

5 OCTOBER 2016

Penalties

The law following Makdessi v Cavendish Square Holdings BV and Parking Eye Ltd v Beavis [2015]

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The question...



Do we have free rein to impose penalties,
following on from *Makdessi v Cavendish Square
Holdings BV and Parking Eye Ltd v Beavis* [2015]
UKSC 67?

Introduction – 3 further questions



1. Do we now have complete freedom of contract?
2. Can the phrase "genuine pre-estimate of loss" be scoured from our legal memories?

And finally....

3. Are "price adjustment" clauses the magic wand?

Freedom of Contract?



Do we now have complete freedom of contract?

"The penalty rule in England is an ancient, haphazardly constructed edifice which has not weathered well."

"We rather doubt that the courts would have invented the rule today if their predecessors had not done so three centuries ago"

Abolition?



Should the penalties rule be abolished?

"In a negotiated contract between properly advised parties of comparable bargaining power, the strong initial presumption must be that the parties themselves are the best judges of what is legitimate in a provision dealing with the consequences of breach"

Retention...



"...is common to almost all major systems of law...",

"Neither of these Reports recommended abolition of the rule. On the contrary, both recommended legislation which would have expanded its scope."

Extension?



Extend the rule?

“ought not to be extended, at least by judicial, as opposed to legislative, decision-making”

Penalties rule remains...

... but more freedom.

Genuine pre-estimate of loss



Can the phrase "genuine pre-estimate of loss" be scoured from our legal memories?

Genuine Pre-estimate of loss

"... a payment of money stipulated as *in terrorem* of the offending party; the essence of liquidated damages is a genuine covenanted pre-estimate of damage."

The future...



Free your mind...

"the law relating to penalties has become the prisoner of artificial categorisation, itself the result of unsatisfactory distinctions: between a penalty and genuine pre-estimate of loss, and between a genuine pre-estimate of loss and a deterrent."

The New, True, Test?

True test



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

"...the correct test for a penalty is whether the sum or remedy stipulated as a consequence of a breach of contract is **exorbitant or unconscionable** when regard is had to the **innocent party's interest in the performance** of the contract."

Legitimate interest



Legitimate interest

"The innocent party can have no proper interest in simply punishing the defaulter"

"His interest is in performance or in some appropriate alternative to performance... **But compensation is not necessarily the only legitimate interest"**

Proportionate?



Proportionality

Principle vs practice

Drafting

Deterrence



"A deterrent provision in a contract is simply one species of provision designed to influence the conduct of the party potentially affected. It is no different in this respect from a contractual inducement. Neither is it inherently penal or contrary to the policy of the law. The question of whether it is enforceable should depend on whether the means by which the contracting party's conduct is to be influenced are "unconscionable" or ..."extravagant"."

Extravagant and Unconscionable?



“In judging what is extravagant, exorbitant or unconscionable, I consider ... that the extent to which the parties were negotiating at arm’s length on the basis of legal advice and had every opportunity to appreciate what they were agreeing must at least be a relevant factor.”

Pre-estimate of loss



Final word on “genuine pre-estimate of loss”...

...still has its uses.

Price adjustment



Are "price adjustment" clauses the magic wand?

Penalties rule only applies to secondary obligations

Difference between primary and secondary obligations



Clever drafting?

"in some cases the application of the penalty rule may **depend on how the relevant obligation is framed** in the instrument, i.e. whether as a conditional primary obligation or a secondary obligation"

"the capricious consequences of this state of affairs are mitigated by the fact that...the classification of terms for the purpose of the penalty rule **depends on the substance of the term and not on its form** or on the label which the parties have chosen to attach to it"

Importance of drafting



"We would accept that the application of the penalty rule **can still turn on questions of drafting**, even where a realistic approach is taken to the substance of the transaction and not just its form".

Disguised penalties



Disguised penalties

"...where it is clear that the parties have **so** circumvented the rule and that the substance of the contractual arrangement is the imposition of punishment for breach of contract, the concept of a disguised penalty **may** enable a court to intervene"



...just a “price adjustment” clause?

“The clause is in reality a price adjustment clause. Although the occasion for its operation is a breach of contract, it is in no sense a secondary provision.”

Conclusion



- **We don't have free rein to impose penalties...BUT**
- **...we do have more latitude before we breach the rule...AND**
- **...with clever drafting we might avoid engaging the rule.**

Contact



Any Questions?

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