

RULE AGAINST PENALTIES

- Arises where the parties to a contract have entered a contract with the term that expressly values the loss that one of the parties may suffer on a breach of the contract and provides that the other party owes a set amount, not as damages to be calculated, but a debt determined under the clause (known as liquidated damages clause)
- Burden of showing that the debt is a penalty is on the person seeking to escape the debt (*Multiplex Constructions Pty Ltd v Abgarus Pty Ltd*)

IS THERE A LIQUIDATED DAMAGES CLAUSE?

- The most common form of the Liquidated Damages clause provides for the payment of a set amount on the occurrence of a particular event
- Parties often agree to LDC because it provides them with some certainty
- LDC provides for a formula for calculating the quantum that reduces the cost to the claimant
- But relief can be:
 - Transfer of personal property: *Wallondilly Shire Council v Picton Power Lines Pty Ltd*
 - The right to withhold payments: *Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd*
 - The recovery of property previously transferred: *General Trading Company (Holdings) Ltd v Richmond Corporation Ltd*

IS THE LDC A PENALTY?

- Usually requires a party to pay a sum or give up a right or take on an obligation on the occurrence of an event
- The mere fact that the sum states that it is forfeitable if an event occurs it is not conclusive as a penalty
 - Courts need to determine whether it was the intention of the parties that the sum should constitute liquidated damages
- It IS a penalty if:
 - There is a contract, a breach or other event that brings performance of the mutual obligations to an end
 - The LDC provides for:
 - A payment that is larger than the loss
 - Payment of income for a service that is no longer provided
 - Payment to secure a risk that has passed
- Is IS NOT a penalty if:
 - A higher interest rate is charged for late payments
 - Acceleration of payments
 - Forfeiture of deposit
- Basic Principles governing the distinction between LDC and penalties – Laid down in *Dunlop Pneumatic Tyre Co Ltd v New Garage Motor Co Ltd* affirmed in *Ringrow Pty Ltd v BP Australia Pty Ltd* - The courts looks to:
 1. The nature of the contract at the time of entering the contract
 2. The substance of the clause
 - The name of the clause (e.g. penalty or LDC) is not determinative: the review looks to the substance of the clause not its title or mere form: *Clydebank Engineering & Shipbuilding Co Ltd v Don Jose Yzquierdo y Castaneda*
 3. The object of the clause
 - An amount provided in a liquidated damages clause that is intended to punish the party who breaches the agreement is a penalty– *Dunlop Pneumatic Tyre Co Ltd v New Garage Motor Co Ltd*
 4. The amount of the penalty/debt
 - Unreasonable Amounts

- If the clause provides for an extravagant, out of proportion and/or unconscionable amount in comparison to the amount of the likely loss, it is likely to be a penalty (*AMEV-UDC Finance Ltd v Austin*)
 - Proportionality
 - Based on the degree of disproportion between the stipulated sum and the damage suffered, the oppressiveness of the term to the defendant and the nature of the relationship between the contracting parties
 - It will be a penalty if the sum stipulated is extravagant or unconscionable in amount in comparison with the greatest loss that can be proved to have followed from the breach (*Dunlop Pneumatic Tyre Co Ltd v New Garage Motor Co Ltd*)
 - Debt > Damages
 - Where the breach of contract is the failure to pay an amount, a clause that requires the payment of a larger amount is prima-facie a penalty: *Dunlop Pneumatic Tyre Co Ltd v New Garage Motor Co Ltd*
5. The formula and meaning of valuing the sum
- Invariable debt with variable circumstances
 - Where the clause provides for a set outcome that does not vary with the extent of the harm or the seriousness of the breach that is prima-facie a penalty: *Dunlop Pneumatic Tyre Co Ltd v New Garage Motor Co Ltd*
 - Lump Sums
 - There is a presumption that it is a penalty when a single lump sum is made payable on the occurrence of one or more or several events some of which may constitute serious but otherwise trifling damage (*Dunlop Pneumatic Tyre Co Ltd v New Garage Motor Co Ltd*)
6. The circumstances under which:
- a. The contract is entered
 - b. The contract is performed; and
 - c. The payment is paid;
7. The amount of the loss be effectively estimated at the time of entering into the contract
- Can the loss be estimated before the breach?
 - However, circumstances where it would be difficult or impossible to provide a realistic pre-estimate of the loss at the time of entering the contract then the agreed amount should be viewed as “genuine”: *Dunlop Pneumatic Tyre Co Ltd v New Garage Motor Co Ltd*
 - *Clydebank Engineering & Shipbuilding Co Ltd v Don Jose Yzquierdo y Castaneda*
 - The question of how to value the delay in supply for 4 naval vessels intended to patrol Spanish waters was not able to be calculated

OUTCOME

- Penalty = The clause is unenforceable, fails entirely and the injured party is left to their other available remedies (*W & J Investments Ltd v Bunting*)
 - Plaintiff is able to recover damages according to the principles governing the assessment of damages at common law for breach of contract (*W & J Investments Ltd v Bunting*)
- Not a penalty = Innocent party can claim the sum as a debt without proof of damage (*Pigram v Attorney General for the State of NSW*)
 - An enforceable LDC entitles the plaintiff to recover the sum stipulated without the need to prove any loss (*Pigram v Attorney General for the State of NSW*)
 - If damages for actual loss sustained by the plaintiff would have exceeded the sum stipulated, the plaintiff is nevertheless confined to recovering the sum stipulated and vice versa (*Diestal v Stevenson*)