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2017 WA LEE LECTURE: THE AUSTRALIAN LAW OF CONTRACTUAL PENALTIES

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I INTRODUCTION

In 2005, in *Ringrow Pty Ltd v BP Australia Pty Ltd*,[1] the High Court (Gleeson CJ, Gummow, Kirby, Hayne, Callinan and Heydon JJ) observed that Lord Dunedin's formulation in *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd*,[2] of the principles governing the identification, proof and consequences of penalties in contractual stipulations had endured for 90 years and had been applied countless times in the High Court and other courts. (The Court cited, as examples, *O'Dea v Allstates Leasing System (WA) Pty Ltd*,[3] *Acron Pacific Ltd v Offshore Oil NL*,[4] *AMEV-UDC Finance Ltd v Austin*,[5] *Stern v McArthur*,[6] and *Esanda Finance Corporation Ltd v Plessnig*.[7]) The Court proceeded on the basis that *Dunlop* continued to express the law applicable in Australia, leaving any more substantial reconsideration for a future case where reconsideration or reformulation might be in issue.

Since then the High Court has substantially reconsidered the Australian common law concerning contractual penalties on two occasions. Each case arose out of one of many representative proceedings in which various banks' customers sought to establish that contractual stipulations authorising fees charged by the bank were penalties. Some of the fees were charged upon a breach of contract and some were charged upon an event other than a breach of contract.

In 2012, in *Andrews v Australian & New Zealand Banking Group Ltd* ('*Andrews*'),[8] the High Court (French CJ, Gummow, Crennan, Kiefel, and Bell JJ) held that the penalty doctrine in equity continued to exist and declared that the circumstances that the fees were not charged by the bank upon breach of contract or other event which it was the customers' responsibility to avoid did not render the fees incapable of characterisation as penalties. That decision changed the Australian law concerning contractual penalties as it had been expressed in the balance of opinion in previous High Court cases and intermediate appellate court decisions. It also differs from the view expressed in the United Kingdom's ultimate appellate court.

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[1] (2005) 224 CLR 656 [12].
[2] [1915] AC 79, 86–8.
[3] (1983) 152 CLR 359, 368, 378, 399, 400.
[4] (1985) 157 CLR 514, 520.
[5] (1986) 162 CLR 170, 190.
[6] (1988) 165 CLR 489, 540.
[7] (1989) 166 CLR 131, 139, 143, 145.
[8] (2012) 247 CLR 205.

After a subsequent trial involving a different customer of the same bank, the trial judge (Gordon J) held in 2014 that none of the fees in relation to which the question of law had been decided in *Andrews* were penalties.[9] Gordon J held that other fees that were charged upon breaches of contract — Mr Paciocco's late payments of minimum monthly amounts due upon his credit card accounts — were penalties. The Full Court of the Federal Court allowed the bank's appeal and set aside that part of Gordon J's decision. The customer appealed. In 2016 the High Court (French CJ, Kiefel, Gageler, and Keane JJ; Nettle J dissenting) dismissed the appeal: *Paciocco v Australia & New Zealand Banking Group Ltd*.[10]

In *Paciocco* the High Court substantially reconsidered the principles governing the identification and proof of a penalty on breach, with extensive references to the way in which Lord Dunedin's propositions should be understood and applied in Australia a century after they had been formulated in England. The question of law decided in *Andrews* was not in issue in *Paciocco*. Unsurprisingly though, some aspects of the principles underlying the Australian common law of penalties were common to both cases and in each case the reasons discuss some issues the resolution of which may not have been strictly necessary for the decision. Inevitably there are some differences amongst the justices' reasoning in the two cases. Some of those differences suggest that there are unanswered questions of principle that may have a substantial bearing upon the nature of the relief a court should grant if it upholds a challenge to a contractual penalty.

This paper suggests possible answers to those questions. In order to set the scene against which those questions arise the paper commences with an identification of relevant aspects of the pre-existing law, summaries of the main propositions relevant to the topic that are to be derived from *Andrews* and *Paciocco*, and reference to likely practical effects of those cases for future penalty disputes. Those topics are explored principally with reference to the common category of penalties involving a secondary contractual obligation or other stipulation to pay a sum of money upon the non-fulfilment or failure of a primary contractual stipulation. Although the same principles are generally applicable in other contexts, it should not be assumed that general expressions in the paper are necessarily appropriate for all other kinds of provisions.

II AUSTRALIAN LAW BEFORE *ANDREWS*

A *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd*

The general principles applied during the century before the recent High Court decisions are very familiar. In the passage in *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd*[11] endorsed by the High Court in *Ringrow*,[12] Lord Dunedin said:

> … I shall content myself with stating succinctly the various propositions which I think are deducible from the decisions which rank as authoritative:—
> 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. …

[9] *Paciocco v Australian and New Zealand Banking Group Ltd* (2014) 309 ALR 249.
[10] (2016) 258 CLR 525.
[11] [1915] AC 79, 86–7.
[12] (2005) 224 CLR 656 [11]–[12].

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 covenanted pre-estimate of damage...
3. The question whether a sum stipulated is penalty or liquidated damages is a question of construction to be decided upon the terms and inherent circumstances of each particular contract, judged of as at the time of the making of the contract, not as at the time of the breach …
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 to be 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. …
   (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 the sum which ought to have been paid...
   (c) There is a presumption (but no more) that it is 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' ….

On the other hand:

   (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 ….

B *Is the Penalty Rule a Rule of Law Not Equity?*

In 2008, the New South Wales Court of Appeal (Allsop P, with whose reasons Giles and Ipp JJA agreed) held in *Interstar Wholesale Finance Pty Ltd v Integral Home Loans Pty Ltd*[13] that the origins of the penalty doctrine lay in equitable sources but the 'modern rule against penalties is a rule of law not equity'. For that proposition Allsop P cited the joint judgment of Mason and Wilson JJ in *AMEV-UDC Finance Ltd v Austin*.[14]

In *AMEV-UDC* the owner of equipment exercised a contractual right to terminate a hiring contract upon the hirer's failure to pay instalments as they fell due. Those breaches of contract did not amount to a repudiation of the contract. A term of the contract entitled the owner to terminate the contract upon a variety of events, including such a breach. The contract entitled the owner upon termination to recover the unpaid instalments with interest, the whole unpaid balance of the hiring charges, and the specified residual value of the equipment, less the proceeds of sale of the equipment. The owner conceded that the contractual provision requiring the hirer to pay the full balance of the unpaid hiring charges was unenforceable as a penalty.[15] The question was whether the hirer's remedy was limited to recovery of the instalments of the rent unpaid at termination (the loss directly caused by the breach) or whether, in addition, the owner was entitled to recover its expectation loss (the difference between the capital

[13] (2008) 257 ALR 292.
[14] (1986) 162 CLR 170.
[15] The hire agreement was in a form indistinguishable from that considered in *O'Dea v Allstates Leasing System (WA) Pty Ltd* (1983) 152 CLR 359. The penal nature of those kinds of provisions might perhaps have been avoided by provisions rebating the future instalments of rent to account for the hirer's early receipt upon termination and giving the hirer any amount by which the net sale price exceeded an appropriately estimated residual value: *IAC (Leasing) Ltd v Humphrey* (1972) 126 CLR 131, 141–5 (Walsh J).

component of the rent payable after termination and the market value of the hired goods at that date, which arose directly from the owner's decision to terminate rather than from the hiree's breach). By majority (Gibbs CJ, Mason and Wilson JJ; Deane and Dawson JJ dissenting) the High Court held that the owner was not entitled to recover its expectation loss.

The trial judge (Rogers J) acknowledged that the damage which the owner suffered beyond the unpaid instalments up to the date of termination was attributable to the owner's exercise of its contractual power of termination at a time when the depreciation in the value of the goods exceeded the instalments payable to the owner up to that time. Rogers J nevertheless found that the owner was entitled to recover the actual damage it had suffered beyond the unpaid rent upon the footing that the court should award the plaintiff compensation for its loss upon principles applied by equity in the exercise of its jurisdiction to relieve against penalties. The New South Wales Court of Appeal (Mahoney and Priestley JJA, Hutley JA dissenting) allowed an appeal, set aside the resulting judgment and remitted the matter for assessment on the footing that the amount of the award was limited to the rent unpaid. Priestley JA considered that Rogers J was correct in having regard to the principles of equity in determining the compensation to which the owner was entitled instead of the penalty but considered that the limitation of the owner's damages to the instalments unpaid at termination accorded with those principles. Mahoney JA did not decide whether equitable principles were applicable but agreed with Priestly JA's conclusion.

On appeal, Gibbs CJ found that the appellant was 'in the position of a plaintiff in an ordinary action for damages for breach of contract' and thus entitled to recover damages sustained as a result of the breach.[16] Gibbs CJ denied that the owner could invoke 'general equitable principles which relate to the relief against penalties when those principles have long since hardened into definite rules governing the position of parties to a contract which contains a clause imposing a penalty for breach'.[17] It was 'well established in the modern law that the liability of a party who has broken a contract which contains a penalty clause is to pay the damages that have resulted from the breach'.[18]

Mason and Wilson JJ expressed conclusions to the same effect. The advent of the judicature system 'hastened the demise of equity's separate jurisdiction to relieve against penalties' and reinforced the principle, which became an 'established rule of law', that a penalty is unenforceable.[19] There was no instance drawn to their attention of the equitable jurisdiction to relieve against penalties having been invoked in England since the *Judicature Act 1873* (UK), 'let alone any instance of the exercise of the jurisdiction in which compensation awarded has exceeded the amount of damages which would have been awarded at common law in lieu of the penalty'. After noting that the cases showed, without exception, that 'once the agreed sum is held to be a penalty the plaintiff recovers damages for breach of contract in lieu of the penalty', their Honours concluded that 'the equitable jurisdiction to relieve against penalties withered on the vine for the simple reason that, except perhaps in very unusual circumstances, it offered no prospect of relief which was not ordinarily available in proceedings to recover a stipulated sum or, alternatively, damages'.

[16] (1986) 162 CLR 170, 175.
[17] Ibid 176.
[18] Ibid.
[19] Ibid 191.

Deane J concluded that the rules concerning the unenforceability of contractual penalties are common law rules derived from equitable principles.[20] He observed that:

> ...the acceptance by the common law of the unenforceability of penalties largely removed the occasion for the exercise of the equitable jurisdiction to relieve against enforcement with the result that the terms upon which equity would grant such relief became ordinarily of but academic or historical interest. The equitable jurisdiction did not, however, cease to exist and the terms upon which equitable relief against penalties would be granted remain directly applicable in those comparatively rare cases in which the party asserting unenforceability is constrained to seek positive relief (whether primary or ancillary) which is purely equitable in character, such as an order for reconveyance.[21]

Applying the common law rule as Deane J described it, the owner was entitled to recover his expectation loss. Dawson J found it unnecessary to consider whether relief against the penalty might be granted upon terms in reliance upon equitable doctrines.[22]

It is notable that various eminent judges who considered the problems thrown up in that litigation gave different answers to the related questions whether the law concerning penalties on breach is a rule of the common law or an equitable remedy and as to the appropriate measure of compensation to be afforded to the promisee of a contractual obligation found to be a penalty. Various statements in *Paciocco* suggest that *Andrew*s may not be the last word upon the first question. There appears to have been no subsequent authoritative decision answering the second question.

C *Is the Penalty Rule Restricted to Penalties for Breach of Contract?*

In *Interstar*,[23] Allsop P referred to four grounds for concluding that the Australian common law concerning contractual penalties was limited to circumstances of breach of contract:

1. The decision of the House of Lords in *Export Credits Guarantee Department v Universal Oil Products Co*[24] approving the first instance decision (Staughton J) and the decision in the Court of Appeal (Waller, Slade LJJ, and Sir Sebag Shaw), which relied upon the decision of the Court of Appeal (Ormerod, Danckwerts and Diplock LJJ) in *Philip Bernstein (Successors) Ltd v Lydiate Textiles Ltd*.[25] In *Philip Bernstein*, Lord Diplock endorsed a concession that there was 'no case in which it has been held that a payment to be made on a specified event not being a breach by the promisor of his own contract is a penalty or can be treated by the courts in the same way as a penalty'. In *Export Credits* the House of Lords expressed its entire agreement with Diplock LJ's refusal 'to extend the law by relieving against an obligation in a contract entered into between two parties which does not fall within the well-defined limits in which the court has in the past shown itself willing to interfere'.[26]

[20] Ibid 197: 'The common law rules relating to the unenforceability of penalties were derived from equitable principles determining the availability of relief in Chancery.'
[21] Ibid 195.
[22] Ibid 219–20.
[23] (2008) 257 ALR 292 [106].
[24] [1983] 2 All ER 205; [1983] 1 WLR 399 (Lord Roskill, with whom Lords Diplock, Elwyn-Jones, Keith and Brightman agreed).
[25] *Sterling Industrial Facilities Ltd v Lydiate Textiles Ltd; sub nom Bernstein (Philip) (Successors) Ltd v Lydiate Textiles Ltd* (unreported, Court of Appeal, Civ Div) [1962] CA Transcript 238; (1962) 106 Sol Jo 669.
[26] [1983] 1 WLR 399, 404.

2. Australian intermediate appellate court judgments to the same effect: *Ringrow Pty Ltd v BP Australia Pty Ltd*,[27] *Bartercard Ltd v Myallhurst Pty Ltd*,[28] and *Wollondilly Shire Council v Picton Power Lines Pty Ltd*.[29]
3. *Export Credits* was also a 'powerful statement' of the public policy that commercial parties should be kept to their bargains 'and consequentially in keeping a doctrine having the consequences of voidness or unenforceability of terms bargained for within strict and clearly identifiable limits'.[30] The High Court clearly stated the same policy in *Ringrow*.[31]
4. Although no High Court decision was directly on point, the dissenting views of Deane J in *AMEV-UDC* were consistent with the doctrine expressed in that case by Mason and Wilson JJ and Dawson J (dissenting), and also with the judgment of Walsh J (Barwick CJ and McTiernan J agreeing) in *IAC (Leasing) Ltd v Humphrey*.[32] In *Ringrow* the High Court referred to the standard application of the law of penalties being attracted in the case of breach and endorsed the well-known passage in Lord Dunedin's speech in *Dunlop*, which formulated the penalty doctrine in terms of the consequence of a breach of contract.[33]

In *AMEV-UDC* Gibbs CJ stated[34] that it was not necessary to consider the holding in *Export Credits Guarantee Department v Universal Oil Products Co*,[35] that a clause providing for payment of money on the happening of a specified event other than a breach of contract is not a penalty. Mason and Wilson JJ referred[36] with approval to that conclusion in *Export Credits*. Dawson J referred to *Export Credits* and concluded that it seemed clear that a provision requiring the payment of money on the occurrence of a specified event, other than a breach, cannot be a penalty;[37] it was 'clearly established' that a penalty clause did not preclude the recovery of actual loss arising from breach of contract and that the quantum of damages was to be assessed upon 'ordinary principles'.[38]

III *Andrews v Australian & New Zealand Banking Group Ltd*

The proceeding that gave rise to the High Court's decision in *Andrews* was a claim for declaratory relief that contractual provisions under which the bank had charged honour, dishonour, non-payment and over limit fees were void or unenforceable as penalties and that the applicants or group members were entitled to restitution of the fees retained by the bank.

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[27] (2004) 209 ALR 3233 [109] (Conti and Crennan JJ), adopting Healy J's reasons for concluding that '[t]he sphere of operation of the penalties doctrine is limited to payment of agreed sums or transfer of a property upon a breach of contract: (Rossiter, *Penalties & Forfeiture*, 1992 p 66.)'.

[28] [2000] QCA 445 [27]–[28] (Thomas JA, with whom Davies JA and Ambrose J agreed, and per Davies JA at [2]).

[29] (1994) 33 NSWLR 551, 555 (Handley JA, with whom Clarke and Meagher JJA agreed), describing the 'classical test' in terms of a contractual stipulation expressing a sum 'to be payable in the event of a breach'.

[30] (2008) 257 ALR 292 [112].

[31] (2005) 224 CLR 656 [31], [32].

[32] (1972) 126 CLR 131, 143 (referring to a preponderance of opinion that the penalty rule applies only in the case of breach of a term of the contract). In *O'Dea v Allstates Leasing System (WA) Pty Ltd* (1983) 152 CLR 359, 390, Brennan J referred to Walsh J's statement and observed that the 'balance of opinion' in the High Court favoured that view.

[33] (2005) 224 CLR 656, [10]–[11], referring to [1915] AC 79, 86–7.

[34] (1986) 162 CLR 171, 174.

[35] [1983] 1 WLR 399, 402.

[36] (1986) 162 CLR 170, 184.

[37] Ibid 211.

[38] Ibid 212.

The contract made it clear that the bank did not agree to provide any credit in respect of the customer's account without a prior written agreement and it was a condition of the bank's account that the customer must not overdraw the account without prior arrangements with the bank. The fees were charged by the bank as a consequence of the bank's decision either to afford or to refuse further accommodation to the customer, where honouring a customer's request for accommodation would result in the account being overdrawn or exceeding a credit limit. A request for an informal overdraft was deemed to be made by the customer where a debit was initiated which, if processed, would result in the account being overdrawn or an approved limited being exceeded.[39]

The reasons in *Andrews* focused upon a detailed study of the origins and content of the equitable jurisdiction to relieve against penalties, with particular reference to equitable relief against penal bonds. There has been a great deal of academic and judicial analysis of the development of the equitable jurisdiction in addition to the analysis in *Andrews*. In *Australian Capital Financial Management Pty Ltd v Linfield Developments Pty Ltd*,[40] Ward JA lists some examples, including the judgment of Kiefel J in *Paciocco*. Only a brief reference to part of that history is necessary here. In centuries past, debts and other obligations were commonly secured by a bond. A simple form of a penal bond involved a borrower undertaking an obligation to pay a specified sum on a fixed day, the sum being far more than (commonly twice) the amount lent, subject to a condition that if the borrower repaid the amount lent before the date the repayment was due the bond would be void. If the condition was not fulfilled, the lender could recover the larger debt created by the bond in an action at law. An equitable jurisdiction developed to relieve against the penalty created by the bond upon terms requiring the borrower to compensate the lender by paying the lesser amount secured by the bond together with interest and costs. Long before the development of the modern law of contract, conditional bonds were used to secure promissory and other stipulations of a kind that are now commonly included in simple contracts.

In *Andrews* the High Court disagreed with the New South Wales Court of Appeal's conclusions in *Interstar* that the modern rule against penalties is 'a rule of law, not equity' and that, as stated in *Export Credits Guarantee Department*,[41] the limits of the penalty doctrine arise 'from the consequences of breach of contract' and so reflect 'the public policy of keeping commercial parties to their bargains'.[42] The court considered that there is a surviving and distinctly equitable remedy for relief against a contractual penalty and that it is not a condition of the equitable rule that the penalty arises otherwise than upon a breach of contract. There was no reason in principle why the scope of the equitable doctrine should be restricted to cases where an action in assumpsit would have lain at common law in the 19th century. The principles of equity continue to develop in an evolutionary way, and to the extent that the common law mirrored equity by the time of the introduction of the judicature legislation, there was no conflict and, in the event of conflict, it would be equity rather than the law that would prevail.[43]

[39] The contractual provisions were varied over time, but that appears to be the substance of each iteration: (2012) 247 CLR 205, [24], [25].
[40] [2017] NSWCA 99, [354], citing Paciocco at [16]–[25], among others.
[41] [1983] 1 WLR 399, 402–4; [1983] 2 All ER 205, 223–4.
[42] *Interstar Wholesale Finance Pty Ltd v Integral Home Loans Pty Ltd* (2008) 257 ALR 292, 324.
[43] (2012) 247 CLR 205, [62]–[63].

The court considered that Brereton J at first instance in *Interstar*[44] correctly understood Mason and Wilson JJ's judgment in *AMEV-UDC* as not deciding that a breach of contract is a necessary condition for relief against the penalty, but instead suggested that relief might be granted in the absence of an express contractual promise to perform the condition upon which the penalty arises 'apparently on the basis that despite the absence of such an express promise, a penalty conditioned on failure of a condition is for these purposes in substance equivalent to a promise that the condition will be satisfied'.[45]

The equitable penalty doctrine was stated in general terms in the joint judgment:

> In general terms, a stipulation prima facie imposes a penalty on a party (the first party), if, as a matter of substance,[46] it is collateral (or accessory) to a primary stipulation in favour of a second party and this collateral stipulation, upon the failure of the primary stipulation, imposes upon the first party an additional detriment, the penalty, to the benefit of the second party. In that sense, the collateral or accessory stipulation is described as being in the nature of a security for and in terrorem of the satisfaction of the primary stipulation.[47] If compensation can be made to the second party for the prejudice suffered by failure of the primary stipulation, the collateral stipulation and the penalty are enforced only to the extent of that compensation.[48]

The narrowness of the question for decision in *Andrews* is reflected in the terms of the Court's declaration[49]

> ...that the circumstances:
> (a) that the ... fees were not charged by the respondent upon breach of contract by its customers, and
> (b) that the customers had no responsibility or obligation to avoid the occurrence of events upon which their fees were charged,
> do not render these fees incapable of characterisation as penalties.

IV *PACIOCCO V AUSTRALIA & NEW ZEALAND BANKING GROUP LTD*

In 2014 the trial judge (Gordon J) found that none of the fees in relation to which *Andrews* was decided were charged by the bank upon a breach of contract by the customer and nor was the event upon which the fees were charged (overdrawing the account or credit limit or attempting to do so) one that the customer had an obligation or responsibility to avoid. The customer's contention that the fees were penalties 'at law' was rejected because they were not paid for breach of contract. The customer's contention that those fees were penalties 'in equity' failed because they were not payable upon the failure of a stipulation.[50] Oversimplifying Gordon J's detailed analysis, the fees were simply charges for additional services rendered by the bank at

[44] *Integral Home Loans Pty Ltd v Interstar Wholesale Finance Pty Ltd* (2007) 2 BFRA 23, 53–4; [2007] Aust Contract Reports 90-261, 90,037.
[45] (2012) 247 CLR 205 [67], quoting Brereton J in *Interstar*. There appears to be an incongruity between that view and the decision in *Andrews* that the penalty doctrine contemplates fees charged upon an event which it was not the customer's obligation to avoid.
[46] As to equity's preference for substance rather than form, see *Parkin v Thorold* (1852) 16 Beav 59, 66–7 (Lord Romilly MR). Contrast *Kellas-Sharpe PSAL Ltd* [2013] 2 Qd R 233 (an agreement to charge a certain interest rate on the condition that upon punctual repayment of the loan a reduced rate will be charged is not a penalty).
[47] The Court cited authority including *Dunlop* [1915] AC 79, 86 (where Lord Dunedin's second proposition is found).
[48] (2012) 247 CLR 205 [10] (some citations omitted).
[49] (2012) 247 CLR 205, 239.
[50] *Paciocco v Australia and New Zealand Bank Group Ltd* (2014) 309 ALR 259, (in relation to equity) [202], [224], [249], [261], [262], [272].

the customer's request. There was no appeal from the trial judge's rejection of Mr Paciocco's claim that those fees were penalties. The appeal concerned only late payment fees charged upon breach of contract.

In the High Court in *Paciocco* each of Kiefel J (as the Chief Justice then was), with whose reasons French CJ agreed, Gageler J, Keane J, and Nettle J (dissenting), delivered extensive reasons which included detailed discussion explaining how Lord Dunedin's propositions in *Dunlop* should be applied in Australia. Analyses of the majority judgments in *Paciocco* were undertaken by the New South Wales Court of Appeal in *Arab Bank Australia Ltd v Sayde Developments Pty Ltd*,[51] the Victorian Court of Appeal in *Melbourne Linh Son Buddhist Society Inc v Gippsreal Ltd*,[52] and the New Zealand Court of Appeal (in a case governed by the common law of Australia) in *Wilaci Pty Ltd v Torchlight Fund No 1 LP*.[53] With the benefit of those analyses, and acknowledging that any attempt to summarise the detailed and differing sets of reasons in *Paciocco* must necessarily involve omissions and inaccuracies, I suggest that the following broad propositions may be derived from *Paciocco.*

First, consistent with the terms of Lord Dunedin's introduction to the quoted propositions in *Dunlop*, those propositions supply guidance upon the question whether a stipulated payment upon breach is a penalty but they should not be applied as though they are rules of law.[54]

Second, in relation to Lord Dunedin's propositions 1 and 3, as the reference to 'inherent circumstances' in Lord Dunedin's proposition 3 reveals, the contractual language is not decisive.[55] The question is one of 'construction' with reference to 'the terms and inherent circumstances of each particular contract, judged as at the time of the making of the contract…'.[56] The word 'construction' does not connote the attribution of legal meaning to the contractual text; it refers to the objective ascertainment of legal characterisation of the stipulation with reference both to the contractual language and the circumstances in which the contract was made.[57]

Third, the underlying legal policy is that the exception from the principle of freedom of contract is justified only where the stipulated payment amounts to a threat of punishment upon default of the primary obligation.[58]

Fourth, a stipulation for payment of a sum upon breach of contract will be characterised as a threat of punishment amounting to a penalty only if the stipulated sum is out of all proportion to, or so disproportionate with, the interests of the party the stipulation is designed to protect as to characterise the stipulation as having a predominantly or exclusively punitive purpose.

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[51] (2016) 93 NSWLR 231 [74]–[76] (McDougall J, with whose reasons Gleeson JA and Sackville AJA agreed).
[52] [2017] VSCA 161 [5]–[11] (Maxwell P) [164]–[174] (Kyrou JA and Cameron AJA).
[53] [2017] 3 NZLR 293 [85]–[89] (Koś P, French and Miller JJ).
[54] (2016) 258 CLR 525 [32] (as illustrated at [33]–[41]) (Kiefel J); [143], [147], [149] (Gageler J); [260], [268] (Keane J); see also Nettle J [318].
[55] (2016) 258 CLR 525 [31] (Kiefel J); [146], [166], [167] (Gageler J); [242], [243], [273] (Keane J); see also Nettle J [317](1) and (3).
[56] (2016) 258 CLR 525 [62] (Kiefel J); [169] (Gageler J, who noted that evidence of the later occurrence of an event can be probative of the earlier probability of that event occurring); [242], [243], [273] (Keane J); see also [346] (Nettle J). This is the point upon which the appeal in *Arab Bank Australia* was upheld.
[57] (2016) 258 CLR 525 [146] (Gageler J); [243] (Keane J); see also [317](3) (Nettle J).
[58] (2016) 258 CLR 525 [17], [22], [32] (Kiefel J); [118], [127] (Gageler J), referring to the explanation in *Andrews* of the conception of a penalty originating in equity as punishment for non-observance of a contractual stipulation; [220], [250]–[257], [259] (Keane J).

The fourth proposition substantially abbreviates and amalgamates detailed passages in the majority justices' reasons on this point. A fuller summary is as follows:

(a) (per Kiefel J) its penal character is revealed by the sum stipulated being extravagant and unconscionable, in the sense that it is 'out of all proportion to the interests of the party which it is the purpose of the provision to protect';[59]

(b) (per Gageler J) it is properly characterised as having no purpose other than to punish, as revealed by the negative incentive to perform arising from the stipulated payment 'being so far out of proportion with the positive interest in performance that the negative incentive amounts to deterrence by threat of punishment'.[60] Gageler J framed the issue[61] reflecting Wilson J's question in *O'Dea*,[62] whether the stipulation 'can be considered to be a "genuine pre-estimate of the creditor's…probable or possible interest in the due performance of the principal obligation"[63] ... or "whether it is a penalty merely to secure the enjoyment of a collateral object"[64]'. That question may be reframed as an enquiry whether the innocent party has an interest in observance of the principal contractual stipulation that 'explains the stipulation for payment as having a purpose other than to punish the offending party'[65] or whether 'the only purpose of the stipulation was to punish: to impose a detriment…in the event that a principal contractual stipulation is not observed, in order to deter non-observance…';[66]

(c) (per Keane J) 'gross disproportion' between the stipulated sum and the potential injury to the innocent party's interests upon the breach points to a 'predominant punitive purpose',[67] the stipulated sum is 'so far out of proportion to the effect upon the legitimate interests associated with the [innocent party's] business that its purpose was punitive',[68] or it is 'exorbitant or unconscionable when regard is had to the innocent party's interest in the performance of the contract'.[69]

The third and fourth propositions are reflected within a single proposition expressed in *Arab Bank* and in *Wilaci*. In *Arab Bank*[70] the New South Wales Court of Appeal derived from *Paciocco* the proposition that '[t]he essence of a penalty is that it is a collateral stipulation, the (or a predominant) purpose of which is to punish the borrower for breach, and thus to compel performance…'. In *Wilaci*[71] the New Zealand Court of Appeal derived the proposition that the 'essential justification, in the face of the usual (and commercially important) principle of freedom of contract, is that a provision that has its sole or predominant purpose to punish a contract breaker is contrary to public policy'.

Fifth, the innocent party's relevant interests protected by the alleged penalty include but may extend beyond the innocent party's interest in the unliquidated damages recoverable at

[59] (2016) 258 CLR 525 [29] (referring to Lord Dunedin's proposition for (a)), [54] (referring to *Ringrow* at [31]–[32] and *Cavendish Square Holdings BV v Makdessi* [2016] AC 1172 [32] (Lord Neuberger and Lord Sumption)).
[60] (2016) 258 CLR 525 [164].
[61] Ibid [157].
[62] (1983) 152 CLR 359, 383. Gageler J observed that this was consistent with *Andrews* and *Dunlop*.
[63] Wilson J citing *Public Works Commissioner v Hills* [1906] AC 368, 375–6.
[64] Wilson J citing *Sloman v Walter* (1783) 1 Bro CC 418, 419; 28 ER 1213, 1214.
[65] (2016) 258 CLR 525 [159].
[66] (2016) 258 CLR 525 [158].
[67] (2016) 258 CLR 525 [221].
[68] (2016) 258 CLR 525 [240].
[69] (2016) 258 CLR 525 [270], quoting Lord Hodge in *Cavendish Square Holdings* [2016] AC 1172 [255].
[70] (2016) 93 NSWLR 231 [74] (2).
[71] [2017] 3 NZLR 293 [85]–[89] (Koś P, French and Miller JJ).

common law for breach of the primary obligation.[72] Those interests may include 'intangible and unquantifiable' interests in contractual performance.[73] In *Paciocco*, the protected interests included financial and economic interests.

Sixth, the onus of proving that a contractual stipulation is a penalty is upon the person asserting it.[74]

Seventh, the 'test' in Lord Dunedin's proposition 4(b) (which, like the other tests, might 'prove helpful, or even conclusive' if it is 'applicable to the case under consideration'[75]) is applicable, if at all, only where the innocent party's interests protected by the alleged penalty are confined to the repayment of the outstanding sum to the exclusion of any other financial, economic, or other consequence protected by the contractual stipulation and arising from the default in payment.

That summary is drawn particularly from the following passages, in which it was said of the 'test' in proposition 4(b) that:

(a) (per Kiefel J) it has 'a narrow range of operation and is confined to the simplest of cases', it fails to take into account the development in *Hungerfords v Walker*[76] that damages for breach of an obligation to pay a sum of money can comprehend both interest and opportunity costs, and it 'says nothing about the damage to a party's wider commercial interests…which was the real issue in *Dunlop*';[77]

(b) (per Gageler J) it (and each other 'test' and 'presumption' mentioned by Lord Dunedin) is one of the 'indicia' or 'considerations which might indicate a payment of money to have been stipulated as in terrorem…'; they do not involve any legal criterion or shift in the evidentiary or persuasive onus of proof.[78] That is illustrated by the circumstance that the only case cited for proposition 4(b) (*Kemble v Farren*[79]) featured all of the indicia in propositions 4(a) to (c). Lord Dunedin intended to convey that, at least by the beginning of the 20th century, statements routinely made in the 19th century English cases that a larger sum payable on a breach of a covenant to pay a smaller sum is a penalty at law and in equity did not embody 'a distinct legal rule'.[80] It was telling that the well-resourced parties had not unearthed any English or Australian case before *Dunlop*, or decided afterwards by reference to it, in which a stipulated payment was held to be a penalty only upon the basis of proposition 4(b);[81]

(c) (per Keane J) it harked back to a condition securing payment of a lesser sum by a covenant to pay a greater sum. In *Dunlop* Lord Parmoor observed that, '[s]ince the damage for the breach of covenant is in such cases by English law capable of exact

[72] (2016) 258 CLR 525 [26], [33], [43]–[47], [65] (Kiefel J); [145], [160] (comparison of a specified sum of money payable upon breach with the amount of unliquidated damages recoverable for the breach 'sometimes but not always decisive, of whether the only purpose of the stipulation is to punish'), [161], [162] (Gageler J); [216], [222], [280]-[284] (including, at [283]: 'For a party to stipulate for a more ample remedy than is available at law is not to visit a punishment on the other party'.) (Keane J).
[73] (2016) 258 CLR 525 [161] (Gageler J). See also per Keane J [222]: *Dunlop* does not suggest 'a narrow view' of the interests capable of protection by an agreed payment provision.
[74] (2016) 258 CLR 525 [69] (Kiefel J); [167] (Gageler J); [240], [279] (Keane J).
[75] [1915] AC 79, 87.
[76] (1989) 171 CLR 125.
[77] (2016) 258 CLR 525 [35].
[78] Ibid [149]–[150].
[79] (1829) 6 Bing 141; 130 ER 1234.
[80] (2016) 258 CLR 525 [151].
[81] Ibid [151].

> definition, the substitution of a larger sum as liquidated damages is regarded, not as a pre-estimate of damage, but as a penalty in the nature of a penal payment'.[82] Keane J found much force in Mason CJ and Wilson J's observation in *Hungerfords v Walker*[83] that 'legal and economic thinking about the remoteness of financial and economic loss have developed markedly in recent times'.[84] It was only in *Hungerfords v Walker* that Australian jurisprudence accepted the economic reality that to be kept out of money due was to suffer real economic loss; the consequence of the acceptance in more recent decisions that 'the borrower in default is not the same credit risk as the prospective borrower with whom the loan agreement was first negotiated'[85] had been accompanied by an appreciation of the nature of the relationship between the greater financial risk assumed by a bank by reason of late payments by customers and the costs to the bank's revenue stream associated with that increased risk.[86]

Eighth, as to the 'presumption' in Lord Dunedin's proposition 4(c), it follows from the first proposition stated in this paper that it is not a legal presumption but is instead merely one indication of a penalty to be taken into account together with all of the 'terms and inherent circumstances of each particular contract'[87]. Kiefel J said of Lord Dunedin's proposition 4(c) that it was 'stated as a presumption ("but no more")' which may be rebutted.[88] This 'presumption' again falls within Gageler J's conclusion that Lord Dunedin's tests and presumptions merely state 'indicia' and do not alter the evidentiary or persuasive onus of proof.[89] Keane J described Lord Dunedin's proposition 4(c) as a weak 'presumption';[90] his Honour disposed of it by referring to the circumstances that the alleged penalty was not apt to operate in terrorem of the customer, as was illustrated by it being the customer's choice to run his affairs by risking the fees.

Ninth, consistently with Lord Dunedin's proposition 4(d), a difficulty in pre-estimating the consequences of the breach is likely to make it more difficult for the party in breach to establish that the stipulated sum is a penalty.[91]

The fifth and sixth propositions proved to be decisive in *Paciocco*. The customer's expert evidence was to the effect that the bank's losses were about $3 for each late payment, compared with the $35 (subsequently reduced to $20), charged as a late payment fee. The majority found that this evidence concerned only the bank's operational costs, such as the costs of its staff contacting the customer and administration costs. The bank's expert gave evidence that there were other impacts of a customer's failure to pay on the due date (requirements to make provisions in its accounts for what it may not recover and requirements to hold additional capital to cover unexpected losses), that these involved injuries to the bank's financial position, and that was reflected in potential costs to the bank. Although those effects upon the bank's financial interests were not recoverable as damages for breach of contract, they should be taken

[82] Ibid [261], quoting from *Dunlop* [1915] AC 79, 101–2.
[83] (1989) 171 CLR 125, 146.
[84] (2016) 258 CLR 525 [263].
[85] Ibid [263] quoting Colman J in *Lordsvale Finance Plc v Bank of Zambia* [1996] QB 752, 763.
[86] (2016) 258 CLR 525 [264].
[87] [1915] AC 79, 87(c).
[88] (2016) 258 CLR 525 [36], [38].
[89] Ibid [149]–[150].
[90] Ibid [265].
[91] Ibid [48], [57] (Kiefel J); [221] (Keane J). None of the judgments in *Paciocco* expressed any qualification upon the continuing authority of *Ringrow's* endorsement of this proposition in *Dunlop*.

into account in assessing whether the late payment fees were penalties.[92] Because the customer's expert had not taken them into account, the customer had failed to fulfil its onus of proving that the late payment fees amounted to penalties upon the application of the principles summarised in the preceding propositions.

V *ANDREWS*: ITS EFFECT OF EXPANDING THE SCOPE OF CONTRACTUAL PENALTIES

The expression of the penalty doctrine in *Andrews* described the nature of the stipulation to which it applies as being, in substance, a stipulation that 'is collateral (or accessory) to a primary stipulation…[and which] upon the failure of the primary stipulation, imposes an additional detriment, the penalty, to the benefit of the second party'.[93] Those very broad words potentially comprehend a great variety of stipulations, including stipulations commonly found in commercial contracts. In *Cavendish Square Holding BV v Makdessi; ParkingEye Ltd v Beavis*[94] Lords Neuberger and Sumption gave some examples of the kinds of stipulations that might be caught: provisions for termination on insolvency, contractual payments due on the exercise of an option to terminate, break-fees chargeable on the early repayment of a loan or the closing out of futures contracts in the financial or commodity markets, provisions for variable payments dependent on the standard or speed of performance, and 'take or pay provisions' in long term oil and gas purchase contracts.

A stipulation arising upon the event of insolvency has since been the subject of challenge as a penalty in *Australia Capital Financial Management Pty Ltd v Linfield Developments Pty Ltd*.[95] Simplifying the facts in that case, the respondent developer (Linfield) entered into a development agreement with the appellant (SXG) in relation to a proposed residential and commercial development of land. SXG had contracted to buy the land for $20 million, with completion fixed for a date about six months after the development agreement was made. Under the development agreement, Linfield agreed to lend $1 million to SXG and to make further sums up to $5 million available to SXG to complete the sale contract if so requested. SXG granted Linfield a call option exercisable in various events of default, including the happening of an 'insolvency event', a term which comprehended the appointment of an administrator to SXG. If Linfield exercised the call option before completion by SXG of its contract to buy land, Linfield was required to pay SXG the $20 million purchase price in exchange for stepping into its shoes under the contract. At the time of contract there was a rising market. SXG argued that it must have been contemplated that the value of the land might increase above the purchase price before the development approval was obtained. Other provisions of the development agreement imposed obligations on Linfield which required it to incur costs of the development. Linfield and SXG were to share equally in project income after repayment to Linfield of the costs of development. There was no express obligation in the development agreement for SXG to avoid the commission of an insolvency event.

Ward JA, with whose reasons McColl and Gleeson JJA agreed, held that in those circumstances the penalty doctrine in equity was engaged because the call option was a stipulation collateral to a primary stipulation in favour of Linfield imposing an additional detriment on the failure of the primary stipulation to the benefit of Linfield.[96] Ward JA applied the principles identified

[92] Ibid [65] (Kiefel J); [171]–[172] (Gageler J); [231]–[232], [279] (Keane J).
[93] (2012) 247 CLR 205 [10].
[94] [2016] AC 1172 [42].
[95] [2017] NSWCA 99.
[96] [2017] NSWCA 99 [361].

by Lord Dunedin in *Dunlop*, as explained in *Andrews* and *Paciocco* in holding that it was not a penalty.[97]

Before *Andrews* the penalty claim in *Australian Capital Financial Management* might have been summarily rejected upon the ground that the suggested penalty did not arise upon breach of contract, thereby avoiding the litigation upon that issue altogether. It is observed in *Meagher, Gummow & Lehane*[98] that when fears have been expressed about the penalty doctrine foiling the workings of secondary stipulations such as derivatives transactions, 'other constraints on the penalty doctrine have led those courts to conclude that the stipulations in question were not penal in any event' and 'such cases would have been decided in the same way whether or not a breach limitation had applied'. The authors' extensive analysis suggests, however, that litigation about such questions is likely to involve legally and factually complex disputes, the necessary characterisation of such contractual stipulations depending heavily upon the particular contractual terms and unique factual circumstances in which each contract is concluded.[99]

VI *PACIOCCO*: ITS EFFECT OF LIMITING SUCCESSFUL PENALTY CLAIMS

The practical significance of *Paciocco* may be illustrated by reference to the reasons for the rejection of the penalty claim in *Australia Capital Financial Management*. After *Andrews* but before *Paciocco*, it might have been thought that there was some weight in a submission advanced in *Australia Capital Financial Management* that the call option provisions were penal in effect because Linfield's entitlement to exercise the option arose upon any breach of the development agreement, however trivial, and the transfer of the property thereby required was unrelated to damage that might be suffered by Linfield as a result of the particular event of default. That submission would have invoked the 'presumption' in Lord Dunedin's proposition 4(c) that there is a penalty when a single lump sum is made payable on the occurrence of one or more of several events, some of which may occasion serious and others only trifling damage. The treatment in *Paciocco* of that 'presumption' (as amounting to one indication to be taken into account with all other considerations, in deciding whether the stipulated payment is out of all proportion to the interest of the innocent party protected by the secondary stipulation) readily justified rejection of such a submission. Ward JA was able to dispose of it by the observation that it did not 'properly take into account that if…there was an Insolvency Event… Linfield…might lose the opportunity to develop the land and share in the profits of that development…(where it had already invested considerable funds and effort towards the proposed development)…that opportunity would not be recoverable as damages…nor could it be assumed that such loss would be readily quantifiable'.[100]

The limiting effect of *Paciocco* is also illustrated by Nettle J's dissenting judgment in that case. Nettle J considered that *Paciocco* was a case in which the *Dunlop* tests were 'perfectly adequate'[101] to resolve the question whether the contractual stipulation was a penalty.[102] Nettle J observed that in cases such as *Clydebank*,[103] *Dunlop*, and *ParkingEye* there was 'evidence or

[97] [2017] NSWCA 99 [363]–[371].
[98] JD Heydon, MJ Leeming, and PG Turner, *Meagher, Gummow & Lehane's Equity Doctrines & Remedies*, LexisNexis Butterworths, 5th ed, 2015 [18-055].
[99] Ibid [18-065] et seq.
[100] [2017] NSWCA 99 [370].
[101] (2016) 258 CLR 525 [322] quoting *Cavendish* [2015] 3 WLR 1373, 1389 [25], 1393 [32].
[102] (2016) 258 CLR 525 [322].
[103] [1905] AC 6.

other indications of some broader interest to be protected'.[104] The bank's only interest in the timeous performance of the monthly payments obligation was the avoidance of costs incurred which the parties reasonably could have conceived would flow from late payment.[105] Unlike an interest rate increase of the kind found to be justifiable on the basis that riskier credit is more costly credit,[106] there was no correlation between the amount of the late payment fee and the amount or duration of lateness of the monthly payments.[107] The correct test in this straightforward kind of case was whether the amount of the late payment fee was extravagant and unconscionable or out of all proportion to the amount recoverable as unliquidated damages for breach of the monthly payments provision.[108]

Applying '*Dunlop* test 4(c)', Nettle J concluded that there was a presumption that the late payment fee was a penalty because it was payable on the occurrence of one or more of several events of which only some might occasion serious damage, and because the late payment fee was fixed regardless of whether the breach was serious or trivial with respect to time or amount.[109] Nettle J found that the evidence of the bank's expert concerning an increase in provision for bad or doubtful debts and increases in regulatory capital did not establish any amount recoverable as damages for breach of contract.[110] In any case, upon Nettle J's analyses the maximum amount of additional costs resulting from late payment established by the evidence was $6.90 per late payment. (This maximum figure was more than double the amount of the loss to the bank of about $3 derived from the customer's expert evidence.) Nettle J considered that the late payment fee of $35, and even the subsequently reduced late payment fee of $20, were 'grossly disproportionate to the greatest amount of damages recoverable for breach of the Monthly Payments obligation'.[111] Also taking into account the circumstances that this was a standard form consumer credit contract and the customer had no opportunity to negotiate its terms because of the bank's bargaining power, the late payment fees were extravagant or out of all proportion to the costs recoverable as damages for breach of contract and thus a penalty.[112]

Paciocco did not break new ground insofar as it decided that one of the requirements for characterisation as a penalty is that a sum stipulated for payment upon breach must be out of all proportion to damage likely to be suffered as a result of breach. In *AMEV-UDC Finance Ltd v Austin*, Mason and Wilson JJ referred to the concept in *Dunlop*[113] and *Clydebank Engineering & Shipbuilding Co v Don Jose Ramos Yzquierdo y Castaneda*[114] that 'an agreed sum is a penalty if it is "extravagant, exorbitant or unconscionable"'. After noting that recent decisions had struck down provisions merely because an agreed sum might be greater than the 'damages which could possibly be awarded for the breach of contract', their Honours observed that there was 'much to be said for the view that the courts should return to the *Clydebank* and *Dunlop* concept, thereby allowing parties to a contract greater latitude in determining what their rights and liabilities will be, so that an agreed sum is only characterized as a penalty if it is out of all proportion to damage likely to be suffered as a result of breach'. That passage was

[104] (2016) 258 CLR 525 [324].
[105] (2016) 258 CLR 525 [326].
[106] *Lordsvale Finance Plc v Bank of Zambia* [1996] QB 752, 763.
[107] (2016) 258 CLR 525 [328].
[108] Ibid [347].
[109] Ibid [348].
[110] Ibid [351], [364].
[111] Ibid [370].
[112] Ibid [371].
[113] [1915] AC 79, 87.
[114] [1905] AC 6, 10–11, 17.

endorsed in *Ringrow*, in which the Court explained that the requirements that the propounded penalty must be 'extravagant and unconscionable in amount' and not merely lacking in proportion, but 'out of all proportion', resulted from the law of penalties being an exception to the principle of freedom of contract.[115]

The practical effect of the majority decision in *Paciocco* nevertheless appears likely to be a substantial reduction in the number of cases in which a party in breach succeeds in establishing that a contractual stipulation is a penalty. That seems likely to result from the combination of the propositions identified in Section IV of this paper, most of which emphasise difficulties in proving that a contractual stipulation is a penalty. Four factors are particularly significant. There is firstly the requirement that at least in some cases (and probably in most commercial litigation of any significance) the required degree of disproportion must be found on a comparison between the challenged stipulation and not merely the recoverable damages for breach, but also the potential damage to any other legitimate interest — including a commercial or financial interest — resulting from breach. Secondly, the exceptional character of a penalty has been very strongly emphasised by the requirement that the extent of the disproportion between the stipulation for payment upon breach and the innocent party's interest in performance must be such as to establish that the sole or predominant purpose of the stipulation is punishment. Thirdly, notwithstanding the 'presumption' in Lord Dunedin's proposition 4(c), the onus of proof throughout remains upon the party asserting that a provision is a penalty. That must often be a difficult onus to fulfil when the interests protected by the alleged penalty include financial, economic or other intangible interests of which the party asserting a penalty may be ignorant. The fourth factor is that a difficulty in pre-estimating possible loss is likely to make it yet more difficult for the party asserting a penalty to fulfil its onus of proof.

VII THE FIELD OF OPERATION OF EQUITY IN RELATION TO CONTRACTUAL PENALTIES

A Penalty for Breach

The manner and circumstances in which equitable principles apply in relation to penalties upon breach of contract appear not to have been settled by *Andrews*. Before *Andrews* a great many cases were decided upon the footing that under the common law a penalty for breach is unenforceable, leaving the promisee with its common law right to recover damages for breach of the primary obligation.[116] The actual decision in *Andrews* — that a penalty may arise in equity otherwise than on breach — is not inconsistent with the co-existence of a discretionary equitable remedy in some kinds of cases, and a common law penalty rule in other kinds of cases. There are strong indications that a common law penalty rule in some form co-existed with the equitable jurisdiction long before the introduction of the judicature system. In *Andrews*, the court concluded that by the time Lord Nottingham was Lord Chancellor in 1673–1682, the courts of law, having seen how equity relieved against penal bonds, granted the same relief at law rather than requiring the intervention of equity.[117] The common law position was subsequently regulated by statutes in 1696[118] and 1705,[119] as a result of which the common law courts became familiar with the law concerning penalties.[120] The court also referred to 18th and 19th century decisions in which common law courts relieved against penal bonds securing the

[115] (2005) 224 CLR 656 [31]–[32].
[116] The effect of some decisions is that the damages are capped at the amount of the penalty. In principle that would seem to turn upon the proper construction of the contract as a whole in each case.
[117] (2012) 247 CLR 205 [53].
[118] 8 & 9 Will III, c 11 (1696).
[119] 4 & 5 Anne C 16 (1705).
[120] (2012) 247 CLR 205 [53], [54].

repayments of particular sums,[121] and to the practice in Chancery of directing an issue 'quantum damnificatus' for a common law jury determination where the sum in question appeared to be a penalty.[122]

It is necessary though to refer to five conclusions expressed in the Court's reasons in *Andrews*:

(a) The penalty doctrine did not disappear from equity 'by absorption into the common law action of assumpsit'.[123]
(b) The 'developments in the practice of the common law courts in assumpsit actions before the introduction of the judicature system did not somehow supplant the equity jurisdiction'.[124]
(c) There is 'no reason in principle why the scope of the equitable doctrine should be restricted to those cases today where, hypothetically, an assumpsit action would have lain at common law'.[125]
(d) '[U]nder the Judicature legislation it is equity not the law that is to prevail'.[126]
(e) There is 'no basis for the proposition that the penalty doctrine is a rule of law not of equity'.[127]

The first four conclusions are not necessarily inconsistent with the view that the equitable jurisdiction to relieve against penalties co-exists with the common law penalty rule. At first glance the fifth conclusion may seem to deny the existence of any common law penalty rule, but on a closer reading it is seen to deny only that the common law was left in sole command of the field. As appears from the second conclusion, the High Court concluded in *Andrews* that before the introduction of the judicature system the common law had not supplanted the equitable jurisdiction, but that does not necessarily deny the existence of a settled common law rule that a penalty for breach of contract is unenforceable and the liability of the party in breach is to pay damages for that breach, assessed in accordance with common law principles. That view of the law is suggested by statements in earlier decisions that were not expressly said in *Andrews* to be wrong.[128]

A view that *Andrews* decided that equity had excluded the application of any common law penalty rule seems inconsistent with the reasons of three of the four majority justices in *Paciocco*. After referring to Gordon J's finding at first instance that the provisions for late payment fees were 'penalties at law',[129] French CJ described the effect of the decision in *Andrews* in terms that are consistent only with the continuing co-existence of a common law rule and some continuing role for equity in relation to penalties in contracts: 'equitable relief against penalties had not been subsumed into the common law rule and … the rule against penalties was not limited to cases arising out of a breach of contract'.[130] Gageler J observed that the 'ultimate question in the first appeal is whether the contractual stipulation for the late

[121] Ibid [56], [57].
[122] Ibid [58].
[123] Ibid [51].
[124] Ibid [61], referring to: cf [*AMEV-UDC*] at 201; *Metro-Goldwyn-Mayer Pty Ltd v Greenham* [1966] 2 NSWR 717, 727. The reasons do not criticise the passages of Deane J's analysis discussed below in this paper.
[125] (2012) 247 CLR 205 [62].
[126] Ibid [63].
[127] Ibid [63].
[128] See in particular *AMEV-UDC* in the reasons of Gibbs CJ, Mason and Wilson JJ, and Deane J and Dawson J (referred to above, in Part II.B of this paper)
[129] (2012) 258 CLR 525 [2].
[130] Ibid [4].

payment fee was unenforceable as a penalty at common law',[131] and that in the appeal 'in which the ultimate issue is whether the late payment fee was unenforceable as a penalty at common law, the parties agree that the governing principles are to be found in *Andrews* and in [*Dunlop*]'.[132] More directly, Gageler J stated that '*Andrews* did nothing to disturb the settled understanding in Australia that a contractual provision imposing a penalty is unenforceable at common law without the discretionary intervention of equity'.[133]

Keane J described the issue as being whether the late payment fees were 'unenforceable as penalties under the general law'.[134] Subsequent passages in Keane J's reasons concerning the origins of the penalty rule and the importance of the principle of freedom of contract are consistent with the continuing existence of a common law rule regulating penalties for breach of contract.[135] Keane J also referred to *Andrews* as having, unsurprisingly, expressed the penalty rule in terms reflecting the 'ongoing influence of its equitable origins *in cases where the impugned payment is charged otherwise than upon breach of contract*'.[136] Consistently with that view of *Andrews*, Keane J considered that the penalty rule was not adequately explained by the 'concerns which led courts of equity to make adjustments to ensure that both parties obtained what equity saw as the "substance" of their transaction and no more in cases within its jurisdiction'.[137] His Honour instead found the rationale for the rule in cases involving breach of contract in the principle that punishment is not part of the function of the common law of contract.[138]

Upon the basis of those analyses, particularly Gageler J's analysis, the view seems open that there is no harshness in the common law penalty rule against which a party asserting a contractual penalty requires equitable relief, nor any prospect of the promisee's conscience being sullied by benefiting from a penalty such as to call for equity's intervention. As Deane J explained in *AMEV-UDC*:[139]

> …it was a fundamental doctrine of equity that relief in Chancery against enforcement of a penalty was only available where the quantum of the damage for which the impugned payment would be compensatory could be ascertained and upon the terms that the claimant did equity by paying the amount of the true damnification. That equitable jurisdiction was to relieve against direct or indirect enforcement. Thus, after penalties became unenforceable at common law, equity did not intervene in the opposite direction to declare that the party asserting unenforceability at common law should be compelled in Chancery to make good the loss actually sustained in any case where common law remedies were inadequate to achieve that result. That being so, the acceptance by the common law of the unenforceability of penalties largely removed the occasion for the exercise of the equitable jurisdiction to relieve against enforcement with the result that the terms upon which equity would grant such relief became ordinarily of but academic or historical interest.

[131] Ibid [74].
[132] Ibid [115]. In relation to this paragraph, French CJ observed at [5]: 'As Gageler J points out, the decision in *Andrews* and that of the House of Lords in [*Dunlop*] set out the governing principles so far as they apply to penalties for breach of contract'.
[133] (2016) 258 CLR 525 [122]. See also [134] and [150].
[134] Ibid [209], [212].
[135] Ibid [249]–[253].
[136] Ibid [253] (emphasis added).
[137] Ibid [252].
[138] Ibid [253]–[254].
[139] (1986) 162 CLR 170, 195.

A qualification is described by Deane J in the following passage:[140]

> The equitable jurisdiction did not, however, cease to exist and the terms upon which equitable relief against penalties would be granted remain directly applicable in those comparatively rare cases in which the party asserting unenforceability is constrained to seek positive relief (whether primary or ancillary) which is purely equitable in character, such as an order for reconveyance. In such cases, it would seem that [statute apart], such relief should be refused unless the plaintiff, in Lord Selborne's words [in Jervis v Berridge[141]] elects 'to forgo legal rights for the sake of equitable remedies' or, as I would prefer to put it, submits to the terms on which equitable relief is available and does, or undertakes to do, equity by paying the amount of the actual loss sustained: cf Mayfair Trading Co Pty Ltd v Dreyer.[142]

In *Paciocco*, Gageler J considered that those passages in Deane J's reasons were consistent with *Andrews*.[143] He remarked that the statement in *Cavendish*[144] that *Andrews* involved 'a radical departure from the previous understanding of the law' was wrong insofar as it referred to the common law of Australia.[145] Gageler J observed that Mason and Wilson JJ's statement in *AMEV-UDC* that 'the equitable jurisdiction to relieve against penalties withered on the vine for the simple reason that, except perhaps in very unusual circumstances, it offered no prospect of relief which was not ordinarily available in proceedings to recover a stipulated sum or, alternatively, damages'[146] was criticised in *Andrews* 'only in so far as the statement might be taken to have drawn a causal link between the withering of the equitable jurisdiction to relieve against penalties and the advent of the Judicature system'.[147] Gageler J continued:[148]

> Nothing in Andrews contradicts the fuller explanation given by Deane J in AMEV-UDC that 'acceptance by the common law of the unenforceability of penalties largely removed the occasion for the exercise of the equitable jurisdiction to relieve against enforcement with the result that the terms upon which equity would grant such relief became ordinarily of but academic or historical interest'. His Honour's explanation, with which Andrews is consistent, continued by pointing out that '[t]he equitable jurisdiction did not, however, cease to exist and the terms upon which equitable relief against penalties would be granted remain directly applicable in those comparatively rare cases in which the party asserting unenforceability is constrained to seek positive relief (whether primary or ancillary) which is purely equitable in character, such as an order for reconveyance.'
>
> The statement in Andrews that '[i]t is the availability of compensation which generates the "equity" upon which the court intervenes' without which 'the parties are left to their legal rights and obligations' is, in context, a reference to the historically important, although now comparatively rare, exercise of equitable jurisdiction to grant relief against penalties. The statements that, '[i]n general terms', a penalty is enforced 'only to the extent' that compensation can be made for prejudice suffered by failure of the primary stipulation and that a party who can provide compensation 'is relieved to that degree from liability to satisfy the collateral stipulation' are similarly directed to, and broadly descriptive of, the grant of equitable relief.

[140] Ibid 195–6.
[141] (1873) 8 Ch App 351, 358.
[142] (1958) 101 CLR 428, 451 et seq.
[143] (2016) 258 CLR 525 [123]–[126].
[144] [2016] AC 1172 [41].
[145] (2016) 258 CLR 525 [121].
[146] (1986) 162 CLR 170, 191.
[147] (2016) 258 CLR 525 [123], referring to *Andrews* (2012) 247 CLR 205 [68].
[148] Ibid [124], [125].

That approach may be reconciled with the various statements in *Andrews* emphasising the continuing role of equity upon the basis that, whilst the equitable jurisdiction has not been absorbed into or destroyed by the common law penalty rule, the scope for its exercise is confined in light of the common law unenforceability of a penalty for breach. Upon this view, if a contractual provision is found to be unenforceable as a penalty for breach the party claiming the penalty is relegated to its legal remedy of damages for the breach, unless the defaulting party seeks a positive order of a purely equitable character such as the re-conveyance of property transferred under the penalty provision.

It is necessary though to add a further reference to Deane J's reasons in *AMEV-UDC*. Deane J's conclusion that there was practically no continuing role for equity appears to have encompassed both penalties on breach and penalties otherwise than on breach; and that appears to have been premised upon an anterior conclusion that in both cases the common law penalty rule incorporated equitable principles governing the form of relief, including as to the compensation to be afforded to the party intended to receive the benefit of the penalty.[149] However that aspect of Deane J's reasons in *AMEV-UDC* is inconsistent with the reasons of Gibb CJ and Mason and Wilson JJ in the same case, and Gageler J did not endorse it in *Paciocco*.[150]

Upon that analysis, it appears, as I have mentioned, that where a contractual provision is found to be unenforceable as a penalty for breach, the promisee is relegated to its legal remedy of damages for the breach, unless equitable principles are enlivened by the defaulting party seeking a positive order of a purely equitable character. Questions then arise about the applicability and effect of 'scaling' in cases of penalty on breach. In *Australian Capital Financial Management*, Ward JA observed in obiter dicta that if a stipulation were found to be penal

> it would be 'unenforceable at common law' (Paciocco (HCA) at [122] (Gageler J)) except (assuming that compensation is available) to the extent that equity would permit 'scaling'; and if positive relief which was purely equitable in character were to be sought in respect of that penal stipulation then, as Deane J noted (at 195) in AMEV (to which Gageler J in Paciocco (HCA) at [124] referred with apparent approval), it would (or might) be necessary for the obligor to submit to any terms on which equitable relief were to made available.[151]

In *Andrews*,[152] the High Court observed that before the judicature system what Nicholls LJ in *Jobson v Johnson*,[153] 'called "the scaling down exercise" by which a court of equity would tailor special relief to ensure adequate compensation, but not more' was not available in an assumpsit action where the collateral stipulation was not for the payment of money but for the transfer of property. The High Court's citation in *Andrews* of *Jobson v Johnson* arguably suggests that 'scaling' is also available in the common case involving a secondary contractual obligation to pay a sum of money upon the breach of a primary contractual obligation. But even if that is so, it would not necessarily suggest that what is in play in such a case is a discretionary

[149] (1986) 162 CLR 170, 197–8.
[150] That section of Deane J's analysis is not mentioned on the only page of his Honour's reasons cited by Gageler J, ie (1986) 162 CLR 170, 195.
[151] [2017] NSWCA 99 [376].
[152] (2012) 247 CLR 205 [60].
[153] [1989] 1 All ER 621, 634, 636.

equitable remedy. In *Jobson v Johnson*,[154] Nicholls LJ analysed the effect of the authorities in these terms:

> An obligation to make a money payment stipulated in terrorem will not be enforced beyond the sum which represents the actual loss of the party seeking payment, namely, principal, interest and, if appropriate, costs, in those cases where (to use modern terminology) the primary obligation is to pay money, or where the primary obligation is to perform some other obligation, beyond the sum recoverable as damages for breach of that obligation.
> …
> Strictly, the legal position is that the clause remains in the contract and can be sued on, but it will not be enforced by the court beyond the sum which represents, in the events which have happened, the actual loss of the party seeking payment. There are many cases which make this clear.
> …
> In this respect, as the law has developed, a distinction has arisen between the enforcement of penalty clauses in contracts and the enforcement of forfeiture clauses.
> …
> This is not the occasion to attempt to rationalise the distinction. One possible explanation is that the distinction is rooted in the different forms which the relief takes. In the case of a penalty clause in a contract equity relieves by cutting down the extent to which the contractual obligation is enforceable: 'the scaling-down' exercise as I have described.
> …
> The scaling down exercise which is carried out automatically by equity is straightforward when the penalty clause provides for payment of a sum of money….

Whether or not Nicholls LJ's analysis in *Jobson v Johnson* represents the law in that kind of case in Australia is not settled and the status of the decision in *Jobson v Johnson* in the United Kingdom is controversial.[155] If that analysis does represent the law in Australia, it would require a variation of the proposition that where a contractual provision is found to be unenforceable as a penalty for breach, the promisee is relegated to its legal remedy of damages for the breach unless equitable principles are enlivened by the defaulting party seeking a positive order of purely equitable character. Instead of being left with a legal remedy of damages for breach, the promisee would be left with a legal entitlement to enforce the contractual provision for a penalty up to the sum which is equivalent to the amount recoverable as damages for breach of the obligation. The difference may be relevant in some contexts,[156] but there still would be no room for the exercise of any equitable discretion in the case of a penalty upon breach of contract.

B *Penalty Otherwise Than for Breach*

At first instance in *Paciocco*[157] Gordon J referred to a necessary element 'at law but not in equity' of the stipulation being payable upon breach of the contract. That expression appears

[154] [1989] 1 All ER 621, 632, 633, 634. Dillon LJ's analysis in relation to cases where the penalty is a sum of money payable on breach of contract was to the same effect: 627e–628d. Kerr LJ expressed a different view, that 'the combined effect of law and equity on penalty clauses is simply that they will not be enforced in favour of a plaintiff without first giving to the defendant a proper opportunity to obtain relief against their penal consequences': 638e.

[155] See the strong criticisms of the decisions by Lords Neuberger and Sumption in *Cavendish* [2015] 3 WLR 1373 [85]–[87].

[156] For example, under some procedural provisions the fact that a claim is to enforce an obligation to pay money confers a procedural advantage which is not available in a claim for damages: see, eg, *Jerrad v Clowes* [1892] 2 QB 11, cited by Nicholls LJ in *Jobson v Johnson* [1989] 1 All ER 621, 633.

[157] (2014) 309 ALR 259 [15].

in a framework Gordon J proposed for resolving a penalty case, which was referred to with approval by Ward JA in *Australian Capital Financial Management*.[158] In a case where there is no breach, a finding that a contractual stipulation is an unenforceable penalty would leave the promisee without any legal remedy to recover losses it incurred as a result of the failure of the primary stipulation. Such a result is likely to produce significant injustices that would not be expected to occur at law, much less in equity. It seems uncontroversial that the equitable remedy in such a case should ensure compensation for any prejudice incurred by a party as a result of the other party being relieved from the contractual penalty.

VIII PRINCIPLES TO BE APPLIED IN DECIDING WHETHER A CONTRACTUAL PROVISION IS UNENFORCEABLE AS A PENALTY IN EQUITY

Under the *Dunlop* principles as explained in *Paciocco*, a secondary obligation imposed upon a promisor upon breach by it of a primary obligation is not a penalty unless the promisor proves the secondary obligation to be extravagant and out of all proportion to the interests of the promisee protected by it, such as to justify a conclusion that it is exclusively or predominantly penal in character. The statement in *Andrews*[159] that a collateral stipulation 'prima facie' imposes a penalty if, upon failure of the primary stipulation, the collateral stipulation imposes 'an additional detriment' upon one party to the benefit of the other party, is so generally expressed as to comprehend penalties exacted both upon and without any operative breach of contract.[160] The literal meaning of the statement might be thought to be that a collateral stipulation is a penalty where it imposes a detriment that exceeds to any degree the detriment imposed by the primary stipulation unless the beneficiary of the stipulation displaces that prima facie position. Upon that view, however, *Andrews* would be substantially inconsistent with *Paciocco*.

In *Australian Capital Financial Management*[161] the New South Wales Court of Appeal held that the principles for determining whether a clause constitutes a penalty do not relevantly differ depending upon whether the penalties doctrine is engaged at law or in equity. In that respect the Court referred to a passage in *Arab Bank Australia Ltd v Sayde Developments Pty Ltd*[162] in which McDougall J (with whose reasons Gleeson JA and Sackful AJA agreed) observed that nothing said in *Andrews* cast doubt upon the position stated in *Ringrow* that the principles identified by Lord Dunedin express the legal position in Australia. Without seeking to question the conclusion in *Australian Capital Financial Management*, *Ringrow* is not necessarily determinative of this issue, since it was decided upon the footing of a common law penalty rule applying only upon breach. But it seems clear from *Andrews* and *Paciocco* themselves that the *Dunlop* principles, as explained in *Paciocco*, are generally to be applied in both cases. (I put to one side the question whether the penalty doctrine applies in relation to 'mere security for the satisfaction of the primary obligation'.[163] That does not describe the character of the common kind of stipulations with which this paper is concerned, which are designed to compensate a party for injuries to its interests upon non-fulfilment of a primary stipulation and avoid wasteful disputes about the appropriate level of compensation.)

[158] [2017] NSWCA 99 [359].
[159] (2012) 247 CLR 205 [10].
[160] Cf *Australian Capital Finance Management* [2017] NSWCA 99 [359]–[361].
[161] [2017] NSWCA 99 [315], [362] (Ward JA, McColl JA and Gleeson JA agreeing).
[162] (2016) 93 NSWLR 231 [73], [74].
[163] See Heydon et al, above n 99 [18-025].

Reference to the context of the statement of the penalty doctrine in *Andrews* suggests that it was not intended to serve the same purpose as the principles expressed in *Dunlop*. The High Court cited *Dunlop* in support of the statement. Furthermore, in the course of a discussion of *Dunlop*, the Court referred to Lord Atkinson's summary of the evidence showing that the stipulated sum 'protected the appellant's interest in preventing undercutting, which would disorganise its trading system'[164] and described the critical issue as being 'whether the sum agreed was commensurate with the interest protected by the bargain'. That there is otherwise no discussion in *Andrews* about the principles applicable in a decision whether a stipulation not arising upon breach is a penalty is unsurprising, given the narrowness of the issue in *Andrews*. The statement concerns a question arising at an anterior stage of the analysis whether a contractual stipulation is capable of being characterised as a penalty or, to express it in terms used in *Andrews*, the 'identification of those criteria by which the penalty doctrine is engaged'.[165]

Gageler J's reasons in *Paciocco* point in the same direction. In describing the significance of *Andrews* for the decision in *Paciocco*, Gageler J referred to 'its explanation of the conception of a penalty as a punishment for non-observance of a contractual stipulation, in its explanation of that conception of a penalty as a continuation of the conception which originated in equity, and in its endorsement of the description of the speech of Lord Dunedin in *Dunlop* as the "product of centuries of equity jurisprudence"'.[166]

Upon the current state of the authorities, the *Dunlop* principles as explained in *Paciocco* are therefore generally to be applied in deciding whether a contractual provision is unenforceable as a penalty at law or in equity.

IX THE AMOUNT OF COMPENSATION FOR THE PARTY INTENDED TO BE THE BENEFICIARY OF THE PENALTY

A *Penalty for Breach*

The statement of the penalty doctrine in *Andrews* includes conclusions that where compensation can be made to the intended beneficiary of the penalty, the penalty is enforced 'only to the extent of that compensation' and the party challenging the penalty 'is relieved to that degree from liability to satisfy' it. That appears to be a reference to 'the scaling down exercise' referred to subsequently in *Andrews*.[167] The analysis above (Section VII:A) suggests that, except in the limited class of cases where the party in breach is constrained to seek specific equitable relief, it will follow as of course that the amount of compensation to be paid to the promisee will be the amount of damages recoverable at common law for breach of the primary obligation. That appears to be so, whether the relevant law comprises rules of the common law or equitable principles; as to the latter, if 'scaling' is applicable in such a case, the amount of those damages would be recoverable as money payable pursuant to the penalty clause: *Jobson v Johnson*.[168]

[164] *Dunlop* [1915] AC 79 [91]–[93].
[165] (2012) 247 CLR 205 [15].
[166] (2016) 258 CLR 525 [127].
[167] (2012) 247 CLR 205 [60], citing Nichols LJ in *Jobson v Johnson* [1989] 1 WLR 1026
[168] [1989] 1 All ER 621, 632–4.

At first instance in *Paciocco*, in relation to compensation for the late payment fees found to be penalties, Gordon J observed that:[169] 'Equity assesses the quantum of loss or compensation based on what is just and equitable, or fair and reasonable, in all the circumstances. The loss may include costs of the proceeding:...'.[170]

Johnes v Johnes was not cited for the proposition in the first sentence and it is not an authority upon the measure of compensation imposed as a condition of equitable relief against the penalty. A judgment for the plaintiff in an action upon a penal bond conditioned upon quiet enjoyment of purchased premises was stayed pending determination by a jury of the truth of the alleged breaches and the assessment of damages sustained as a result. The report of the case, which was heard by Lord Eldon, suggests that no direction was made about the manner of assessment of the damages. The jury found the breaches proved and assessed damages in a certain sum 'besides his costs and charges'. The court awarded a large sum for costs, which was readily explicable by the circumstance that the plaintiff had been kept in court for 12 years 'attending to writs of error…forty-nine out of fifty were brought for delay'.

The current edition of *Meagher, Gummow & Lehane*[171] was published before the High Court's decision in *Paciocco*. It records that at the level of basic principle the correct approach to the measure of compensation required in equity is 'entirely free of authority'.[172] After a detailed discussion of the point, with particular reference to *AMEV-UDC*, it is suggested that the choice of principle yet to be made by the courts is 'to order compensation (i) in the form of an indemnity for actual loss suffered by the obligee upon failure of the primary stipulation, or (ii) only for actual loss that flows from that failure'.[173] The concluding passage of the same paragraph suggests that the former measure of loss would be unduly generous.

It would seem wholly unsurprising if in the case of a penalty for breach, compensation is required as a condition of equitable relief, the amount of that compensation would be consistent with the contractual measure of damages. Subject to any question whether the penalty clause operates as a cap upon damages, there would be no ground for denying the ascertained amount of those damages to the innocent party once the penalty was held to be unenforceable. And there seems no particular reason why the measure should be any different. In this respect, although the High Court's reasons in *Andrews* are inconsistent with aspects of Mason and Wilson JJ's reasons in *AMEV-UDC*, nothing in *Andrews* appears to be inconsistent with Mason and Wilson JJ's view that 'the amount of compensation which equity regarded as just and equitable recompense for loss suffered, usually happened to be equivalent to the amount of damages recoverable at common law'.[174] I have not found any authority against that proposition. In principle, it does not seem inappropriate. Equity's distinctive remedies for breaches of trust or fiduciary duty may make it wrong to seek analogies with the common law measure of compensation in such cases[175] but there is nothing of that kind here.

[169] For example, the equitable method articulated by Gordon J in *Paciocco* in first instances, and favoured in Heydon et al, above n 99 [18-190].
[170] (2014) 309 ALR 249 [48] citing *Johnes v Johnes* (1814) 3 ER 969, 975.
[171] Heydon et al, above n 99 [18-185].
[172] Ibid [18-195].
[173] Ibid [18-185]–[18-195].
[174] (1986) 162 CLR 170, 193, citing *Elsley* (1978) 83 DLR (3d), 13.
[175] *Youyang Pty Ltd v Minter Ellison* (2003) 212 CLR 484, 500.

Furthermore, in *Andrews*[176] the High Court held that there was no ground to cavil with the following four propositions identified by Mason and Wilson JJ as emerging from their review of the doctrine of penalties:

> (1) equity would only relieve where compensation could be made for the actual damage suffered by the party seeking to recover the penalty; (2) the actual damage suffered by the party was assessed in an action at common law, such as an action of covenant, or upon a special issue quantum damnificatus which could be joined in an action on the case: ...; (3) the expression 'actual damage' seems to have been used in contradistinction to 'agreed sum' or 'liquidated' or 'stipulated' damages, not by way of opposition to damage which was recoverable at law; (4) there seems to have been no instance of equity awarding compensation over and above the amount awarded as common law damages, other than cases in which equity would not relieve against the penalty.[177]

Those propositions suggest that the measure of compensation historically imposed in the equitable jurisdiction as a condition of relief against a penalty for breach was fixed with reference to principles that did not differ from the principles applicable in a claim for damages. In relation to the second proposition quoted from *Andrews*, consistently with the reference to joining the 'special issue quantum damnificatus' in an action on the case, that term does not refer to an equitable writ but to a direction for the assessment of compensation by a jury.[178] It is possible that directions were made in some of the old cases requiring a measure based upon different principles than apply to common law damages, but the points made by Mason and Wilson JJ in *AMEV-UDC* and endorsed in *Andrews* are consistent with such directions not having been given in the usual course, if at all. I have not been able to find any reference to directions of that kind such as might suggest a contrary conclusion. It is said in the current edition of *Meagher, Gummow & Lehane*[179] that a 'skeleton of rules on quantification in such cases does not seem to have been left behind when the general use of jury trials in civil cases was abolished'.

Thus from the perspective of legal history it seems a reasonable view that, even if, contrary to the analysis above (Section VII:A), a discretionary equitable remedy is applicable in the general run of cases involving a penalty for breach of contract, the promisee's compensation in any event should reflect the amount of the damages recoverable for that breach. That does not seem an obviously unjust result where a contractual stipulation is found to be so far out of proportion with the potential injury to the innocent party's interests as to characterise it as a threat of punishment upon default.

It is true that upon that approach in some cases the innocent party might be left with compensation that is demonstrably less than the amount of its loss attributable to the breach. That might occur in a case in which the innocent party's interests protected by the stipulation extend beyond the interests protected by damages recoverable for breach. If the total loss, including the loss attributable to injury to those other interests, substantially exceeds the contractual measure of damages for the breach, but the amount stipulated nevertheless remains out of all proportion with the total losses, it will be seen that the innocent party has not recovered all of its loss attributable to the breach. But that is not a persuasive ground for adopting a more generous measure of compensation: a principle that the innocent party is to be

[176] (2012) 247 CLR 205 [65].
[177] (1986) 162 CLR 170, 190.
[178] See John Norton Pomeroy, *A Treatise on Equity* (2nd ed, 1892), vol 1, quoted by Ward JA in *Australian Capital Financial Management* [2017] NSWCA 99 [373].
[179] Heydon et al, above n 99 [18-185].

compensated for the proved amount of its total loss, even though it exceeds the contractual measure of damages recoverable upon breach, might operate as an incentive to a party in a powerful bargaining position to include unrealistically severe provisions purporting to provide liquidated damages.

B *Penalty Arising Otherwise Than on Breach*

In the case of penalties in equity arising otherwise than on breach, the measure of compensation preferred by the authors of *Meagher, Gummow & Lehane* as discussed above (Section IX:A) is analogous with the measure of compensation allowed for breach of contract. There seems to be no persuasive reason for adopting a different approach in that case.