Whitaker* (1872) LR 8 CP 70, 27 LT 676; *Catton v. Bennett* (1884) 51 LT 70; *Collins v. Stimson* (1883) 48 LT Rep. N.S. 828, 11 Q.B.Div. 142; *Howe v. Smith* (1884) 27 Ch D 89; *Soper v. Arnold* 14 App. Cas. 429 where Lord Macnaghten said: "Everybody knows what a deposit is. The purchaser did not want legal advice to tell him that. The deposit serves two purposes- if the purchase is carried out, it goes against the purchase money- but its primary purpose is this, it is a guarantee that the purchaser means business." at p. 435, also per Lord Herschell at p. 433; *Depree v. Bedborough* (1863) 4 Giff. 479, at p. 483; *Ex parte Barrell* LR, 10 Ch. 512, at p. 514 per James LJ

[178] *Howe v. Smith* (1884) 27 Ch D 89

[179] *Ibid.*, at p. 95 ; see also the observations of Fry LJ at p. 101, and Bowen LJ at p. 98 where he said: "... a deposit, if nothing more is said about it, is, according to the ordinary interpretation of business men, a security for the completion of the purchase. But in what sense is it a security for the completion of the purchase? It is quite certain that the purchaser cannot insist on abandoning his contract and yet recover the deposit, ..."; *Sprague v. Booth* [1906] AC 576, at p. 580; *John Baker & Co. Ltd. v. Littman* [1941] Ch. 405, at p. 412 per Clauson LJ

a part payment.

8.46 With this characteristic, a deposit has always been treated as a good alternative to providing for agreed damages.[180] The agreed damages clause is, no doubt, subject to the penalty doctrine[181], while allowing equitable relief against forfeiture of deposit might be regarded as against its purpose and function. On the other hand, a deposit might be excessive in amount without any relation to the loss suffered by the payee as the result of breach. Just as a penalty, it may act *in terrorem* and be a means of intimidating the payer to perform his contract, and penalizing him in case of default. This may justify the existence of an equitable jurisdiction to relieve the payer against its forfeiture.

The special character and status of the deposit on the one hand, and the purpose and spirit of the equitable intervention of the courts to relieve against penalties and forfeitures on the other has made the position as to the recoverability of the deposit by the payer after termination of the contract for his breach unclear, uncertain and controversial. This section will, therefore, be devoted to illuminating the position under English law: the availability of equitable relief against forfeiture of deposit, the basis for this jurisdiction, the circumstances upon which it may be exercised, and the relationship between that and the penalty doctrine are the issues which will in turn be dealt with.

3.2. The Existence of the Jurisdiction to Grant Relief

3.2.1. Relief by granting extra time to perform

8.47 It cannot be doubted that where the court relieves a payer from forfeiture of his interest in the property or instalments of purchase price by decreeing specific performance or giving the contract breaker extra time to perform his contract, the payer is also relieved against forfeiture of his deposit. Thus, if he performs his contractual obligation within the time granted and the agreement is completed, the deposit, which was subject to forfeiture, will be considered as a part of the contract price. It can also not be doubted that, in appropriate circumstances, if the payer is ready, able and willing to perform his contract, relief against forfeiture of deposit by giving a further time and opportunity to

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[180] Furmston M P, Contract Planning: Liquidated Damages, Deposits and the Foreseeability Rule (1991) 4 JCL 1, at p. 2

[181] *Supra.*, chapter 2

perform may be granted.[182] In *Starside Properties Ltd. v. Mustapha*[183], a deposit of £1250 was payable by instalments. Upon the purchaser's default in the punctual payment of one of the instalments, and the vendor's termination and forfeiture of the instalments of the deposit already paid, the court relieved the purchaser from forfeiture by granting him a further time to complete the agreement. Neither at the trial nor in the Court of Appeal, which recognised the jurisdiction of the court to grant a further relief, was the nature of the payments made as instalments of the deposit questioned. The case, therefore, can provide an authority for the view that a payer may be relieved against forfeiture of his deposit by giving him an extra time to perform his contractual obligation, if he is willing, able and ready to complete, and if the forfeiture amounts to exaction of a penalty. The conditions for the existence of such a jurisdiction, its limitations and the circumstances upon which it may be exercised appear to be the same as those which were, examining the equitable relief from forfeiture of the payer's interest in the property, considered.[184]

3.2.2. Relief by ordering repayment of deposit

8.48 The most controversial issue is whether courts have jurisdiction to relieve a payer from forfeiture of his deposit by ordering its repayment. Though, in principle, there seems no reason why such a jurisdiction should not be available, case law as to the issue does not appear to be very clear: Some earlier cases deny the existence of any equitable power for the courts to order repayment of deposit; conversely, there are a few authorities which have applied the penalty doctrine to relieve the payer against forfeiture of deposit. In the recent years, however, there have been some judicial decisions which have shed much light onto the issue, the recent decision of the Privy Council in *Workers Trust and Merchant Bank Ltd. v. Dojap Investments Ltd.*[185] being the most important one of them. These recent developments, together with the previous conflicting authorities, after a brief consideration of the issue in principle, should in some detail be discussed.

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[182] See Pawlowski M, Relief Against Forfeiture of Deposits (1992) Estate Gazette, 21 Nov 1992, Issue 9246, 76, at pp. 77,78

[183] [1974] 1 WLR 816, [1974] 2 All ER 567, for the full description of the case see *supra.*, para. 7.16

[184] See *supra.*, chapter 7

[185] *Workers Trust and Merchant Bank Ltd. v. Dojap Investments Ltd.* [1993] 2 All ER 370

3.2.2.1. Considering the issue in principle

8.49 In principle, disregarding the special status of deposits, there seems no reason why the rules against penalties should not be applicable to the forfeiture of deposits. There is little difference between agreeing on a special sum of money to be paid upon breach, and agreeing on the same sum to be forfeited upon default.[186] As far as the penalty doctrine is concerned, both these sums can reflect the genuine attempt of the parties to pre-estimate the likely loss which might flow from breach, or they may be an excessive amount, without any relation to the probable loss, stipulated to act *in terrorem* of the defaulting party. These considerations suggest that a deposit, if it is in gross disproportionate to the likely loss resulting from breach, should be held to be a penalty, and just as a penal sum is not recoverable by the innocent party, it should also not be forfeitable by the payee.

On the other hand, deposits enjoy a special characteristic: They are guarantees that the contract will be performed and completed. Being a guarantee, it should be forfeited if the contract is terminated for the payer's default, because otherwise it cannot be regarded as a guarantee. A deposit is not provided for to decide about the amount of damages which may result from breach. It is not the primary function of a deposit to compensate the payee for damages which is likely to be suffered by him as the result of breach. Put another way, a contract may provide both for a deposit as a guarantee for the performance and completion of the contract, and for an agreed damages clause as an attempt to pre-estimate the losses which are likely to flow from breach.[187] The latter is subject to the penalty doctrine and may be held penal if it has no relation to the likely loss, but the former has primarily nothing to do with damages[188] and should be forfeited if the contract goes off for the payer's breach. It is because the parties have intended a deposit to act as a guarantee, and an agreed damages to pre-assess the future probable losses.

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[186] See Carter J W, A Comment on Dojap (Reasonable Deposit) (1993) 6 JCL 269, at p. 271; Pawlowski M, Relief Against Forfeiture of Deposits (1992) Estate Gazette, 21 Nov 1992, Issue 9246, 76; Murdod S, Deposits, Penalties and Equitable Relief (1993) Estate Gazette, 22 May 1993, Issue 9320, 122

[187] See, e.g., *Lock v. Bell* [1931] 1 Ch. 35

[188] Though it should be taken into account if the innocent party claims further damages resulting from breach. see *Lock v. Bell, ibid.*; *Commission Car Sales (Hastings) Ltd. v. Saul* [1957] N.Z.L.R. 144, at p. 146; see also Guest A.G., Benjamin's Sale of Goods, 4th ed.,1992, paras. 15-131,15-132

3.2.2.2. Earlier cases against any equitable intervention

8.50 The special characteristic of a deposit has led the courts to hold in several instances that the rules against penalties have no application to the forfeiture of deposits.[189] In *Depree v. Bedborough*[190], in an action for the recovery of deposit by the assignee of the purchaser, Sir John Staurt the Vice Chancellor observed:

> "I am unable to follow the argument of counsel for the assignees, that upon the abandonment there arisen a right to have the security returned which was exacted to prevent the contract being abandoned on the part of the purchaser; and no case can be found to support that view- at any rate none has been cited to show that in a case like this a person making default has been held to be entitled to the security which he paid to prevent an abandonment of his contract."[191]

Furthermore, the vice-chancellor, emphasising on the point that there has been a default on the part of the purchaser, said:

> "... How the person who is in default can, upon that default, and in consequence of that default, acquire any right to the money which was parted with as a security that there should be no default, it is difficult to conceive, ..."[192]

8.51 In *Hinton v. Sparkes*[193], Bovill CJ was quite explicit about the non-applicability of the penalty doctrine to deposits. He said:

> "The intention of the parties, as I collect it from the agreement, is, that this is to be taken as the ordinary case of payment of a deposit, which is to be forfeited on the purchaser's failure to complete the contract. ... The numerous cases referred to as to the distinction between penalty and liquidated damages have in my judgment no application to a contract in the form of that now in question."[194]

The most commonly cited judicial opinion as to this point is the observations of Jessell

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[189] See, e.g., *Lea v. Whitaker* (1872) LR 8 CP 70, 27 LT 676; *Catton v. Bennett* (1884) 51 LT 70; *Ockenden v. Henly* EB & E 485, 27 LT (QB) 361; *Collins v. Stimson* (1883) 48 LT Rep. N.S. 828, 11 Q.B.Div. 142; *Soper v. Arnold* 14 App. Cas. 429 per Lord Herschell at p. 433; *Depree v. Bedborough* (1863) 4 Giff. 479; *Ex parte Barrell LR* 10 Ch 512, at p. 514; *Hinton v. Sparks* (1868) LR 3 CP 161; *Wallis v. Smith* (1882) 21 Ch.D. 243; *Lock v. Bell* [1931] 1 Ch. 35; *Linggi Plantations Ltd. v. Jagatheesan* [1972] 1 M.L.J. 89 (P.C.); see also Guest A.G., Benjamin's Sale of Goods, 4th ed.,1992, paras. 15-132, 15-133; Atiyah P S, Adams J N, The Sale of Goods, 9th ed., 1995, pp. 502-503

[190] (1863) 4 Giff. 479, 66 ER 795

[191] *Ibid.*, at p. 483

[192] *Ibid.*, at p. 482

[193] (1868) LR 3 CP 161

[194] *Ibid.*, at p. 165

M.R. in *Wallis v. Smith*[195] which is to the similar effect:

> "There is a class of cases relating to deposits. Where a deposit is to be forfeited for the breach of a number of stipulations, some of which may be trifling, some of which may be for the payment of money on a given day, in all those cases the judges have held that this rule [the rule against penalties] does not apply, and that the bargain of the parties is to be carried out."[196]

3.2.2.3. Cases for the intervention and application of the penalty doctrine: Consideration and Analysis

8.52 In the early years of the century, there have been some cases where the rules against penalties have been applied to deposits. In *Commissioner of Public Works v. Hills*[197], the Privy Council held that the contractor who had failed to complete the project on time was entitled to get its security money back, subject to a deduction of the employer's actual loss as a result of the breach. Lord Dunedin, delivering the judgment of the Board, applied the rules against penalties to the clause providing for the forfeiture of deposit and other certain retention moneys, and argued that the amounts provided to be forfeited upon default could not be regarded as a genuine pre-estimate of damages.[198]

8.53 The case may illustrate the application of the penalty doctrine to deposits, and it has often been so regarded.[199] It may, however, be said that the sum which was referred to as a "security money" in this case was not in fact a deposit which has the special character of

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[195] (1882) 21 Ch.D. 243

[196] *Ibid.*, at p. 258 ; see also *Lock v. Bell* [1931] 1 Ch 35; *Lowe v. Hope* [1970] Ch. 94, [1969] 3 All ER 605 where Pennycuick J was in no doubt that, upon termination, a vendor would be entitled to forfeit the deposit. at p. 98 and p. 607 respectively ; *Commission Car Sale v. Saul* [1957] N.Z.L.R. 144, at p. 146 (sale of goods, forfeiture of a deposit of 25%); *Reid Motors v. Wood* [1978] 1 N.Z.L.R. 319, at p. 325; see also the Scottish case of *Roberts & Cooper, Ltd. v. Christian Salvesen & Co., Ltd.* (1918) S.C. 794 where Lord President (Strathclyde), reviewing English and Scottish authorities and expressing the view that the law as to the forfeiture of deposits is the same in both jurisdictions, said: "... it is well-settled law that where, in a contract of sale, the intending buyer deposits part of the price, he cannot, if he repudiates the contract without justification, claim repayment of the deposit. ... Holding these views, it is unnecessary that I should express any opinion upon the question whether the forfeiture of the deposit is to be viewed as penalty or liquidated damages." at pp. 806, 808, and per Lord Mackenzie at p. 812 (Lord Skerrington dissenting). In *Zemhunt (Holdings) Ltd. v. Control Securities Mc* (1992) S.C. 58, the above view was expressed to be "the correct statement of the law of Scotland". at p. 66 per Clerk LJ

[197] *Commissioner of Public Works v. Hills* [1906] AC 368

[198] *Ibid.*, at p. 376

[199] See, e.g., Beale H., Unreasonable Deposits (1993) 109 LQR 524, at p. 525; Adams J E, The Usual 10% Deposit-Can it be justifies still? (1983) 80 Law Society's Gazette 2811, at p. 2813, no. 17; Pawlowski M, Relief Against Forfeiture of Deposits (1992) Estate Gazette, 21 Nov 1992, Issue 9246, 76

being a guarantee for the completion of the agreement. The contractual clause which dealt with the consequences of the creditor's breach (*i.e.* cl. 17), provided for the forfeiture of the security money and other retention moneys, upon default, "as and for liquidated damages sustained by the said Government [*i.e.* the employer] for the non-completion of the said line"[200]. It would, therefore, seem that the parties had intended to pre-assess damages which might have resulted from breach, rather than to provide for a sum of money to act as a guarantee for the completion. True that they called the sum also a "security", but the Privy Council, it appears, regarded it as an amount agreed upon to determine the amount of probable future losses as a result of the non-completion. Since the special status of a deposit is due to its distinctive characteristic which the amount in question in the *Hill's* case[201] lacks it, it seems to be hardly surprising that the Privy Council did not regard it forfeitable. Put another way, it being recognised as an amount agreed upon to pre-assess damages, the Board had no difficulty to apply the penalty doctrine to decide whether it was a genuine pre-estimate.

8.54 This can be supported by the statement of Lord Mackenzie in the Scottish case of *Roberts & Cooper v. Salvesen & Co.*[202], who, on the question of the recoverability of deposit by the defaulting purchaser, did not consider the *Hill's* case to be in point, saying:

> "It would be necessary to consider this topic [*i.e.* the application of the penalty doctrine, as it was applied in the *Hill's* case] if the case raised the question whether the £3,000 was of the nature of a penalty or was liquidated damages ... . In my opinion that question does not arise here, inasmuch as the £3,000 was a deposit in the sense in which that term is used in the cases referred to. [*i.e.* as guarantee for the performance]."[203]

8.55 *Pye v. British Automobile Commercial Syndicate Ltd.*[204] has also been regarded as supporting the applicability of the penalty doctrine to deposits.[205] In this case, in an

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[200] *Commissioner of Public Works v. Hills* [1906] AC 368, at p. 373

[201] *Commissioner of Public Works v. Hills* [1906] AC 368

[202] [1918] S.C. 794

[203] *Ibid.*, at p. 812

[204] [1906] 1 KB 425

[205] See Adams J E, The Usual 10% Deposit-Can it be justifies still? (1983) 80 Law Society's Gazette 2811, at p. 2813, no. 17; Pawlowski M, Relief Against Forfeiture of Deposits (1992) Estate Gazette, 21 Nov 1992, Issue 9246, 76

action by the buyer for the recovery of deposit, the technical rules against penalties were applied, and the deposit, having been recognised as not being in the nature of penalty, was held to be forfeitable. Bigham J., considering the statement of Jessel M.R. in *Wallis v. Smith*[206] concluded that the authorities cited for that view did not support it. He, however, observed that being a deposit was a circumstance which had to be taken into account when determining the nature of payment, saying:

> "... I think that there is some ground for saying that where the sum of money in question has been deposited, that is a circumstance which must be taken into account by a judge in ascertaining the intention of the parties."[207]

It should be noted that in this case also, like the *Hill's* case[208], the forfeiture clause provided for the forfeiture of deposit, upon default, "as and by way of liquidated damages"[209].

8.56 Furthermore, in *Brickles v. Snell*[210], the Privy Council, refusing to decree specific performance of a contract for the sale of land after termination of the agreement for the purchaser's default, regretted that a claim for the recovery of the deposit, in the alternative, had not been inserted, so that there could have been "a complete adjudication on all matters in dispute between the parties".[211] The statement may imply that the Board might have relieved the purchaser against forfeiture of the deposit had there been a claim for such a relief. But the nature of relief which might have granted, and the grounds on which it might have been based are by no means clear. Needless to say, therefore, that the case cannot be regarded as an authority for the view that the rules against penalties should be applied to deposits.

3.2.2.4. Recent developments: Reasonableness of deposit

8.57 Despite the above cases and judicial statements[212], the observations of Jessel M.R.

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[206] *Wallis v. Smith* (1882) 21 Ch D 243

[207] *Pye v. British Automobile Commercial Syndicate Ltd.* [1906] 1 KB 425, at p. 430

[208] *Commissioner of Public Works v. Hills* [1906] AC 368

[209] *Pye v. British Automobile Commercial Syndicate Ltd.* [1906] 1 KB 425, at p. 426

[210] [1906] 2 AC 599

[211] *Ibid.*, at p. 604

[212] See also *Bridge v. Campbell Discount Co. Ltd.* [1962] 1 All ER 385, [1962] AC 600, per Lord Denning at p. 631

in *Wallis v. Smith*[213] has been reaffirmed by the Privy Council in *Linggi Plantations Ltd. v. Jagatheesan*[214]. In a contract for the sale of an estate for $3,775,000, a 10% forfeitable deposit was provided for and duly paid. Upon default, the vendors forfeited the deposit, though they could prove no damages resulting from the breach. The purchasers claimed for the recovery of the deposit, relying on the section 75 of the Contracts (Malay States) Ordinance 1950, on the ground that the forfeiture amounted to a penalty. The Privy Council held that the rules relating to deposit have always been treated as distinct from the law against penalties.

Lord Hailsham of St. Marylebone, delivering the judgment of the Board, said that "a *reasonable* deposit has always been regarded as a guarantee of performance as well as a payment on account, and its forfeiture has never been regarded as a penalty in English law or common English usage."[215] The Board, thus, treated a 10% deposit as a reasonable deposit[216], and did not regard it subject to the penalty doctrine, and consequently subject to the sec. 75 of Contracts Ordinance 1950. The Privy Council, however, was careful to confine its decision to deposits which are "reasonable". A deposit, in the words of Lord Hailsham LC "might turn out to be the imposition of a penalty, by purporting to render forfeit something which is in truth part payment".[217] This implies that a deposit, being unreasonable, might be regarded as a penalty which is subject to equitable relief.[218]

8.58 The observations of Lord Hailsham LC was relied upon in the recent case of

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[213] *Wallis v. Smith* (1882) 21 Ch D 243

[214] [1974] 1 M.L.J. 89

[215] *Ibid.*, at p. 94 [emphasis added]. In his lordship's view, the rules relating to deposit was much older than the rules against penalties. They were imported from the civil law and, assuming the deposit or earnest to be reasonable, forfeiture of a deposit was not normally subject to equitable relief. at p. 91 per Lord Hailsham LC, citing *Wallis v. Smith* (1882) 21 Ch D 243

[216] The Board held that there was "nothing unusual or extortionate" in a 10% deposit. *Ibid.*, at p. 93

[217] *Ibid.*, at p. 94

[218] It has surprisingly sometimes been suggested that even a deposit equal to 90% of the purchase price cannot be treated as penal. see Johnston P, Selling Land by Instalments (1992) Estate Gazette, 1 Feb 1992, issue 9204, 73

Workers Trust and Merchant Ltd. v. Dojap Investments Ltd.[219]. It was stated that the above view did accurately reflect the law: "It is not possible", in the words of Lord Browne-Wilkinson, "for the parties to attach the incidents of a deposit to the payment of a sum of money unless such sum is reasonable as earnest money."[220] In the case, a contract for the sale of land in Jamaica provided for the payment of a deposit of 25% of the purchase price (cl. 4), with express power in the vendor to forfeit it upon default (cl. 13). The purchasers having failed to provide a satisfactory undertaking for the payment of the balance of the purchase price on the required date, the vendors terminated the contract, and purported to forfeit the deposit. The purchasers rendered the balance with interest three days later, but it was refused. They, then, started proceedings claiming, *inter alia*, relief against forfeiture of the deposit.[221] The claim was rejected by the judge; but on appeal, the Court of Appeal of Jamaica relieved the purchaser from forfeiture to the extent that the deposit exceeded 10% of the contract price. The vendors appealed against the decision to grant relief and the purchasers cross-appealed claiming that they should have been relieved against forfeiture of the whole deposit. The amount of the deposit being recognised as unreasonable, the Privy Council held that the provision for its forfeiture, in the absence of special circumstances to justify it, would amount to the imposition of a penalty and, accordingly, the purchasers should be relieved against the forfeiture.

8.59 A few important points could be referred to in this decision: **First**, Lord Browne-Wilkinson, delivering the judgment of the Board, tried to summarise the law relating to penalties and forfeitures in general terms. He observed:

> "In general, a contractual provision which requires one party in the event of his breach of the contract to pay or forfeit a sum of money to the other party is unlawful as being a penalty, unless such provision can be justified as being a payment of liquidated damages, being a genuine pre-estimate of the loss which the innocent party will incur by reason of the breach. One exception to this general rule is the provision for the payment of a deposit by the purchaser on a contract for the sale of land. Ancient law has

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[219] *Workers Trust and Merchant Bank Ltd. v. Dojap Investments Ltd.* [1993] 2 All ER 370 (P.C.)

[220] *Ibid.*, at p. 706 and p. 374 respectively

[221] The purchaser also claimed specific performance which was rejected by the judge at first instance. But it was not in issue before the Court of Appeal and Privy Council, for Dojap had arranged to purchase the same land from the first mortgagee. see *ibid.*, p. 372

> established that the forfeiture of such a deposit (customarily 10% of the contract price) does not fall within the general rule and can validly be forfeited even though the amount of the deposit bears no reference to the anticipated loss to the vendor flowing from the breach of contract."[222]

Although it might seem that this statement does not accurately reflect the law as to penalties and forfeitures[223], it does clearly confirm the special status of deposits. This special status, described as "anomalous"[224] by the Board, has been traced back to the Roman law of arra, and possibly further back.[225] A deposit, therefore, has expressly been treated as forfeitable upon default, without equity having any power to relieve against such a forfeiture.[226]

8.60 **Second**, the reason for deposits being treated differently from other advance payments is that such a payment is intended by the parties to act as an earnest for the performance of a contract, or as a security that the purchaser means business. Obviously, if the purchaser defaulted in the performance of his contractual obligations, such a deposit might be forfeited, for it was the primary intention of providing for such an advance payment.

8.61 **Third**, the special status afforded to deposits is capable of being abused by the

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[222] *Workers Trust and Merchant Bank Ltd. v. Dojap Investments Ltd.* [1993] 2 All ER 370 (P.C.), at p. 705 and p. 373 respectively

[223] **Firstly**, it would seem that, as far as the onus of proof is concerned, an agreed damages clause is, *prima facie*, valid unless the defendant shows that it is not a genuine pre-estimate of the probable losses resulting from breach. see *Robophone Facilities Ltd. v. Blank* [1966] 3 All ER 128, [1966] 1 WLR 1428, at p. 1447; **Secondly**, it was discussed that the relief afforded by courts against forfeiture of advance payments (except deposit) is to some extent different from relief against penalties. Such a relief may normally be granted if the forfeiture clause is penal and it is unconscionable for the payee to retain the money. (see *supra.*, paras. 8.37 *et seq.*) **Thirdly**, the Privy Council regarded the forfeitability of a deposit as an exception to the general rule, while it would seem that the general rule, as it was considered in detail (*supra.*, para. 8.45 and references made therein), is that a deposit should be forfeited upon default without any equitable relief being available, and the relief against forfeiture of deposit is an exception. see the illuminating observations of Carter J W, A Comment on Dojap (Reasonable Deposit) (1993) 6 JCL 269, at pp. 270-271, who describes the general proposition of the Privy Council "as either a profound statement of a new principle, or as a loose and perhaps inaccurate attempt to state compendiously two different rules".

[224] *Workers Trust and Merchant Bank Ltd. v. Dojap Investments Ltd.* [1993] 2 All ER 370 (P.C.), at p. 705 and p. 373 respectively ; see also Guest A.G., Benjamin's Sale of Goods, 4th ed.,1992, para. 15-132

[225] Relying on *Howe v. Smith* (1884) 27 Ch.D. 89, at pp. 101-102 per Fry LJ; see *Workers Trust and Merchant Bank Ltd. v. Dojap Investments Ltd.* [1993] 2 All ER 370 (P.C.), *ibid.*

[226] *Workers Trust v. Dojap, ibid.*

parties: They may provide for an excessive sum of money as a deposit, and in this way escape from the application of the rules against penalties. Put another way, they may insert a disguised penalty in their contract by calling it a deposit. There has always been a tendency that such an abuse could not be allowed. As pointed out, in the *Linggi* case[227], Lord Hailsham LC confined the special status of deposits to advance payments which are *in truth* a deposit. His lordship referred to them as "reasonable deposits". Before him, Denning LJ expressly recognised the power of courts to relieve against forfeiture of deposits which were excessive in amount. He pointed out:

> "... suppose that a vendor of property, in lieu of the usual ten per cent. deposit, stipulates for an initial payment of fifty per cent. of the price as a deposit and part payment, and later, when the purchaser fails to complete, the vendor re-sells the property at a profit and, in addition, claims to forfeit the fifty per cent. deposit. Surely the court will relieve against the forfeiture. The vendor cannot forestall this equity by describing an extravagant sum as a deposit, any more than he can recover a penalty by calling it liquidated damages."[228]

This passage implies that Denning LJ recognises the special status of deposits by accepting the forfeitable nature of "the usual ten per cent. deposit", but he confines the rule to "true deposits" by believing in the equity's power to relieve the purchaser from forfeiture of an excessive amount described as a deposit.

8.62 Likewise in *Dojap*[229], it was emphasised that the special status of deposits is only afforded to reasonable deposits.[230] The main task of the courts in dealing with the question of the forfeiture of deposit is to decide whether the advance payment provided for and described as a deposit is reasonable in amount as a real "earnest money". If it is, then it is forfeitable upon default and there is no equitable power to relieve against such a forfeiture, even where the amount of deposit has no possible relation to the loss suffered by the payee as a result of the breach.[231] But if it is not, it cannot be treated as a deposit, as if the parties have not stipulated for a deposit at all.[232] It is an advance payment which

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[227] *Linggi Plantations Ltd. v. Jagatheesan* [1974] 1 MLJ 89

[228] *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 QB 476, at p. 638

[229] *Workers Trust and Merchant Bank Ltd. v. Dojap Investments Ltd.* [1993] 2 All ER 370 (P.C.)

[230] *Ibid.*, at p. 374

[231] See *ibid.*, at p. 373

[232] See *ibid.*, at p. 376, where Lord Browne-Wilkinson said: "If it [the vendor] cannot establish that the

the provision for its forfeiture, if not justified according to the special circumstances of the case, may be regarded as a penalty.

A reasonable deposit, accordingly, might be a penalty in a sense that it is not a genuine pre-estimate of damages, but the special status of deposits requires that no relief against forfeiture of such a penal sum can be afforded. Such a penalty, in the words of Lord Browne-Wilkinson, has been referred to as a "permissible penalty".[233] Also an unreasonable deposit, though it is subject to the penalty doctrine, may, in certain circumstances, not be held to be a penalty, for it might be recognised as a genuine pre-estimate of the payee's likely losses which might flow from breach. The Privy Council described it as drawing a line "between a reasonable, permissible amount of penalty and an unreasonable, impermissible penalty".[234]

8.63 To sum up the discussion, it may be stated that the present position of law stands as follows: A deposit, if it is reasonable as an earnest money, is not subject to the rules against penalties and forfeitures.[235] It means that such a deposit would be retained by the payee if the contract was terminated for the payer's default, even if the amount of deposit had no relation to the actual loss which is likely to be suffered by the payee by reason of the breach. An unreasonable deposit, however, may be ordered to be refunded by relieving the payer against its forfeiture.[236]

This special status afforded to deposits, though it looks simple and clear at first sight, creates several problems some of which may have still remained unsolved. Drawing a line between a reasonable and unreasonable deposit in different contracts is one of them: How

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whole sum was truly a deposit, it has not contracted for a true deposit at all."

[233] *Ibid.*, at p. 374; see also Carter J W, A Comment on Dojap (Reasonable Deposit) (1993) 6 JCL 269, at p. 271

[234] *Ibid.*, at p. 374

[235] See also Guest A.G., Benjamin's Sale of Goods, 4th ed.,1992, paras. 15-132, 15-133 ; Atiyah P S, Adams J N, The Sale of Goods, 9th ed., 1995, pp. 502-503

[236] It should be mentioned here that this is the legal position disregarding the discretionary jurisdiction afforded to courts by statute to order the repayment of deposit in contracts for the sale or exchange of an interest in land, (sec. 49(2) of the Law of Property Act 1925). The statutory jurisdiction will shortly be discussed. see *infra.*, chapter 9, paras. 9.10 *et seq.*

can a reasonable deposit be distinguished from an unreasonable one? In other words, what are the tests to determine the reasonableness of a deposit? Secondly, it does not seem to be clear whether an unreasonable deposit is subject to the rules against penalties, in its strict sense, or it should be subject to the equitable jurisdiction to relieve against forfeiture, as discussed earlier[237]. These issues should in turn be considered here.

3.2.3. Test of Reasonableness

8.64 The only case which might shed some light on the question of determining the reasonableness of a deposit is *Dojap*[238]. In that case, a deposit of 25% of the contractual price was held to be unreasonable. As a primary point, the Privy Council rejected the argument of the judge at first instance to the effect that the deposit was reasonable because it was the common practice of banks selling property in Jamaica to demand deposits of between 15% to 50%.[239] A deposit, therefore, cannot be regarded as reasonable merely because it is commonly asked for by a certain group of vendors or sellers.[240] This would seem to be the right approach. Determining the reasonableness of deposits by a reference to the common practice of certain groups would open a floodgate for abusing the special rules relating to deposits, and consequently evading the law as to penalties.

8.65 The Board expressed its view as to a reasonable deposit in sale of land in the following terms:

> "... without logic but by long continued usage both in the United Kingdom and formerly in Jamaica, the customary deposit has been 10%. A vendor who seeks to obtain a larger amount by way of forfeitable deposit must show special circumstances which justify such a deposit."[241]

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[237] See *supra.*, paras. 8.37 *et seq.*

[238] *Workers Trust and Merchant Bank Ltd. v. Dojap Investments Ltd.* [1993] 2 All ER 370, for the facts of the case see *supra.*, para. 8.58

[239] *Ibid.*, at p. 374

[240] See also Beale H., Unreasonable Deposits (1993) 109 LQR 524, at pp. 528-529

[241] *Workers Trust and Merchant Bank Ltd. v. Dojap Investments Ltd.* [1993] 2 All ER 370 (P.C.), at p. 374; see Anonymous (1818) 3 Madd. 494, 56 ER 586, where Sir John Leach, the Vice-chancellor observed that, though there was no fixed rule as to what amount should be deposited, it would be a useful rule that the usual deposit of 10 per cent. should be made when biddings were opened. see also Adams J E, The Usual 10% Deposit-Can it be justified still? (1983) 80 Law Society's Gazette 2811 ; Oakley A J, Deposits: still a guarantee of performance?, part I [1994] The Conveyancer and Property Lawyer 4, at p. 41; The Conveyancing Standing Committee's Consultation Paper, Deposits on Exchange of Contracts in

An increase in the amount of deposits in Jamaica because of the introduction of a transfer tax of 7.5% by the Transfer Tax Act 1971 was not regarded as justifying the deposit in question: **First**, as to the tax element, although it was not unreasonable to stipulate for the advance payment of such a tax, there was no justification for the view that such an advance payment should be capable of being forfeited if the contract was not completed. For, in the words of Lord Browne-Wilkinson, "such tax is either not in the event payable or is recoverable by the vendor".[242] **Second**, apart from the tax element, there was no evidence to show special circumstances which might justify a deposit of 25% as being a reasonable deposit.[243]

In the Board's view, therefore, the "long continued usage" was regarded as the key point in determining the reasonableness of the deposit. As to the contracts for the sale of land this usage has been quite clear: A deposit of 10% has normally been provided for as a guarantee for the completion of the agreement.[244] Therefore, if the parties stipulate for an amount larger than 10% of the purchase price as a deposit, the vendor must show some special circumstances which may justify the larger deposit. In the absence of such circumstances, the deposit would be regarded as unreasonable, as it was in *Dojap*[245].

8.66 It still remains to be decided what constitutes a reasonable deposit in contracts other than sale of land where there may be no established continued usage as there is with regard to the land transactions. This seems to be one of the most problematic areas in the law relating to deposits. We will come back to this issue later when analysing the law applicable to the forfeiture of deposits.[246]

Residential Conveyancing-Time for a change?, Feb. 1988, para. 1; To see the history of giving deposits in sale of land see Wilkinson H, Deposits: who needs them? (1984) 81 The Law Society's Gazette 347; Wilkinson H, Deposits: way back when? (1984) 81 The Law Society's Gazette 1268

[242] *Workers Trust and Merchant Bank Ltd. v. Dojap Investments Ltd.* [1993] 2 All ER 370, at p. 375

[243] See *Dojap, ibid.*

[244] See the Second Report of the Conveyancing Committee: Conveyancing Simplifications (1985), para. 3.10; The Conveyancing Standing Committee's Consultation Paper, Deposit on Exchange of Contracts in Residential Conveyancing- Time for Change?, Feb. 1988, para. 11

[245] *Workers Trust and Merchant Bank Ltd. v. Dojap Investments Ltd.* [1993] 2 All ER 370

[246] See *infra.*, paras. 8.79 *et seq.*

3.3. Unreasonable Deposit: subject to the penalty doctrine or equitable relief against forfeiture?

8.67 There is no doubt that a deposit being held as unreasonable may be regarded as an impermissible penalty against its forfeiture the payer would be entitled to be relieved. The question, however, is upon what grounds such a relief should be granted: Is an unreasonable deposit subject to the penalty doctrine so that if there was a gross disproportionate between the amount of deposit and the loss which is likely to flow from breach, it would be held to be a penalty? *or* is it subject to the equitable doctrine of relief against forfeiture as pronounced by Somervell and Denning LJJ in *Stockloser v. Johnson*[247]?

3.3.1. Application of the Penalty Doctrine?

8.68 In *Dojap*[248], though *Stockloser v. Johnson*[249] was referred to, nonetheless Lord Browne-Wilkinson, referring to the conflicting views of Somervell and Denning LJJ on the one hand and Romer LJ on the other, did not think it necessary to decide which of those views were correct. His lordship tried to distinguish *Stockloser v. Johnson* on the ground that it was a case "where a party [was] seeking relief from forfeiture of contract to pay a price by instalments, the party in default having been let into possession in the meantime".[250] It is quite puzzling upon what principles the case was so distinguished[251], but in any event, the Board held that the deposit of 25% was not a reasonable deposit, and so the provision for its forfeiture was a "plain penalty"[252]. The Board, therefore, on the authority of *Public Works Commissioner v. Hills*[253], relieved the purchaser against its forfeiture by ordering the vendor to return the whole deposit less damages actually suffered by it as the result of the breach.

8.69 Applying the decision in the *Hill's* case has been taken as an indication that Lord

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[247] *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 QB 476, at p. 636 per Somervell LJ and p. 638 per Denning LJ; see *supra.*, paras. 8.37 *et seq.*

[248] *Workers Trust and Merchant Bank Ltd. v. Dojap Investments Ltd.* [1993] 2 All ER 370

[249] *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 QB 476

[250] *Workers Trust and Merchant Bank Ltd. v. Dojap Investments Ltd.* [1993] 2 All ER 370, at p. 376

[251] See McKendrick E, Contract Law, 2nd ed., 1994, p. 333

[252] See *Workers Trust and Merchant Bank Ltd. v. Dojap Investments Ltd.* [1993] 2 All ER 370, at p. 376

[253] [1906] AC 368

Browne-Wilkinson was thinking in terms of the rules against penalties.[254] It has also been suggested that ordering the entire deposit to be repaid and not allowing the vendor to keep any part of that shows the tendency of the Board to apply the penalty doctrine.[255] This argument may, however, be open to doubt: it is not clear how the application of the equitable jurisdiction to relieve against forfeiture in the line drawn by Denning LJ would result in the court allowing the vendor to keep some [probably the reasonable] part of the deposit. As emphasised by the Board, the deposit being recognised as unreasonable, the situation is as if the parties had never stipulated for a true deposit. If, therefore, the purchaser was to be relieved against forfeiture of such an advance payment, quite apart from the application of any certain set of rules, there would be no justification to allow the vendor to keep any part of that, except what which would compensate him for his actual loss.

8.70 It is true that in the *Hill's* case[256], the Privy Council applied the penalty rules to decide whether the security and retention moneys could be regarded as genuine pre-estimate of actual losses which might be suffered by the payee as a result of the breach, and true that relying on this case might show the application of the penalty doctrine to the unreasonable deposit in *Dojap*[257], but it is submitted that the issue cannot be regarded as solved and settled. The following may support the proposition:

First, the general statement of law made by Lord Browne-Wilkinson at the beginning of his judgement[258], showed that the Board was thinking of the same rules to be applied to penalties and forfeiture of moneys already paid, that is, in the Board's view, the sum agreed to be paid or forfeited upon default, if it could not be justified as a genuine pre-

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[254] See Beale H., Unreasonable Deposits (1993) 109 LQR 524, at p. 528 ; Wallace H, Deposit or Penalty? The price of greed (1993) 44 NILQ 207, at p. 209; see also Smith S A, Contract, (1994) Current Legal Problems (vol. 47, part 1, Annual Review, edited by Pettet B), p. 25 who considered that Lord Browne-Wilkinson effectively assessed the reasonableness of the deposit on the same grounds as stipulated sums.; Chitty on Contracts, 27th ed., vol. 1, 1994, para. 26-064; Treitel G.H., The Law of Contract, 9th ed., 1995, p. 907; Murdod S, Deposits, Penalties and Equitable Relief (1993) Estate Gazette, 22 May 1993, Issue 9320, 122

[255] Beale H, *ibid.*; Smith S A, *ibid.*

[256] *Commissioner of Public Works v. Hills* [1906] AC 368

[257] *Workers Trust and Merchant Bank Ltd. v. Dojap Investments Ltd.* [1993] 2 All ER 370

[258] See *supra.*, para. 8.59

estimate of the loss which might flow from breach, would be regarded as unlawful for being a penalty. Now, bearing this in mind, it would hardly be surprising to see that the Board, without any hesitation, tended to apply the penalty rules to the forfeiture of an unreasonable deposit, for, in the Board's view, it was apparently the law which was applicable to forfeitures. Since the general statement made by the Board does not accurately state the law as to relief against forfeiture[259], so the application of the penalty doctrine to the forfeiture of unreasonable deposits may, it seems, not be regarded as an accurate legal position.

Second, although the Board was referred to *Stockloser v. Johnson*[260], the conflicting opinions expressed in that case were not considered in detail. The difference of opinion in that case, as stated by Lord Browne-Wilkinson, was that whether, "if the forfeiture had been a penalty, the court had jurisdiction to order repayment".[261] The majority were in favour of such a jurisdiction, but Romer LJ was against it. The Board did not refer to the point that, in the majority's view, being penal was not the only requirement to relieve against forfeiture, but it had also to be unconscionable for the payee to retain the money. It was Romer LJ's view which was relied upon by the vendors to show that, even if the forfeiture clause was in the nature of penalty, the purchaser would not be relieved by ordering the repayment of the deposit. The Board, however, distinguished the case, on a somewhat puzzling ground, to enable itself, it appears, to decide that an unreasonable deposit, which was penal in nature, could be ordered to be refunded. The reference to *Stockloser v. Johnson*, therefore, does not indicate that the Board regarded the equitable jurisdiction of relief against forfeiture as inapplicable to the forfeiture of unreasonable deposits.

3.3.2. Application of the rules relating equitable relief against forfeiture

8.71 The above analysis may support the view that unreasonable deposits should be subject to the equitable relief against forfeiture. The following reasons may also be forwarded:

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[259] See *supra.*, note 223

[260] *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 QB 476

[261] *Workers Trust and Merchant Bank Ltd. v. Dojap Investments Ltd.* [1993] 2 All ER 370, at p. 376

First, the dicta of Denning LJ in *Stockloser v. Johnson*[262] is in line with this proposition.

Second, a deposit, as it was discussed, has different functions: it is a guarantee for the due completion of the contract, and at the same time a payment on account of the purchase price.[263] Where a deposit is not regarded as a reasonable deposit, it means that, in truth, it is not an earnest to bind the bargain. It, therefore, cannot be considered as a real guarantee, but it is still an advance payment on account of the contract price.[264] Thus, there is no difference between such a deposit and a mere part payment to justify the application of different rules as to them. In other words, the rules relating to the equitable relief against forfeiture which are applicable to part payments, should also be applied to unreasonable deposits.

Third, the application of the technical rules of the penalty doctrine to deposits may, in some cases, result in unjustifiable and absurd consequences: One of these rules is that if a single sum is provided to be paid upon different breaches of varying importance, there is, then, a presumption that the agreed sum is a penalty.[265] When the parties are negotiating the agreed damages clause, they are going through the process of pre-determining the amount of losses which might flow from every breach [or at least, they are supposed to do so], and they can avoid the presumption by being careful in drafting their agreement. However, the situation as to deposits is different: The parties, agreeing about a deposit, are not normally in a position to pre-assess the amount of future probable losses. They agree upon a sum of money to act as a guarantee for the due completion of the agreement. It is, therefore, the nature of a deposit to be forfeited upon every default which leads to non-completion. Thus, almost as to every deposit, there would be a presumption that it is a penalty, for it may be forfeited (even without any express agreement) upon different breaches of varying importance. Therefore, application of the penalty doctrine would mean that, unless the presumption is rebutted[266], the deposit

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[262] *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 QB 476, at p. 638; see *supra.*, paras. 8.38-8.39

[263] *Howe v. Smith* (1884) 27 Ch D 89; see *supra.*, para. 6.39

[264] For example, if the deposit, being unreasonable, is not regarded as a penalty, it will certainly constitute a part of the purchase price.

[265] See *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd.* [1915] AC 79; see also *supra.*, paras. 2.36-2.37

[266] See *supra.*, paras. 2.38 *et seq.*

would constitute a penalty, and in case that it is recognised as unreasonable[267], it will be ordered to be returned, even if, in fact, there is no gross disproportionate between the amount of the unreasonable deposit and the actual losses suffered by the vendor.

8.72 In view of the above reasons, it is submitted that an unreasonable deposit should be subject to the rules relating to equitable relief against forfeiture of part payments.[268] Accordingly, an unreasonable deposit should be refunded if, in addition to being in the nature of penalty, it was unconscionable for the payee to retain it.[269] Thus, where, for example, the unreasonable deposit, despite being in the nature of penalty, is not grossly disproportionate to the loss actually suffered by the payee as a result of the breach, or where the benefits derived from the contract by the payer justifies the retention of the unreasonable deposit by the payee, the payer's claim for relief against forfeiture may be refused, on the ground that it is not unconscionable to allow the payee to keep the unreasonable deposit.

3.4. Analysis of the Law

3.4.1. The Possibility of the Application of the Penalty Doctrine to Deposits

8.73 It has been suggested by many writers and commentators[270] that the little difference between deposits and sums agreed upon as agreed damages[271] does not justify the application of different rules to them. Both may be a genuine attempt of the parties to pre-estimate damages, and, in some cases, they both may act as a penalty. It has,

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[267] For the reasonable deposit, even if penal in nature, would be considered as a permissible penalty. see *Workers Trust and Merchant Bank Ltd. v. Dojap Investments Ltd.* [1993] 2 All ER 370, at p. 374; *supra.*, para. 8.62

[268] A general tendency towards this view can be inferred from Carter J.W., Breach of Contract, 2nd ed., 1991, para. 1259; Beatson J, Discharge for Breach: The Position of Instalments, Deposits, and other Payments Due before Completion (1981) 67 LQR 389, at p. 392; Goff & Jones, The Law of Restitution, 4th ed., 1993, p. 433; Harpum C, Deposits as Penalties (1993) 52 CLJ 389, at p. 390

[269] For the requirement of unconscionability see *supra.*, paras. 8.39 *et seq.*

[270] See, e.g., Furmston M P, Cheshire, Fifoot & Furmston's Law of Contract, 13th ed., 1996, p. 641; McGregor on Damages, 15th ed., 1988, para. 502; Atiyah P S, Adams J N, The Sale of Goods, 9th ed., 1995, p. 503;

[271] See Carter J W, A Comment on Dojap (Reasonable Deposit) (1993) 6 JCL 269, at p. 271; Pawlowski M, Relief Against Forfeiture of Deposits (1992) Estate Gazette, 21 Nov 1992, Issue 9246, 76; Murdod S, Deposits, Penalties and Equitable Relief (1993) Estate Gazette, 22 May 1993, Issue 9320, 122; The distinction between the law's treatment of stipulated sums and its treatment of forfeiture clauses has sometimes been referred to as "anomalous": see Smith S A, Contract, (1994) Current Legal Problems

therefore, been emphasised that the rules against penalties should be applicable to deposits.[272] In other words, any deposit, not being a genuine pre-estimate of damages which is likely to flow from breach, should be held to be a penalty and refundable. There may be many advantages for this view, among them the symmetry in the application of the similar rules to the similar areas of the law, and also perhaps the practical simplicity of the application of the established rules relating to penalties to deposits are the most important ones. The Law Commission also has felt it hard to see why these two concepts should not be treated similarly.[273]

8.74 It is perhaps appropriate to discuss the differences between a deposit and an agreed sum to be paid upon breach to see how efficient the above proposition could be. There are three main differences suggested as justifying the different treatments afforded to relief against penalties and relief against forfeiture of deposits. These differences relate to the time for the payment of a sum of money as a deposit on the one hand and as an agreed damages on the other, the prior ownership of the payee as to a deposit which is subject to forfeiture, and the primary purpose of providing for a deposit and an agreed damages.

3.4.1.1. Difference in Time of Payment

8.75 The payment of a deposit is made in advance before any default occurs, while an agreed sum is agreed to be paid after breach.[274] Put another way, in agreed damages case, it is the innocent party who normally brings an action to recover the agreed sum, but in deposit cases, the innocent party is normally in the position of a defendant who resists the return of the forfeited deposit. It may be thought that such a difference may bear a practical significance: The party who pays a deposit parts with the payment and is

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(vol. 47, part 1, Annual Review, edited by Pettet B), at p. 24

[272] Farrand J T, Contract and Conveyance, 4th ed., 1983, p. 204 (Professor Farrand feels difficulty in seeing how equity has come to tolerate not intervening and relieving against forfeiture of deposit as a "penalty".); Treitel G.H., The Law of Contract, 9th ed., 1995, p. 907; see also Treitel G.H., Remedies for Breach of Contract, 1988, p. 242

[273] Law Commission's Working Paper, no. 61, "Penalty Clauses and Forfeiture of Monies Paid", 1975, para. 57

[274] Farrand J T, Contract and Conveyance, 4th ed., 1983, p. 204; Treitel G.H., The Law of Contract, 9th ed., 1995, p. 907; Furmston M P, Contract Planning: Liquidated Damages, Deposits and the Foreseeability Rule (1991) 4 JCL 1, at pp. 4-5; Law Commission's Working Paper, no. 61, "Penalty Clauses and Forfeiture of Monies Paid", 1975, para. 58

likely to be far more conscious about the consequences of his default which is the forfeiture of his deposit[275], while the party who agrees to pay a sum of money upon default, which might look a remote contingency to him at the time of entering into the contract, is less likely to have seriously intended it.[276] But does this justify the application of different rules to these two concepts? If it does, then where it is established that the defaulting party had seriously intended to pay the penal sum upon his default, and he was completely conscious about the consequences of his breach, there would be no justification for not enforcing the penalty. But the agreed damages clauses have never been treated as such.[277]

3.4.1.2. Forfeiture of deposit as a sum already belonged to the payee

8.76 When a deposit is paid, it belongs to the payee as soon as it is paid, and upon default, the payee only keeps the money which had already belonged to him, while a penalty is exacting the payment of an excessive sum of money or appropriating to himself moneys which belonged to the other party.[278] This difference was specially emphasised by Denning LJ[279] who regarded the forfeiture clause in the *Hill's* case[280] as a penalty in the strict sense, and as being distinct from forfeiture of deposit and moneys already paid. In the *Hill's* case, in his view, unlike the case of deposits, the security and retention moneys belonged to the payer, and the provision for forfeiture of such moneys should be- and, in fact, was- viewed as subject to the rules against penalties.

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[275] Bigham J. in *Pye v. British Automobile Commercial Syndicate Ltd.* [1906] 1 KB 425, said: "There is also this further fact that this agreement does not merely contain a stipulation that in the event of a breach of the contract, the sum of £300 shall be paid as liquidated damages. The plaintiff here has himself already paid this sum to the defendants. He has parted with the money, and that circumstance is significant to show that he did not intend to have it back if he committed a breach of the agreement." at p. 430

[276] Especially where the sum is far in excess of the loss which may be likely to flow from breach. see Atiyah, Essays on Contract, Essay 12: "Freedom of Contract and the New Right", 1990, pp. 368-369, where Professor Atiyah, considering the primary purpose of parties providing for a penalty clause, concludes: "... it seems to me clear that the common law's refusal to enforce penalty clauses shows an intuitive understanding that such clauses are not genuine contractual promises or obligations. They are fakes, masquerading as contractual promises."; see also Atiyah, Introduction to the Law of Contract, 1995, p. 299

[277] See Law Commission's Working Paper, no. 61, "Penalty Clauses and Forfeiture of Monies Paid", 1975, para. 59

[278] See Law Commission's Working Paper, loc. cit., para. 58

[279] *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 QB 476, at pp. 488-489

[280] *Commissioner of Public Works v. Hills* [1906] AC 368

The significance of such a distinction may be open to doubt: A contract may provide for the forfeiture of *either* a sum of money which already belongs to the payee *or* a sum which is in the payee's possession but belongs to the payer. In both cases, it would seem that the same rules should be applicable to the forfeiture clause. This is supported by the reliance made on the *Hill's* case by the Privy Council in *Dojap*[281], to order repayment of the forfeited deposit. Notwithstanding that in *Dojap*, the deposit belonged to the vendor as soon as it was paid but in the *Hill's* case the security money belonged to the payer, the Privy Council applied the same rules to the both situations. Further, as argued by the Law Commission[282], the recoverability of an unpaid deposit by the prospective payee after termination seems to break down the above distinction[283], though it may be argued that such a deposit also already belonged to the prospective payee, as soon as the contract is entered into.

3.4.1.3. The Primary Purpose of Providing for a Deposit and an Agreed Damages

8.77 The purpose of an agreed damages clause is normally to pre-estimate the amount of loss which is likely to flow from breach, while a deposit primarily is a guarantee that the contract will be performed. It would seem that it is this distinction which may justify the application of different rules to these two concepts.[284]

It has been argued that every penalty is also, in a sense, a guarantee for the completion of the agreement.[285] In *Bridge v. Campbell Discount Co. Ltd.*[286], Lord Radcliffe observed:

> "I know, of course, that to travel to another branch of equity's relief jurisdiction, the precise reason why a deposit made on a sale of land is not recoverable if the bargain goes off by the purchaser's default is that it is treated as a guarantee (see *Howe v. Smith*); but nevertheless every penalty,

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[281] *Workers Trust and Merchant Bank Ltd. v. Dojap Investments Ltd.* [1993] 2 All ER 370 (P.C.)

[282] Law Commission's Working Paper, no. 61, "Penalty Clauses and Forfeiture of Monies Paid", 1975, para. 59

[283] See, e.g., *Hinton v. Sparkes* (1868) LR 3 CP 161; *Damon Cia Naviera SA v. Hapag-Lloyd International SA* [1985] 1 All ER 475, [1985] 1 WLR 435; see also Waddams S M., The Law of Damages, 1983, p.540

[284] *Cf.* Harpum C., Relief Against Forfeiture and the Purchaser of Land [1984] CLJ 134, at p. 162

[285] See Farrand J T, Contract and Conveyance, 4th ed., 1983, p. 204; Professor Treitel suggests that the difference "lies in the motive force of the words used". See Treitel G.H., The Law of Contract, 9th ed., 1995, p. 907

[286] *Bridge v. Campbell Discount Co. Ltd.* [1962] 1 All ER 385, [1962] AC 600

> even a penal bond, is in some sense a guarantee for the due performance of the contract, and I do not see any sufficient reason why in the right setting a sum of money may not be treated as a penalty, even though it arises from an obligation that is essentially a guarantee."[287]

It is no doubt true that a penalty in some sense can act as a guarantee, since, regardless of the penalty doctrine, the non-completion of the agreement would result in the recovery of the penal sum by the innocent party. However, what seems to be important and determinative is the *primary* purpose of an agreed damages and a deposit: This can, in fact, objectively show the *intention* of the parties when they make the contract. When the parties agree about the amount of damages which may flow from breach, they do not, objectively, intend it as a guarantee for the completion, and conversely agreeing about the deposit, the parties, objectively, have the guarantee aspect in mind, and do not intend the deposit to be an amount to compensate the payee for damages resulting from breach.[288] This gives a deposit, its special status. In any event, it seems, it should be accepted that a deposit is a special creature[289], different from an agreed damages: Application of the penalty doctrine to deposits would mean the negation of this legal institution, or keeping the name of deposits but without any content. If the parties are required to genuinely pre-estimate damages which is likely to flow from breach when agreeing about deposit, then such a sum cannot be called a deposit: it is, in fact, an agreed damages which, instead of an undertaking to pay it upon default, the promisor pays it in advance. Whatever the history of deposits[290], it has been accepted in this legal system, and it has practically been used by the contracting parties for a very long time, with the intention of acting as a guarantee. It would, therefore, seem inappropriate to treat it just like an agreed damages

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[287] *Ibid.*, at p. 624

[288] That is why if the amount of deposit falls short of the sum needed to compensate the innocent party, he is entitled to bring an action for the recovery of his loss, taking into account, of course, the amount of the forfeited deposit. see, e.g., *Lock v. Bell* [1931] 1 Ch. 35. The Law Commission has observed that "deposits are usually arbitrary sums, seen not as potential compensation but as a complete or partial guarantee against breach and an inducement to perform." see Law Commission's Working Paper, no. 61, "Penalty Clauses and Forfeiture of Monies Paid", 1975, para. 65 ; Professor Farrand says: "The traditional ten per cent. on a sale of land represents pure practice and is never even a perfunctory pre-estimate." see Farrand J T, Contract and Conveyance, 4th ed., 1983, p. 204; see also Carter J W, A Comment on Dojap (Reasonable Deposit) (1993) 6 JCL 269, at p. 271

[289] See Carter J W, A Comment on Dojap (Reasonable Deposit) (1993) 6 JCL 269, at p. 271; Barnsley's Conveyancing Law and practice, 3rd ed., p. 224

[290] See *Howe v. Smith* (1884) 27 Ch D 89, at pp. 101-102 per Fry LJ; see also Wilkinson H, Deposits: who needs them? (1984) 81 The Law Society's Gazette 347; Wilkinson H, Deposits: way back when? (1984) 81 The Law Society's Gazette 1268

while parties have no intention of assessing damages when agreeing upon that. It is, therefore, suggested that, despite many criticisms, the approach taken by many English courts to treat it as distinct from an agreed damages clause, with its special status, is the correct one.

8.78 In the meantime, it should not be forgotten that the whole discussion about the special status of deposits assumes the deposit to be a true and reasonable one[291]: The parties should not be allowed to misuse the special rules relating to deposits, just like they are not allowed to agree upon an excessive amount as agreed damages. The approach taken by the Privy Council in *Dojap*[292], therefore, should be generally welcomed, though in some detailed points, arising out of the decision, it might need some elaboration. It should be hoped that this task will effectively be done in the future.

3.4.2. A Consideration of the Reasonableness Test

3.4.2.1. In Contracts for the Sale of Land

8.79 The final point to conclude this section is the issue of the reasonableness of a deposit. In contracts for the sale of land, as it was pointed out[293], because of the long continued usage, a deposit of 10% has been regarded as reasonable. "A vendor" said Lord Browne Wilkinson in *Dojap*, "who seeks to obtain a larger amount by way of forfeitable deposit must show special circumstances which justify such a deposit."[294] This shows that being in a certain proportion to the contract price would not always be a decisive factor: a deposit may be more than 10% of the contract price, but the vendor will have to show some special circumstances to justify the reasonableness of such a deposit. The Law Commission, proposing in general the application of the penalty doctrine to deposits, thought that deposits in land transactions had a special status and proposed a statutory specified percentage of the purchase price as a valid and forfeitable deposit. They said:

> "We are by no means convinced that at the present time ten per cent. is the

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[291] See, e.g., *Linggi Plantations Ltd. v. Jagatheesan* [1974] 1 MLJ 89; *Workers Trust and Merchant Bank Ltd. v. Dojap Investments Ltd.* [1993] 2 All ER 370; see also *supra.*, paras. 8.57 *et seq.*

[292] *Workers Trust and Merchant Bank Ltd. v. Dojap Investments Ltd.* [1993] 2 All ER 370

[293] *Supra.*, para. 8.65

[294] *Workers Trust and Merchant Bank Ltd. v. Dojap Investments Ltd.* [1993] 2 All ER 370, at p. 374

right figure and we are inclined to think that a lower figure, perhaps five per cent. would be preferable."[295]

However, in the light of the Privy Council's decision in *Dojap*, it does now seem extremely unlikely that a deposit of 10% would be regarded as unreasonable.[296]

3.4.2.2. In Other Transactions

8.80 The problem remains unsolved as to the contracts other than sale of land. On the one hand, in some of these contracts- such as sale and purchase of cars, package holiday contracts[297]- there is a quite settled practice of requiring the payment of a deposit to guarantee the completion of the contract. On the other, it is not clear whether there is an established long continued usage with regard to the amount of the forfeitable deposits in these contracts.[298]

8.81 One possible solution which might be inferred from the general proposition of the Privy Council at the beginning of their discussion in *Dojap*[299], is that deposits in contracts other than sale of land are, from the outset, subject to the rules against penalties. The

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[295] Law Commission's Working Paper, no. 61, "Penalty Clauses and Forfeiture of Monies Paid", 1975, para. 66, citing the suggestion of the California Law Revision in its 1973 Recommendations as to forfeitability of a five per cent deposit on contracts to purchase real property ; see also Oakley A J, Deposits: still a guarantee of performance?, part II [1994] The Conveyancer and Property Lawyer 100, at pp. 100-101, where he suggests that "the forfeiture of 10 per cent. deposit will generally leave the vendor comfortably ahead in financial terms." ; Adams J E, The Usual 10% Deposit-Can it be justifies still? (1983) 80 Law Society's Gazette 2811, where Professor Adams, observing that the 10% deposit produces a bonus to the vendor in great majority of cases, suggests the introduction of the lower figure of seven per cent. (at p. 2812) ; Wallace H, Deposit or Penalty? The price of greed (1993) 44 NILQ 207, at p. 212 ; Such an overcompensation may be seen in *Windsor Securities Ltd. v. Loreldal and Lester* (1975) The Times, 10 Sep. 1975, where a 10% deposit amounting to £235,000 was successfully forfeited while the property could be resold at a profit of £150,000. In Oliver J's view, there was nothing to show that the forfeiture was unreasonable or in the nature of penalty.

[296] See Atiyah, Introduction to the Law of Contract, 1995, p. 437, no. 27 ; Harpum, proposing the availability of equitable relief against forfeiture of deposits, suggests that the usual 10% deposit would be difficult to be regarded as unconscionable to be retained by the payee. (Harpum C., Relief Against Forfeiture and the Purchaser of Land [1984] CLJ 134, at p. 164) ; see also Harpum C, Deposits as Penalties (1993) 52 CLJ 389, at p. 390 ; Pawlowski M, Relief Against Forfeiture of Deposits (1992) Estate Gazette, 21 Nov 1992, Issue 9246, 76, at p. 78 ; Oakley A J, Deposits: still a guarantee of performance?, part II [1994] The Conveyancer and Property Lawyer 100, at p. 107 ; Storey I R, Conveyancing, 4th ed., 1993, p. 265; Farrand J T, Contract and Conveyance, 4th ed., 1983, p. 204

[297] See Milner A, Liquidated Damages: An Empirical Study in the Travel Industry (1979) 42 M.L.R. 508

[298] Professor Atiyah suggests that in the context of sale of goods, providing for the forfeitable deposits of up to 10% is not uncommon. Atiyah P S, Adams J N, The Sale of Goods, 9th ed., 1995, p. 548 ; see also *Reid Motors v. Wood* [1978] 1 N.Z.L.R. 319, where, as to a contract for the sale of goods, it was stated: "In the normal course of business, a deposit as security for completion of the transaction is usually in the vicinity of 10 per cent. of the total price. ... " at p. 327 per Coates J.

Board, stating the general application of the penalty doctrine to the sums agreed to be paid or forfeited upon breach, regarded "the provision for the payment of a deposit by the purchaser on a contract for the *sale of land*"[300] as an exception to the general rule. This may imply that deposits in other transactions are subject to the general rule proposed by the Board.[301] This is also what was proposed by the Law Commission as one of the provisional solutions.[302] The fact that it was a proposition for reform by the Law Commission shows that it has not been the Law, as it may generally be understood.[303]

8.82 In addition to the criticisms made to this general statement of the law[304], the proposed solution itself, may be subject to some objections:

First, the solution proposed ignores the primary purpose of providing for a deposit which is to guarantee the performance and completion of the contract. This, as it was argued[305], may result in negating the institution of deposit and replacing it by an agreed damages which is paid in advance.

Second, it may lead to the conclusion that there is no difference between a deposit and a part payment.[306] True that a deposit is also an unconditional part payment, but it should be observed that every unconditional part payment could not be regarded as a deposit. The main difference, it seems, lies in this point: A deposit is *intended* to be a guarantee for the completion of agreement, but not a part payment. No doubt that, in certain cases,

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[299] *Workers Trust and Merchant Bank Ltd. v. Dojap Investments Ltd.* [1993] 2 All ER 370

[300] *Ibid.*, at p. 373 [emphasis added]

[301] It has also been argued that there is no "long continued usage" for the payment of a certain percentage as a deposit in sale of goods, and, therefore, deposits in such contracts may well be subject to the equitable relief against forfeiture. see Oakley A J, Deposits: still a guarantee of performance?, part II [1994] The Conveyancer and Property Lawyer 100, at p. 107

[302] Law Commission's Working Paper, no. 61, "Penalty Clauses and Forfeiture of Monies Paid", 1975, paras. 65-66

[303] See Beale H., Unreasonable Deposits (1993) 109 LQR 524, at p. 529

[304] See Carter J W, A Comment on Dojap (Reasonable Deposit) (1993) 6 JCL 269, at pp. 270-271; *supra.*, note 223

[305] *Supra.*, para. 8.77

[306] Assimilating deposits to the unconditional part payments, it has been suggested that the equitable relief against forfeiture should be available in respect of deposits, as it is with regard to the forfeiture of unconditional payments. The writer sees the only relevant difference in that the right to retain a deposit, in case of termination for the payer's default, is implied. see Harpum C., Relief Against Forfeiture and the Purchaser of Land [1984] CLJ 134, at p. 162

an unconditional part payment may also, in effect, act as a guarantee- for it creates, by the fear of its forfeiture, a motive in the payer to complete his agreement[307]- but this is not, it would seem, what has primarily been intended by the parties when entering into the contract. This justifies that a deposit should have its special status.

Third, it raises the question that upon what grounds a deposit in sale of land should be treated differently as from deposits in contracts other than sale of land. Put another way, what justifies such a different treatment? The Law Commission has answered this question in the following terms:

> "Land transactions, ..., stand on a somewhat different footing. The position with regard to the status of the deposit is probably better understood and in most cases the vendor and purchaser will be acting with legal advice. It may therefore be that deposits paid in connection with sales of land and houses merit special treatment."[308]

If such an explanation is accepted as the basis for the different treatment, then in any other contract where the parties have well understood the status of deposit and risk of losing it upon default, the deposit should be regarded as forfeitable. Thus, the construction of the contract and discovering the real intention of the parties would determine *whether* the deposit should be forfeited without any equitable intervention to relieve against its forfeiture, *or* it should be subject to the rules against penalties.

Furthermore, it should be observed that a deposit has a settled meaning among people who enter into a contract. As it was observed more than 100 years ago by Lord Macnaghten in *Soper v. Arnold*[309]:

> "Everybody knows what a deposit is. The purchaser did not want legal advice to tell him that. The deposit serves two purposes- if the purchase is carried out, it goes against the purchase money- but its primary purpose is this, it is a guarantee that the purchaser means business."[310]

In this way, it seems that it should be presumed that the parties know the purpose of providing for a deposit, and intend it to act as a guarantee for the completion of the agreement.

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[307] See *Howe v. Smith* (1884) 27 Ch D 89, at p. 101 per Fry LJ

[308] Law Commission's Working Paper, no. 61, "Penalty Clauses and Forfeiture of Monies Paid", 1975, para. 66

[309] 14 App. Cas. 429

[310] *Ibid.*, at p. 435

8.83 The other possibility might be that there is no justifiable ground for distinguishing land transactions from other contracts.[311] The purpose of providing for a deposit in both groups of contracts is the same, and therefore, in principle, the rules as to deposits in both should be the same. The only difference might be that in contracts for the sale of land, the reasonableness of the deposit could rather easily be determined by referring to the long continued usage of providing for a 10 per cent. deposit in these transactions.[312] It is, however, a difficult task to ascertain what constitutes a reasonable deposit in contracts other than sale of land[313], especially since there is, apparently, no decided case on the point. It would perhaps be preferable for the legislator to step in, and provide for a certain percentage of the contractual price to be presumed as the reasonable deposit. This may be something between 5 to 10 per cent. of the contract price. The parties, of course, are in liberty to provide for a higher percentage as the forfeitable deposit, but such a sum should be justified referring to the special circumstances of the case. In the absence of such special circumstances, the amount provided for as a deposit would be subject to the equitable doctrine of relief against forfeiture, as proposed earlier.[314]

8.84 Having concluded that a reasonable deposit has its special characteristic, and is subject to forfeiture without equity having any power to intervene, while an unreasonable deposit should be subject to the equitable jurisdiction of relief against forfeiture, it may be proposed, in general terms, that the courts have power to relieve against forfeiture of deposits, if the forfeiture clause is in the nature of penalty, and it is unconscionable for the payee to retain the deposit. This would be in line with what was suggested by Lord Denning as to relief against forfeiture of advance payments in *Stockloser v. Johnson*[315]. To determine the unconscionability, however, one important factor is the reasonableness

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[311] See Greig & Davis, The Law of Contract, 1987 (With Fourth Cumulative Supplement, 1992), p. 1462; Oakley A J, Deposits: still a guarantee of performance?, part II [1994] The Conveyancer and Property Lawyer 100, p. 107; Guest A.G., Benjamin's Sale of Goods, 4th ed.,1992, para. 15-132

[312] See *Workers Trust and Merchant Bank Ltd. v. Dojap Investments Ltd.* [1993] 2 All ER 370, see also references cited in note 241 above.

[313] It has sometimes been suggested that where there is no "long continued usage" for the payment of a deposit, the whole deposit should be recoverable subject only to a deduction for provable damages suffered. see Oakley A J, Deposits: still a guarantee of performance?, part II [1994] The Conveyancer and Property Lawyer 100, at p. 107

[314] *Supra.*, para. 8.72

[315] *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 QB 476

of the deposit: In this way, if the deposit was reasonable, then it would not be unconscionable for the payee to retain it[316]. But if it was unreasonable, then, considering other factors, it should be ascertained whether the retention of the deposit amounts to unconscionability.

[316] Some judicial statements may support this: In Bigham J's view, for example, being a deposit is a circumstance which must be taken into account to determine whether it should be regarded as in the nature of penalty: see *Pye v. British Automobile Commercial Syndicate Ltd.* [1906] 1 KB 425, at p. 430; see also the observations of Lord Skerrington in the Scottish case of *Roberts & Cooper v. Salvesen & Co.* [1918] S.C. 794, at pp. 814-815

Chapter 9

Statutory Jurisdiction to Relieve Against Forfeiture

1. General Remarks

9.01 In addition to the equitable jurisdiction of relief against forfeiture, there are, in certain instances, some statutory measures which empower the court to relieve a payee against forfeiture of moneys already paid. These measures mainly relate to specific contracts[1] or specific areas of the law[2], and the detailed analysis of them falls beyond the scope of this study. It is, however, appropriate to have a general reference to some of these statutory measures.

9.02 The measures taken with regard to consumer credit transactions to protect the consumer against the probable harsh and disadvantageous contractual terms contain certain provisions which deal with the forfeiture clauses: They empower the court, in certain and proper cases, to grant the consumer relief against forfeiture of both his interest in the subject-matter and/or moneys already paid. The Consumer Credit Act 1974 and the Unfair Terms in Consumer Contracts Regulations 1994[3] contain the most important part of these regulations, and should briefly be looked at. Consideration should also be given to the important discretionary power of courts, conferred by sec. 49(2) of the Law of Property Act 1925, to relieve against forfeiture of deposits in contracts for the sale or exchange of an interest in land. The possible inter-relation of this statutory power with both the penalty doctrine and the equitable rules to relieve against forfeiture of deposits makes it appropriate to consider it in some detail. Thus, after a brief look at the main statutory provisions to relieve against forfeiture in consumer context, the discretionary power of courts under sec. 49(2) will be examined.[4]

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[1] For example, contracts for the sale or exchange of an interest in land, see sec. 49(2) Law of Property Act 1925

[2] For instance, consumer law (see, e.g., Unfair Terms in Consumer Contracts Regulations 1994, SI 1994/3159)

[3] SI 1994/3159 implementing the EC Directive of 5 April 1993 on Unfair Terms in Consumer Contracts: see [1993] OJ L95/29

[4] The forfeiture of leases for breach of covenants or conditions is also mainly governed by statute: sec. 146 of the Law of Property Act 1925 regulates the power of courts to relieve the lessee against forfeiture

2. Statutory Relief Against Forfeiture in Consumer Context

2.1. Consumer Credit Act 1974

9.03 The Consumer Credit Act 1974, as a piece of legislation aiming towards the protection of consumers, contains certain provisions which are similar in effect to measures for the equitable relief against forfeiture. These provisions provide for certain measures either to protect the consumer's possessory interest in property, or to afford a positive relief to him by ordering repayment of moneys already paid by him.

2.1.1. Protection of the consumer's possessory interest

9.04 The possessory interest of a consumer in the property resulting from a regulated agreement[5], within the scope of the Act, is protected in two ways: **First**, requiring the creditor to serve a default notice before being able to repossess for the debtor's default: sections 87-89 of the Act concern the enforcement by the creditor of the remedies provided for the breach under a regulated agreement. The creditor cannot take immediate action to enforce his contractual rights to terminate and retake possession of the subject-matter for the debtor's default unless he serves a default notice giving the debtor at least seven days time during which he may remedy his breach. **Second**, relieving the debtor against forfeiture by making time orders: Under section 129 of the Act, courts have general and wide power to allow the debtor time for both payment or

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of his interest in the subject-matter for breach of any covenant or condition other than non-payment of rent. Relief against forfeiture for non-payment of rent, though it originally has an equitable basis (see, e.g., *Bowser v. Colby* (1841) 1 Hare 109, (1841) 66 ER 969 at pp. 125-126 and p. 976 respectively), is mainly governed by sections 210-212 of the Common Law Procedure Act 1852. Furthermore, sec. 38 of the Supreme Court Act 1981 empowers the High Courts to grant summary relief in any action for a forfeiture for non-payment of rent. Such a relief in county court proceedings has been regulated by sec. 138 of the County Court Act 1984.

[5] A regulated agreement, according to the definition given by sec. 189(1) of the Act, is a "consumer credit agreement" or a "consumer hire agreement", other than an "exempt agreement": Any personal credit agreement [*i.e.* an agreement for providing any amount of credit by any person (the creditor) to an individual (the debtor)] by which the creditor provides a credit of not exceeding £15,000 to the debtor is referred to as a "consumer credit agreement". (sec. 8, CCA 1974) A "consumer hire agreement" is an agreement for the bailment of goods made by a person with an individual (the hirer) which, not being a hire-purchase agreement, is capable of subsisting for more than three months and does not require the hirer to make payments exceeding £15,000. (sec. 15, CCA 1974) [The amount of £15,000 in both definitions has been substituted by £5,000 by The Consumer Credit (Increase of Monetary Limits) order 1983, SI 1983/1878, art 4, Schedule, part II.] Certain agreements, like land mortgage agreements in which the creditors are local authorities or building societies, which otherwise fall within the scope of the definitions above, have been titled as exempt agreements. These agreements have been listed in or under sec. 16 (sec. 189(1), CCA 1974), and are not regulated by the Act except for the provisions relating to extortionate credit bargains (secs. 137-140, CCA Act 1974).

remedying any breach of contract which is not related to the payment of money. Such a time order, in fact, relieves the debtor against forfeiture of his interest in possession of the property for his default.

2.1.2. Positive Relief

9.05 The Act also empowers the court to order, in certain circumstances, repayment of moneys already paid by the hirer or debtor following termination of the contract for the debtor's default. Two main instances merit mentioning: **First**, as to a regulated consumer hire agreement[6] the court may[7], in an application by the hirer after the recovery of possession of goods by the owner otherwise than by action[8] *or* in a proceeding where it makes an order for the delivery to the owner of goods[9], order repayment of the whole or part of any sum paid by the hirer to the owner in respect of goods. Where, thus, it appears *just* for this power to be exercised, the court, "having regard to the extent of the enjoyment of the goods by the hirer", may order the whole or part of the moneys already paid by the hirer to be returned to him. **Second**, a general power to reopen extortionate credit bargains[10] to do justice between the parties has also been afforded to the court by the Act[11]. In reopening the agreement, the court may, *inter alia*, order the creditor to repay the whole or part of any sum paid under the credit bargain by the debtor[12] for the purpose of "relieving the debtor ... from payment of any sum in excess of that fairly due and reasonable". The court, thus, has a statutory power to grant positive relief against forfeiture of moneys already paid with regard to specific credit agreements which may be exercised where "the court thinks just" to do so.

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[6] As to definition of the regulated consumer hire agreement see *supra*., note 5

[7] Under section 132 of the Consumer Credit Act 1974

[8] Sec 132(1)(a), CCA 1974

[9] Sec 132 (2), CCA 1974

[10] "Credit bargain" has exactly the same meaning as the credit agreement [any agreement between an individual (the debtor) and any other person (the creditor) to provide credit of any amount] where, in computing the total charge for credit, no transaction other than the credit agreement is to be taken into account. Where other transactions are also to be taken into account, the credit agreement together with those transactions are referred to as "credit bargain". (sec. 137 CCA 1974). When a credit bargain is extortionate is dealt with by section 138, CCA 1974.

[11] Sec 137, CCA 1974

[12] Sec 139(2)(c), CCA 1974

2.2. Unfair Terms in Consumer Contracts Regulations 1994

9.06 These regulations, which implement the EC Council Directive 93/13 on Unfair Terms in Consumer Contracts[13], were made on 8 December 1994 by the Secretary of State for Trade and Industry under the European Communities Act 1972, sec 2(2), and came into force on 1st July 1995. They generally provide that unfair terms in contracts concluded between a consumer[14] and a seller or supplier[15] are not binding on the consumer.[16]

9.07 Any contractual term which has "not individually been negotiated"[17], and "contrary to the requirement of good faith causes a significant imbalance in the parties' rights and obligations to the detriment of the consumer"[18] has been referred to as an unfair contractual term. The Regulations contain "an indicative and non-exhaustive"[19] list of terms which may be considered as unfair.[20] Being indicative would mean that the terms listed would not necessarily be regarded as unfair if the court was not satisfied that the term in question had all the necessary prerequisites for being considered so. Furthermore, the court may regard a term in a consumer contract as unfair, even though it has not been listed in the Schedule 3 of the Regulations.[21] Yet the list, it is thought[22], could be *considered as a guideline* for the sort of contractual terms which might have the effect of creating an imbalance in the parties' *rights and obligations to the* detriment of the consumer.

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[13] [1993] OJ L 95/29

[14] A "consumer" is a natural person who, in making contracts within the scope of the Regulations, is acting for purposes outside his business. (Reg. 2)

[15] A "seller" or "supplier" means a person who sells goods or supplies goods or services, and, in making a contract within the realm of the Regulation, is acting for purposes relating to his business. (*Ibid.*)

[16] Reg. 5(1), If the contract was capable of continuing in existence without the unfair term, it would still be binding on the parties. (Reg. 5(2))

[17] Reg. 3(1)

[18] Reg. 4(1)

[19] Reg. 4(4)

[20] Schedule 3, Unfair Terms in Consumer Contracts Regulations 1994

[21] See Treitel G.H., The Law of Contract, 9th ed., 1995, p. 251; Atiyah, An Introduction to the Law of Contract, 5th ed., 1995, p. 316

[22] See Treitel G.H., The Law of Contract, 9th ed., 1995, *ibid.*; Professor Treitel refers to these terms as "*prima facie* unfair terms". Treitel, *ibid.*

9.08 Among the terms listed in Schedule 3 of the Regulations is the term which has the object or effect of "permitting the seller or supplier to retain sums paid by the consumer where the latter decides not to conclude or perform the contract, without providing for the consumer to receive compensation of an equivalent amount from the seller or supplier where the latter is the party cancelling the contract".[23] Although there has been some academic debate on the necessity of payment of mutual deposits in contracts for the sale of land[24], and the insertion of mutual forfeiture provisions, nonetheless in practice they have rarely been used. The normal forfeiture provisions allow *only* the creditor to retain moneys already paid in case of the premature termination of the contract for the debtor's default. The illustration given in the Schedule is, it has been submitted[25], based on the civil law institution of inclusion of forfeiture provisions by which a contract may, in certain circumstances, be terminated both by the payer upon the forfeiture of his deposit, and by the payee on the return of the double of the deposit. It would, however, seem that the Regulations may still apply to forfeiture clauses in consumer contracts: The list, as it was emphasized, is only indicative and non-exhaustive, and does not prevent the court from categorizing a forfeiture provision as an unfair term even though it has not been specifically listed in the Schedule. Hence, a forfeiture provision in a standard consumer contract may be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations to the detriment of the consumer.

9.09 A forfeiture provision being regarded as unfair would not be binding on the consumer. It follows that not only the creditor cannot sue the consumer for any unpaid amount which is to be forfeited under the forfeiture clause, but also the consumer can recover back any money which has been forfeited under the unfair term. Put another way, the court would, in consumer transactions for the sale or supply of goods and

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[23] para. (d), Schedule 3

[24] See, e.g., The Conveyancing Standing Committee's Consultation Paper, Deposits on Exchange of Contracts in Residential Conveyancing-Time for a change?, Feb. 1988, para. 22; Wilkinson H, Deposits: who needs them? (1984) 81 The Law Society's Gazette 347, p. 347; Wilkinson H, Deposits: way back when? (1984) 81 The Law Society's Gazette 1268; Wilkinson, Deposits-Time for a Change? (1988) 52 The Conveyancer and Property Lawyer 237, at pp. 238, 241

[25] Treitel G.H., The Law of Contract, 9th ed., 1995, p. 912

services, have statutory jurisdiction to relieve the consumer against forfeiture of moneys already paid by ordering their repayment. This jurisdiction would be exercised where the forfeiture clause is, within the definition of the Regulations, categorized as an unfair term.

3. Statutory jurisdiction to relieve against forfeiture of deposit

3.1. General Considerations

9.10 There is also, with regard to the contracts for the sale or exchange of an interest in land[26], a statutory jurisdiction to relieve the purchaser against forfeiture of his deposit. Due to the importance of this statutory power, its equitable nature and the possible inter-relation between the penalty doctrine and the circumstances upon which this jurisdiction should be exercised, it is appropriate to examine the relevant legislation in some detail.

9.11 Sec 49(2) of the Law of Property Act 1925 provides:

> "Where the court refuses to grant specific performance of a contract, or in any action for the return of a deposit, the court may, if it thinks fit, order the repayment of any deposit."

The subsection clearly empowers the court to order repayment of the purchaser's deposit on its discretion. The scope of this jurisdiction and the circumstances in which this discretionary power should be exercised have invited a considerable academic debate[27], though the subsection has only been invoked in a limited number of cases[28]. This section will devote itself to a brief discussion on the historical background of the enactment of

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[26] See sec. 49(3), Law of Property Act 1925

[27] See, e.g., Treitel G.H., The Law of Contract, 9th ed., 1995, pp. 907-908 ; Farrand J T, Contract and Conveyance, 4th ed., 1983, pp. 205-206; Annand R. & Cain B., Conveyancing Solutions: 3, Remedies under the Contract, 1988, pp. 48-50; Adams J E, The Usual 10% Deposit-Can it be justifies still? (1983) 80 Law Society's Gazette 2811, p. 2812 ; Wilkinson H.W., Returning the Purchaser's Deposit (1980) 130 N.L.J. 668; Thompson M.P., Relief Against Forfeiture (1981) 125 S.J. 405; Harpum C., Relief Against Forfeiture and the Purchaser of Land [1984] CLJ 134, pp. 169-175; Oakley A J, Deposits: still a guarantee of performance?, part II [1994] The Conveyancer and Property Lawyer 100, pp. 101-105; Wallace H, Deposit or Penalty? The price of greed (1993) 44 NILQ 207, pp. 212-215; Pawlowski M, Relief Against Forfeiture of Deposits (1992) Estate Gazette, 21 Nov 1992, Issue 9246, 76, pp. 77-78; As to discussions about the equivalent of sec 49(2) in some Australian states see: Greig & Davis, The Law of Contract, 1987 (With Fourth Cumulative Supplement, 1992), pp. 1462-1463; Lindgren, Time in the Performance of Contracts, 1976, paras. 739-748

[28] See, e.g., *Charles Hunt Ltd. v. Palmer* [1931] 2 Ch. 287 ; *James Macara Ltd. v. Barclay* [1944] 2 All ER 31; *Schindler v. Pigault* (1975) 30 P & C.R. 328; *Cole v. Rose* [1978] 3 All ER 1121; *Universal Corp. v. Five Ways Properties Ltd.* [1979] 1 All ER 552; *Faruqi v. English Real Estates* [1979] 1 WLR 963; *Maktoum v. South Lodge Flats Ltd.* (1980) The Times, 21 April 1980; *Dimsdale Developments (South East) Ltd. v. DeHaan* (1983) 47 P & CR 1

the subsection which reveals the primary object of the legislation. The scope of the jurisdiction and the exercise of this discretionary power will then in turn be dealt with. The latter discussion will make it clear whether, exercising the power under the subsection, the rules relating to penalties or equitable doctrine of relief against forfeiture could/should be applied.

3.2. Historical Background

9.12 The primary purpose behind the enactment of the subsection was, as it was suggested by the draftsman in his commentary[29], to remove the unsatisfactory consequence resulting from cases like *Re Scott and Alvarez's Contract*[30] where the purchaser, though he could successfully resist a decree of specific performance, was at law not entitled to recover his deposit. The typical example was the case where the court, due to a pre-root defect in the vendor's title which was not known to him and consequently the purchaser was not entitled to rely on it[31] as a ground for rescission, would not decree specific performance[32], but, at the same time, the purchaser would be regarded as in breach if he did not complete the contract. The first consequence of the purchaser's breach was the forfeiture of his deposit by the vendor which, considering the circumstances of the case, was not a satisfactory result.[33] Section 49(2) was, in fact, a legislative response to mitigate the injustice of such cases.[34] This has also been made clear by Clauson J. in *James Macara Ltd. v. Barclay*[35] where he, considering the scope of the jurisdiction, said:

> "The primary purpose of the provision was to remove the difficulty which had stood in the way of a purchaser who, though in a position to successfully resist specific performance in equity, was at law precluded

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[29] Wolstenholme & Cherry's Conveyancing Statutes, 13th ed., Vol. I, 1972, p. 125 ; See also Wilkinson (1980) 130 N.L.J. 668

[30] [1895] 1 Ch. 569, [1895] 2 Ch. 603 ; Also see *Re National Provincial Bank of England and Marsh* [1895] 1 Ch. 190 ; *Beyfus v. Lodge* [1925] Ch. 350

[31] See sec 45(1)(b), Law of Property Act 1925

[32] To decree specific performance in such a case, in the words of Lindley L.J. in *Re Scott and Alvarez's Contract* [1895] 1 Ch 569, [1895] 2 Ch 603, would result in "manifest injustice". (at p. 614) ; *cf. Ibid.*, Lopes L.J. at p. 614

[33] See *Re Scott and Alvarez's Contract* [1895] 1 Ch 569, [1895] 2 Ch 603, per Lindley L.J. at p. 614

[34] *Schindler v. Pigault* (1975) 30 P & C.R. 328, at p. 336 per Megarry J.; Also see Harpum C., Relief Against Forfeiture and the Purchaser of Land [1984] CLJ 134, at pp. 169-170

[35] [1944] 2 All ER 31

from recovering his deposit."[36]

9.13 There is no doubt now that the subsection does cover such a situation and, in fact, even a situation where it is shown that the vendor's action for specific performance has failed or would fail, but the purchaser has neither legal nor equitable ground to refuse performance and rescind the contract.[37] In *Faruqi v. English Real Estates*[38] the plaintiff contracted to purchase a registered property "subject to entries on the registers of title". A deposit of 10% was provided for and duly paid. On inspecting the charges register, it was found that the vendor's title was subject to restrictive covenants contained in a deed of 1883. The court held that, though the purchaser had agreed to purchase subject to the entries on the register whatever they might happen to be, the vendors had in equity the duty to disclose any defects in the title which were known to them[39], and failing to do this, they would not be entitled to a decree of specific performance[40]. Thus, despite the legal right of the vendors to retain the deposit prior to the enactment of section 49(2) of the Law of Property Act 1925, the purchaser held to be entitled to recover the deposit under the subsection.[41]

3.3. The Scope of the Jurisdiction

3.3.1. The Broad Interpretation of the Subsection: the existence of a wide discretion

9.14 It is now clear that the statutory jurisdiction of courts to order repayment of the deposit is not confined to a situation for which it was enacted.[42] The wording of sec

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[36] *Ibid.*, at p. 32

[37] See *Charles Hunt Ltd. v. Palmer* [1931] 2 Ch. 287; *Finkielkraut v. Monohen* [1949] 2 All ER 234 ; *Faruqi v. English Real Estates* [1979] 1 WLR 963; *A.A. Jones & Sons Ltd. v. Weeden* (1964) 82 W.N. (Pt. 1)(N.S.W) 326

[38] *Ibid.*

[39] *Ibid.*, at p. 967, per Walton J.

[40] *Ibid.*, at p. 968

[41] The deposit had been paid to a stakeholder. The Court's declaration, therefore, was that the plaintiff was "entitled to give a good receipt and discharge for the deposit to the stakeholder." pp. 968-969

[42] *Universal Corp. v. Five Ways Properties Ltd.* [1979] 1 All ER 552; See also Treitel G.H., The Law of Contract, 9th ed., 1995, pp. 907-908; Furmston M P, Cheshire, Fifoot & Furmston's Law of Contract, 13th ed., (Butterworths, 1996), p. 642; Downes T. A., Textbook on Contract, 3rd ed., 1993, p. 334; Harpum C., Relief Against Forfeiture and the Purchaser of Land [1984] CLJ 134, p. 171; Harris D, Remedies in Contract and Tort, 1988, pp. 28-29; Thompson (1981) 125 S.J. 405, 406; Wilkinson (1980)

49(2) clearly supports a broad interpretation of the subsection: Though its first limb refers to a situation where the court has refused to decree specific performance, the second limb, *i.e.* "in any case for the return of a deposit", is apparent in conferring upon the courts a wide discretionary power to order the return of the purchaser's deposit.[43]

9.15 The first support for the broad construction of the subsection can be found in the observations of Megarry J. in *Schindler v. Pigault*[44]. The learned judge considered that the subsection empowered the court to mitigate the vendor's right at law to forfeit the deposit.[45] The jurisdiction of the court, in his view, was not limited to cases where there was an unconscionable conduct attributable to the vendor. This discretionary power was exercisable "where justice required it"[46]. In the case itself, Megarry J. was prepared to exercise the jurisdiction to relieve the purchaser against forfeiture of his 10% deposit where he had failed to comply with a notice to complete the contract. The purchaser's failure was partly attributable to the vendor who had denied access to the property, making it practically impossible to the purchasers to make a sub-sale through which they could get enough funds to complete the agreement. Though an order for specific performance might have been refused in any event according to the facts of the case, yet the case does illustrate a clear tendency towards a wide and flexible interpretation of the subsection.

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130 N.L.J. 668, 669

[43] It may be thought that, as a rule of interpretation, regard should be had "to the mischief which the enactment is intended to deal with". As it has been pointed out in "Maxwell on The Interpretation of Statutes", "it is a canon of interpretation that all words, if they be general and not precise, are to be restricted to the fitness of the matter, that is, to be construed as particular if the intention is particular". [12th ed., Langon P.St.J., p. 86, 1969, This was contended by the defendants in *Universal Corp. v. Five Ways Properties Ltd., ibid.,* at p.555] It should, however, be noted that, as observed by Buckley L.J. in the *Five Ways* case, "that doctrine ... does not entitle the court to disregard the plain and natural meaning of wide general terms in a statute. If the language is equivocal and requires construction, then the doctrine is a proper one to refer to; but if the language is quite plain then the duty of the court is to give effect to what Parliament has said, and it seems to me that in the present case Parliament has conferred a wide and general discretion". [at p. 555] See also Bennion F., Statutory Interpretation, 2nd ed., 1992, pp. 403-405

[44] (1972) 30 P & C.R. 328

[45] *Ibid.*, at p. 336

[46] *Ibid.*

9.16 Mervyn Davies Q.C., in *Cole v. Rose*[47], relying on the judgment of Megarry J., thought that the jurisdiction of courts under the subsection depended on the existence of "some special circumstances in the particular matter, being circumstances that suggest that it is perhaps unfair or inequitable that the purchaser should lose his deposit".[48] This "surprisingly narrow reading of Megarry J's view"[49] was not followed in *Universal Corp. v. Five Ways Properties Ltd.*[50] where Buckley L.J., preferring the views of Megarry J., held that the courts had an unfettered and unlimited jurisdiction to order the repayment of deposits.

The case was concerned with a contract to purchase land in London by a Liberian corporation who had intended to finance the purchase from funds in Nigeria. Due to a change in Nigerian exchange regulations, the purchaser was unable to remit enough funds to complete the agreement on time. The vendors, having served a notice of completion, terminated the agreement and forfeited the 10 per cent. deposit which had been duly paid by the purchasers. In an action for the recovery of the deposit under sec 49(2) of the Law of Property Act 1925, Walton J. at first instance[51] held that the statutory power under the subsection, "considering the mischief against which it [was] directed", could only be exercised where the court would not have decreed specific performance to the vendor. On the facts, the purchaser would not have been able to resist the decree of specific performance; and therefore, the case fell outside of the ambit of the subsection.[52] Even if he was wrong on the point, he went on to observe that there had to be severe limits on the application of the sub-section: There must, as the first and crucial step, be an act or omission on the vendor's part which, in the circumstances of the case, "is not straightforward or is tricky, or has some other mark of equitable disfavour attached to it".[53]

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[47] [1978] 3 All ER 1121

[48] *Ibid.*, at p. 1130

[49] Farrand J T, Contract and Conveyance, 4th ed., 1983, p. 205

[50] [1979] 1 All ER 552

[51] [1978] 3 All ER 1131

[52] *Ibid.*, at p. 1137

[53] *Ibid.*

9.17 The Court of Appeal reversed Walton J's decision. Buckley L.J. observed that the jurisdiction under the subsection was "unqualified by any language of the subsection".[54] This discretionary power, though it must be exercised judicially and with regard to all relevant circumstances, is not confined to a situation where the vendor's conduct has been somehow open to criticism.[55] It could be exercised where the "justice of the case requires", taking the word "justice" to be used in a wide sense. Thus, the repayment of the purchaser's deposit must be ordered where it is "the fairest course between the parties".[56]

3.3.2. Subsequent Authorities Supporting the Broad View of the Court's Discretion

9.18 The unfettered and unlimited jurisdiction of courts to order repayment of the purchaser's deposit, established in the *Five Ways* case, has been confirmed by the subsequent authorities[57]: In *Maktoum v. South Lodge Flats Ltd.*[58], Mervyn Davies Q.C., sitting as a Deputy High Court Judge, applied the subsection to order repayment of the purchaser's deposit, amounting to 10% of the purchase price, which had been forfeited to

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[54] *Universal Corp. v. Five Ways Properties Ltd.* [1979] 1 All ER 552, at p. 555; Also in Eveleigh L.J.'s view, the limitations contended for on the scope of the jurisdiction was "not plain and obvious". at p. 556

[55] *Universal Corp. v. Five Ways Properties Ltd.* [1979] 1 All ER 552, at p. 555

[56] *Universal Corp. v. Five Ways Properties Ltd.* [1979] 1 All ER 552, *Ibid.*

[57] In Australia, apart from one Victorian case where the narrow view has been favoured (*In re Hoobin, Perpetual Executors and Trustees Association of Australia Ltd. v. Hoobin* [1957] V.R. 341, per O'Bryan J. at pp. 350-351), the statutory jurisdiction has consistently, it appears, been construed in a broad way: see, e.g., *Zsadony v. Pizer* [1955] V.L.R. 496, per Deane J. ; *Jones v. Mallett* (1958) unreported (on appeal, see [1959] V.R. 122) where Adams J. said: "... I consider that the court has a discretion not to be fettered by particular rules, but exercised in favour of the purchaser, where consideration of justice and fairness require it." , This passage was cited with approval in *Yammouni v. Condidorio* [1959] V.R. 479 ; *Nelson v. McDonald*, unreported, 27 Nov. 1972, Sup. Ct. of N.S.W., per Mahoney J., cited with apparent approval in *Lucas & Tait (Investments) Pty. Ltd. v. Victorian Securities Ltd.* [1973] 2 N.S.W.L.R. 268, Street C.J. in Equity ; *Wilson v. Kingsgate Mining Industries Pty. Ltd.* [1973] 2 N.S.W.L.R. 713 ; *Poort v. Development Underwriting (Victoria) Pty. Ltd.* [1976] V.R. 779 (affirmed on appeal: [1977] V.R. 454) where Gillard J., citing his unreported decision in *Brew v. Whitlock*, June 1965, said: "The court now would have jurisdiction conferred on it to order the return of the deposit, whenever the contract under which it was paid was not completed by the parties, but was determined prior to conveyance." (at p. 785) *cf.* section 69 of the Property Law Act 1974-1986 of Queensland which confines the recovery of deposit by a purchaser to a situation where a decree of specific performance "would not be enforced against the purchaser by the court by reason of a defect in or doubt as to the vendor's title, but such defect or doubt does not entitle the purchaser to rescind the contract". See also New Zealand Law Commission, Report No. 29, A New Property Law Act 1994, sec. 55, paras. 284-289, and Preliminary Paper No. 16, The Property Law Act 1952 (A discussion Paper), 1991, paras. 195-205

[58] (1980) The Times, 21 April 1980; for a rather detailed account of the case based on the transcript of the judgment see Harpum C., Relief Against Forfeiture and the Purchaser of Land [1984] CLJ 134, at pp.

the vendor pursuant to the termination of the contract for the purchaser's breach. Though the purchaser's claim for specific performance was refused[59], yet the facts of the case suggest that the court would have decreed specific performance, had the vendor sued for it. Thus, the case illustrates a broad application of sec 49(2) to order repayment of the deposit.

9.19 In *Dimsdale Developments (South East) v. DeHaan*[60], the purchasers having paid a deposit of almost 10 per cent., failed to complete the agreement on the contractual date. They also failed to comply with the vendor's notice requiring completion. Thus, the vendors terminated the contract and forfeited the deposit. They shortly resold the property at a profit of about 15%, having incurred expenses amounting to a total of £6500, which was about half of the forfeited deposit. In the purchaser's action for, *inter alia*, the recovery of his deposit, Mr. Gerald Godfrey Q.C., having cast some doubt on the appropriateness of the application of the discretion under the subsection where the vendor was entitled to specific performance[61], saw himself bound to follow the decision of the court of Appeal in the *Five Ways* case[62]. He, therefore, held that the justice of the case required the exercise of the discretion, but only on terms that the purchaser should submit to the deduction of the vendor's loss resulting from breach.[63]

3.4. Exercise of the Jurisdiction

3.4.1. General Remarks

9.20 Having concluded that the discretionary power conferred upon the courts to order

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[59] It has been suggested that this is precisely the sort of case in which the purchaser should be relieved against forfeiture of her interest in the property by decreeing specific performance. See Harpum, *ibid.*, at p. 174, no. 39

[60] (1983) 47 P. & C.R. 1

[61] *Ibid.*, at p. 11, "section 49(2)", in his view, " was plainly enacted so as to mitigate [the] obvious injustice" resulting from cases where the vendor is for some reason not entitled to specific performance, but the purchaser is not entitled to rescission. Thus, "in a case in which the vendor", he said, "is entitled to specific performance, it is difficult to discern any reason why the justice of the case should require that the defaulting purchaser should recover his deposit."

[62] *Universal Corp. v. Five Ways Properties Ltd.* [1979] 1 All ER 552; see *Dimsdale Developments (South East) Ltd. v. DeHaan* (1983) 47 P & CR 1, at p. 12

[63] *Dimsdale Developments (South East) Ltd. v. DeHaan* (1983) 47 P & CR 1, at p. 12

repayment of deposits under sec. 49(2) Law of Property Act 1925 is a wide and unlimited jurisdiction, the important question is "how this unfettered jurisdiction should be exercised"? Upon what circumstances can a court order repayment of the purchaser's deposit under its statutory power? The decided cases do not give a clear answer to this question. The established point appears to be that the jurisdiction should be exercised where it is "just and equitable to deny to the vendor the enjoyment of a forfeited deposit"[64]. In Megarry J's view[65], the repayment of a deposit under the subsection should be ordered "where justice required it", dependent on "a general consideration of the conduct of the parties (and especially the applicant), the gravity of the matters in question, and the amounts at stake".[66] Buckley L.J. proposed the exercise of the jurisdiction where it would represent the fairest course between the parties[67], subject to this power being exercised "judicially and with regard to all relevant considerations, including the very important consideration of the terms of the contract..."[68].

3.4.2. Being the "Fairest Course between the Parties"

9.21 Being "fair", "equitable" or "just" as tests for the application of the statutory jurisdiction does not resolve the problem: These are some undefined factors and do not set certain and specific boundaries to determine the circumstances upon which the jurisdiction would be exercised. One thing appears to be clear: Where the vendor is refused a decree of specific performance and the purchaser, though he could successfully resist specific performance, is not in a position to rescind the contract and recover his deposit, it is very likely that an order for the return of the deposit would represent the fairest course between parties. But, the jurisdiction is not restricted to this situation: it might be exercised in cases where the court would have ordered specific performance had

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[64] See *Lucas and Tait (Investments) Pty. Ltd. v. Victoria Securities Ltd.* [1973] 2 N.S.W.L.R. 268, per Street C.J. in Eq. at p. 273

[65] *Schindler v. Pigault* (1975) 30 P & C.R. 328

[66] *Schindler v. Pigault* (1975) 30 P & C.R. 328, at p. 336 ; These are, in fact, the factors suggested to be considered where the court considers exercising its jurisdiction to grant relief against forfeiture of the payer's interest in the subject-matter: see *Shiloh Spinners Ltd. v. Harding* [1973] AC 691, at pp. 723-724 per Lord Wilberforce; see also Harpum C., Relief Against Forfeiture and the Purchaser of Land [1984] CLJ 134, p. 172

[67] *Universal Corp. v. Five Ways Properties Ltd.* [1979] 1 All ER 552, at p. 555

[68] *Ibid.*

the vendor sued for it[69], and even in cases where the purchaser has wrongfully repudiated the agreement.[70] What are the factors in such cases which should be considered in order to determine whether or not the court would exercise its statutory jurisdiction in favour of a defaulting purchaser?

3.4.2.1. The relevant circumstances in the Five Ways case

9.22 In the *Five Ways* case[71], though Buckley L.J. did not consider the merits of the purchaser's contention that the deposit should be ordered to be returned on the ground that the vendor was at all relevant times aware that the plaintiff needed to finance the contract from Nigeria, he was, nonetheless, clearly inclined to consider such an argument as defensible. He said:

> "It is not clear to me that, when the circumstances are investigated at the trial, the trial judge might not justifiably reach the conclusion that, having regard to all the relevant circumstances, including those in which the notice of rescission and forfeiture were given, it would not be more just to order repayment of the deposit, leaving the defendant such remedy in damages as may be available to it, than to allow it to retain the very substantial deposit which was paid in this case."[72]

Considering the relevant circumstances of the case shows that, other than the purchaser's above contention, only twelve days after the notice of rescission when the purchaser's money became available, the vendor declined to proceed with the contract. Furthermore, the deposit in itself was a very large amount, while considering the short life of the contract, the amount of damages suffered by the vendor was presumably much lesser than the deposit. In short, the relevant circumstances were, it seems, as follows:

1) Granted that the vendor knew that the contract was intended to be financed from abroad, the breach was a) not intentional, b) trivial ;

2) The purchaser was, at all relevant times, willing to complete the contract, while the vendor refused to proceed with the contract only twelve days after rescission ;

3) The amount of the deposit was presumably much higher than damages which might

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[69] See, e.g., *Universal Corp. v. Five Ways Properties Ltd.* [1979] 1 All ER 552; *Maktoum v. South Lodge Flats Ltd.* (1980) The Times, 21 April 1980; *Dimsdale Developments (South East) Ltd. v. DeHaan* (1983) 47 P & CR 1

[70] See, e.g., cases referred to above, no. 69

[71] *Universal Corp. v. Five Ways Properties Ltd.* [1979] 1 All ER 552, The facts of the case have already been given. See *supra.*, para. 9.16

[72] *Ibid.*, at pp. 555-556

have been suffered by the vendor.

3.4.2.2. Circumstances for the exercise of the jurisdiction in the Maktoum case

9.23 The relevant circumstances for the exercise of the jurisdiction in *Maktoum v. South Lodge Flats Ltd.*[73] has been summarized by Mr Harpum from the transcript of the judgement:

> "(i) All the payments that were required of the plaintiff were made punctually, whereas the defendant was dilatory in performing his obligations. (ii) the defendant had served a notice to complete at almost the earliest possible date despite the delays on its side. (iii) The plaintiff had paid the whole purchase price within the due time and the failure to complete was of most technical kind, likely to be short-lived, and not such that it could possibly have caused any material loss or much inconvenience to the defendant. (iv) The defendant stood to gain by the purchaser's non-performance. It could resell at a possible profit of £259,000, and it had had the benefit of the interest-free use of the instalments paid by the plaintiff in advance. (v) The deposit of £122,100 was a considerable sum of money. Against this were the consideration that the parties had expressly agreed to the forfeiture of the deposit (which is hardly of any weight as it would be implied anyway), and that the specific performance claim had prevented the defendant from reselling, so that it might have missed the best price."[74]

It is clear enough that the conduct of the parties [(i) and (ii) above], the gravity of breach (iii) and the amounts at stake [(iv) and (v)] were the issues which were considered relevant to determine whether the repayment of the deposit could be the fairest course between the parties.[75]

3.4.2.3. Relevant circumstances in the Dimsdale case

9.24 In *Dimsdale Developments (South East) Ltd. v. DeHaan*[76], Mr. Gerald Godfrey Q.C., having considered the financial position of the parties- *i.e.* the extra expenses incurred by the vendor as a result of the breach, the profit on resale and the amount of

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[73] (1980) The Times, 21 April 1980

[74] Harpum C., Relief Against Forfeiture and the Purchaser of Land [1984] CLJ 134, at pp. 174-175

[75] See also *Wilson v. Kingsgate Mining Industries* [1973] 2 N.S.W.L.R. 713, where Wootten J. - considering the willingness of the purchaser to complete and the vendor's unwillingness to proceed with the contract only four days after termination (conduct of the parties), that the breach was due to "the temporary inadvertence" of those who had properly been employed to act for the purchaser (the gravity of the breach), that there was no evidence for damages suffered by the vendor and the fact that if he had suffered any loss, a remedy at law was available to him- found it inequitable to allow the vendor to retain the deposit. at pp. 734-735

[76] (1983) 47 P. & C.R. 1 ; for the facts of the case see *supra.*, para. 9.19

deposit- concluded:

> "In the end ... the defendants, if the deposit is not returned, will be some £23,250 better off. In my judgment this does call for an exercise of my discretion in favour of the plaintiffs."[77]

The facts, as reported, show that the purchaser's breach was due to their financial problem resulting from their inability in sorting out their planning and mortgage matters. The vendor's act in terminating the contract did not seem to be harsh and unreasonable: the purchasers failed to complete the agreement on the contractual date, *i.e.* October 28. The vendor's notice requiring completion was sent on 10 November which was not complied with. There was then a period of further correspondence and delays. On January 25, the vendors informed the purchaser that they regarded the contract as repudiated. The only circumstance which led the court to exercise its jurisdiction under the subsection was, it appears, the financial position of the parties: the fact that the amount of deposit was considerably greater than the amount needed to compensate the vendor for his actual losses resulting from breach.

9.25 In contrast, at least in one English case[78], making profit by the vendor and being better off as the result of termination and forfeiture of deposit has not been regarded as an adequate basis to attract the exercise of the discretion where the purchasers had deliberately refused to perform their contract. In Goff J.'s view, this is "inherent in cases where a deposit is forfeited".[79] Also in *Barrett v. Beckwith (No. 2)*[80], Holland J.[81] did not consider it appropriate to make a comparison between the financial position of the vendor "on the footing that the contract had been completed in due time with his position on the footing that the contract was not completed", in order to discern whether the court's

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[77] *Ibid.*, at p. 12

[78] *Michael Richards Properties Ltd. v. Corporation of Wardens of St. Saviour's Parish, Southwark* [1975] 3 All ER 416. In this case, Goff J. was of the view that, though the jurisdiction was not limited to the special situation for which it was enacted, "outside of that ambit, it should only be exercised, if at all, sparingly and with caution." at p. 424

[79] *Ibid.*, at p. 425

[80] (1974) 1 B.P.R. 9439, [1974] A.C.L.D. 55; A short report of the case has also appeared in The Australian Digest, 2nd. ed., 42, 441-444

[81] Sitting as the judge of New South Wales Supreme Court. It should be noted that sec. 55(2A) of the Conveyancing Act, 1919 in New South Wales is the equivalent of sec. 49(2) of the Law of Property Act 1925 with very similar wording and almost the same effect. Holland J. confirms the view that the discretion under the subsection should be exercised where "it is unjust and inequitable for the vendor to

discretionary power should be exercised. Nor did he regard the increase in the value of the property as relevant. In the learned judge's view, the existence of these factors was not of themselves enough to attract the exercise of the statutory power. Other considerations such as problems as to title, misrepresentation, mistake or inequitable conduct on the vendor's part should also be present.

3.4.3. Concluding Analysis

9.26 Considering the decided cases on the point, it would seem difficult to draw some certain lines and boundaries for the circumstances upon which the statutory jurisdiction should be exercised. It has even been suggested that the "attempted classifications", within the general category of the exercise of the jurisdiction where it is unjust and inequitable to allow the vendor to retain the deposit, "will tend only to obscure rather than to elucidate the approach to the exercise of this statutory jurisdiction".[82] Two important points, however, can be derived from cases: **First**, the vendor should not be deprived from his legal right to forfeit the deposit unless it is certain that allowing him to retain it would be unjust and inequitable. Therefore, the mere consideration that the purchaser would suffer some hardship resulting from the loss of his deposit should not be regarded as an adequate basis for the exercise of the statutory power.[83] **Second**, the jurisdiction should not be exercised in a way to negate or weaken the primary purpose of providing for a deposit as a guarantee for completion and due performance. This has rightly been emphasized by Wootten J. in *Wilson v. Kingsgate Mining Industries*[84] where he said:

> "It is no doubt important that the court should not adopt an attitude in ordering the return of deposits under sec. 55(2A) [the equivalent of s. 49(2) of the Law of Property Act 1925 in New South Wales] which would weaken the proper function of a deposit in providing a sanction for

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insist upon due performance of the contract and in default to forfeit the deposit".

[82] *Lucas & Tait (Investments) Pty. Ltd. v. Victoria Securities Ltd.* [1973] 2 N.S.W.L.R. 268, per Street C.J. in Eq. at p. 273

[83] See, e.g., *Lucas v. Victoria Securities, ibid.*, where the fact that the purchaser was confronted with an unexpectedly rigorous practice on the part of the Sydney City Council which might have precluded him from obtaining planning consent and renovation of the building in the manner described by the purchaser was not considered as justifying the exercise of the statutory power. See also *Long v. Worona Pty. Ltd.* (1973) 1 B.P.R. 9109 (N.S.W. Sup. Ct., Helsham J.) shortly reported in The Australian Digest, 2nd. ed., Vol. 42, 186 ; *Poort v. Development Underwriting (Victoria) Pty. Ltd.* [1976] V.R. 779 (affirmed by the Full Court: [1977] V.R. 454), Gillard J. at p. 786

[84] [1973] 2 N.S.W.L.R. 713, at p. 735

purchasers treating the making and completion of a contract with due seriousness and good faith."

3.4.3.1. Application of the penalty doctrine?

9.27 It has been suggested by several writers[85] that, in determining the circumstances upon which the discretionary power should be exercised, the rules against penalties should be applied. Thus, under the statutory jurisdiction, a deposit would be ordered to be repaid if its retention by the vendor amounted to a penalty. In other words, where there is a gross disproportion between the amount of the deposit and the damages which are likely to be suffered by the vendor as a result of the breach, the courts should, on the application of the purchaser, exercise their statutory discretion. Some cases in which the court has exercised its jurisdiction to order repayment of the purchaser's deposit on the *mere* ground that the actual losses suffered by the vendor is disproportionately less than the deposit may support this proposition.[86]

9.28 The great advantage of this view is moving towards a symmetry in the law applicable to penalties and forfeiture of advance payments. It, however, ignores the primary purpose for which a deposit is provided: Application of the rules against penalties would result in the unfortunate situation that a deposit would not be more than a cover or security for damages to which the vendor might be entitled. It, in the words of Wootten J., would weaken the primary purpose of providing for a deposit which is a guarantee for the due performance and completion of the contract. Thus, the real character of a deposit would be lost, and it would be replaced by the agreement of the parties as to the pre-assessment of damages which may be suffered by the vendor as a result of breach.[87]

3.4.3.2. Application of the rules relating to relief against forfeiture of part payments?

9.29 One other possibility is the application of the rules relating to relief against

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[85] See, e.g., Treitel G.H., Remedies for Breach of Contract, 1988, p.241 ; Goff & Jones, The Law of Restitution, 4th ed., 1993, p. 428; Pawlowski M, Relief Against Forfeiture of Deposits (1992) Estate Gazette, 21 Nov 1992, Issue 9246, 76, at p. 78; Wallace H, Deposit or Penalty? The price of greed (1993) 44 NILQ 207, at pp.213-214 ; Thompson (1981) 125 S.J. 405, 406 ; *cf.* Carter J W, A Comment on Dojap (Reasonable Deposit) (1993) 6 JCL 269, at p. 271

[86] See, e.g., *Dimsdale Developments (South East) Ltd. v. DeHaan* (1984) 47 P. & C.R. 1

[87] See *supra.*, para. 8.77; All criticisms about the possibility of the application of the penalty doctrine to the equitable relief against forfeiture of deposits may also be repeated here. See also Lindgren, Time in the Performance of Contracts, 1976, para. 745

forfeiture of part payments in the line suggested by Denning L.J. in *Stockloser v. Johnson*[88]. Thus, the forfeiture of deposit being considered as a penalty, the court would exercise its statutory jurisdiction to order the repayment if the retention of the deposit by the vendor would be unconscionable.

It can be argued that in most cases where the statutory jurisdiction has been exercised it was unconscionable for the vendor to retain the deposit, for a close consideration of the relevant circumstances of these cases would reveal that to allow the vendor to keep the deposit would unjustly enrich him at the purchaser's expense. However, it is difficult to suggest that the exercise of the statutory power would be limited to cases where the forfeiture of deposit is regarded as a penalty.[89] The statutory power has clearly been exercised in cases where the purchaser, though being in a position to successfully resist a decree of specific performance, was at law precluded from rescinding the contract and recovering his deposit[90], no matter whether or not the forfeiture of deposit amounted to a penalty. It would therefore seem that the application of the rules relating to relief against forfeiture as suggested by Denning L.J.[91] would unnecessarily limit the scope of the jurisdiction.

9.30 Furthermore, the special character of deposits, as pointed out[92], requires a special treatment as different from part payments. Applying the above rules may result in the recoverability of a deposit by the purchaser where it should, due to its special status, be forfeited. There may well be cases where a customary 10 per cent. deposit is penal in nature and it is also unconscionable for the vendor to retain it, but an order for the recovery of deposit in such cases might be contrary to the special character of the deposit. In short, the application of these rules would, it seems, result in both a) unnecessary limitation of the discretionary power under the subsection where it should be

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[88] *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 QB 476

[89] Though, as it was already argued (*supra.*, para. 8.71), there is, in most cases, a presumption in favour of the contention that the forfeiture of deposit constitutes a penalty, yet it does not mean that such a forfeiture is always penal in nature. It is quite obvious that this presumption, in proper cases, could be rebutted. See *supra.*, paras. 2.38 *et seq.*

[90] *Charles Hunt Ltd. v. Palmer* [1931] 2 Ch. 287 ; *Faruqi v. English Real Estates* [1970] 1 W.L.R. 963

[91] *Stockloser v. Johnson* [1954] 1 All ER 630, [1954] 1 QB 476

[92] *Supra.*, para. 8.77

exercised, and b) extending it to some situations where an order for the recovery of deposit would be contrary to its special status.

3.4.3.3. Application of the rules relating to equitable relief against forfeiture of deposits?

9.31 The third possibility is the application of the rules relating to relief against forfeiture of deposits as it was previously discussed.[93] In this way, a reasonable deposit[94] would be immune from any intervention of courts under the statutory power, but an unreasonable deposit would be ordered to be returned if its forfeiture amounted to a penalty and it was unconscionable for the vendor to retain it. This view would result in a symmetry in the law applicable to the equitable relief against forfeiture of deposits and the statutory discretion to order their repayment. It is, however, to be noted that in the majority of cases[95] where the statutory discretion has been exercised, the deposit was a customary 10% deposit which is normally regarded as reasonable.[96] It would, therefore, seem that the statutory jurisdiction has apparently a wider scope than the equitable rules against forfeiture of deposits.

3.4.3.4. Application of the test suggested by Lord Wilberforce in the Shiloh Spinners case

9.32 The other possibility is the application of the tests suggested by Lord Wilberforce in *Shiloh Spinners Ltd. v. Harding*[97] as to relief against forfeiture of an equitable interest in property. According to this view, in exercising its statutory discretion, the court should consider the conduct of the parties, particularly whether the applicant's default was wilful, the gravity of the breaches and the disparity between the amount of deposit and the damages caused by the breach. Though at first sight this might not seem an

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[93] *Supra.*, paras. 8.72, 8.84; Though the Law Commission in its Working Paper did not discuss the statutory jurisdiction as to relief against forfeiture of deposit in land transactions, its general recommendation for reform in this area was, to some extent, similar to this alternative. See Law Commission's Working Paper, no. 61, "Penalty Clauses and Forfeiture of Monies Paid", 1975, paras. 65-67

[94] For the requirement of reasonableness, see *supra.*, paras. 8.79 *et seq.*

[95] See, e.g., *Dimsdale Developments (South East) Ltd. v. DeHaan* (1984) 47 P. & C.R. 1 ; *Faruqi v. English Real Estates* [1979] 1 W.L.R. 963 ; *Universal Corp. v. Five Ways Properties Ltd.* [1979] 1 All ER 552 ; *Charles Hunt Ltd. v. Palmer* [1931] 2 Ch. 287

[96] See *Workers Trust and Merchant Bank Ltd. v. Dojap Investment Ltd.* [1993] 2 WLR 702, [1993] 2 All ER 370, *supra.*, paras. 8.64-8.65; See also Storey I.R., Conveyancing, 4th ed., 1993, p. 265

[97] [1973] AC 691; See *supra.*, para. 7.62

appropriate type of relief to be employed as an analogy[98], most cases regarding the issue strongly support it. Megarry J., introducing the broad interpretation of sec. 49(2), thought the jurisdiction should be exercisable "on wider grounds,... including a general consideration of the conduct of the parties (and especially the applicant), the gravity of the matters in question, and the amounts at stake."[99] Other cases, following the broader view, in effect, employed these considerations to determine whether the discretion should be exercised, though they did not put any clear emphasis on them.[100] Considering these factors, the court, it appears, can determine whether an order for the repayment of the deposit would be the fairest course between the parties, bearing in mind that the primary purpose of providing for a deposit and whether the amount of the deposit can *reasonably* be regarded as a guarantee for the due performance and completion of the contract should also always be taken into account.[101] This will, it seems, give the courts the opportunity to consider the relevant circumstances of the case in a rather broad way, and to decide upon what the justice of the case requires.

3.5. The relationship between the statutory power and the equitable inherent jurisdiction

9.33 There is one small issue which still remains unclear: What is the relationship between the equitable jurisdiction of courts to relieve against forfeiture of deposits and

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[98] That is because Lord Wilberforce employed these tests to determine "appropriate" cases "where the primary object of the bargain was to secure a stated result which could effectively be attained when the matter came before the court, and when the forfeiture provision had been added by way of security for the production of that result." *Shiloh Spinners Ltd. v. Harding, ibid.*, at p. 723. His lordship considered such situations as appropriate cases where the court can exercise its power to relieve the purchaser against forfeiture of his interest in the subject-matter. (See *supra.*, para. 7.19) It is quite clear that this type of relief is based upon the assumption that the contract is capable of being specifically performed. *supra.*, para. 7.27; see also Harpum C., Relief Against Forfeiture and the Purchaser of Land [1984] CLJ 134, p. 172

[99] *Schindler v. Pigault* (1975) 30 P. & C.R. 328, at p. 336

[100] See, e.g., *Universal Corp. v. Five Ways Properties Ltd.* [1979] 1 All ER 552, *supra.*, para. 9.22; *Maktoum v. South Lodge Flats Ltd.* (1980) The Times, 21 April 1980, *supra.*, para. 9.23; *Wilson v. Kingsgate Mining Industries* [1973] 2 N.S.W.L.R. 713, at pp. 734-735, *supra.*, note 75

[101] See *Poort v. Development Underwriting (Victoria) Pty. Ltd.* [1976] V.R. 779 (affirmed on appeal: [1977] V.R. 454) where Gillard J., considering the circumstances upon which the subsection should be exercised, observed: "Not only should the court consider the terms of the contract between the parties, but it seems to me that there are a number of other relevant considerations to be kept in mind, namely, the conduct of the respective parties, whether the vendor can be adequately compensated, particularly having regard to the nature and size of the premises sold and the subsequent history of the premises, and *whether having regard to the same factors, the amount of the deposit can be regarded as a mutually fair and reasonably proportioned security for due performance by the purchaser.*" at p. 786, citing his decision in

their statutory power? Does the statutory power cover all cases in which the court would have exercised its equitable jurisdiction to order the repayment of deposit? And if yes, should the circumstances upon which these two jurisdictions are exercised be/remain different?

3.5.1. The Statutory Power Broader than the Equitable Jurisdiction

9.34 It would seem that the court's statutory power is broad enough to include every case in which the court would have inclined to the exercise of its equitable jurisdiction. Both the broad wording of the subsection and the liberal interpretation of courts[102] support this view. The subsection does, it is suggested, confer on the courts a discretionary power which is much broader than the equitable inherent jurisdiction.[103]

Since the subsection covers the cases where the court, exercising its inherent equitable jurisdiction, would have relieved the purchaser from the forfeiture of his deposit, the circumstances upon which the equitable jurisdiction would have been exercised should, it is submitted, be regarded as the relevant factors to determine whether the court should exercise its statutory power. Thus, an unreasonable deposit[104], being in the nature of penalty, would be ordered to be returned to the purchaser if it was unconscionable for the vendor to retain it.[105] Outside this ambit, though there is no equitable jurisdiction to relieve against forfeiture of deposit[106], the court has still an unlimited statutory power to order, in proper cases, the repayment of the deposit. As it has been emphasized, this power should be exercised where, considering all the relevant circumstances of the case,

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Brew v. Whitlock, June 1965 (unreported), [emphasis added]

[102] See *supra.*, paras. 9.14-9.17

[103] The proposition accords with the principle that an area where the legislator steps in, a change in law should be presumed. This could, for example, be seen as to relief against forfeiture of leases for breach of covenants other than payment of rent where the prevailing view is that, by the enactment of sec 146(2) of the Law of Property Act 1925, any general equitable inherent jurisdiction which might have previously existed has been ousted: see, e.g., *Official Custodian for Charities v. Parway Estates Development Ltd.* [1985] 1 Ch. 151, at p. 155; *Smith v. Metropolitan City Properties Ltd.* [1986] 1 E.G.L.R. 52; *Billson v. Residential Apartments Ltd.* [1991] 3 All ER 265 (reversed on other grounds by the House of Lords: [1992] 1 All ER 141); see also Evans & Smith, The Law of Landlord and Tenant, 4th ed., 1993, p. 211

[104] For the issue of reasonableness of deposit see *supra.*, paras. 8.79 *et seq.*

[105] See *supra.*, paras. 8.72, 8.84

[106] See *supra.*, para. 8.63

the repayment of the deposit is the fairest course between parties.[107] It was already considered that, to determine the fairness in individual cases, among the alternatives discussed above[108], the last view[109] has attracted much support among cases. Thus, considering the conduct of the parties, the gravity of breaches and the amounts at stake, the court would be able to determine whether the statutory power, in cases which would have fallen outside the scope of the equitable jurisdiction, should be exercised.

3.5.2. Apparent Problems

9.35 Two further points in this respect need some clarification: **First**, the equitable jurisdiction of courts is normally exercised by ordering repayment of the deposit less damages suffered by the vendor as a result of the breach[110], while exercising the statutory power, the courts only order the repayment of the deposit and leave the vendor to claim for his damages, if any, in an independent action.[111] Now, considering this apparent distinction, it might be thought how the statutory power could cover situations where the court would have exercised its inherent equitable jurisdiction. There seems to be no reason why the courts should not be able to condition their order under the subsection on some equitable terms. True that the apparent wording of the subsection refers to "repayment of any deposit" and does not speak of any condition, yet, considering the broad discretion conferred upon the courts, it does not seem to be contrary to the spirit of the subsection if the courts make their order subject to the compensation of the vendor for damages caused by the breach.[112]

The difficulty may also be overcome by conditioning the exercise of the statutory power on the submission of the purchaser to compensate the vendor for actual losses suffered.

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[107] *Universal Corp. v. Five Ways Properties Ltd.* [1979] 1 All ER 552, *supra.*, para. 9.20

[108] *Supra.*, paras. 9.27 *et seq.*

[109] *Supra.*, para. 9.32

[110] See, e.g., *Workers Trust and Merchant Bank Ltd. v. Dojap Investment Ltd.* [1993] 2 WLR 702, [1993] 2 All ER 370 (P.C.); see also *supra.*, para. 8.44

[111] See, e.g., *James Macara Ltd. v. Barclay* [1944] 2 All ER 31; *Universal Corp. v. Five Ways Properties Ltd.* [1979] 1 All ER 552, at pp. 555-556 per Buckley L.J.; *Lucas & Tait Pty. Ltd. v. Victoria Securities Ltd.* [1973] 2 N.S.W.L.R. 268, where Street C.J. in Eq., stating the possibility of exercising the court's discretionary power to order repayment of the deposit, says: "In appropriate cases he [the vendor] should be left to prove the damages payable to him by the defaulting purchaser in accordance with the established rules governing the measure of damages..." at p. 273; *Wilson v. Kingsgate Mining Industries* [1973] 2 N.S.W.L.R. 713, at pp. 735-736 per Wootten J. See also Thompson (1981) 125 S.J. 405, 406

[112] See Williams T.C. & Lightwood J.M., Williams on Vendor and Purchaser, 4th ed., Vol. 1, p. 31, no. c

Though this distinction might be true in some commonwealth jurisdictions[120], it cannot now be maintained in England: The recent decision of the Privy Council in *Dojap*[121] showed that the deposit, being considered as unreasonable, should, in proper circumstances, be ordered to be repaid in full less only damages caused by the purchaser's breach. The court cannot order the return of that part of the deposit which exceeds a reasonable amount, because the situation is as if the parties have not provided for a true deposit at all.[122] In England, therefore, the equitable jurisdiction of courts to relieve against forfeiture of deposits is also a "nothing or all" remedy, just like the statutory power.

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ordered the rest to be returned to the purchaser. ; *Delbridge v. Low* [1990] 2 Qd. R. 317, at pp. 330-331 per Derrington J.; *Mehmet v. Benson* (1963) 81 W.N. (Pt. 1) (N.S.W.) 188

[120] In Australia for example: see cases cited above, note 119

[121] *Workers Trust and Merchant Bank Ltd. v. Dojap Investment Ltd.* [1993] 2 WLR 702, [1993] 2 All ER 370

[122] *Ibid.*, at p. 376

The broad discretion of the courts would certainly allow them to refuse the exercise of their power if the purchaser did not submit to a deduction in respect of the vendor's damages.[113] This was effectively achieved in *Dimsdale Developments (South East) Ltd. v. DeHaan*[114] where Gerald Godfrey Q.C., sitting as a Deputy Judge, saw no reason why the purchasers should not pay damages to the vendors for losses caused by the breach. He, then, said:

> "... I will exercise my discretion in favour of the plaintiffs, but only if they are prepared to submit either (1) to a deduction of £6500 from the deposit to cover the defendant's losses, or (2) to an inquiry as to damages in that regard ... with an order for the deduction from the deposit of the sum certified on the inquiry to be due from the plaintiffs to the defendants."[115]

9.36 **Second**, the remedy afforded to the purchaser under the subsection is a "nothing or all" remedy.[116] In other words, the court cannot exercise its statutory power to order the return of that part of the deposit which, for instance, exceeds a reasonable amount. It should either order the repayment of the whole deposit or refuse to exercise its discretion. This has been made clear by Vaisey J. in *James Macara Ltd. v. Barclay*[117] where he said:

> "... it should be noticed that while the court may order the return of the whole of the deposit, it is not, at any rate in terms, authorised to allow the return of less than the whole. ... it must be all or nothing."[118]

Bearing this in mind, it may be thought that the court might be able to order the repayment of a part of the deposit which exceeds the reasonable amount under its inherent equitable jurisdiction[119], while it is not possible under the statutory power.

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[113] See the observations of Gillard J. in *Poort v. Development Underwriting* [1976] V.R. 779 (affirmed by the Full Court: [1977] V.R. 454) where the learned judge, considering the "all or nothing" character of the purchaser's remedy under the subsection, thought that this would not raise any great difficulty: In order to exercise the discretionary power, the purchaser must satisfy the court that the innocent vendor would not be injured by the exercise of the jurisdiction. "The obvious method to achieve this objective" the judge said "would be for the defaulting purchaser to offer to pay any damages which the vendor had suffered by his default ..." at p. 785

[114] (1984) 47 P. & C.R. 1

[115] *Ibid.*, at p. 12

[116] This has sometimes been regarded as the weakness of this remedy: see Adams J E, The Usual 10% Deposit-Can it be justifies still? (1983) 80 Law Society's Gazette 2811, p. 2812 ; But *cf.* Harpum C., Relief Against Forfeiture and the Purchaser of Land [1984] CLJ 134, at p.171

[117] [1944] 2 All ER 31

[118] *Ibid.*, at p. 32

[119] See, e.g., *Freedom v. A.H.R. Constructions Pty. Ltd.* [1987] 1 Qd. R. 59, at pp. 64-66, 70 per McPherson J. who permitted the defendant to retain an amount equal to 10% of the purchase price, but

Conclusion

The following could be referred to as the summary of conclusions and propositions at which this study has arrived:

- The intervention of courts to relieve against penalties and forfeitures historically stems from the relief afforded to contract-breakers in the Chancery Courts. Such a jurisdiction, which was well established in the mid-seventeenth century and was then adopted by the Common Law Courts, was based on the concept of fairness: it was, in the eyes of equity, inequitable to allow a party to exact a disproportionately large penalty while it was possible to compensate him for the actual loss suffered as a result of the breach, and while the clause had been stipulated as a means of security. Despite the historical basis for the intervention of courts, many attempts have been made to justify the doctrine on other legal or economic grounds. Although it is, due to the shortcomings of all justifications, difficult to adopt any single justification for the doctrine, yet it seems that "fairness" should, as the first basis for the intervention, still be in the front line.

- Several practical rules have, in the course of time, been developed to distinguish enforceable liquidated damages from an unenforceable penalty. These rules have well been brought together and stated in the leading case of *Dunlop Pneumatic Tyre Co. Ltd v. New Garage and Motor Co. Ltd.*[1]. An agreed sum being disproportionately large in comparison with the damages which might conceivably result from breach at the time when the parties enter into the contract will not be regarded as a genuine pre-estimate of the loss resulting from breach, and thus may be struck out as being a penalty. The move in English law, following some Australian authorities, to return to the concepts of being "extravagantly" large, or "unconscionable" in amount to justify the intervention of courts, is a welcome move, being both in line with the principle of freedom of contract and limiting the relief to situations where the unfairness and hardship resulting from the literal enforcement of the parties agreement is evident, and also harmonious with attempts made at international and European levels to unify the law in this area. In all these model laws or general conditions, the intervention of courts is reserved to a situation where there is *excessive* disparity between the agreed

[1] [1915] AC 79, per Lord Dunedin

sum and the actual loss resulting from breach.[2] It should however be mentioned that to achieve such a harmony, there is still, it seems, a long way to go: In English Law, and most other common law legal systems, the loss which may conceivably result from breach at the time when the contract is made, is the basis for the comparison between the agreed sum and the actual loss- and the other practical rules for the distinction between liquidated damages and penalties have been developed accordingly[3]- while international documents refer to the actual loss as the basis of the comparison. Furthermore, the agreed sum, being recognized as a penalty, is normally regarded as unenforceable in the English legal system, and it is the promisee who has to prove his actual loss to be able to get compensation for damages resulting from breach; while it appears from international documents that in case the agreed sum is regarded as penal in nature- by being recognized as excessively in excess of the actual loss- the judge may only reduce the agreed sum to a reasonable amount which can compensate the promisee.

- An agreed damage clause may, in certain circumstances, act as limiting the promisor's liability as a result of any likely future breach. In such a case, the following two situations should be distinguished:

  1. Where the agreed damage clause is regarded as liquidated damages, *i.e.* by not being recognized as a penalty, there is no doubt about the validity of the clause. Such a clause, thus, will effectively limit the promisor's liability, though it may, in certain circumstances, be subject to the statutory restrictions regarding limitation clauses.

  2. If the clause is a penalty, then the validity of, and the extent to which, such a clause may limit the promisor's liability are unclear: it has, in this study, been suggested

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[2] See, e.g., Article G of the UNCITRAL's "Uniform Rules on Contract Clauses for an Agreed Sum Due upon Failure of Performance" which allows the reduction of the agreed sum, by a court or tribunal, where "the agreed sum is shown to be *substantially disproportionate* in relation to the loss that has been suffered by the obligee". [emphasis added]; see also Article 4.508 of the first version of "The Principles of European Contract Law" (Article 9:509 in the revised version, 1996) which provides: "... despite any agreement to the contrary the specified sum may be reduced to a reasonable amount where it is *grossly excessive* in relation to the loss resulting from the non-performance and the other circumstances." Para. (2) [emphasis added]; Article 7.4.13 of UNIDROIT's "Principles of International Commercial Contracts", Rome 1994, is in the similar terms. Article 7 of the Council of Europe's "Resolution (78)3 Relating to Penal Clauses in Civil Law" provides as such: "The sum stipulated may be reduced by the court when it is *manifestly excessive*. ..." Appendix to the Resolution, adopted by the Committee of Ministers on 2 March 1978 [emphasis added].

[3] For example, the presumption of being in the nature of penalty where a single sum is provided to be paid upon different breaches of varying importance

that the whole question should depend on the construction of the clause to determine whether the *intention to limit the liability to the agreed amount* could be attributed to the parties.

- A clause providing for the acceleration of instalments, due to be paid in certain periodical intervals, may, in certain circumstances, be subject to the penalty doctrine: where the clause provides for the acceleration of *only* principal- and not interest or finance charge, or any element like that- there seems no reason to subject the clause to the penalty doctrine; while providing for the acceleration of elements other than principal- like interest or finance charge- as well as principal, may invite judicial intervention as being penal in nature.

- The well-established rule in English law is that the penalty doctrine is *only* applicable where there is a breach of contract between the contracting parties. This rule however extends to a situation where the agreed sum has made payable upon termination if, and only if, termination is based upon breach of a contractual obligation by the promisor. The rule, however, especially as to its application to termination clauses, leads to some unsatisfactory anomalies, among which are the possibility of the avoidance of the application of the penalty doctrine by skilful drafting, and the clearly unjust consequences as to certain contracts, like hire-purchase or similar agreements. It has, considering the purpose of the courts' equitable intervention and all other factors, been submitted in this thesis that the courts should extend their power to any situation where there is a legal liability upon termination, irrespective of whether the agreement is terminated for the exercise of an option by the promisor, or for the occurrence of breach or any other event stipulated in the contract by the promisee.

- The application of the penalty doctrine to minimum payment clauses- provided to be paid upon termination, particularly in financing transactions- is one of the major sources of confusion and uncertainty in this area of the law: such a clause is normally held to be a penalty where it provides for the promisee's true loss of bargain if the breach upon which termination is based is a non-repudiatory breach, or even if termination has been provided to be based upon every breach of contract, whether repudiatory or not. The parties, of course, can promote a simple term into the category of conditions- by, for instance, agreeing upon a "time of the essence" provision- and achieve the desired consequences without any problem caused by the

possible application of the penalty doctrine. It has, in this thesis, been argued that the present law is not- for many reasons, particularly giving priority to the form over substance, and not being harmonious with commercial realities of life- satisfactory. It has alternatively been proposed that a minimum payment clause providing for the recoverability of the promisee's true loss of bargain should be upheld, regardless of whether termination has been provided to be based upon a repudiatory or a non-repudiatory breach. This is because a) such a loss should be regarded as the legally recoverable loss in the event of termination for any breach by the promisor, for providing for the promisee's right of termination upon breach of a specific term, in the absence of any evidence to the contrary, *prima facie* indicates the common intention of the parties that the breach of that term would be considered as a repudiatory breach, going to the root of the agreement and entitling the promisee to recover his loss of bargain upon termination for that breach; b) the parties should not be taken as confined to the legally recoverable loss when they agree upon damages in advance, but they can pre-estimate the actual loss resulting from termination even if it is not recoverable in an action for unliquidated damages at common law.

- In financing transactions, drawing up a minimum payment clause in a way to include the true loss of bargain- and not to exceed it greatly, in order to avoid its non-enforceability for being a penalty- is of great importance. Two important factors should, *inter alia*, be taken into account: a) A proper discount should be given for the interest element in future instalments so that the recoverable amount could represent the present value of the future instalments. b) A proper allowance should also be given for the increased value to the creditor resulting from possible repossession and disposing of the subject-matter.

- Upon the premature termination of a contract for the promisor's breach, one of the important issues is the possible remedies available to the contract-breaker, at common law or equity, to recover his advance payments where there may also be a clause in the contract providing for the forfeiture of the promisor's probable interest in the subject-matter, as well as moneys already paid. The most important feature of the discussion lies on the possible inter-relationship of the equitable rules to relieve against forfeiture and the penalty doctrine.

- The recoverability of advance payments at common law depends on the construction of the contract to determine the intention of the parties as to the nature of the payee's right to the part payment. If the payee's right is conditional upon completion of the contract or a specific part of the contract, then the payer, upon premature termination of the contract which results in the condition being failed, will be entitled to recover his advance payment. Where the parties have expressly, e.g. by providing for a forfeiture clause, or implicitly, e.g. by regarding the advance payment as a deposit, shown their intention that the payee's right to advance payments is unconditional, there will be no right at common law for the payer to recover the advance payments where the contract is prematurely terminated for his breach, though relief in equity, in certain circumstances, may be available.

- There is no doubt that, in certain circumstances "where the primary object of the bargain is to secure a stated result which can effectively be attained when the matter comes before the court, and where the forfeiture provision is added by way of security for the production of that result"[4], the courts have equitable jurisdiction to relieve against forfeiture of the promisor's interest in the subject-matter. Such a jurisdiction, though it has mostly been developed through cases concerning land, is not restricted to such cases. It may be available in commercial contracts, though it has been limited to cases where the forfeiture of proprietary or possessory interest in the subject-matter is in stock. Whether such a relief, in English law, may be available after termination for breach of an essential stipulation is not settled yet: the weight of English authority is against the existence of such a jurisdiction, but there is much to be said in favour of the view that the courts, even in such a situation, have the equitable power to relieve against forfeiture, though this power could only be exercised sparingly and in exceptional circumstances. In Australia, there is, now, no doubt about the existence of such a jurisdiction, but its scope and circumstances upon which it should be exercised are, to a large extent, controversial.

- To exercise the jurisdiction to relieve against *contractual* forfeiture of property, certain factors like conduct of the applicant for relief, the gravity of the breach in question, and the disparity between the value of property which is subject to forfeiture and the actual losses caused by the breach should be considered. It has, in this thesis,

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[4] *Shiloh Spinners Ltd. v. Harding* [1973] AC 691, at p. 723 per Lord Wilberforce

been argued that the gross disproportion between the actual loss and the value of interest, which is subject to forfeiture, should be considered as a sufficient ground to attract the judicial intervention of courts. Thus the courts would grant relief against forfeiture of property where the forfeiture clause could be considered as a *penalty*. This, however, has not, it appears, been regarded as the sole ground for the exercise of the courts' equitable power which may also be exercised where the unconscionable conduct of the promisee in exercising his legal rights is evident. Factors like the conduct of the applicant for relief, or the gravity of breaches in question are undoubtedly relevant to determine whether the promisee's emphasis on the exercise of his strict legal rights amounts to unconscionable conduct.

- The jurisdiction to relieve against *legal* forfeiture[5] of property, which may not rightly be regarded as a *penalty* in its strict sense, should only be exercised in exceptional circumstances. The existence of these circumstances depends on the existence of unconscionable conduct on the part of the promisee. Whether the creditor has contributed to the breach, the gravity of the promisor's breach, and whether the creditor's emphasis on the strict exercise of his legal rights is for taking unconscionable advantage from breach, could be regarded as the relevant elements in discerning this unconscionability.

- Although a clause providing for the forfeiture of moneys already paid and an agreed damage clause have much in common, and it is, in principle, difficult to justify the application of different principles as to them, the position in English law as to the equitable relief against forfeiture of moneys already paid seems very much unsettled and controversial. The least controversial proposition is that a defaulting payer may be relieved against forfeiture of his part payments by granting an extension of time to complete the contract. Where, however, the payer is not ready, willing or able to complete, or where decreeing specific performance or granting extra time is, for any reason, impossible, it has, following the majority's view in *Stockloser v. Johnson*[6], been submitted that the courts should have jurisdiction to grant relief by ordering repayment of the instalments. To grant such a positive relief, the existence of two conditions are necessary: a) the forfeiture provision must be of a penal nature, in a

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[5] For the contrast between "legal forfeiture" and "contractual forfeiture" see *supra.*, para. 7.60

[6] [1954] 1 All ER 630, [1954] 1 QB 476

sense that there should be a gross disproportion between the forfeited sum and the likely actual loss which may result from breach at the time when the parties enter into the contract. b) It must be unconscionable for the creditor to retain the forfeited money. To discern this requirement, all circumstances surrounding the contract, at the time when the jurisdiction is invoked, must be examined. The court, thus, would grant such a positive relief only where it was convinced that the forfeiture would, considering the actual loss caused by the breach and all benefits received by the creditor, unjustly enrich the creditor at the promisor's expense, or unconscionably overcompensate him.

- Al though, at first sight, there seems no substantial difference between providing for an agreed damage to be paid upon breach and a deposit to be forfeited upon default, the special character of a deposit, as a guarantee of performance, has led most English courts to treat any possible relief which may be afforded against forfeiture of deposits rather differently from the penalty doctrine. Recent developments, especially in the light of the recent Privy Council case of *Workers Trust and Merchant Ltd. v. Dojap Investment Ltd.*[7], show that a deposit, being considered as reasonable, would be immune from any intervention of courts on equitable grounds. Thus, a reasonable deposit, though it might not be a "genuine pre-estimate of damages" and may be regarded as a penalty in this sense, is not subject to the penalty doctrine or any equitable intervention. It is not clear whether forfeiture of unreasonable deposits is subject to the penalty doctrine or the rules relating equitable relief against forfeiture. It has been argued and submitted, in this study, that the latter is more likely. In general terms, it may be proposed that the courts have jurisdiction to relieve against forfeiture of deposit if the forfeiture is in the nature of penalty, and it is unconscionable for the payee to retain the deposit. To determine the unconscionability, however, one important factor is the reasonableness of the deposit: thus, a reasonable deposit would not be unconscionable to be retained by the payee.

- In certain instances, the courts have also been empowered by statute to relieve against forfeiture. An important illustration is the discretionary power conferred upon the courts under sec. 49(2) of the Law of Property Act 1925 to relieve against forfeiture of deposit in contracts for the sale or exchange of an interest in land. Although the

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[7] [1993] 2 All ER 370

subsection was first enacted for a specific purpose, it is now clear that the statutory jurisdiction of the courts is a wide discretionary power to order the return of the purchaser's deposit, not limited for the purpose for which it was enacted. It is very difficult to determine the circumstances for the exercise of the jurisdiction in general terms, but it has been argued in this thesis that the courts should, following the tests suggested by Lord Wilberforce in the *Shiloh Spinners* case[8], consider the conduct of the parties, the gravity of breach in question and the disparity between the deposit and the damages caused by the breach to determine whether an order for the repayment of the deposit can constitute "the fairest course between the parties". It seems that, at least in English law, the statutory power of courts is broad enough to include cases where the court would have exercised its equitable power to relieve against forfeiture of deposit.

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[8] *Shiloh Spinners Ltd. v. Harding* [1973] AC 691

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