STIPULATIONS FOR THE PAYMENT OF AGREED SUMS

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1. Introduction

The way in which the courts apply the rules for ascertaining whether or not a stipulation for the payment of an agreed sum in a contract is a penalty assumes first that the law has an inherent objection to one party being over-compensated at the expense of the other; secondly, it assumes that over-compensation will occur if one party is paid a greater sum than he could theoretically recover by an action for damages in court. It is submitted that neither of these assumptions is correct.

The penalty rules have, it is suggested, been misapplied, at least since the decision in *Dunlop Pneumatic Tyre Co. Ltd.* v. *New Garage & Motor Co. Ltd.*,[1] so that their application today is at least as likely to give rise to an injustice as not, or to lead to a result which will have disadvantageous economic consequences for the parties concerned. The recent High Court decision in *O'Dea* v. *Allstates Leasing System (W.A.) Pty. Ltd.*[2] illustrates both these results, and will be discussed in some detail.

Finally it will be suggested that the penalty rules, having become associated with an enormous labyrinth of fine distinctions and obscure jurisprudence, should be no longer regarded as good law. Parties who contract at a disadvantage are adequately protected today by statute or rules of equity and law,[3] and there is no sensible basis for distinguishing between a promise to pay for goods or services at an over-value and promises to pay damages which have the appearance of over-valuing the loss to the other party.

2. The Historical Perspective

(a) Terminology

In order to assess the significance of the historical development of the penalty rules, it is first necessary to identify those types of transactions where a question as to the application of those rules may arise.

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[1] [1915] A.C. 79.

[2] (1983) 57 A.L.J.R. 172; flld. *United Dominions Corporation Ltd.* v. *Austin* [1983] 1 N.S.W.L.R. 636; *Citicorp Australia Ltd.* v. *Hendry* (1984) A.C.L. 35. 179.

[3] In equity the doctrines of undue influence, equitable pressure, unconscionable or unconscientious contracts, misrepresentation, mistake, and fraud. See e.g. J. D. Heydon, "Harsh Contracts" *Papers Presented at the 22nd Australian Legal Convention Brisbane 1983* Law Council of Australia 1984; J. G. Ross-Martyn, "Unconscionable Bargains" (1971) 121 *N.L.J.* 1159; S. M. Waddams, "Unconscionability in Contracts" (1976) 39 *M.L.R.* 369; A. H. Angelo and E. P. Ellinger, "Unconscionable Contracts – A Comparative Study" (1979) 4 *Otago L.R.* 300; M. Cope, "The Review of Unconscionable Bargains in Equity" (1983) 57 *A.L.J.* 279.

The first type of transaction is the penal bond with conditional defeasance. One party who wished to secure the performance of some obligation by the other caused a bond to be executed between them, whereby the performing party bound himself absolutely to pay a sum of money on a date certain. The parties would however agree that the bond would not take effect if some condition (the agreed performance) be fulfilled before that date. Where the performing party had agreed to perform by paying a sum of money, but had bound himself in default under the bond to pay a larger sum, the bond was known as a "money bond".[4]

Secondly the parties may enter into a contract, rather than a specialty (bond) under seal, whereby one party must pay a greater sum if he defaults in payment of a lesser amount. That is to say one party will promise to pay a certain sum by a certain date, but should he not do so, will pay a larger sum by way of damages. I shall refer to this as a "money contract".

Thirdly, the default under the contract which gives rise to payment of an agreed sum may be a default in performing an obligation which does not involve the payment of money. The party promises to deliver goods, or to perform services, but should he not do so, to pay an agreed sum. For the sake of brevity, such an obligation shall be called "a performance obligation" to distinguish it from "a money obligation"; a money obligation being a promise to pay money.

One other distinction must be adverted to. Money obligations can be of two kinds. They may be primary obligations or they may be secondary obligations.[5] Primary obligations are best defined by reference to secondary obligations on the premise that all obligations are of one kind or the other, and secondary obligations are easier to define. A secondary obligation is the liability to pay damages which arises or is implied automatically by law on any breach of contract.[6]

(b) Early Historical Interpretation

Originally a penalty was associated with the penal bond with conditional defeasance and also with the obligation to pay a greater sum on failure to pay a lesser amount. In both instances the obligee brought his action in *debt* not in *assumpsit.*[7] In this form of action the reason *why* the debt arose was generally irrelevant, since the debt action is brought on a liquidated amount.

By the close of the sixteenth century Chancery was beginning to relieve systematically against penalties where they arose in relation to money bonds and money contracts.[8] For many years there had been a jurisdiction to relieve in cases of "fraud, accident, mistake or surprise", but relief had been confined to two instances. First one of the parties may have satisfied

[4] See generally A. W. B. Simpson, "The Penal Bond with Conditional Defeasance" (1966) 82 *L.Q.R.* 392; A. W. B. Simpson, *A History of the Common Law of Contract* (1975) at 88 *et seq.*

[5] The most sophisticated analysis of the distinction between primary and secondary obligations is made by Lord Diplock in *Photo Production Ltd.* v. *Securicor Transport Ltd.* [1980] A.C. 827 at 848.

[6] *Id.* 848-849.

[7] In the case of a penal bond the proper action was debt *sur obligation*; in the case of a money contract debt *sur contract*. Simpson, *supra* n. 4; J. H. Baker, *An Introduction to English Legal History* (2nd ed. 1979) at 268-270; S. F. C. Milsom, *Historical Foundations of the Common Law* (1969) at 215-217 and at 223 *et seq.*; D. Browne (ed.) *Ashburner's Principles of Equity* (2nd ed. 1933) at 265-266.

[8] E. G. Henderson, "Relief From Bonds in the English Chancery: Mid-Sixteenth Century" (1974) 18 *American Journal of Legal History* 298.

the debt, but because he had left the bond in the creditor's hands was subjected to a second suit;[9] or secondly, the debtor prayed for more time, as although he had been willing and able to pay, some unforeseen accident had prevented him doing so by the appointed day.[10]

By the late sixteenth century this jurisdiction had blossomed and Chancery were relieving against money bonds and money contracts in a systematic way.[11] The reasons for this are not altogether clear. Simpson[12] suggests that the penal bond had theoretically always had a compensatory function, but it was only in the mid-sixteenth century that Chancery was prepared to go behind the form and, as he says, to put the theory into practice.

It may also not have been unimportant that the money-lending transaction was often attendant with imposition and other unconscionable behaviour, especially in an era where the transaction would more likely have a personal than a mercantile character.[13] If this is so it is merely the genesis of a jurisdiction to scrutinise money-lending contracts which extends down to the present day.[14]

The attitude taken by Chancery to penal bonds and penal contracts must also have been influenced by parallel developments in relation to other heads of equitable intervention. In particular, equity was developing a jurisdiction to relieve against foreclosure of mortgages,[15] and also against forfeiture of proprietary interests, the usual example being a lessee who has made a default under the lease.[16]

Despite these different strands to the equity jurisdiction, a number of common threads emerged. First, Chancery remained more or less constant to the principle that it would only relieve against failure to pay money where an indulgence of time could be granted and compensation paid but would not relieve against other failures to perform.[17] Thus with foreclosure of mortgages, by insisting that the mortgagee stipulate for no collateral advantage, equity was able to give relief, because the failure of the mortgagor consisted solely in the payment of money.[18]

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[9] Barbour, *The History of Contract in Early English Equity* 85-88; cited in W. S. Holdsworth, *History of English Law* (1922-66) vol. v at 292.

[10] *Seldon Society* vol. 79 at 14; Holdsworth, *supra*, n. 9 at 330.

[11] Henderson, *supra* n. 8; *Seldon Society* vol. 79 at 15 and cases cited therein.

[12] *Supra* n. 4 at 412 and at 419-421.

[13] The growth of Joint Stock companies dates from the later part of the seventeenth century. Similarly incorporation by Royal Charter, though of earlier lineage, during that period became much more common.

[14] Arguably the necessity for raising money places the borrower in a special position of disadvantage not attendant to a normal mercantile transaction, and thus makes judicial scrutiny more likely. In the instance of expectant heirs this was merely one example of a wider principle under which equity scrutinised bargains: *Ashburner op. cit. supra* n. 7 at 296-298; *cf. Earl of Aylesford* v. *Morris* (1873) L.R. 8 Ch. App. 484. Apart from this special category, "financial need" has been recognised as a particular disability which may result in unconscientious advantage being taken by the stronger party: see e.g. Kitto, J. in *Blomley* v. *Ryan* (1954) 99 C.L.R. 362 at 415. The activities of moneylenders have also of course been imperfectly subject to statutory regulation.

[15] *Seldon Society* vol. 79 at 30 *eq seq.*

[16] *Ashburner op. cit. supra* n. 7 at 262-4; *Seldon Society* vol. 79 at 27-30.

[17] *Tall* v. *Ryland* (1670) 1 Chan. Cas. 183; 22 E.R. 753; *Woodward* v. *Gyles* (1690) 2 Vernon 119; 23 E.R. 686; *Blake* v. *East India Co.* (1674) 2 Chan. Cas. 198; 22 E.R. 909; *Rolfe* v. *Paterson* (1772) 2 Brown 436; 1 E.R. 1048; *Lowe* v. *Peers* (1768) 4 Burr. 2229; 98 E.R. 160.

[18] This is more obviously expressed on the basis that equity would relieve because "once a mortgage, always a mortgage"; *Rolls* v. *Colwell* Reg. Lib. 1678/9 Bf. 163; *Seldon Society* vol. 79 case 916; *Eyres* (1680) 2 Chan. Cas. 33; 22 E.R. 833. *Cf. Kreglinger* v. *New Patagonia Meat and Cold Storage Co. Ltd.* [1914] A.C. 25.

After some hesitancy it was also settled that relief against forfeiture of leasehold estates would only be granted for non-payment of rent.[19] The basis for equitable intervention in leases is rather more speculative; it may have been influenced by the fact that many such forfeitures were expressed in the form of a penal bond, or by the particular nature of the transaction and the consequences for the tenant.[20]

The reason why relief was given against the consequences of a failure to pay a sum of money was said to be that the forfeiture which occurred on default was in reality the execution of a security, designed to ensure performance took place.[21] If performance could be made, albeit untimely, and if due compensation was paid, then by granting an indulgence for payment the courts were said to be giving the creditor "all that he expected or desired".[22] Thus with a legal mortgage, the principal intent of the transaction was said to be a loan of money, and the conveyance of the legal estate was regarded purely as a security for repayment.[23]

These principles while explaining intervention in money bonds and contracts did not however touch the sum which was payable on default of a performance obligation. If one takes first a money contract, because the promise to pay a small sum primarily, but to pay a larger sum on default, juxtaposed two obligations which could be precisely valued in relation to each, the natural inference was that the larger sum was merely security for the smaller. But when one compares a performance obligation, to perform services, but with a sum payable in default, the means of relatively valuing the two promises is much less obvious and so too is the inference that the money was merely stipulated for as a security.

The way this distinction translated into sixteenth century jurisprudence was understandably as a procedural distinction. Money bonds were actionable in *debt*, money contracts or performance contracts in either *debt* or *assumpsit*.[24]

The distinction between an action in *debt*, where any breach of covenant giving rise to the debt was not traversible, and an action in *assumpsit* for damages for breach of covenant was not merely semantic. A very real distinction between the two developed in that an action in *debt* was an action to enforce a penalty; an action in *assumpsit* was a claim for liquidated damages. The penalty/liquidated damages dichotomy reflected a procedural rather than a substantive distinction. Certain presumptions developed, so that regardless of nomenclature a sum would be a penalty if it was payable on a failure to pay a sum of money, but

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[19] *Hill* v. *Barclay* (1811) 18 Ves. Jun. 56; 34 E.R. 238; *Reynolds* v. *Pitt* (1812) 19 Ves. 134; 34 E.R. 468.

[20] It has been suggested, *e.g. Holdsworth, op. cit. supra* n. 9 at 330, that the true basis of relief was that no one should abuse a legal advantage; but "abuse" is a protean term, and no doubt it is fair to suggest that in reality contractual terms, probably negotiated at arm's length, were being disregarded in the exercise of some ill defined jurisdiction to protect the tenant.

[21] *Sloman* v. *Walter* (1784) 1 Bro. C.C. 418; 28 E.R. 1213, *per* Lord Thurlow.

[22] *Peachy* v. *Duke of Somerset* (1724) 1 Stra. 477 at 453; 93 E.R. 626 at 630, *per* Lord Macclesfield.

[23] E.g. *Emanuel College* v. *Evans* (1625) 1 Ch. Rep. 18; 21 E.R. 494; *Anon* v. *Anon, Seldon Society* vol. 29, 85.

[24] *Winter* v. *Trimmer* (1762) 1 Black 395; 96 E.R. 225; *Harrison* v. *Wright* (1811) 13 East. 343; 104 E.R. 402.

liquidated damages if the promised performance was of a different kind.[25]

The nature of this distinction was altered somewhat by the statute of 8 & 9 Will. 3, Ch.11, s.VIII. This section provided in essence that a verdict upon a penal sum would be suspended to serve as security against future breaches of covenant, but the plaintiff could obtain damages, assessed by the jury, for the actual *breaches* complained of. It was limited to action upon "any Bond or Bonds, or any Penal Sum, for Non-performance of any Covenant or Agreements in any Indenture, Deed or Writing contained . . ." and was permissive in language.

As far as money bonds and money contracts were concerned, equity had always relieved, and the statute really allowed no amelioration to that position; and indeed, by 4 & 5 Anne, c.3, s.XIII all penal bonds subject to a conditional defeasance were statutorily avoided on payment of principal, interest and costs.

But obligees under performance contracts were able to avoid the statute with relative ease. At this time the innocent party who had stipulated for performance or a sum of money in lieu had three choices of procedure available on default: (i) to sue as for a penalty in *debt*, without using the Statute of William; (ii) to invoke the statute; (iii) to sue for breach of contract in *assumpsit*.

At first the obligee merely chose the former course, but the rule had been settled by the late eighteenth century that the provisions of the statute were compulsory in an action in *debt* for the penalty.[26] This had the consequence for the plaintiff that he had to plead his action in *assumpsit* in order to avoid the statute. At this point a conflict arose between Chancery and the law courts as to the proper characterisation of stipulations to pay an agreed sum otherwise than on default of the payment of money. Before the Act there had been a rule of interpretation that such clauses were as and for liquidated damages and not penalties.[27] Chancery now sought to imply a new presumption 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.[28]

This was of course the rule which had been applied (*inter alia*) to mortgages and money contracts, but the suggestion in *Sloman* v. *Walters* that it would apply to performance contracts was a novel extension of the doctrine.

It has been suggested in recent years that the rule in *Sloman* v. *Walters*[29] should apply to all stipulations for the payment of a sum of money, in default of performance under a contract, but the decision itself

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[25] *Blake* v. *East India Co., supra* n. 17; *Woodward* v. *Gyles, supra* n. 17. *Cf. Barton* v. *Glover* (1815) Holt 43; 171 E.R. 154.

[26] 1 Wms. Saund. 51 at 64; 85 E.R. 59 at 64 (in notes to *Gainsford* v. *Griffith*).

[27] *Supra* n. 25.

[28] *Sloman* v. *Walters, supra* n. 21. *Cf. Wallis* v. *Smith* (1882) 21 Ch.D. 243 at 260, *per* Jessel, M.R.

[29] *Ibid.* The wide application of the principle has been suggested e.g. by The Law Commission (United Kingdom), Working Paper No. 61 "Penalty Clauses and Forfeiture of Monies Paid" at 19; *per* Baggallay, L.J. in *The Protector Loan Co.* v. *Grice* (1880) 5 Q.B.D. 592, cited by Wilson and Brennan, JJ. in *O'Dea* v. *Allstates Leasing System (W.A.) Pty. Ltd. supra* n. 2 at 182 and 185 respectively.

would not support such a wide interpretation. In *Sloman* the obligee who had been promised the use of certain premises, had unwisely allowed the sum to be described as a penalty, and the case stands for the more limited proposition that the penalty rules could be invoked where the action was either brought in *debt*, or, being brought in *assumpsit*, the stipulation was *described* by the parties as a penalty subject to the qualification next mentioned. The issue which Lord Thurlow in *Sloman* was attempting to address was the extent to which a penalty (actually so called) could be enforced, if the damages could not easily be quantified. The rule became settled that in such a case the penalty would be enforced.[30] Lord Eldon, commenting on the *Sloman* case in his judgment in *Astley* v. *Weldon*[31] was clearly of the opinion that had the contract in *Sloman* described the sum payable as liquidated damages rather than as a penalty, the obligee would have been able to enforce the stipulation.

The common law meanwhile was encouraging parties to avoid this scrutiny by simply covenanting "not to do something, but should it be done to pay $x".[32] In addition the parties would avoid describing the sum as a penalty, and by stipulating the sum "as and for liquidated damages" the enforceability of the provision was put beyond doubt. While this proved effective, it was not intended to suggest that there was any significant difference between an obligation to pay money on breach, that is to say a secondary obligation, and an obligation to pay money otherwise than on breach.[33] That distinction is one that has only become significant in this century. The form of words adopted was merely a formula which had been approved by the courts as being outside the penalty rules, and which therefore it was wise to adopt.

(c) Nineteenth century developments

The modern law on penalties takes form from the time the courts chose to disregard the intentions of the parties as expressed on the face of the contract. If *Astley* v. *Weldon*[34] was the spark, then *Kemble* v. *Farren*[35] was the flame. Both were hard cases. Both involved a member of the acting profession who was paid a small salary; who was required to observe a number of covenants; and who was liable to pay a very large sum on any default. In the former case the parties had not stipulated for liquidated damages, although it was true that they had not actually used the word "penalty". In order to grant relief, the court invoked a presumption that where a sum was payable on a number of contingencies, one of which involved the non-payment of a lesser sum, the parties would

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[30] *Fletcher* v. *Dyche* (1787) 2 T.R. 32; 100 E.R. 18; *Duckworth* v. *Alison* (1836) 1 Mees. & W. 412; 150 E.R. 494.

[31] (1801) 2 Bos & Pul 347 at 352; 126 E.R. 1318 at 1322.

[32] *Blake* v. *The East India Co., supra* n. 17; *Rolfe* v. *Paterson, supra* n. 17; *Lowe* v. *Peers, supra* n. 17; *Ponsonby* v. *Adams* (1770) 2 Bro. P.C. 431; 1 E.R. 1044. *Cf.* Lord Eldon, Ch.J., *Ibid.* 351-352, 1321-1322 respectively.

[33] At least where the non-performance consisted of a promise to do other than pay a sum of money, and the parties had avoided the use of "penalty". The form adopted, either a prohibition with a permissive element, e.g. "not to do, unless $X is paid", or a prohibition with a sanction, e.g. "not to do, and to pay $X if he does" may have required different facts to be pleaded: *Legh* v. *Lillie* (1860) 6 H. & N. 165; 158 E.R. 69; but the distinction does not appear otherwise relevant.

[34] *Supra* n. 31.

[35] (1829) 6 Bing. 141; 130 E.R. 1234; *Cf. Reilly* v. *Jones* (1823) 1 Bing. 302; 130 E.R. 122.

have intended a penalty.[36] As the default in *Astley* was non-appearance for theatrical performances the presumption is on the facts an unlikely one, especially as the contingency which could have given rise to the obligation on the actress to pay a sum of money was the imposing of a small fine under the rules of the theatre.

In *Kemble* v. *Farren* the parties ensured that they described the sum payable as liquidated damages. In order to grant relief the court had to apply the presumption, not as a matter of intent, but on the contrary as a rule of law regardless of intention. Again as in *Astley*, the breach relied on in *Kemble* was not a non-payment of money but rather refusal to perform.

The effect of this decision was two-fold. First it spawned a host of exceptions which the courts appeared happy to concede. If the obligor was required to perform only one obligation[37] the liquidated sum assigned to the breach thereof was unobjectionable, even where it appeared excessive;[38] *a fortiori* where liquidated sums were assigned to individual covenants.[39] And covenants to pay liquidated damages on a *per diem* basis or other basis proportionate to the extent of the loss were similarly excused.[40]

More importantly the distinction between a penalty as a claim in *debt*, and liquidated damages as agreed compensation for breach of covenant broke down, because the distinction was so artificial that it could not exist without the nomenclature necessary to maintain it. It was as if the courts had ruled that where money is paid towards the price of goods, they would no longer regard the language of the parties in determining whether it was a deposit or a part payment. What criteria then were to be employed?

After *Kemble* nearly all the reported cases until *Dunlop Pneumatic Tyre Co. Ltd.* v. *New Garage and Motor Co. Ltd.* rather surprisingly involve "penalty" stipulations, described as such by the parties,[41] or stipulations where the parties have used neither the expression "penalty", nor "liquidated damages".[42] In the majority of cases the clause was enforced, and one can discern the courts (in defiance of *Kemble*) clinging to the traditional distinction between the concepts that parties should be free to value the performance they will receive (where traditionally they would have stipulated for liquidated damages) and that where no attempt at valuation has been made and the sum stipulated for is only a penalty or security, then the courts should intervene. Being however unable to rely on the use of nomenclature to determine intention, that is the express

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[36] *Supra* n. 31 at 352-354; 1322-1323 respectively.

[37] *Strickland* v. *Williams* [1899] 1 Q.B. 382. *Cf. Betts* v. *Burch* (1859) 4 H. & N. 511; 157 E.R. 938; distinguished *Wallis* v. *Smith* (1882) 21 Ch.D. 244 at 275-277; *McGregor on Damages* (14th ed. 1980) paras 350-351; 355-356.

[38] *Galsworthy* v. *Strutt* (1848) 1 Ex. 659 at 665.

[39] *Imperial Tobacco Co.* v. *Parslay* [1936] 2 All E.R. 515.

[40] *Lord Elphinstone* v. *The Monkland Iron & Coal Company Ltd.* (1886) 11 App. Cas. 332; *Law* v. *Local Board of Redditch* [1892] 1 Q.B. 127; *Clydebank Engineering and Shipbuilding Co. Ltd.* v. *Don Jose Ramos Yzquierdo Y Castaneda* [1905] A.C. 6; *Diestal* v. *Stevenson* [1906] 2 K.B. 345.

[41] *Lord Elphinstone* v. *The Monkland Iron & Coal Company Ltd., Ibid.; Clydebank Engineering and Shipbuilding Co. Ltd.* v. *Don Jose Ramos Yzquierdo Y Castaneda, Ibid.; Diestal* v. *Stevenson, Ibid; Strickland* v. *Williams, supra* n. 39; *cf. Wilson* v. *Love* [1896] 1 Q.B. 626, distinguished in *Diestal* v. *Stevenson* at 351 on the basis that since the term "penalty" was inserted by lawyers they must be taken to mean what they say.

[42] *Cf. Webster* v. *Bosanquet* [1912] A.C. 394; *In re Newman, Ex. p. Copper* (1876) 4 Ch.D. 724.

use of the terms "penalty" or "liquidated damages", the courts had to introduce new rules to ascertain intention.

Thus, if the sum payable on default was "unconscionable and extravagant", a penalty was presumed to have been intended.[43] Such novel tests were however without historical basis, but were instituted in order to roughly maintain the distinction which the courts had long recognised, between obligations to pay money on default of a promise to pay a lesser sum, and obligations to pay money on default of a promise to otherwise perform.

It must be acknowledged however that during this period preceding the *Dunlop* decision the authorities were by no means all one way, and there is an underlying tension in particular concerning the question whether a sum payable on several contingencies should or should not ever be enforced.

3. The *Dunlop* Case

In *Dunlop*, the courts were required to determine the fate of this distinction and to state the principles upon which relief would be granted. If one examines the leading judgment in that case, and in particular the principles formulated by Lord Dunedin, it is difficult to isolate any single rationale upon which they are based. Those principles are as follows:

> *1. Though the parties to a contract who use the words "penalty" or "liquidated damages" may prima facie be supposed to mean what they say, yet the expression used is not conclusive. The court must find out whether the payment stipulated is in truth a penalty or liquidated damages . . . .*

Comment: Kemble v. *Farren* is affirmed. The use of nomenclature is not decisive, because the parties may not recognise whether a stipulation is truly a penalty or not. In other words, a penalty is defined by rules of law not rules of intention.[44]

> *2. The essence of a penalty is a payment of money stipulated as in terrorem of the offending party: the essence of liquidated damages is a genuine pre-estimate of damage.*

Comment: The notion that a sum may be *in terrorem* was not one of any importance in the development of the penalty rules, although there was a small clutch of authorities dealing with legacies containing a restraint against marriage where the term appears.[45]

There are a number of deficiencies in the definition of a penalty as being a stipulation *"in terrorem"* of the other party. First it has been pointed

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[43] *Clydebank Engineering and Shipbuilding Co. Ltd.* v. *Don Jose Ramos Yzquierdo Y Castanedo, supra* n. 41 at 10 and at 17; *Webster* v. *Brosanquet. Id.* at 398.
In *Law* v. *Local Board of Redditch, supra* n. 40 at 180 Lord Esher, M.R. states that it must be "so large" as to make it "so absurd" that it could be paid by way of liquidated damages.

[44] This conclusion was becoming obvious in the line of decisions referred to in n. 41. Once the parties could not indicate their intention, and more significantly the outcome of the judicial inquiry, by the language they chose, the most one could say regarding their intention was that they intended certain factual consequences to follow from their contract, and because those consequences approximate to a legal principle, it will be labelled accordingly.

[45] E.g. *Fry* v. *Porter* (1669) 1 Chan. Cas. 138; 22 E.R. 731; *Jarvis* v. *Duke* (1681) 1 Vernon 19; 23 E.R. 274; *Hicks* v. *Pendarvis* (1678) 2 Freem. 41; 22 E.R. 1046.

out that a sum will normally be *in terrorem* only if its existence is known to the other party.[46] Secondly, the notion of an *in terrorem* stipulation may import some requirement that there be a motive or intention to intimidate.[47] Thirdly, the notion is a relative one, and the difficulty is determined in relation to what alternative consequence the stipulation can be said to be *in terrorem*.

Any liability will tend to intimidate, but the degree of intimidation will depend upon external factors. Take for instance the relationship between the intended imposition and the means to pay, or the cost of avoiding the imposition, or the extent of liability which would be exposed but for the imposition. It is not clear to which relationship the court is referring when a clause is said to be *in terrorem*. It cannot be the relationship between the penalty clause and the exposure to damages as assessed by the court as this would involve an obvious sophism. It is *in terrorem* because it exceeds court quantified damages; clauses which exceed court quantified damages are therefore *in terrorem*. But it is difficult to see how it could be indexed to the cost of performance, since the *Dunlop* rules at least appear to exclude that as an irrelevant consideration.[48]

Nor is there any magic in the term "penalty". Divorced from its historical context, it is an amorphous expression which depends upon definition for any normative content. In the context of stipulations for the payment of agreed sums it may be said to have been defined comprehensively by the rules and presumptions articulated in the *Dunlop Case*. But being merely descriptive, it matters not how "penalty" is defined, rather than the reason for so defining it. As previously explained that definition has changed significantly over the years.

Looking at the definition of liquidated damages, whether a sum is a genuine pre-estimate of damages depends greatly upon the type and extent of damage that it is intended to compensate for, and more importantly on whether the courts will allow the parties to compensate for types of loss which are not protected by the courts in an award of damages.

Until *Kemble's Case*, relief against obligations to pay money on default of performance obligations was exceptional because the parties could so easily avoid the penalty rules. Where the courts did find as for a *penalty* actually so called, it would only be upheld if either the sum paid did not exceed the loss, or the loss was not easily ascertainable.[49] Quite apart from the procedural differences, there were two schools of thought as to why the question of over-compensation was not traversible. The first, and strictest, denied that the question of compensation arose, other than in the narrow sense that an exorbitant inequality of exchange could raise a presumption of unconscientious behaviour against a protected class.[50] There were two strands to this school. The first is put by Jessel, M.R.,

[46] *Per* Lord Radcliffe, *Bridge* v. *Campbell Discount Co. Ltd.* [1962] A.C. 600 at 622; *Cf.* Lord Robertson, *Clydebank Engineering and Shipbuilding Co. Ltd.* v. *Don Jose Ramos Yzquierdo Y Castanedo*, *supra* n. 40 at 19-20.

[47] See *e.g. Osborne's Concise Law Dictionary* (6th ed. 1976), " . . . intended to frighten or intimidate"; *Mozley and Whiteley's Law Dictionary* (9th ed. 1977) " . . . for the purpose of intimidation".

[48] As it should be in ascertaining the loss to the innocent party. However, in a pragmatic way it is not a matter to which the innocent party is completely indifferent, since the greater the disparity to the guilty party between the cost of performance, and the damages payable, the greater the likelihood that he will choose to perform.

[49] *Supra* n. 30.

[50] *Infra* nn. 134 and 135.

> . . . I have always thought and still think, that it is of the utmost importance as regards contracts between adults—persons not under disability, and at arms length—that the courts of law should maintain the performance of the contracts according to the intention of the parties; that they 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.[51]

The second strand encapsulated the notion that the stipulation was part of the consideration agreed for, and no question of compensation arose.[52]

The other school concedes that the purpose of damages is compensatory, but will not enquire as to the value the parties place upon the covenant to perform, again unless it amounts to evidence of impropriety.[53] There was at the time *Dunlop* was decided, no established rule, except in relation to money bonds and money contracts, that the parties could not stipulate for a sum in excess of what the courts would award as damages, because the weight of authority was the other way. It may indeed have been that in requiring a "genuine pre-estimate" Lord Dunedin was doing no more than subscribing to the second school discussed above; and the reference to "extravagant and unconscionable" really described the circumstance where the inequality amounts to existence of an unconscientious dealing.[54]

As a totality, it is quite impossible to be certain whether the *Dunlop* rules reflect the narrow compensation approach associated with money bonds, or that of the second school above, whereby parties are free within very broad limits to value the benefit they expect to receive. As it has happened the narrow approach adopted since *Dunlop*[55] has given a certain respectability to the former.

What the post-*Dunlop* cases have suggested, is that where damage can be reasonably quantified under the remoteness rules, any *significant* disparity between that legal measure of loss and the stipulated sum will result in the stipulation being struck down.

In so doing the courts have not only developed rules for recovery which are deficient in that they artificially curtail the *types* of loss which may be recovered, but they have also insisted that the parties cannot contract to overcome those deficiencies. Thus, if a breach of contract is going to cause loss of a type not recoverable at common law, for example inconvenience, mental distress, dislike of legal proceedings, (costs which it can be said the individual would be prepared to pay a sum of money to avoid, thereby showing he does value them), then even if the stipulated

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[51] *Wallis* v. *Smith, supra* n. 28 at 266.

[52] E.g. *Rolfe* v. *Peterson, supra* n. 17; *Astley* v. *Weldon, supra* n. 31 at 351 *per* Lord Eldon, Ch.J.

[53] E.g. *Lowe* v. *Peers, supra* n. 17.

[54] The authority cited by Lord Dunedin in support of his probanda that it should not be "extravagant and unconscionable" is *Clydebank Engineering and Shipbuilding Co. Ltd.* v. *Don Jose Ramos Yzquierdo Y Castaneda, supra* n. 40 at 10-11. In *Clydebank* Lord Halsbury appears to express in narrow terms, the type of clause which he considers would offend the rule.

[55] Especially the unwillingness to concede that the parties may contemplate losses, or value performance, beyond the level and types of damages which they may recover in court. See e.g. *Robophone Facilities Ltd.* v. *Blank* [1966] 1 W.L.R. 1428 at 1448. *Cf.* The Law Commission (United Kingdom) Working Paper No. 61 at 33. It is difficult to see what damages the Spanish Government could have proved for under the damages rules had they been required to. See also e.g. *W. T. Malouf Pty. Ltd.* v. *Brinds Ltd.* (1980) 52 F.L.R. 442; *Harvey* v. *Rogers* (1983) 32 S.A.S.R. 247.

sum reflects that value, there is a likelihood that the stipulation will be struck down.[56]

It has been suggested elsewhere that what the courts are really doing is insisting that they and not the parties be the sole dispensers of "terror".[57] That suggestion underlines two competing perspectives in this debate. If one considers the effect of a clause from the guilty party's viewpoint, then it will be in *in terrorem* whenever the sum payable is greater than the cost to the guilty party to perform. Be that as it may, the rule that the parties cannot stipulate for types of loss which are not recoverable in court is concerned with another perspective; that of the effect on the innocent party. The issue is whether allowing recovery of the sum will over-compensate the innocent party. By not recognising certain types of loss, the court it is said protects against the risk of over-compensation. For reasons which are developed below, it is submitted that this risk is seriously over-stated.[58]

Apart from this supposed possibility of over-compensation, the rule requiring reference to court assessed damages does not appear to rest on any other grounds. Two possibilities do suggest themselves, but neither are I believe more than superficially attractive.

(i) The payment of damages involves a reference to normative rules, deviation from which the courts are able to monitor and quantify. Reference may perhaps also be made to the fact that juries always enjoyed competence in fixing damages, and the modern damages rules are merely a rationalisation of that well recognised function.[59]

The major difficulty with this explanation is that an established judicial competence in assessing damages is not inconsistent with an ability in the contracting parties to exclude that competence. The penal bond was enforced *at law* and the question of over-compensation was not traversible.[60] Further the contemporary power of the court to quantify damages is not free from party regulation. A clause limiting damages to a figure *below* that recoverable at law is efficacious.[61] Nor is it true that the courts are unable to quantify performance obligations. The *quantum meruit* and *quantum valebant* counts are examples of when they will do so. And in relation to such obligations, the rule against inquiring into the adequacy of consideration ensures that the court will not quantify the value of such promises where the parties have already done so.

Significantly the House of Lords as long ago as 1674 rejected the suggestion that the quantification of damages was a prerogative jury concern.[62]

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[56] Mental anguish may in some circumstances be a recoverable head of loss; *infra* n. 75.

[57] Simpson *supra* n. 4 at 420.

[58] *Infra*, p. 517.

[59] The genesis of modern contract law was the action on the case, and early *assumpsit* being tortious in flavour, damages were a question for the jury, as they remained even when *assumpsit* became a truly contractual action. The modern law of damages formulated in terms of remoteness, mitigation (etc.), can be traced only from the nineteenth century.

[60] In the absence of the bond the jury would have had to fix the damages. See also *supra* n. 12.

[61] At least where it is in the nature of a stipulation for liquidated damages (or possibly a limitation clause) and not a penalty: *Cellulose Acetate Silk Co. Ltd.* v. *Widnes Foundry (1925) Ltd.* [1933] A.C. 20; *cf. Wall* v. *Rederiaktiebolaget Luggude* [1915] 3 K.B. 66. *Vide* Gordon, (1974) 90 *L.Q.R.* 296; Hudson, "Penalties Limiting Damages" (1974) 90 *L.Q.R.* 31. Where the stipulation is a penalty in contemporary theory it should be ignored and damages should be at large; where it is not a penalty it is difficult to understand how it can be evaded.

[62] *Blake* v. *East India Co., supra* n. 17.

(ii) *The "exchange" conundrum*. It can be argued that where parties exchange promises to perform there is a true exchange of values, which each party is free to quantify idiosyncratically. But the promise to pay a sum as damages may be said to be outside the exchange process, in that it is not part of the bargain but rather is designed to regulate rights where the bargain breaks down. But this overlooks the fact that the promise to pay damages *is* part of the exchange process. Parties value that promise, either because it is an incentive to performance,[63] or a limitation on possible liability. One other consequence of not allowing the parties to stipulate for loss of the kind a court will not quantify is that it institutes, or at least encourages, a distinction between sums which become payable on breach of contract, and sums that are otherwise payable. The problems which such a distinction generate will be discussed below.[64]

> 3. *The question whether a sum stipulated is a 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 breach.*

Comment: The requirement that the clause be judged at the time of the contract is quite understandable in the historical perspective, given that at least until *Kemble* v. *Farren* the parties could determine the enforceability of a stipulation according to the language they adopted. The difficulties which this principle does present arise from the fact that the intention of the parties is no longer determinative, and whether or not a sum is a penalty depends upon rules of law, albeit couched as rules of interpretation. One consequence is that a sum may not represent a penalty at the time of contract, whereas it will at the time of breach, and the opposite is of course also true.[65]

> 4. *To assist this task of construction various tests have been suggested, which if applicable to the case under consideration may prove helpful, or even conclusive. Such are:*
> *(a) It will be held 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.*

Comment: The terminology "extravagant and unconscionable" is ambiguous. For reasons already discussed, it may have been used merely to allow the courts to intervene when there was such an imbalance of benefits and burdens under the contract, that the inference fairly arose that one party had taken unconscientious advantage of a superior position over the other party. At the time when this test was suggested the trend of the authorities was to allow the parties to enforce penalty clauses, notwithstanding that they had often labelled them as a "penalty".[66] This

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[63] Obviously the greater the enforceable sanction for non-performance, the greater the incentive to perform.

[64] *Infra*, p. 519.

[65] *Cf.* The Law Commission (United Kingdom) Working Paper No. 61 at 22, which suggests that judging the validity of the clause by reference to circumstances as they exist after the breach would mean the introduction of an unacceptable degree of uncertainty.

[66] See e.g. authorities collected *supra*, n. 41.

interpretation is often overlooked, because the Courts' perception of what constitutes "exorbitant" or "unconscionable" stipulations has been narrowly interpreted.[67]

(b) 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 that which ought to have been paid.

Comment: This rule dates from the mid-sixteenth century. Although there may have been valid policy reasons then for instigating a prophylatic rule, it is at least possible that the controls which exist today in relation to money-lending transactions could allow some amelioration to the rule. For example, failure to pay a sum of money may well have consequences which an award solely of interest would not protect.[68]

(c) There is a presumption (but no more) that it is a penalty when "a single lump sum is made payable by way of compensation on the occurrence of one or more or all of several events, some of which may occasion serious and others but trifling damage" . . .

Comment: In both *Kemble* v. *Farren* and *Astley* v. *Weldon* the stipulation was struck down because one of the contingencies upon which the penalty sum became payable was the non-payment of a lesser sum, thus bringing the facts within rule (b) above. Rule (c) represents an extension of that reasoning to contingencies which may not include a failure to pay a lesser sum. The latter rule therefore rests on two premises; first that where damages are quantifiable in court, the court assessed loss will in the instance of some of the events on which the damages are payable, be less than the stipulated sum; and secondly that such a deviation *above* the sum assessed by the court will be struck down. Here the fiction that the court is merely construing the intention of the parties is starkly revealed. If there was a greater likelihood of a breach resulting in loss exceeding the stipulated sum than of a breach which results in a lesser degree of damage, it is difficult to avoid the inference that the parties intended liquidated damages. Even accepting that the rule is designed to guard against the risk of over-compensation, the fact that at the time of the contract the possibilities of over or under-compensation are equal cannot suggest that one party intends to penalise the other for non-performance. There may indeed be sound economic reasons why the parties may prefer a "blunderbuss" clause.[69] If they enter into a number of such transactions they can spread the risks of over or under-compensation across a number of contracts, thus minimising the risk of either, and also avoiding the costs involved in negotiating liquidated sums in relation to every conceivable breach in every contract. Even when the contract is a "one-off" example, it may make economic sense to bear the risk of over or under-compensation

[67] *Supra* n. 55.

[68] *Cf.* criticism of Jessel, M.R. in *Wallis* v. *Smith, supra* n. 28 at 257 of the rule that damages cannot be awarded for non-payment of money.

[69] There is a line of authorities where contracts containing a number of stipulations of varied importance, none of those stipulations being for the payment of an ascertained sum of money, were not considered to be caught by the *Astley* doctrine; *Wallis* v. *Smith, supra* n. 28; *Galsworthy* v. *Strutt* (1848) 1 Exch. 659; *Atkyns* v. *Kinnier* (1850) 4 Exch. 776, *Lord Elphinstone* v. *The Monkland Iron and Coal Co. Ltd., supra* n. 40; *Reynolds* v. *Bridges* (1856) 6 El. & Bl. 528; 119 E.R. 961.

occurring, rather than bearing those costs of drafting around the penalty rules.

> *(d) It is no obstacle to the sum stipulated being a genuine pre-estimate of damage, 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.*

Comment: It is clear that rule (c) must be read subject to rule (d). Rule (d) has at least since *Sloman* v. *Walters* been accepted, so that, notwithstanding the fact that the parties had stipulated for a "penalty" actually so called, if damages could not be quantified, it would be upheld. The damages which the rule contemplates are clearly those which are of a kind which the court will quantify; effects on sales, production, profits and the like. Although they may be theoretically quantifiable,[70] on the facts the means of proof will be practically impossible to adduce. Contrast the position where such loss has been quantified, but the innocent party wishes to recover an excess amount representing loss such as inconvenience, and distress, upon which he places a value, but which the courts will not recognise.[71]

In conclusion, the historical perspective suggests that the rules in *Dunlop* reflect an assortment of notions; a jumble of historical curiosities which out of context provide no unitary rationale for invalidating stipulations for the payment of an agreed sum. The difficulties in which the House of Lords found itself arose directly from the fact that after *Kemble* v. *Farren* the parties could no longer stipulate for liquidated damages, and by such escape scrutiny. As outlined earlier this raised considerable difficulties because the distinction between a liquidated assessment of damages for breach of covenant and a penalty in a debt action was too artificial to exist if the parties could not be taken to mean what they said. Even if the court put the matter as one of intention, as it did in a number of cases, by saying in essence "you have used 'penalty' but you really intended liquidated damages", the problem of finding satisfactory criteria was no less acute.[72]

4. A Suggested Rationale

The authors of the United Kingdom Law Commission's Working Paper Number 61, "Penalty Clauses and Forfeiture of Monies Paid", suggested that the present state of the rules could be rationalised by allowing judicial scrutiny "wherever the object of the disputed contractual obligation is to secure the act or result which is the true purpose of the contract."[73] With respect this type of reform entirely addresses the wrong issue, which is *why* should intervention occur, rather than *when* should it occur.

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[70] The real significance is not that they may or may not in fact be quantifiable, but rather *assuming* they were ascertained, the loss would be of a *type* protected by an award of damages.

[71] *Cf. supra* n. 56; *infra* n. 75.

[72] The reference to intention in this context is but a disguised reference to rules of law; *supra* n. 44.

[73] *Supra* n. 29 at 18.

Quite apart from this, the "primary purpose" test is difficult to defend. If one party stipulated for the payment of an agreed sum on non-fulfilment of a condition, his purpose may be either compensatory, or coercive. But the two are not exclusive. A coercive clause to be effective must stipulate for a sum greater than the cost to the other party of performing, otherwise that party will prefer to pay the money than perform. The exercise of that choice however bears no necessary relationship to the measure of the innocent party's loss, if that be what the Law Commission was attempting to regulate.[74]

This relationship between coercion and compensation can be expanded to demonstrate how in practical terms, the danger of over-compensation appears to have been overstated.

What the innocent party wants is performance or its equivalent in money terms. That equivalent represents the *real* loss resulting from non-performance, including all the elements like mental anguish and inconvenience which are non-recoverable in the courts.[75] Sometimes it may not be possible to prognosticate in an individual case the extent of those costs, but parties may obviously attempt a pre-estimation based on averaging the risks that over or under-compensation will occur, either in relation to a number of possible breaches under a single contract, or by averaging the risks over a number of similar transactions.

If that equivalent of performance is $x, that is to say the sum at which the party is indifferent whether he accepts the money or performance, he will stipulate for that sum. Because he is indifferent as to which he prefers, the question whether the sum is coercive or not becomes irrelevant. If it is lower than the cost to the guilty party of performing he will pay the money, otherwise he will perform. In a rough way, the innocent party by inflating the measure of agreed damages signals to the other party that the performance is highly valued, and where the sum exceeds the cost of performance, ensures that it is the performance and not the money he receives.[76]

If one party agrees to delivery at a day certain, but at a price fixed at the time of contract, the risk of market fluctuations is a mercantile speculation he agrees to bear. Similarly if he agrees to pay a sum in consequence of non-performance, he takes the risk, not only that he will not perform, but that the agreed sum will be greater than the cost of performing at the proper time. Where the agreed sum is payable on a number of contingencies both parties spread their risks and minimise their costs. Rather than bargain to cover every contingency, they minimise transaction costs by averaging their potential loss, either over a number of transactions, or with regard to a number of possible contingencies within the one transaction.

Where the stipulated sum is high in relation to the loss which may

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[74] *Cf.* Summary of Proposals, *Id.* 52, para. 68(b)(vi).

[75] On non-pecuniary loss, generally McGregor, *op. cit. supra* n. 37 at para. 65 *et seq.*; F. Dawson, "General Damages in Contract for Non-Pecuniary Loss" (1983) 10 *N.Z.U.L.R.* 232. "Mental distress" which is in some circumstances recoverable, may be too narrow a concept to embrace all the types of costs which the innocent party would prefer to avoid; and which he will attempt to avoid by increasing the sanctions for breach of contract. These may include inconvenience, aversion to litigation, hidden administrative costs, and injury to goodwill.

[76] Inasmuch as the guilty party is physically able to perform, and will make a rational choice to minimise his own costs.

be recovered in the courts, it may be that the putative innocent party is indicating that he values performance highly; probably as indicated above because his real loss, that is the value he places on avoiding such costs as inconvenience, anguish, and time consumption, is not provable. However, to inflate this loss in the hope that breach and therefore over-compensation will occur is counter-productive since the guilty party will have a greater incentive to perform and not to breach. Further, the innocent party may have to pay a price for ensuring he receives performance, since stipulating for a sum likely to be greater than the cost of performance to the performing party will push the costs of market fluctuations and similar onto that party. The innocent party will probably therefore have to pay an increased price,[77] for what becomes in reality an insurance provided by the performing party.

To intervene at the time of breach is obviously to affect an unfair redistribution of contract risks, and to deprive one party of a benefit he not only contracted for, but which may have been reflected in the price he paid. No doubt in individual cases the agreed sum will "over-compensate" the innocent party, either because his losses are averaged over a number of transactions, or because the estimate of the loss was proved wrong, or because there is an averaging in the transaction itself.[78] But all this means quite simply is that the guilty party has as it happened, made a bad bargain. The only possible reason to intervene to prevent enforcement of such a clause, in circumstances where the inadequacy of exchange in the original considerations would not permit intervention, is to require the innocent party to mitigate.[79]

To suggest that the existence, or indeed even the possibility of, over-compensation is sufficient nonetheless to justify judicial intervention, is to propose a jurisdiction which in relation to other contractual terms the courts have assiduously eschewed.

Where parties contract for the payment of a sum of money as a primary obligation, the general rule is taken to be that notwithstanding a substantial inequality of exchange, the court will not inquire into the adequacy of consideration.[80] There are of course exceptions to this rule,

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[77] The adjustment in the price paid by the innocent party will only occur if (a) the cost of performing is *less* than the sum payable on breach, (if it was greater, then the guilty party would need no pecuniary incentive to risk the consequences of breach) *and* (b) the parties are neither of them price setters.

[78] Averaging in the transaction occurs when parties are prepared to stipulate for a sum which will e.g. compensate if the contract is breached at some intermediary point of performance, but will overcompensate if breached after that point; undercompensate if breached prior to it. Parties will only agree to this type of stipulation if the benefit to them of so doing, is greater than the benefit of stipulating against every conceivable breach. *Cf.* Lord Parker of Waddington in *Dunlop* at 99; Scrutton, L.J. in *English Hop Growers* v. *Dering* [1928] 2 K.B. 174 at 182; *Robophone Facilities* v. *Blank* [1966] 1 W.L.R. 1428 at 1449 *per* Diplock, L.J.; *Gleeson* v. *Kingston* (1880) 6 V.L.R. (L) 243; *per contra Amos* v. *Commissioner for Main Roads* N.S.W. C.A. 1 December 1983 (unreported).

[79] It is not sufficient to justify intervention that the innocent party by mitigating will be over-compensated, but rather that by not insisting upon mitigation there may be "economic waste" which will have repercussions beyond the immediate parties. The law in a number of apparently unrelated doctrines recognises this danger; e.g. in the refusal of specific performance: *Attica Sea Carriers Corp.* v. *Ferrostaal Poseidon Bulk Reederei GmbH* [1976] 1 Lloyd's Rep. 250; in refusal to recognise trusts for non-charitable and capricious purposes: *Brown* v. *Burdett* (1882) 21 Ch.D. 667. The risks of mitigation *not* occurring are slight however, since the innocent party will undertake it whenever it increases his return, as it usually will.

[80] See e.g. Treitel, *The Law of Contract* (6th ed. 1983) 57-58; Anson, *The Law of Contract* (25th (Centenary) ed. 1979) 96-97; *cf.* the Roman Law doctrine of *laesio enormis.*

arising either because of some defect in the bargaining process,[81] or because one party belongs to a protected class who, if unconscientiously taken advantage of by the other party, can seek relief in equity.[82] However, it is not clear why such exceptions adequately protect the party who makes a bad bargain in the exchange of primary obligations to perform, yet are not considered adequate to protect the party who makes a bad bargain in relation to his damages obligation. Indeed the fact that most contracts are performed rather than broken, would suggest that it is the primary exchange of values which is in need of greater scrutiny.

Secondly, it is obvious that the courts have no catholic objection to over-compensation, as there are many contractual rules which allow one party to secure a greater benefit than he has paid for.[83] The difficulty then arises, of how to restrictively define over-compensation without prejudicing its integrity as an objection to the parties quantifying the level of damages. The reality appears to be that the courts *have* selectively utilised the concept; so that over-compensation has no integrity as a general objection; rather the scrutiny of agreed sum stipulations is itself an exception to the opposite rule, that the parties are free to conclude a bargain on their own terms.

5. The Problem of Breach

There is a rule now established, that where a sum of money is payable otherwise than on a breach of contract the penalty rules will not apply.[84] It is difficult in principle to defend the requirement of so identifying a breach of contract, especially since in practice the obligation to pay will often be expressed as an alternative mode of performance, reposing a choice in the promisor which can be exercised without breaching the contract.[85]

Historically the significance of the breach/no breach dichotomy does not appear to have been appreciated within the context of the penalty rules until it became useful as a device for avoiding judicial scrutiny. That did not occur until after the courts finally decided that a promise to pay an

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[81] E.g. mistake preventing consent, fraud, misrepresentation, duress, undue influence, or illegality.

[82] *Infra* nn. 134 and 135.

[83] E.g. doctrines relating to non-severable entire obligations; total failure of consideration where some benefit has nonetheless been conferred; deposits; deviation; stipulations for payment of agreed sums on events other than breach of contract; performance bonds.

[84] E.g. *In re Apex Supply Co. Ltd.* [1942] Ch. 108; *Moss Empires Ltd.* v. *Olympia (Liverpool) Ltd.* [1939] A.C. 544 at 551 and at 558; *Tool Manufacturing Co. Ltd.* v. *Tungsten Electrical Co. Ltd.* [1955] 1 W.L.R. 761 at 767; *Export Credits Guarantee Department* v. *Universal Oil Products Co.* [1983] 1 W.L.R. 399 at 403. For the sake of brevity, the terminology "breach/no breach dichotomy" will be adopted to describe the distinction between obligations arising on breach of contract, and obligations arising on the occurrence of an event other than the breach of the contract in which the relevant clause appears. The terminology is slightly misleading since it does not appear to embrace payments becoming due on termination of the *agreement* by the bailor, *i.e.* not on breach as such, but on exercise of an election to discharge the agreement; (so called anticipatory secondary obligations). Payments due under such an election are subject to the penalty rules: *Cooden Engineering Co. Ltd.* v. *Stanford* [1953] 1 Q.B. 86 at 116. The terminology adopted should be construed so as to embrace those circumstances. Where the bailee terminates different considerations may apply depending upon whether he does so pursuant to a contractual right, *infra* n. 85. Where the bailor terminates damages will vary according to whether termination follows repudiation: *Overstone Ltd.* v. *Shipway* [1962] 1 W.L.R. 177; (unexpired term recoverable subject to discounts); or whether termination follows some more trivial breach; e.g. *Financings Ltd.* v. *Baldock* [1963] 2 Q.B. 104; (accrued rentals only). The distinction seems difficult in principle to justify.

[85] *Associated Distributors* v. *Hall* [1938] 2 K.B. 83.

agreed sum on default of a promise to perform (other than to pay money), could be subject to the penalty rules; and this less than a century ago.

It is submitted that this distinction emerged, first, because the courts were narrowly interpreting the words "exorbitant, extravagant and unconscionable" where the parties had stipulated for liquidated damages which could exceed possible loss as quantified by the court.[86] Second it may be that, in formulating the present rules, a number of judges in *Dunlop* imprudently (but understandably[87]) overlooked the possibility that a stipulated sum could be payable otherwise than on a breach. For whatever reason the distinction is a recent one.

This distinction between sums which are payable on breach, and sums which otherwise became payable unwittingly obfuscates the questions of *when* intervention should occur, and *why* it should occur. Further, as a result of the rigid breach/no breach dichotomy a number of unfortunate consequences flow. First, the inquiry as to the justification for intervention becomes subverted by the overriding necessity to identify a breach of contract, and eventually is lost sight of. The justification, and the necessity for breach, develop a mutually exclusive association. In order to provide relief where an obligation to pay an agreed sum arises before breach, the courts have had to escape this straight-jacket. Usually they have strained at an interpretation which produces an obligation arising on breach.[88] Occasionally the less timorous souls have escaped the formalism of the breach mentality by adopting a robust "substantive" approach.[89] Where theoretical purity is pursued the courts have accepted that such a rigid breach/no breach dichotomy produces absurd results,[90] but have chosen to leave the rules in place. Sometimes the problem is not adverted to.

This dichotomy as a determinant of intervention cannot but have become further entrenched by the increasingly sophisticated contractual analysis of the nature and function of contractual obligations,[91] emphasising as it does the difference between promises to perform, and promises to pay damages. But whatever the importance of distinguishing primary and secondary obligations in relation to other issues,[92] the emphasis on a functional distinction between obligations to perform and obligations to pay damages in relation to penalty clauses merely strengthens formalism and diverts attention from the critical questions of whether and on what basis the courts should intervene; and why the breach/no breach distinction should be maintained. Against this sophisticated analysis, "substance" rules,[93] whatever their juristic merit, inevitably appear rather

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[86] *Supra* n. 54.

[87] There was nothing in the history of the development of the penalty rules up to that date which would have alerted the court to the potential difficulties.

[88] E.g. Gibbs, C.J., Wilson and Deane, JJ. in *O'Dea* v. *Allstates Leasing System (W.A.) Pty. Ltd., supra* n. 2.

[89] E.g. Murphy, J. in *O'Dea, Ibid.*; Lord MacDermott, C.J. in *Lombank Ltd.* v. *Kennedy and Whitelaw* [1961] N.I. 192; Lord Denning in *Bridge* v. *Campbell Discount Co. Ltd.* [1962] A.C. 600.

[90] E.g. Harman, L.J. in *Campbell Discount Co. Ltd.* v. *Bridge* [1961] 1 Q.B. 445; Black, L.J. in *Lombank Ltd.* v. *Kennedy and Whitelaw, Ibid.*

[91] E.g. *Moschi* v. *Rolloswin Inv. Ltd.* [1973] A.C. 331; *Photo Production Ltd.* v. *Securicor Transport Ltd., supra* n. 5; *Hyundai Heavy Industries Co. Ltd.* v. *Papadopoulos* [1980] 1 W.L.R. 1129.

[92] E.g. the operation of Exclusion or Limitation Clauses; see *Photo Production Ltd.* v. *Securicor Transport Ltd., supra* n. 5 at 851, *per* Lord Diplock; or in determining whether a right to sue for breach of contract subsists despite election not to discharge the contract: *Lep Air Services* v. *Rolloswin Inv. Ltd.* [1971] 1 W.L.R. 934 at 941, *per* Megaw, L.J.

[93] *I.e.* rules that identify some policy basis other than form, on which to predicate judicial intervention, see *e.g. supra* n. 89.

lame; and in order to avoid the implication that the courts can scrutinise any exchange of values, such an approach is often taken in conjunction with broad "public policy" or "unconscientious" objections.[94]

Another consequence of forcing whatever justifications exist for the penalty rules onto intractable intervention rules, is the production of results which cannot be reconciled with the supposed rationale underlying those rules because the result owes more to formalistic restraints than policy requirements. Thus to use overcompensation as an example, supposing the prevention of over-compensation explains intervention in penalty clauses, why can parties invoke judicial rules to protect their over-compensation by careful drafting if the law has a serious objection to over-compensation? Does a principle that "the law will protect against over-compensation arising only in certain formally defined circumstances" have, standing alone, any logical integrity?

When one looks at money forfeiture clauses, the same problems are evident, although in a different context. Clauses stipulating for the forfeiture of money already paid, or the payment of money accruing due before breach or discharge of contract fall *prima facie* into the category of primary promises to perform, since their effect is to make the payment of the money consideration unconditional. In some instances the contract-breaker may be able to recover this sum, or be absolved from the obligation to pay it, either because the payment is construed as having been made contingently upon completion of the contract,[95] or because there is some equity allowing relief.[96]

Where the money is not refunded to the contract-breaker in circumstances in which an innocent party would receive it, a "no-liability to pay" rule has been replaced by a "contractual liability to pay" rule, so that the economic and probably the juristic result is indistinguishable from that had a penalty stipulation been inserted.

This similarity has led to criticism in recent years, and it has been suggested that the penalty rules should be expanded to accommodate such clauses.[97] In the light of the above discussion, this suggestion is interesting for two reasons. First, the undoubted merit of uniformity rather subtlety obscures the more important inquiry whether the penalty rules are the most appropriate vehicle for reform. Second, the application of the penalty rules to forfeiture clauses involves the abandonment of the rigid breach/no breach dichotomy, since forfeiture assumes an accrued rather than an inchoate obligation. This consequence may explain in part the different treatment of penalty and forfeiture clauses; since with few exceptions,[98] the courts have preferred to relieve from forfeiture of money, if at all, by construing contractual intention so as to find that the

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[94] See *e.g.* Murphy, J. in *O'Dea, supra* n. 2 at 178.

[95] See *e.g. Hyundai Heavy Industries Co. Ltd.* v. *Papadopolous, supra* n. 98 at 1134; 1136-1137; 1141-1142; 1148-1150; 1152-1153; *Hyundai Heavy Industries Co. Ltd.* v. *Pournaras* [1978] 2 Lloyd's Rep. 502 at 507; *McDonald* v. *Denny Lascelles Ltd.* (1933) 48 C.L.R. 457 at 476.

[96] E.g. *Stockloser* v. *Johnson* [1954] 1 Q.B. 476; *Pitt* v. *Curotta* (1931) 31 S.R. (N.S.W.) 477 at 480-482; *McDonald* v. *Denny Lascelles Id.* 470 and at 478.

[97] E.g. The Law Commission (U.K.) Working Paper No. 61 at 36 and at 42; *Bridge* v. *Campbell Discounts Ltd., supra* n. 89 at 624 *per* Lord Radcliffe; *Starside Properties Ltd. v. Mustapha* [1974] 1 W.L.R. 816 at 819; *Cf. Linggi Plantations Ltd.* v. *Jogatheesan* [1972] 1 *M.L.J.* 89 (P.C.) at 91; and cases cited *Id.*

[98] *Supra* n. 96.

advance payment was only made conditional upon completion.[99] This however creates an obvious assymetry with penalty clauses where in contrast, the fact that both parties may have intended a penalty clause to be effective will not prevent judicial scrutiny.

6. Acceleration Clauses and the *O'Dea* Case

The tension between forfeitures and penalties, and the imperspicuity introduced by the breach/no breach inquiry is most obvious in the instance of "acceleration clauses".[100] Analytically such clauses are somewhat atypical, since at the moment of breach an obligation already exists, albeit only payable at a future time, and breach affects not the quantum, but the performance of the obligation.[101] Until the *O'Dea* decision, the accepted jurisprudence was that such a clause was not a penalty stipulation.[102] Nor is it easily characterised as a forfeiture, since the obligation to pay has not *accrued* due before breach. In reality an obligation to pay the entire contract price, without receiving the *quid pro quo*, is indistinguishable from a forfeiture clause where the price is paid at the outset unconditionally; unconditionally in the sense of regardless of whether the payee is excused full or part performance of his obligations.[103] The difficulty of this explanation is that it cannot be reconciled with the supposed necessity for identifying an obligation arising *upon* breach in order to invoke the penalty rules. The obligation to pay is one which presently exists at the moment of breach.

Thus the courts after having drawn a square hole, have found the only way to push a round peg through it, is to characterise the acceleration clause as something it is not. The recent High Court decision in *O'Dea* v. *Allstates Leasing System (W.A.) Pty. Ltd.*[104] illustrates the different techniques which may be employed to achieve this. The facts of *O'Dea* simply stated, were that the respondent leased to Mr and Mrs O'Dea and another couple, the second respondents on appeal, trading together as Granich Geraldton, a prime mover for a period of thirty-six months, the contract containing a number of clauses presently referred to. The respondents took the same day from another party, M. G. O'Dea Pty. Ltd., a guarantee that all obligations imposed upon the lessee under the original contract would be punctually performed.

The terms of the contract of hire between the respondent and Granich Geraldton provided (*inter alia*) that the vehicle would be leased for the

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[99] *Supra* n. 95.

[100] See e.g. R. M. Goode, "Acceleration Clauses" [1982] *J.B.L.* 148; *cf.* R. M. Goode, *Payment Obligations in Commercial and Financial Transactions* (1983), 51-53.

[101] *Protector Endowment Loan and Annuity Co.* v. *Grice* (1880) 5 Q.B.D. 592.

[102] *Thompson* v. *Hudson* (1869) L.R. 4. H.L. 1; *Wallingford* v. *Mutual Society* (1880) 5 App. Cas. 685; *Protector Endowment Loan and Annuity Co.* v. *Grice, Ibid.; Lamson Store Service Co. Ltd.* v. *Russell Wilkins & Sons Ltd.* (1906) 4 C.L.R. 672; *I.A.C. (Leasing) Ltd.* v. *Humphrey* (1972) 126 C.L.R. 131. In *O'Dea* v. *Allstates Leasing System (W.A.) Pty. Ltd.* Gibbs, C.J., Wilson and Brennan, JJ. were prepared to accept the acceleration cases, at 174, 181, and 183 respectively. Murphy, J. would not follow them, at 178. Deane, J. doubted that they should be followed, but did not finally decide, at 190. *Cf.* the authorities cited by Deane, J. at 190-191. And see *Acron Pacific Ltd.* v. *Offshore Oil Ltd. N.L.* (1983) 8 A.C.L.R. 233 at 246.

[103] Advance payments were traditionally regarded as forfeited, regardless of the fact that the breach by the guilty party discharged the payee from performing his obligations under the contract, where the payment was made expressly as a deposit, or expressly subject to a forfeiture clause: see e.g. *Howe* v. *Smith* (1884) 27 Ch.D. 89; *Wallis* v. *Smith* (1882) 21 Ch.D. 243; *McGregor, op. cit. supra* n. 37 at paras 388-396.

[104] *Supra* n. 2.

36 months at an entire rental of $39,550.32 which was due upon execution of the agreement, but which could be paid in equal monthly instalments throughout the term, providing the lessee made no default under the agreement. Should a default occur, the entire outstanding sum became due and payable, the vehicle could be repossessed, and the lessor thereupon had the option either to find a substitute lessee, or to sell the vehicle. Should the vehicle be sold, the lessee agreed to pay any deficiency between the amount realised by sale, and the sum of $13,300.

When the lessee defaulted, the respondents repossessed the vehicle, after first discharging a possessory lien for $7003.32 in favour of a company which had not been paid for repairs, and sold it for $20,000.[105] The appeal to the High Court was concerned solely with the issue whether the sum of $31,436.04, the amount of rent outstanding and due, amounted to a penalty.

Two judges, Gibbs, C.J. and Wilson, J., accepted that a clause which accelerated upon breach the payment of a debt then presently existing, did not involve a penalty.[106] Brennan, J. gave the proposition only qualified support, holding that he did not have to rely on it.[107] Each of these judges avoided in a different manner the consequence that the penalty rules did not apparently apply. The Chief Justice interpreted the contract as not providing for a sum payable unconditionally, but only for a number of obligations accruing due on a monthly basis.[108] On the face of the contract it is fair to say other interpretations were open. Brennan, J. believed that equity had a jurisdiction to relieve against the exaction of the unexpired rentals because the lessor had both the vehicle and the money, the position therefore being analogous to relief against forfeiture.[109] There are a number of interesting aspects to this reasoning. First Brennan, J. must have accepted that the obligation to pay the entire rental had already accrued due, since at least one of the essential differences between a penalty and a forfeiture is that in the latter the sum does not become payable on breach by the guilty party, but rather does not become repayable by the innocent party.[110] For Brennan, J. this was a necessary step to avoid the unfortunate fact that the obligation not arising on breach, the penalty rules would not apply. Secondly, it is by no means established that where money is expressly paid or payable under a forfeiture clause, equity can relieve beyond giving more time. The one case which tenuously asserts such an equity exists in relation to chattels was only cited as a reference in his judgment.[111]

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[105] It was conceded on appeal that the $7003.32 was recoverable by the respondent, and that sum will not be included in any subsequent computations made by the writer in respect of the *O'Dea Case*.

[106] *Supra* n. 2 at 174 and at 181 respectively.

[107] *Id.* 183.

[108] *Id.* 174.

[109] *Id.* 185.

[110] *Hinton* v. *Sparkes* (1868) L.R. 3 C.P. 161 at 166; *Lock* v. *Bell* [1931] 1 Ch. 35. *Cf. Public Works Commissioner* v. *Hills* [1906] A.C. 368.

[111] *Stockloser* v. *Johnson* [1954] 1 Q.B. 476. *Cf. Steedman* v. *Drinkle* [1916] 1 A.C. 275 where the contract was unrescinded, and the guilty party was ready and willing to perform, but the innocent party justified in refusing performance. *Cf. Galbraith* v. *Mitchenall Estates* [1965] 2 Q.B. 473. Where there is no express forfeiture clause, or the money is not paid expressly as a deposit, the guilty party may recover the payment, subject to any condition attaching to its payment: *Mayson* v. *Clouet* [1924] A.C. 980; *McDonald* v. *Denny Lascelles Ltd.* (1933) 48 C.L.R. 457; *Hyundai Heavy Industries Co. Ltd.* v. *Papadopoulos* [1980] 1 W.L.R. 1129. Although this line of authorities is referred to by Brennan, J. at 185-187, if one accepts his Honour's premise that the sum had accrued due in *O'Dea*, the case would appear more properly to be one of an express forfeiture. For the position in relation to deposits paid otherwise than in relation to land see *Yardley* v. *Saunders* [1982] W.A.R. 231.

Wilson, J., as far as one can reasonably interpret his judgment, believed that the clause stipulating for an entire rent, albeit payable monthly, only applied providing the vehicle was leased for three years without repossession. The clause which allowed repossession and stipulated that "All moneys due for unexpired terms shall become immediately due and payable", was not an acceleration clause, but a quantification of damages.[112] Again it is fair to say other interpretations are possible.

Deane, J. agreed with the interpretation of Wilson, J. that as a matter of construction the liability to pay the entire rental did not survive the election by Allstates to repossess.[113] But even if mistaken, any rental due after breach was "as a matter of substance" a penalty.[114] Murphy, J. avoided any acceleration polemics, choosing instead to regard this as an instance of paying a greater sum after a default in payment of a lesser one.[115] It must be assumed therefore that like Wilson and Deane, JJ. he saw the sum payable on breach as a different obligation from the obligation to pay rent.

There are two important points to be drawn from these judgments. First, a majority of the Judges was not prepared to upset settled distinctions, but rather as a matter of construction, to hold that they did not apply to the facts.[116] It should therefore be a matter of little ingenuity to draft clauses which will make it plain that the rental obligation in similar future cases is not discharged by the exercise of an option to repossess.

More importantly, each judge found that the sum payable in *O'Dea* was not a genuine pre-estimate of damage, or that it was extravagant and unconscionable in amount.[117] That these findings should be made in such a presumptive manner is somewhat disturbing. It will be remembered that the respondents repossessed the vehicle, and also claimed $31,436.04, the sum of the outstanding rentals due.[118]

The vehicle was sold for $20,000. If they had succeeded the plaintiffs would have received $59,550.32,[119] from which the original cost of the vehicle, plus the hidden costs involved in negotiating and servicing the agreement, would need to be subtracted in order to arrive at a true profit. Expressed as a per annum per centage of income it would probably not represent an "exorbitant" figure.

Further, supposing that Granich Geraldton had made all thirty-six payments, the plaintiffs would have recovered no less, but probably no more than[120] $52,850.32, the profit element in which would have to be

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[112] *Supra* n. 2 at 181-182.

[113] *Id.* 188.

[114] *Id.* 189.

[115] *Id.* 178.

[116] *Supra* n. 102.

[117] *Per* Gibbs, C.J. at 176; Murphy, Wilson, Brennan, and Deane, JJ. at 178, 182, 185 and 189 respectively.

[118] There were additional claims for interest and discharge of a lien which were conceded by the appellants before the appeal. See also *supra* n. 105.

[119] That is a sum representing the outstanding rental together with the rental already received ($39,550.32); plus the $20,000 they realised on the resale of the vehicle. The amount of the lien and interest claimed is discounted.

[120] They would have received the entire rentals ($39,550.32), plus at least $13,300.00 on resale of the vehicle, since the appellants were bound to compensate the plaintiffs in accordance with clause 31 of the agreement, for any deficiency on resale below that sum. Since that sum would represent the anticipated market value of the vehicle at the expiry of the term, it is problematic whether any greater sum would be realised.

allocated between three years on a compounding basis. Against this the plaintiff had to build in an average cost representing losses on insolvency, including not only loss of profit but also damage to the machines;[121] and the risk that if the clause was struck down they would be substantially under-compensated. The effect of the decision in *O'Dea* was of course to under-compensate, because the plaintiff received only $28,114.28,[122] from which the original cost of the vehicle, plus other costs referred to above, plus the costs of the court action had to be subtracted. Although enforcing the agreement *may* have led to an over-compensation in the instant case, taking the returns from all Allstates leasing activities as a composite figure, the accusation of over-compensation amounts merely to saying they have made excessive profits. Nor may this be said to be an artificial approach, since businesses average costs and profits over all their activities.

But it may be questioned whether in fact over-compensation did occur in *O'Dea*. Given that Allstates must have been alive to the risk of default, and insisted upon the terms inserted in the contract, and given also that Granich Geraldton must have found these terms more reasonable than any quoted elsewhere, the inference fairly arises that only by insisting upon such terms could Allstates secure a reasonable profit.

The effect of *O'Dea* is simply to increase to cost of hiring the vehicles, by spreading the risks of default by inefficient hirers, to those who are able to discharge their contractual obligations. Where the market for the type of vehicles Allstates deal in falls between the time of hiring and default, then Allstates receive no more at that juncture than they would have had the agreement run its course.[123] Although Allstates may receive interest on the money during the unexpired period, that always supposes that they are able to recover it.[124]

Further, the decision in *O'Dea* will likely make it more difficult for others in the position of Granich Geraldton to enter the market in future. Lessors are more likely to insist on proof of reliability which only established operators will be able to provide. Without being able to enforce promises such as those given by the appellants here, how will Allstates be able to assess the ability or willingness of future lessees to complete the term of the lease?

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[121] If both the lessee and the guarantor were insolvent, a not unlikely possibility where personal guarantees have been taken from partners, sole traders, or companies in which the husband and wife are the only shareholders, then the cost of discharging a repairer's lien would fall on the lessors.

[122] The sum of $20,000.00 from resale of the vehicle, plus the instalments paid or payable until date of breach ($8,114.28). While it may be possible to argue that in *legal* terms the lessor was not under-compensated since he received damages ascertained by the Court, any divergence between the legal standard of just compensation and *factual* undercompensation might have suggested to the court that their interpretation of the relevant contract was the wrong one. *Cf. Overstone Ltd.* v. *Shipway* [1962] 1 W.L.R. 117. Whether the excess realised over $13,300.00 should be brought into account would depend on whether the resale was in mitigation, or a collateral sale in a market where supply exceeded demand.

[123] That is the full sum of the rentals, plus the sum of $13,300, supposing at the time of default the vehicle was only worth that amount or less, any deficiency below $13,300 being made good by the lessee.

[124] It would also be necessary to off-set against the interest payable on the recovered sum for the unexpired term the costs of recovering the sum, and taxation consequences. It is arguable that the entire rental sum would be taxable under s. 25(1) Income Tax Assessment Act 1936 (Cth.) notwithstanding the early termination; *Heavy Minerals Pty. Ltd.* v. *F.C.T.* (1966) 115 C.L.R. 512; *Commissioner of Taxation (N.S.W.)* v. *Meeks* (1915) 19 C.L.R. 568. Any interest received by its investment certainly would be. *Cf. Yeoman Credit Co.* v. *McLean* [1962] 1 W.L.R. 131; *Overstone Ltd.* v. *Shipway, supra* n. 122.

7. Conclusion

It is submitted that the time has long passed for the courts to readdress the issue of *why* they should intervene to redistribute agreed contract risks. Should parties be allowed to make their own bargains, or will the courts require them to stipulate for payment of an agreed sum on a contingency only when its function is compensatory? If the latter, what is being compensated; the value to the defendant of the lost performance as he himself qualifies it,[125] or a value which the court artificially fixes upon the premise that certain types of cost are irrecoverable.

Further, is it legitimate for judges to protect the parties to a business contract, because the consequences of their folly *appear* "harsh" or "unconscionable", even though the innocent party has contracted upon terms which he and others in the trade would not be prepared to ameliorate, without corresponding adjustments to the price and other conditions? In the wider spectrum is it not obvious where the choice must lie between penalising efficiency and encouraging inefficiency[126] on the one part, and ensuring that the parties bear the (sometimes erroneous) calculation of the respective contractual risks on the other?

In the United Kingdom the courts are moving strongly to view that, at least in commercial contracts, they should not mend bargains.[127] At present this is being manifested both in circumstances where default has resulted in a forfeiture of proprietory interests,[128] and in a desire to confine the penalty rules to as narrow an application as possible.[129] Economically this is a preferable result, because questions of overcompensation really only involve wealth redistribution according to which party has made the best bargain. Transaction costs involved in court proceedings, or attempting to draft irreprovable contracts must be borne, either by Allstates, who if they cannot trade profitably will not trade at all, or more likely by the hirers of vehicles, who must consequently pay an increased rental, regardless of whether they are efficient[130] or not. At least one recent writer has equated certainty in commercial contracts with the goal of transactional justice.[131]

Where the transaction is a consumer one, there may be more justification for judicial scrutiny. But it would cause less distortion to

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[125] *Supra* p.

[126] "Efficiency" is used here in its naive sense, to mean merely "X-efficiency" or (very approximately) the ability to trade in a competitive market at the most profitable level. Allocative efficiency would require a much more complex model: See *e.g.* K. W. Clarkson, R. L. Miller, and T. J. Muris "Liquidated Damages v. Penalties: Sense or Nonsense?" [1978] *Wisconsin L.R.* 351; Posner *Economic Analysis of Law* (2nd ed. 1977) para. 4.10; C. J. Goetz and R. E. Scott "Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach" (1977) 77 *Col. L.R.* 354.

[127] Recent general statements of principle to the effect that certainty will be preferred to conscionability, at least in commercial contracts, appear e.g. in *The Laconia* [1977] A.C. 850 at 878; *Photo Production Ltd.* v. *Securicor Transport Ltd., supra* n. 5 at 851; *cf. The Afovos* [1980] 2 Lloyd's Rep. 469 at 479.

[128] E.g. *Scandinavian Trading Tanker Co. A.B.* v. *Flota Petrolera Ecuatoriana* [1983] 2 A.C. 694. *Sport International Bussum BV* v. *Inter-Footwear Ltd.* [1984] 1 All E.R. 376.

[129] E.g. *Export Credits Guarantee Department* v. *Universal Oil Products Co.* [1983] 1 W.L.R. 399.

[130] In the sense that they are able to trade profitably when others in similar circumstances cannot.

[131] D. Tiplady, "The Judicial Control of Contractual Unfairness" (1983) *M.L.R.* 601.

settled principles,[132] and give rise to far fewer anomalies,[133] if a more appropriate vehicle for reform was adopted. For example, both in Australia[134] and elsewhere[135] there has been a widening of those classes of protected contractors in respect of which the courts will scrutinise agreements entered for unconscientious advantage taking. This type of doctrine represents a unitary approach to all contract stipulations, whether they be primary or secondary in character, or whether the obligation to pay arises before or after breach.

It is also true that statutory reforms offer some protection to the consumer against *O'Dea* type provisions.[136] An intention based doctrine may also have some utility in this regard,[137] providing judges could resist the temptation to apply it as a fiction. But protection for the consumer must be seen as the exception rather than the rule. Whatever rationalisation is made, *O'Dea* demonstrates it is long overdue.

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[132] In particular the doctrine that the courts will not inquire as to the adequacy of consideration; *cf.* also the position of forfeitures under express provisions.

[133] E.g. The importance of whether the payment arises on breach of contract or on some other contingency; or whether a higher rate of interest is charged on default, rather than a mere concessional rate is withdrawn; see *O'Dea* v. *Allstates Leasing System (W.A.) Pty. Ltd., supra* n. 2 at 174 *per* Gibbs, C.J.

[134] E.g. *Blomely* v. *Ryan* (1956) 99 C.L.R. 362; *The Commercial Bank of Australia* v. *Amadio* (1983) 57 A.L.J.R. 358.

[135] E.g. *Cresswell* v. *Potter* [1978] 1 W.L.R. 255; *Backhouse* v. *Backhouse* [1978] 1 W.L.R. 243; *A. Schroeder Music Publishing Co. Ltd.* v. *Macaulay* [1974] 1 W.L.R. 1308; *Lloyds Bank Ltd.* v. *Bundy* [1975] Q.B. 326; *Archer* v. *Cutler* (1980) 1 N.Z.L.R. 386; *cf. Multiservice Bookbinding Ltd.* v. *Marden* (1979) Ch.84.

[136] E.g. Contracts Review Act, 1980 (N.S.W.) s. 7; Hire Purchase Acts, ss. 11, 12, and 15; *cf.* Consumer Credit Act 1974 (U.K.) ss. 100, 132, 137-140.

[137] E.g. *Hyundai Heavy Industries Co. Ltd.* v. *Papadopoulos, supra* n. 103.