THE REFORMULATION OF
THE PENALTY DOCTRINE:
WHERE TO FROM HERE?

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This thesis is presented for the Honours degree of Bachelor of Laws of Murdoch University in 2017. I hereby declare it is my own account of my research.

Word count: 19,995 (excluding title pages, table of contents, footnotes and bibliography).
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Full Name of Degree:  Bachelor of Laws with Honours

Thesis Title:  The Reformulation of the Penalty Doctrine: Where to from Here?

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Year:  2017
ABSTRACT

Recent case law has brought the common law contractual penalty doctrine under scrutiny and has created uncertainty. Traditionally, the penalty doctrine has only ever applied in situations where there has been a breach of contract. The Australian High Court reformulated the penalty doctrine in Andrews v Australia and New Zealand Banking Group Ltd. This reformulation extended the application of the penalty doctrine to instances other than breach of contract. As the penalty doctrine is found in almost all common law countries, this decision has not gone unnoticed and has received heavy criticism.

The United Kingdom Supreme Court, in Cavendish Square Holding BV v Makdessi, commented on the decision of Andrews v Australia and New Zealand Banking Group Ltd and disapproved of the reformulation, given the many problems associated with extending the doctrine. These problems include infringing upon the freedom of contract as well as requiring the judiciary to review the substantive fairness of parties' agreements. This is not the role of the courts. The courts role is supervisory only. Despite these substantial criticisms, the Australian High Court proceeded to confirm the decision in Andrews in Paciocco v Australia and New Zealand Banking Group Limited. In this more recent High Court decision, French CJ suggested statutory reform as the appropriate way forward.

This paper argues that in light of the historical formulations of the penalty doctrine, the High Court in Andrews was not justified in stating that the doctrine had always applied in instances other than breach of contract. Further, the High Court should have explained their reasons for extending the penalty doctrine when the principles of contractual construction had not changed for over a century. This paper also analyses the different conclusions reached in the Supreme Court decision in the United Kingdom, where the traditional application of the doctrine was upheld. Given the shared jurisdictional history with respect to the penalty doctrine, the different findings are perplexing. Proposed reforms to the doctrine, in light of French CJ's comment, are also considered and evaluated. This paper concludes that consideration of the parties’ bargaining positions when deciding if a payment is a penalty is a relevant factor in other jurisdictions and a beneficial reform that should be adopted by the Australia courts.
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ACKNOWLEDGEMENTS

I would like to first, sincerely and gratefully thank my supervisor Dr Stephen Shaw for his ongoing support, consultation and guidance. Your wisdom, encouragement and humour made this process not only possible, but easier than it should have been – thank you.

I would also like to thank my family for their ongoing support, encouragement and understanding. Without your help I would not have had the time required to dedicate myself so fully. Thank you for always believing in me.

Finally, I would like to thank my work colleagues at the Federal Court of Australia. Your understanding, flexibility, friendship and encouragement over the years have done more than you know. Thank you for helping me grow.
I INTRODUCTION

The penalty doctrine (the Doctrine) is a principle of contract law which has existed for centuries. The Doctrine applies in situations where a secondary obligation such as the payment of a sum of money falls due when a person breaches a primary obligation in the contract. If that sum of money is extravagant and out of all proportion to the loss suffered by the non-breaching party as a result of that breach, that sum constitutes a penalty and is unenforceable because of the Doctrine.

The Doctrine received recent scrutinisation by the Australian High Court in *Andrews v Australia and New Zealand Banking Group Ltd*. Part of this scrutiny involved the High Court making an historical analysis of the Doctrine and its developments. The High Court concluded that, as equity had always looked to substance over form, the Doctrine had always applied to sums that fell due on an event not occasioning breach of contract. The High Court’s decision thereby extended the scope of the Doctrine to apply in instances other than breach of contract. Prior to the decision in *Andrews*, the Doctrine had only ever applied to situations of breach of contract. As the High Court gave no reason for modifying the Doctrine, this decision confused the legal community and was criticised by commentators.

The United Kingdom Supreme Court decision of *Cavendish Square Holding BV v Makdessi* was handed down following the decision of *Andrews*. The Court in *Cavendish* discussed the extended application of the Doctrine in *Andrews* and criticised it. The Supreme Court disagreed with the Australian High Court’s historical analysis in *Andrews* and refused to extend the Doctrine’s application.

The Australian High Court then considered the decision of *Andrews* and the decision of *Cavendish* in *Paciocco v Australia and New Zealand Banking Group Limited*. The High Court confirmed the decision in *Andrews* and confirmed the extended application of the Doctrine despite the criticism that *Andrews* had received by the Court in *Cavendish* and by commentators in Australia. French CJ stated that

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1 (2012) 247 CLR 205 (‘*Andrews*’).
2 [2015] UKSC 67 (‘Cavendish’).
3 (2016) 333 ALR 569 (‘*Paciocco*’).
a ‘difference has emerged since the decision in *Andrews* between the Supreme Court of the United Kingdom and this Court in relation to the scope of the law relating to penalties’. However, as Australia and the United Kingdom are separate jurisdictions, the High Court held that Australian law does not need to follow the law of the United Kingdom. French CJ noted with respect to the Doctrine, that ‘more than one account of its construction and more than one view of whether it should be abrogated or extended or subsumed by legislative reform is reasonably open’. French CJ concluded that perhaps in Australia ‘statutory law reform offers more promise than debates about the true reading of English legal history’.

The law involving contractual penalties has been an area of flux ever since. In order to evaluate the historically based decision of *Andrews*, an historical overview of the Doctrine and its developments are required. This is provided in Chapter II and Chapter III of this thesis. This will determine whether the High Court in *Andrews* was justified in determining that the Doctrine has always applied in instances other than breach of contract.

Chapter IV discusses the facts in *Andrews* and analyses the case from first instance through to the High Court decision, in light of the historical analysis undertaken in Chapters II-III. This is necessary in order to evaluate whether or not the decision in *Andrews* was justified.

Chapter V evaluates the decision of *Cavendish* in order to understand why the United Kingdom refused to follow the decision of *Andrews* and extend the scope of the Doctrine. This is relevant given the United Kingdom and Australia share a jurisdictional history with respect to the Doctrine.

Chapter VI analyses the High Court decision of *Paciocco* in order to better understand the effect of the change to the law brought about by the decision of *Andrews*. The reasons why the High Court affirmed the decision of *Andrews* and any comments on the United Kingdom decision in *Cavendish* is also relevant.

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4 Ibid 573 [6].
5 Ibid 575 [10].
6 Ibid.
In light of French CJ’s comments, Chapter VII evaluates each reform to the Doctrine that has been proposed over the years and concludes as to which reforms, if any, would benefit the Australian jurisdiction.
II HISTORY OF THE PENALTY DOCTRINE

A 13th Century – 16th Century

Penalty clauses have been traced back to the 13th century in England. During the 13th century, the common law courts held penalties to be lawful. Penalties were contained within defeasible bonds. Defeasible bonds were promises under seal to pay a quantified sum of money which ceased to have effect on the satisfaction of a condition. The condition usually required performance of a primary obligation. The party who held the bond was able to bring their action in debt making it unnecessary for them to prove their loss. This made it possible to specify an amount much greater than their loss. From the late 16th century equity started to relieve against full enforcement of a penalty in a bond in instances where it would be unjust to do so. Examples include where the obligor failed to meet the condition on time due to mistake, accident or extremity, or when payment was made but the bond was not cancelled.

B 17th Century

In the 17th century, equity started to refund the difference between the penalty that was paid and the true damage caused by the breach, together with interest and costs. The common law courts then amended their procedures regarding actions pleaded in assumpsit with respect to money bonds. As Lord Nottingham stated, the common law courts ‘changed their rules… when they saw that equity would

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relieve, [and] have chosen rather to relieve the parties themselves’.\textsuperscript{14} The common law courts refusal to enforce penalties led to the rise in principle that a penalty clause was unenforceable.\textsuperscript{15} These changes provided procedural ease and ‘avoid[ed] the delay and wasted costs associated with obtaining a judgment at law on the bond and then an injunction from the Chancellor’.\textsuperscript{16} This position was then regulated at common law\textsuperscript{17} with the Statute of William III in 1696,\textsuperscript{18} regarding non-performance of agreements or covenants and consequently suing upon the penalty, and the Statute of Anne in 1705\textsuperscript{19} with respect to money bonds.\textsuperscript{20}

A principle emerged during the 17th century where relief against the penalty would not be granted if compensation was unavailable or could not be ascertained.\textsuperscript{21} A primary example includes Tall v Ryland\textsuperscript{22} where a bond was entered into for £20

\textsuperscript{14} D E C Yale (ed), Lord Nottingham’s ‘Manual of Chancery Practice’ and ‘Prolegomena of Chancery and Equity’ (Cambridge University Press, 1965) quoted in Andrews v Australia and New Zealand Banking Group Ltd (2012) 247 CLR 205, 229-230 [53]; Austin v United Dominions Corporation Ltd [1984] 2 NSWLR 612, 625-626. Blackstone also commented on these procedural changes, stating that the common law courts were induced ‘to adopt (where facts can be clearly ascertained) the same principles of redress as have prevailed in our courts of equity’: Sir William Blackstone, Commentaries on the Laws of England (Clarendon Press, 1765-1769) vol 4, 435. See also Andrews v Australia and New Zealand Banking Group Ltd (2012) 247 CLR 205, 229-230 [53]; Simpson, above n 11, 419.

\textsuperscript{15} AMEV-UDC Finance Ltd v Austin (1986) 162 CLR 170, 189.

\textsuperscript{16} Rossiter, above n 8, 11.

\textsuperscript{17} See Andrews v Australia and New Zealand Banking Group Ltd (2012) 247 CLR 205, 229-230 [53].

\textsuperscript{18} Statute 8 & 9 Wm III c 11 s 8 (1696) (The Administration of Justice Act 1696). Bonds within the Statute of William III were for the non-performance of several covenants and permitted damages to be assessed once breaches were proved. Execution was restrained once damages, interest and costs were paid: Andrews v Australia and New Zealand Banking Group Ltd (2012) 247 CLR 205, 230 [54]. See also Andrews v Australia and New Zealand Banking Group Ltd (2011) 288 ALR 611, 617 [12]. However, judgment remained as security in case of further breach: Andrews v Australia and New Zealand Banking Group Ltd (2012) 247 CLR 205, 230 [54] citing E P Hewitt and J B Richardson, White and Tudor’s Leading Cases in Equity (Sweet & Maxwell Ltd, 9th ed, 1928) vol 2, 224. See also AMEV-UDC Finance Ltd v Austin (1986) 162 CLR 170, 202 (Deane J).

\textsuperscript{19} Statute 4 & 5 Anne c 3 ss 12, 13 (1705) (The Administration of Justice Act 1705). A common money bond fell within the Statute of Anne because ‘only one breach can be assigned, and the penal sum is not for the non-performance of several covenants’: Preston v Dania (1872-73) LR 8 Ex 19 (B Bramwell) quoted in Andrews v Australia and New Zealand Banking Group Ltd (2011) 288 ALR 611, 619. Payment of the assessed loss plus interest would act as though the condition had been met: Rossiter, above n 8, 12. If paid into court together with costs, this would satisfy the damage in full and result in the discharge of the bond: Rossiter, above n 8, 12; Andrews v Australia and New Zealand Banking Group Ltd (2012) 247 CLR 205, 230 [54].


\textsuperscript{21} See Tall v Ryland (1670) 1 Chan Cas 183; 22 ER 753 cited in AMEV-UDC Finance Ltd v Austin (1986) 162 CLR 170, 187.

\textsuperscript{22} (1670) 1 Chan Cas 183; 22 ER 753.
conditioned upon the plaintiff not disparaging the defendant’s goods. However, the plaintiff breached the condition24 and applied for equitable relief against the penalty, alleging that the damage was ‘not considerable nor valuable’. However, it was for this reason that equitable relief was denied:26

[T]he bond was not conditioned for Payment of Money or Performance of Covenants, or for any Matter for which Damages in an Action of Debt, Covenant or any other Action, was recoverable; nor was there any-Way to measure the Damages but by the Penalty.27

Equity would not relieve against a bond of which compensation was not available.28

C 18th Century

A number of important cases29 relevant to the development of the Doctrine occurred during the 18th century. In Peachy v Duke of Somerset,30 the Lord Chancellor stated: ‘the true ground of relief against penalties is from the original intent of the case, where the penalty is designed only to secure money, and the Court gives him all that he expected or desired.’31 The Lord Chancellor held32 that a court will relieve against forfeitures when the loss or damage has been completely compensated:33

23 The parties were fishmongers with adjacent shops; Ibid 183; 753.
24 Tall v Ryland (1670) 1 Chan Cas 183, 183; 22 ER 753, 753.
25 Ibid.
26 Ibid.
27 Ibid 184; 753.
28 Ibid 183; 753.
29 See, eg, Hardy v Martin (1783) 1 Cox 26 where the plaintiff sold the lease and good-will of the shop to the defendant for £300. The plaintiff entered into a bond to the defendant in the amount of £600. This bond contained the condition that for 19 years, the plaintiff should not sell brandy in quantities less than 6 gallons within 5 miles of London and Westminster; or else the bond would become void. The plaintiff breached the condition and brought an action in equity, requesting the court to determine the actual damage sustained and restrain Martin by injunction on payment of these damages. Lord Loughborough held that ‘the penalty is never considered… as the price for doing what a man has expressly agreed not to do. The court will restrain him from setting up a trade in opposition to his own agreement, although he has paid the penalty’. He held the court will moderate the damages sought to the real damage sustained in a case such as this, which involved an agreement not to sell brandy with a penalty for selling it. An injunction was granted to restrain the defendant from executing the penalty, with quantum damnumificatus to be determined: See Hardy v Martin (1783) 1 Cox 26, 26-27.
30 (1720) 1 Strange 447; 93 ER 626. The plaintiff made leases contrary to the custom of the manor and without a licence from the lord. The leases gave the leaseholders rights to fell timber and dig stones. The question before the court was whether such leases constituted a forfeiture at law and whether equity would provide relief: Peachy v Duke of Somerset (1720) 1 Strange 447, 447; 93 ER 626, 626-627.
31 Peachy v Duke of Somerset (1720) 1 Strange 447, 453; 93 ER 626, 630.
32 The Lord Chancellor further stated that ‘forfeitures are intended only to secure the lord’s rents and services, and therefore [it’s] very proper for a Court of Equity to interpose and prevent his having more than that security’: Ibid 449; 628.
33 The forfeiture was by way of security only and so relief against forfeiture was granted upon payment of compensation.
'As of a fine or rent, for there, upon payment of what is due, with interest, equity will relieve'. This case demonstrates the engrained procedure of awarding damages plus interest and costs. This case further refined the principle that equity requires the damage to be compensable, otherwise no “handle” exists in which for equity to intervene: ‘for it is the recompense that gives this Court a handle to grant relief’.  

In *Sloman v Walter* the court held that ‘[w]here the penalty of a bond is only to secure the enjoyment of a collateral object, equity will grant an injunction against a suit for the recovery, and an issue quantum damnificatus, to try the real damage’. *Parks v Wilson* further provided if the condition required conveyance of an interest or estate in land, equity may treat the condition as evidence of an agreement to convey. Specific performance may be ordered as payment of the bond was considered inadequate compensation. This demonstrates the promissory nature of the bond and that non-performance of a condition was characterised as a breach of contract; only when damages are inadequate compensation for breach of contract, will specific performance be awarded. During the late 18th century courts started to show ‘restlessness with their longstanding duty to relieve against penalties [which] has been attributed to… the principle of freedom of contract reach[ing] its zenith’. 

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34. *Peachy v Duke of Somerset* (1720) 1 Strange 447, 447; 93 ER 626, 626. The Lord Chancellor held that this was agreeable to relief against penal bonds in which the court would not allow the parties to ‘take any other advantage of the forfeitures, than what is necessary to satisfy the original intent of the agreement’. *Peachy v Duke of Somerset* (1720) 1 Strange 447, 449; 93 ER 626, 628.  
35. In this case, that included the tenant accepting a licence or paying the relevant fine: Ibid 449; 628.  
37. (1783) 1 Bro CC 418 (‘Sloman’).  
38. The Lord Chancellor also stated that ‘where a penalty is inserted merely to secure the enjoyment of a collateral object, the enjoyment of the object is considered as the principal intent of the deed, and the penalty only as accessional, and, therefore, only to secure the damage really incurred’: Ibid 419.  
39. An issue directed by a court of equity to be tried in a court of law, to ascertain before a jury the amount of damages suffered by the non-performance or breach of contract. The court will grant relief upon payment of damages once ascertained.  
40. *Sloman v Walter* (1783) 1 Bro CC 418, 418.  
41. (1723) 10 Mod 515, 518; 88 ER 832, 833.  
44. *Austin v United Dominions Corporation Ltd* [1984] 2 NSWLR 612, 626 (Priestley JA).
D 19th Century

In Astley v Weldon,\textsuperscript{45} reference was made to Sloman\textsuperscript{46} where ‘nothing but the damage actually sustained by breach of the agreement could be recovered’,\textsuperscript{47} and Hardy v Martin\textsuperscript{48} where ‘on payment of the damage actually sustained, the Plaintiff was restrained by the Court of Chancery from taking out execution for the penalty’.\textsuperscript{49} Lord Eldon concluded if a stipulated sum was very ‘enormous and excessive’ when considered as liquidated damages, it shall instead be taken to be a penalty.\textsuperscript{50} Kemble v Farren\textsuperscript{51} was another important decision\textsuperscript{52} regarding the development of the Doctrine as Tindal CJ refused to enforce an agreement, despite the sum having been described as a liquidated damages clause.\textsuperscript{53} Instead, Tindal CJ determined its true nature as a penalty.\textsuperscript{54} Although the plaintiff sued for the penalty, a verdict for actual damages sustained\textsuperscript{55} pursuant to the Statute of William III was handed down.\textsuperscript{56} Tindal CJ further commented:\textsuperscript{57}

But that a very large sum should become immediately payable, in consequence of the nonpayment of a very small sum, and that the former should not be considered

\textsuperscript{45} (1801) 2 Bos & Pul 346 (‘Astley’) later approved in Elphinslone v Monkland Iron and Coal Company (1886) 11 App Cas 347. In Astley the parties had agreed that for three years, the plaintiff would pay the defendant a sum of money per week to perform at the plaintiff’s theatres. The defendant was required to perform such acts as required, attend the theatre half an hour before acts commenced and pay all fines. Any party who breached this agreement was bound to pay the other £2001. The defendant refused to perform at one theatre, did not attend half an hour before acts commenced and withdrew from performing for a long period of time. With evidence of fines incurred and the agreement proved, a verdict of £201 in damages was entered in favour of the plaintiff. However, if the court was of the opinion that the £2001 constituted liquidated damages, this sum would be entered instead. However, the sum was held to be a penalty: See Astley v Weldon (1801) 2 Bos & Pul 346, 346-348.

\textsuperscript{46} (1783) 1 Bro CC 418.

\textsuperscript{47} Astley v Weldon (1801) 2 Bos & Pul 346, 350.

\textsuperscript{48} (1783) 1 Cox 26 (‘Hardy’).

\textsuperscript{49} Astley v Weldon (1801) 2 Bos & Pul 346, 350.

\textsuperscript{50} Ibid 351. Heath J also held an agreement containing covenants for the performance of several acts, together with one large sum to be paid upon breach of that performance, provides that the sum stipulated for must be a penalty: Ibid 353.

\textsuperscript{51} (1829) 6 Bing 141; 130 ER 1234 (‘Kemble’).

\textsuperscript{52} Coleridge J concluded in Reynolds v Bridge (1856) 6 El & BI 528, 541; 119 ER 961, 966, with reference to Astley and Kemble that: ‘[I]f you find a covenant the breach of which will occasion a damage, not uncertain, but such as is capable of being ascertained, as where there is a particular sum to be paid which is much less than the sum named as payable upon the breach, there it is held that the last named sum is specified by way of penalty, because a Court of equity would limit the amount to be actually paid’.

\textsuperscript{53} Kemble v Farren (1829) 6 Bing 141, 149; 130 ER 1234, 1237.

\textsuperscript{54} Ibid.

\textsuperscript{55} The damages sustained amounted to a sum less than the penalty.

\textsuperscript{56} Kemble v Farren (1829) 6 Bing 141, 141-142; 130 ER 1234, 1234. Both Astley and Kemble are examples of the common law courts exercising their jurisdiction in accordance with the 1696 statute: AMEV-UDC Finance Ltd v Austin (1986) 162 CLR 170, 189.

\textsuperscript{57} Kemble v Farren (1829) 6 Bing 141, 148; 130 ER 1234, 1237 (emphasis added).
as a penalty, appears to be a contradiction in terms; the case being precisely that in which courts of equity have always relieved, and against which courts of law have, in modern times, endeavoured to relieve, by directing juries to assess the real damages sustained by the breach of the agreement.

By the end of the 19th century it appears breach was considered a necessary element, required for compensation to be made available, the handle upon which equity will intervene. ‘If… [monetary compensation] cannot be made, then courts of equity will not interfere’ and the Doctrine cannot apply. Non-performance or satisfaction of a condition, requiring payment of the bond due to breach, were therefore characterised as a breach of contract.

The Common Law Procedure Act 1854 (UK) was then enacted to extend the common law courts’ jurisdiction given the inconvenience of concurrent proceedings, in order to establish a common law right whilst receiving a remedy in Chancery. However, the power of the common law courts to grant injunctions was limited to preventing repetitious or continued contract breaches. The Judicature Acts in 1873 and 1875 rectified this problem, enabling each court to exercise both jurisdictions. The Statute of William III and Statute of Anne were consequently repealed.

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58 See, eg, Ibid; Reynolds v Bridge (1856) 6 EL & BL 528, 541; Wallis v Smith (1882) LR 21 Ch D 243: Cited in Andrews v Australia and New Zealand Banking Group Ltd (2011) 288 ALR 611, 624.

59 Joseph Story, Commentaries on Equity Jurisprudence: As Administered in England and America (Boston: Little and Brown, 13th ed, 1886) vol 2, 534-535 [1314].


61 A problem existed due to the limitations of the common law regarding available remedies after a bond was found to be penal. Examples include the remedy of injunction required to restrain a party from recovering a bond at law and the relevant procedures required in order to take complex accounts: Andrews v Australia and New Zealand Banking Group Ltd (2012) 247 CLR 205, 232 [59] citing Edwards-Wood v Baldwin (1863) 4 Giff 613; 66 ER 851.


63 This was with respect to preventing repetitious or continued contract breaches of which the plaintiff could bring an action for damages; Ibid.

64 Supreme Court of Judicature Act 1873 and Supreme Court of Judicature Act 1875.


E 20th Century

The most significant cases regarding the development of the Doctrine occurred during the 20th century: Clydebank Engineering & Shipbuilding Co Ltd v Yzquierdo y Castaneda67 and Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd.68 Principles from both cases have subsisted for over a century. In Clydebank the Spanish Government contracted for the construction of four torpedo boats. The contracts contained a provision described as a penalty for the payment of £500 per week for delivery delays.69 As the boats were delivered many months late, the Spanish Government claimed for the penalty calculated at £67,500. Describing the £500 as a “penalty” was not conclusive as to the parties’ rights.70 The Lords looked to the substance and nature of the transaction. Lord Robertson decided they could only refuse to enforce the payments if they were ‘stipulated in terrorem and could not possibly have formed a genuine pre-estimate of the creditor’s probable or possible interest in the due performance of the principal obligation’.71

The difficulty in determining whether the provision constituted a penalty revolved around the practical impossibility in ascertaining the damages suffered as a result of late delivery. The damages were not ascertainable in kind as compared to a ‘commercial vessel [which] is ascertainable in money’.72 As stated by the Earl of Halsbury L.C.:73

If it was an ordinary commercial vessel capable of being used for obtaining profits, I suppose there would not be very much difficulty in finding out… the hire of such a vessel, and what would therefore be the equivalent in money of not obtaining the use of that vessel… during the period which had elapsed between the time of proper delivery and the time at which it was delivered…

Lord Davey also pointed out that the £500 was suggested by the appellants.74 It defies logic that the appellants would have offered a particular sum if they did not believe it to be commensurate with the loss that would be suffered.

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67 [1905] AC 6 (‘Clydebank’).
68 [1915] AC 79 (‘Dunlop’).
69 ‘The penalty for later delivery shall be at the rate of £500 per week for each vessel’: Clydebank Engineering & Shipbuilding Co Ltd v Yzquierdo y Castaneda [1905] AC 6, 6.
70 Clydebank Engineering & Shipbuilding Co Ltd v Yzquierdo y Castaneda [1905] AC 6, 9-10.
71 Ibid 19 quoting Lord Kyllachy. See also ibid 10 where the Earl of Halsbury L.C. described a penalty as something to be held over the other party in terrorem.
72 Clydebank Engineering & Shipbuilding Co Ltd v Yzquierdo y Castaneda [1905] AC 6, 12.
73 Ibid.
74 Ibid 18.
All Lords held the provision was a valid liquidated damages clause. The distinction between a liquidated damages clause and a penalty relied upon ‘whether it is… unconscionable and extravagant, and one which no Court ought to allow to be enforced’. Lord Robertson observed that ‘the question remains, had the respondents no interest to protect by that clause, or was that interest palpably incommensurate with the sums agreed on?’ Lord Davey also described as an established principle, that if you ‘find a sum of money made payable for the breach… and when you find that the sum payable is proportioned to the amount… or the rate of the non-performance of the agreement… you infer that prima facie the parties intended the amount to be liquidate damages and not [a] penalty’. However, he stated it is always open to a party to show that the amount stipulated is ‘so exorbitant and extravagant’ that the sum could not possibly have been regarded as damages for any breach within contemplation of the parties.

This demonstrates from the 20th century that identification of a penalty was based upon the sum being an amount in excess or disproportionate to the other party’s loss. This aligns with the Earl of Halsbury L.C.’s requirement of the sum being unconscionable or extravagant. Although no rule was made for determining what would constitute as unconscionable or extravagant, it was held to depend upon the nature of the transaction. The Earl of Halsbury L.C. encapsulated this problem, as ‘it is impossible to lay down any abstract rule as to what it may or it may not be extravagant or unconscionable to insist upon without reference to the particular facts and circumstances… established in the individual case’. Consideration of the point of time at which the contract was made was also held to be an important factor.

*Dunlop*, which occurred after *Clydebank*, is the case most renowned for solidifying the rules of application with respect to the Doctrine. *Dunlop* involved a contract for the supply of tyres and tubes where the respondents had agreed not to sell items for

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75 Ibid 10 (Earl of Halsbury L.C.).
76 Ibid 20.
77 Ibid 16.
78 Ibid.
79 This included what was to be done and the likely loss that would follow.
80 *Clydebank Engineering & Shipbuilding Co Ltd v Yzquierdo y Castaneda* [1905] AC 6, 10.
less than Dunlop’s current price list; supply to persons suspended by Dunlop; and export without Dunlop’s consent. A provision required the respondents to pay Dunlop £5 for every tyre, cover or tube sold or offered in breach of contract. The £5 was described as liquidated damages and not a penalty. The respondents sold covers and tubes at a price less than Dunlop’s current price list in breach of contract. Dunlop sought damages as per the contract.

Lord Dunedin drew from previous cases and listed propositions as the law then stood. This included that the word “penalty” or “liquidated damages” was not conclusive; a penalty is the payment of money stipulated in terrorem of the party in breach whereas liquidated damages is a genuine pre-estimate of damage; and whether a sum constitutes a penalty or liquidated damages is a question of construction in light of the terms and circumstances of each contract, to be considered at the time the contract was entered into and not at the time of breach.

Lord Dunedin went on to frame the following well-known tests:

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:

81 Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd [1915] AC 79, 86.
83 Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd [1915] AC 79, 86-87 citing Public Works Commissioner v Hills [1906] AC 368; Webster v Bosanquet [1912] AC 394. This essentially summarised all that was stated by the various Lords in Clydebank.
85 Citing Lord Halsbury L.C. in Clydebank Engineering & Shipbuilding Co Ltd v Yzquierdo y Castaneda [1905] AC 6 (emphasis added).
86 Citing Kemble v Farren (1829) 6 Bing 141; 130 ER 1234 (emphasis added).
87 Citing Lord Watson in Lord Elphinstone v Monkland Iron and Coal Co (1886) 11 AC 332.
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.\textsuperscript{88}

Lord Dunedin stated that the above tests, if applicable to the case being considered, may prove helpful or even conclusive in assisting with whether a contractual provision constitutes a penalty.\textsuperscript{89}

Lord Atkinson observed\textsuperscript{90} it would be very difficult for Dunlop to prove the precise amount of monetary loss suffered from undercutting and considered £5 was fair given the breaches specified. Consequential injury to their trade from undercutting was in the company’s contemplation as no direct loss could be suffered from merely offering a tyre cover or tube for sale, at less than the price list.\textsuperscript{91} Lord Atkinson observed\textsuperscript{92} that in effect, the agreement provided for one obligation which was to sell or offer goods in accordance with the company’s price list – as Dunlop sold different types of goods, this single obligation could be breached in numerous ways.\textsuperscript{93} This appears to go against the grain of Lord Dunedin’s test (c) listed above and Lord Watson’s presumption, namely that the provision is a penalty where a single lump sum is due upon the occurrence of different events, some occasioning serious and others only trifling damage. However, Lord Atkinson qualified his reasoning and stated the presumption was rebutted because the damage caused by each of the events, despite their varied importance, were of such an uncertain nature that the damage could not be accurately ascertained.\textsuperscript{94}

\textsuperscript{88} Citing Lord Halsbury L.C. in \textit{Clydebank Engineering & Shipbuilding Co Ltd v Yzquierdo y Castaneda} [1905] AC 6; Lord Mersey in \textit{Webster v Bosanquet} [1912] AC 394 (emphasis added).

\textsuperscript{89} \textit{Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd} [1915] AC 79, 87.

\textsuperscript{90} Ibid 91.

\textsuperscript{91} Ibid 91-92.

\textsuperscript{92} Lord Atkinson referred to \textit{Lord Elphinstone v Monkland Iron and Coal Co} (1886) 11 AC 332, 345 (Lord Herschell) where the Court observed that an agreement had a single obligation, the breach of which provided for a sum in proportion to the extent of which the obligation was left unfilled: it did not provide a lump sum for breach of any one of several obligations which varied in importance: \textit{Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd} [1915] AC 79, 93. Lord Atkinson drew upon this decision as analogous to Dunlop.

\textsuperscript{93} \textit{Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd} [1915] AC 79, 93-94.

\textsuperscript{94} Ibid 96.
The agreement for liquidated damages was therefore appropriate given the uncertainty in ascertaining and proving damages. Liquidated damages save parties the time and costs associated with proving damages in court. In a case such as this, if Dunlop was unable to prove damages they would have only received nominal damages which would typically be incommensurate with the consequential damage caused to their distribution chain. Lord Atkinson believed the uncertainty in ascertaining damages, provided that the £5 was not in terrorem but was a genuine pre-estimate of the appellants’ probable interest in performance of the agreement.

He observed the sum was not unconscionable, unreasonable or extravagant either.

Lord Parmoor questioned the rationality in interfering with the language of a contract. This interference with freedom of contract is one reason commentators criticise the Doctrine. Lord Parmoor stated this ‘interference should not be extended’, which is relevant in light of the recent Australian High Court decisions which scrutinised the history of the Doctrine and extended its application. Lord Parmoor stated ‘an extravagant disproportion’ must exist between the specified sum and any damages capable of pre-estimation in order to justify interference with the freedom to contract. Lord Parmoor also referred to the rule constituting a presumption that a penalty exists, and like Lord Atkinson, decided the presumption had been displaced by the inability to accurately pre-estimate the damage.

Lord Parker distinguished between cases in which the damage likely to result from each requirement is the same in kind, and cases in which the damage likely to result varies in kind with each requirement: ‘Cases of the former class seem… to be completely analogous to those of a single stipulation, which can be broken in various ways and varying damage’. He applied that distinction to Dunlop.

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95 It is therefore logical for parties to agree on what those damages are, especially if the actual loss is difficult to ascertain.
97 Ibid 97.
98 Ibid 101.
99 This interference was recognised from around the time of the doctrine’s inception.
103 Ibid 103-104.
104 Ibid 98 (Lord Parker of Waddington).
deciding that the damage likely to accrue from breach of each condition was the same in kind, amounting to the disturbance of the company’s distribution system.\textsuperscript{105} Subsequently all Lords agreed that the provision was a liquidated damages clause and not a penalty.

The rules formulated by Lord Dunedin in \textit{Dunlop} have been described as ‘a product of centuries of equity jurisprudence’.\textsuperscript{106} The Doctrine had slowly developed into a principled area of law by the 20\textsuperscript{th} century. Breach of contract was considered a necessary element in order for compensation to be made available, without which, relief would not be granted. This requirement first emerged in the 17\textsuperscript{th} century and was confirmed in the cases that followed. The promissory nature of the bond, was also evident. In the ninety-seven years following \textit{Dunlop}, but prior to Andrews, the Australian High Court considered the Doctrine further. It is now appropriate to consider these decisions.

\textsuperscript{105} Ibid 99.
\textsuperscript{106} Rossiter, above n 8, 33.
III FOLLOWING DUNLOP

*Dunlop* provided the Doctrine’s foundation throughout common law jurisdictions.107 Examples include Australia,108 England,109 New Zealand,110 Canada,111 Northern Ireland,112 Hong Kong,113 and Singapore.114 The Australian High Court applied Lord Dunedin’s rules in *IAC (Leasing) Ltd v Humphrey*,115 *O’Dea v Allstates Leasing System (WA) Pty Ltd*,116 and *AMEV-UDC Finance Ltd v Austin*,117 confirming that the Doctrine’s application was restricted to situations


114 *CLAAS Medical Centre Pte Ltd v Ng Boon Ching* [2010] 2 SLR 396; *Edward Jason Glenn v Australia and New Zealand Banking Group Ltd* [2012] SGHC 61 cited in Manly, ‘Substance over Form: Australia’s Highest Court Reconsiders the Penalty Doctrine’, above n 107, 20.

115 (1972) 126 CLR 131. This case confirmed the penalty doctrine’s application in instances of breach of contract only: ‘[I]t is only when a provision operates so that the event upon which an obligation is placed upon a party to pay a sum of money… is the breach by the former party of… the contract, that the question arises whether [the provision is] a penal. Thus if a sum has become payable because a party has exercised an option… the exercise of which is conditional upon a payment… the question of a penalty does not arise’: *IAC Leasing Ltd v Humphrey* (1972) 126 CLR 131, 143.

116 (1983) 152 CLR 359. ‘[W]here the agreement is terminated by reason of a breach committed by the hirer, the sum payable will be a penalty unless it is a genuine pre-estimate of the loss suffered by the owner by reason of the breach’: citing *Cooden Engineering Co Ltd v Stanford* [1953] 1 QB 86; *Campbell Discount Co Ltd v Bridge* (1962) AC 600; *Financings Ltd v Ballock* (1963) 2 QB 104. ‘If… terminated by the hirer himself… the question whether the sum payable is liquidated damages or a penalty does not arise’: *O’Dea v Allstates Leasing System (WA) Pty Ltd* (1983) 152 CLR 359, 367. See also *O’Dea v Allstates Leasing System (WA) Pty Ltd* (1983) 152 CLR 359, 394, 397-398.

117 (1986) 162 CLR 170 (‘AMEV-UDC’). The penalty doctrine has no application to a clause which provides for payment of a sum on the occurrence of an event other than breach of contract: *AMEV-UDC Finance Ltd v Austin* (1986) 162 CLR 170, 184 (Mason and Wilson JJ) with reference to *Bridge v Campbell Discount Co Ltd* [1962] AC 600; [1962] 1 All ER 385 (affirmed in *Export Credits Guarantee Department v Universal Oil Products Co* [1983] 1 WLR 399, 402-403; 2 All ER, 223-224). ‘[A]n agreed sum… [should] only [be] characterised as a penalty if it out of all proportion to [the] damage likely to be suffered as a result of breach’: *AMEV-UDC Finance Ltd v Austin* (1986) 162 CLR 170, 190 citing *Robophone Facilities Ltd v Blank* [1966] 1 WLR 1428, 1447-1448; 3 All ER 128, 142-143. Only ‘where compensation was not possible, or damages could not be assessed…
where there had been a breach of contract. *Ringrow Pty Ltd v BP Australia Pty Ltd*\(^{118}\) was the last High Court decision to consider the Doctrine prior to *Andrews*.

In *Ringrow*,\(^{119}\) BP Australia sold a service station to Ringrow who was required to purchase fuel from BP Australia exclusively.\(^{120}\) However, Ringrow breached this agreement,\(^{121}\) entitling BP Australia to terminate and either claim liquidated damages,\(^{122}\) or exercise an option to buy back the service station at market value excluding goodwill.\(^{123}\) BP Australia terminated and sought to exercise the option.\(^{124}\) Ringrow claimed the option constituted an unenforceable penalty.\(^{125}\) Hely J at first instance rejected that contention.\(^{126}\) On appeal the Full Court of the Federal Court agreed with Hely J.\(^{127}\) Ringrow appealed to the High Court.\(^{128}\)

Ringrow referred to Lord Dunedin’s rules in *Dunlop* as authoritative with respect to penalties. This was not challenged.\(^{129}\) The High Court affirmed *Dunlop*, stating that this ‘formulation has endured for 90 years’\(^{130}\) and continues to ‘express the law applicable in this country’.\(^{131}\) The High Court determined that the Doctrine ‘in its standard application, is attracted where a contract stipulates that on breach the contract-breaker will pay an agreed sum which exceeds… a genuine pre-estimate of the damage likely to be caused’.\(^{132}\) ‘In typical penalty cases, the court compares what would be recoverable as unliquidated damages with the sum of money

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\(^{118}\) (2005) 224 CLR 656 (‘*Ringrow*’).

\(^{119}\) Ibid.

\(^{120}\) Ibid 656.

\(^{121}\) Ringrow purchased fuel from a third party; Ibid 657.

\(^{122}\) This was calculated by reference to BP Australia’s expected profits over the balance of the term of the agreement.

\(^{123}\) If BP Australia exercised the option, liquidated damages were no longer payable: *Ringrow Pty Ltd v BP Australia Pty Ltd* (2005) 224 CLR 656, 657.

\(^{124}\) *Ringrow Pty Ltd v BP Australia Pty Ltd* (2005) 224 CLR 656, 660-661 [3].

\(^{125}\) Ibid 661 [5].

\(^{126}\) Ibid 658, 661.

\(^{127}\) Ibid 661 [7].

\(^{128}\) Ringrow argued excluding goodwill from the resale price constituted a penalty as goodwill was included in the purchase price paid by Ringrow. Ringrow further argued a comparison of the service station’s current value with the consideration due for transferring the service station back to BP Australia, demonstrated the option’s penal character: Ibid 664 [17].

\(^{129}\) *Ringrow Pty Ltd v BP Australia Pty Ltd* (2005) 224 CLR 656, 662-663 [11]-[12].

\(^{130}\) Ibid 663 [12].

\(^{131}\) Ibid.

\(^{132}\) Ibid 662 [10].
stipulated as payable on breach’. However, as this involved the value of property transferable on a particular event, the High Court held this extended application required a different approach than typical penalty cases: This required a comparison between ‘the value of what is transferred… [with] the price to be received’, which must be extravagant and unconscionable. The High Court decided valuing the goodwill was necessary, constituting the alleged difference. An expert witness gave evidence at first instance that no sources of significant goodwill existed. No new evidence was submitted. The High Court held it was therefore ‘not possible to say what, if any, money sum it has lost. Hence it is not possible to say that there is a penalty… which rested on a comparison of the consideration payable to the appellant for the transfer back… with the real value’ of the service station.

Ringrow’s argument, that a disproportion existed between BP Australia’s legitimate commercial interests and the promise extracted to protect them, was also held to be irrelevant. The High Court stated that: ‘[N]either Dunlop…

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133 Ibid 665 [21].
134 Ringrow submitted Lord Dunedin’s principles were not constrained to payments of money, but included the transfer of valuable property where that value exceeded the damage suffered: Ibid 664 [17].
135 Ringrow Pty Ltd v BP AustraliA Pty Ltd (2005) 224 CLR 656, 665 [21].
136 Ibid 666 [21].
137 Ibid 666 [21]-[22].
138 Ibid 666 [23].
139 No sources of significant goodwill existed other than location but that this did not provide monetary value; Ibid. The trial judge accepted the evidence of the expert witness and held that Ringrow had failed to establish the existence of valuable goodwill of which Ringrow would be deprived due to exercising the option: Ringrow Pty Ltd v BP Australia Ltd (2003) 203 ALR 281, 314 [146].
140 Ringrow Pty Ltd v BP Australia Pty Ltd (2005) 224 CLR 656, 666 [24].
141 Ibid.
142 Ringrow stated BP Australia’s only legitimate commercial interest included preservation of the service station for exclusive sale of BP petroleum products during the agreement’s term. Ringrow argued that this interest could have been satisfied by leasing the service station to BP Australia for the unexpired term following termination: Ibid 664 [17].
143 Ringrow submitted that the agreement could be terminated due to various events, some of which may only occasion trifling damage. Ringrow stated that this demonstrated the lack of proportion between breach and outcome: Ringrow Pty Ltd v BP Australia Pty Ltd (2005) 224 CLR 656, 664 [17], [19]. Although the option could be exercised after terminating the agreement for technical breaches, the Court held that this only pointed to a possible ‘precondition’ of a penalty. This did not demonstrate so great a disparity between what BP Australia was to receive on transfer of the service station with a genuine pre-estimate of damage: Ringrow Pty Ltd v BP Australia Pty Ltd (2005) 224 CLR 656, 670 [35].
144 Ringrow Pty Ltd v BP Australia Pty Ltd (2005) 224 CLR 656, 667 [27].
145 Ibid 667 [26].
nor any other authority supports the “proportionality” doctrine which the appellant advanced. The ‘penalty must be judged as “extravagant and unconscionable in amount”. It is not enough that it should be lacking in proportion. It must be “out of all proportion”. The High Court also referred to AMEV-UDC where Mason and Wilson JJ held an agreed sum should only be ‘characterized as a penalty if it is out of all proportion to damage likely to be suffered as a result of breach’. The High Court then held that,

The principles of law relating to penalties require only that the money stipulated to be paid on breach or the property stipulated to be transferred on breach will produce for the payee or transferee advantages significantly greater than the advantages which would flow from a genuine pre-estimate of damage.

The High Court therefore held the provision was not a penalty and affirmed the continuing application of the rules formulated in Dunlop. Breach of contract was also considered essential. The next High Court decision to consider the Doctrine, following Ringrow, was the controversial decision of Andrews: this decision scrutinised the Doctrine’s history and extended its scope of application.

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147 The appellant also relied on Pigram v Attorney-General (NSW) (1975) 132 CLR 216, 227 (Gibbs J); O’Dea v Allstates Leasing System (WA) Pty Ltd (1983) 152 CLR 359, 369 (Gibbs CJ), 383 (Wilson J), 399 (Deane J).
148 Ringrow Pty Ltd v BP Australia Pty Ltd (2005) 224 CLR 656, 667 [27].
149 Ibid 669 [30], [32].
150 Ibid 667 [27].
151 (1986) 162 CLR 170, 193.
152 AMEV-UDC Finance Ltd v Austin (1986) 162 CLR 170, 190 (emphasis added).
153 Ringrow Pty Ltd v BP Australia Pty Ltd (2005) 224 CLR 656, 667 [27] (emphasis added).
154 Ibid 671 [39].
IV ANDREWS v ANZ

Andrews\textsuperscript{155} is the controversial Australian High Court decision that confounded the legal community by extending the Doctrine to apply in instances other than breach of contract. This case involved a class action against ANZ regarding a variety of customer fees. The fees charged by ANZ were identified as honour, dishonour, and non-payment fees in respect of deposit accounts, and over limit and late payment fees in respect of credit card accounts.\textsuperscript{156} Andrews v Australia and New Zealand Banking Group Ltd\textsuperscript{157} was appealed to the Full Court of the Federal Court from the primary judgment of Gordon J, but was instead removed into the High Court. The High Court decision in Andrews radically transformed the way the Doctrine had been understood to operate given the Doctrine had only ever applied to breach of contract. As no explanation was given for modifying the Doctrine, the decision of Andrews was criticised.\textsuperscript{158} Extending the application of the Doctrine, with respect, required an explanation. Instead, the High Court held that because equity looks to substance over form, the Doctrine has always applied in situations other than breach. However, the history of the Doctrine demonstrates that up until Andrews the Doctrine only applied where damages that were dismissed as a penalty related to breach of contract (see Chapter II). It is now appropriate to evaluate Gordon J’s decision at first instance.

A At First Instance

At first instance Gordon J found that the late payment fee was payable upon breach of contract and was therefore capable of being characterised as a penalty.\textsuperscript{159} Gordon J’s decision aligned with Dunlop and the case history. ANZ did not appeal against

\textsuperscript{155} (2012) 247 CLR 205.
\textsuperscript{156} Ibid 219 [19].
\textsuperscript{157} (2011) 288 ALR 611.
\textsuperscript{158} ‘[T]he policy which underlies the decision in Andrews was not in fact articulated. And the concept of ‘penalty’ adopted by the High Court is not only convoluted, it lacks contemporary support in the law. Since its scope is unclear and its application uncertain, so also is the decision in Andrews. That seems to us unacceptable’: J W Carter et al, ‘Contractual Penalties: Resurrecting the Equitable Jurisdiction’ (2013) 30 Journal of Contract Law 99, 132; ‘One can only guess at what the policy rationale was, because none was articulated, beyond a claim that this was the historical English position, a claim substantially refuted by the United Kingdom Supreme Court’: Anthony Gray, ‘The Law of Penalties and the Question of Breach’ (2017) 45 Australian Business Law Review 8, 8; See also Jessica Palmer, ‘Implications of the New Rule Against Penalties’ (2016) 47 Victoria University of Wellington Law Review 305, 317; Anthony Gray, ‘Contractual Penalties in Australian Law After Andrews: An Opportunity Missed’ (2013) 18 Deakin Law Review 1, 17.
\textsuperscript{159} Andrews v Australia and New Zealand Banking Group Ltd (2011) 288 ALR 611, 611.
this finding. Gordon J held that the honour, dishonour, non-payment and over limit fees, were not charged upon the event of breach of contract by the customer. Gordon J held that the occurrence of the event for which the fees were charged (overdrawing or attempting to overdraw) was not an event the customer had an obligation to avoid. Gordon J therefore concluded it was unnecessary to consider whether the fees were also capable as being characterised as a penalty, as the fees were outside the scope of the Doctrine. Gordon J held the fees were charged as a consequence of ANZ deciding to provide or decline further accommodation to the customer. This was not a unilateral decision by the customer as it required the customer to request further accommodation, with the bank accepting or rejecting that request, before any fee became payable. No obligation existed of which breach could occur. ANZ argued the fees unrelated to breach could not constitute a penalty. However, ANZ admitted the fees charged relating to breach of contract did not constitute a genuine pre-estimate of damage, which went against ANZ’s position that the fees were not penalties.

Gordon J confirmed the Doctrine is ‘confined to payments for breach of contract’, and has ‘no application to contractual payments that arise upon termination of the agreement where the agreement is terminated on the occurrence of an event that does not constitute a breach of contract’. If the Doctrine had always applied to situations other than breach of contract as later held by the High Court, Gordon J presumably would have pointed to this in her decision. This application would presumably be common knowledge amongst the judiciary who enforce its application. This demonstrates that the High Court transformed the scope of the Doctrine. Gordon J also stated that the ‘court’s modern jurisdiction in

163 Ibid.
166 Ibid.
167 Ibid 611, 615.
168 Ibid 615.
169 Ibid 611.
relation to the law of penalties cannot be divorced from its origins'. As discussed in Chapter II, breach of contract was historically an essential element in order for compensation to be available. Where compensation was unavailable or could not be ascertained, equity would not relieve against the penalty. Gordon J explained that the ‘law of penalties is a narrow exception to the general rule that the law seeks to preserve freedom of contract’.

The applicants in *Andrews* argued that historically, equity granted relief in defeasible bonds despite being expressed in terms of condition and defeasance rather than an obligation capable of breach. The applicants argued equity looked to substance over form and that the scope of the Doctrine was not restricted to breach of contract. Gordon J accepted equity looked to substance over form and although the equitable jurisdiction was restricted to breach, it extended to matters expressed as condition and defeasance. This is no different to judges looking to the substance of the agreement rather than words used. In *Dunlop*, for example, the use of the words “liquidated damages” or “penalty” in describing a clause was not conclusive. Further, a defeasible bond still looked and behaved like a contractual agreement and a liquidated damages clause provided the sum was proportionate to the damage incurred. Performance of the obligation constituted the contractual agreement, whereas the bond constituted the liquidated damages clause. Defeasible bonds are therefore not analogous to a term which does not impose an obligation. A sum payable on an event occurring which the party had no obligation to avoid, cannot fall within the category of constituting, in substance, breach.

The applicants in *Andrews* referred to the *Statute of William III* and the *Statute of Anne* in support of their argument. However, in accordance with Gordon J’s observation, the applicants ignored the procedural object of the statutes to

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170 Ibid 615.
171 Monetary compensation was required in order for equity to have a “handle” so as to provide relief. See, eg, *Peachy v Duke of Somerset* (1720) 1 Strange 447, 453; 93 ER 626, 630 (Lord Macclesfield); Story, above n 59, 534-535 [1314].
173 (2011) 288 ALR 611.
174 Ibid 618.
175 Ibid.
176 *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd* [1915] AC 79, 86.
177 (2011) 288 ALR 611.
streamline relief against penalties: \(^{178}\) ‘where proceedings were brought at law by the obligee, the obligor would obtain from the court of law the relief for which otherwise it would have needed to institute a separate suit in equity to obtain’. \(^{179}\) As the Statute of Anne recognised substance over form which was carried over from equity into the common law, the applicants argued this meant ‘common law relief against money bonds was available in respect of instruments which did not in terms impose an obligation to pay the lesser sum; terms which did not reflect a promise or what would later become a term of a contract’. \(^{180}\) Gordon J stated such a general proposition did not follow. \(^{181}\) In money bonds the bond became void upon payment of the lesser sum at the agreed time (the primary obligation). \(^{182}\) Relief was available when the bond required payment of a sum larger than the original stipulated amount. \(^{183}\) Gordon J held that this takes on the form of an obligation to pay the original amount. \(^{184}\) This conclusion is logical. The bond imposed an obligation upon a party, who, if they breached that obligation, was required to pay the bond. The court would only enforce that bond to the extent of actual loss suffered. Naturally, loss can only flow from breach. The existence of the Statute of Anne does not mean that the Doctrine is applicable to terms that do not impose an obligation upon a party.

In Andrews, for example, the applicants did not breach an obligation because they had overdrawn their account. No obligation was imposed upon the applicants to not overdraw their account. It cannot follow that the Doctrine applies in that situation. ANZ had the option to accept or decline their instruction in providing further accommodation. ANZ’s decision dictated whether a particular fee became due. As Gordon J stated, this was not a unilateral action by the applicant such as failing to perform an obligation resulting in breach. \(^{185}\) The event leading to the fee required action by both the applicants and ANZ. No logical correlation exists between the applicants’ argument regarding the Statute of Anne and the current case: money

\(^{178}\) Ibid 621.
\(^{179}\) Ibid 621 [26] (Gordon J).
\(^{180}\) Ibid 621 [27].
\(^{181}\) Ibid 621 [28].
\(^{182}\) See ibid 621.
\(^{183}\) See ibid.
\(^{184}\) See ibid 621 [28].
\(^{185}\) Ibid 612.
bonds are not analogous to situations not imposing an obligation (and therefore not requiring breach).

The applicants cited Sloman\textsuperscript{186} and Peachy v Duke of Somerset\textsuperscript{187} in support of their argument but that decision lends no assistance. These cases did not discuss the application of the Doctrine in instances other than breach, but formulated principles now well established regarding the Doctrine (see Chapter II). This was also pointed out by Gordon J.\textsuperscript{188} The applicants also cited Ringrow,\textsuperscript{189} focusing on what the High Court had meant by “standard application”.\textsuperscript{190} The applicants argued that by recognising a standard application existed, a non-standard application must also exist. This non-standard application was said by the applicants to amount to a class of penalty which could be struck down but did not require breach of contract.\textsuperscript{191} The phrase in Ringrow that the applicants’ referred to included:\textsuperscript{192}

The law of penalties, \textit{in its standard application}, is attracted where a contract stipulates that on breach the contract-breaker will pay an agreed sum which exceeds what can be regarded as a genuine pre-estimate of the damage likely to be caused by the breach.

Gordon J commented that selecting a single phrase and attempting to ‘elevate it into an acknowledgment by the High Court that there is some other class of penalty which could be struck down and that this other class just happened to be (or include) the class of cases into which the applicants’ individual claims fell’\textsuperscript{193} was inappropriate. She concluded Ringrow provided no support in respect of the applicants’ submissions.\textsuperscript{194}

The applicants’ reasoning does appear to be flawed. The High Court in Ringrow determined that ‘[i]n typical penalty cases, the court compares what would be recoverable as unliquidated damages with the sum of money stipulated as payable on breach’ (see Chapter III).\textsuperscript{195} However, as this case involved the value of property

\textsuperscript{186} (1783) 1 Bro CC 418.
\textsuperscript{187} (1720) 1 Strange 447.
\textsuperscript{188} See Andrews v Australia and New Zealand Banking Group Ltd (2011) 288 ALR 611.
\textsuperscript{189} (2005) 224 CLR 656.
\textsuperscript{190} Andrews v Australia and New Zealand Banking Group Ltd (2011) 288 ALR 611, 629.
\textsuperscript{191} Ibid.
\textsuperscript{192} Ringrow Pty Ltd v BP Australia Pty Ltd (2005) 224 CLR 656, 662 [10] (emphasis added).
\textsuperscript{193} Andrews v Australia and New Zealand Banking Group Ltd (2011) 288 ALR 611, 629 [52].
\textsuperscript{194} Ibid.
\textsuperscript{195} Ringrow Pty Ltd v BP Australia Pty Ltd (2005) 224 CLR 656, 665 [21].
transferable on a particular event, the High Court held this extended application required a different approach than typical penalty cases: This required a comparison between ‘the value of what is transferred… [with] the price to be received’, which must be extravagant and unconscionable. The High Court stated:

Lord Dunedin’s statement applies not only to cases where money is payable but also to cases where money’s worth (including property) is transferable on a particular event. In that extended application, Lord Dunedin’s statement requires a different approach for that employed in typical penalty cases.

This demonstrates what the High Court meant by non-standard application. The applicants’ argument is also illogical in light of the overall judgment where the High Court confirmed Lord Dunedin’s rules in Dunlop as the governing principles for identifying a penalty clause. The High Court never mentioned that non-standard application included occurrences other than breach of contract.

Further, the High Court has the power to modify the law. Presumably, the High Court in Ringrow would have expressly stated another class of penalty existed, if that was their intention, and that this included situations other than breach of contract. The High Court did not. However, the High Court recognised that the time may come when a particular feature of Australian conditions, a change in the nature of penalties, or an element in the contemporary market-place could suggest the need for a new formulation. In reference to an element in the contemporary market-place, the High Court cited AMEV-UDC where Mason and Wilson JJ highlighted the importance of freedom of contract, stating ‘an agreed sum [should] only [be] characterized as a penalty if it is out of all proposition to [the] damage likely to be suffered as a result of breach’. Mason and Wilson JJ made no reference to breach

196 Ringrow submitted Lord Dunedin’s principles were not constrained to payments of money, but included the transfer of valuable property where that value exceeded the damage suffered: Ibid 664 [17].
197 Ringrow Pty Ltd v BP Australia Pty Ltd (2005) 224 CLR 656, 665 [21].
198 Ibid.
199 Ibid 666 [21]-[22].
201 See also ibid 630 [57] (Gordon J).
203 See ibid 663 [12].
204 (1986) 162 CLR 170.
205 ‘This concept has been eroded by more recent decisions which… have struck down provisions for the payment of an agreed sum merely because it may be greater than the amount of damages which could possibly be awarded for the breach of contract’; Ibid 190 (emphasis added).
of contract not being necessary. Instead, they referred to breach explicitly and inclusively. Ringrow does not assist the applicants’ argument.

The remaining case that the applicants relied upon significantly was Integral Home Loans Pty Ltd v Interstar Wholesale Finance Pty Ltd\(^\text{206}\) where Brereton J held at first instance that the provision constituted a penalty. The provision allowed Interstar to terminate the agreement if Interstar decided that Integral had engaged in deceptive conduct regarding loan application files.\(^\text{207}\) Brereton J determined that the Doctrine was therefore applicable to a clause entitling a party to terminate a contract based on various events (such as insolvency or death) because the clause served to ‘secure the interests of the party in receiving performance of the main promise of the contract … [and] their effect is that the [other] party’s entitlement to continue to enjoy the benefit of the contract is conditional upon its not committing any event of default’.\(^\text{208}\) It is important to note that on the facts, the right to terminate the contract was not conditional upon breach and no right as to damages resulted from the event that entitled termination. Brereton J held that the Doctrine was not limited in application to contracts terminated for breach. Brereton J held the Doctrine extended to situations where a contract is terminated upon a right to do so, following the occurrence of default which the defaulting party had an obligation in substance to avoid. This decision was overturned\(^\text{209}\) by the New South Wales Court of Appeal in Interstar Wholesale Finance Pty Ltd v Integral Home Loans Pty Ltd\(^\text{210}\) because the Court found that the Doctrine did not extend past situations involving breach of contract.

Gordon J stated that Brereton J’s proposition had no support from case law in Australia, United Kingdom, New Zealand, Hong Kong or Canada.\(^\text{211}\) Gordon J pointed out that although the Doctrine has had applicability with respect to

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\(^\text{206}\) [2007] NSWSC 406 (‘Integral’).
\(^\text{207}\) Under clause 20.3(c); Ibid [5].
\(^\text{208}\) Integral Home Loans Pty Ltd v Interstar Wholesale Finance Pty Ltd [2007] NSWSC 406 [71].
\(^\text{209}\) Ibid [74]-[77]; See also Andrews v Australia and New Zealand Banking Group Ltd (2011) 288 ALR 611, 635 [72].
\(^\text{210}\) (2008) 257 ALR 292 (‘Interstar’).
\(^\text{211}\) Andrews v Australia and New Zealand Banking Group Ltd (2011) 288 ALR 611, 635 [73].
terminating an agreement based upon a breach of contract, the Doctrine has had no applicability with respect to payments falling due upon terminating an agreement, where the ability to terminate is based upon the occurrence of an event not constituting a breach of contract. Given this decision was overturned, it does not provide assistance to the applicants’ argument. In \textit{Interstar}, the Court of Appeal stated:

[Intermediate appellate authorities in Australia, the persuasive view of a unanimous House of Lords, existing High Court authority and other views expressed in the High Court constrained the primary judge (and constrain this court) to limiting the application of the doctrine of penalties to circumstances of breach of contract. This statement reconfirms the position of the law regarding the Doctrine prior to \textit{Andrews} and that case law history completely undermines the proposition that the Doctrine has always applied in instances other than breach of contract.

The applicants’ argument regarding the Doctrine applying in instances other than breach of contract found no support in the cases cited. It therefore appears that Gordon J rightly dismissed their application regarding a number of fees not charged in relation to breach. As there had been no breach of contract, the Doctrine could not apply. It is relevant to point out that Gordon J, in support of her decision, referred to an extensive list of authority in Australia and the United Kingdom, all

\footnotesize{\textsuperscript{212} Ibid 632 citing \textit{Cooden Engineering Co v Stanford} [1953] 1 QB 86, 96-97, 116; 2 All ER 915, 920-921, 932 (Somervell LJ and Hodson LJ); \textit{Campbell Discount Co Ltd v Bridge} [1962] AC 600, 614-615, 621, 631, 632; All ER 388-389, 393, 399, 400 (all House of Lords members supported the application of the penalty doctrine in these circumstances); \textit{United Dominions Trust (Commercial) Ltd v Ennis} [1968] 1 QB 54, 64, 67, 69; All ER 348, 350, 351 (Lord Denning MR, Harman LJ and Salmon LJ); \textit{O'Dea v Allstates Leasing System (WA) Pty Ltd} (1983) 152 CLR 359, 367, 375, 382-383, 391, 397-398 (All High Court members supported the application of the penalty doctrine in these circumstances); \textit{AMEV-UDC Finance Ltd v Austin} (1986) 162 CLR 170; \textit{Esanda Finance Corporation Ltd v Plessnig} (1989) 166 CLR 131.

\textsuperscript{213} See \textit{Associated Distributors v Hall} [1938] 2 KB 83, 87-8; 1 All ER 511, 512-513 (Slesser LJ with whom Scott LJ and Clauson LJ agreed); \textit{IAC (Leasing) Ltd v Humphrey} (1972) 126 CLR 131, 142-143 (Walsh J with whom Barwick CJ and McTiernan J agreed) cited in \textit{Andrews v Australia and New Zealand Banking Group Ltd} (2011) 288 ALR 611, 632.

\textsuperscript{214} \textit{Andrews v Australia and New Zealand Banking Group Ltd} (2011) 288 ALR 611, 633.

\textsuperscript{215} \textit{Interstar Wholesale Finance Pty Ltd v Integral Home Loans Pty Ltd} (2008) 257 ALR 292 [106].

\textsuperscript{216} \textit{Re Apex Supply Co Ltd} [1942] Ch 108, 109; [1941] 3 All ER 473, 475; \textit{Campbell Discount Co Ltd v Bridge} [1962] AC 600, 613-614; 1 All ER 385, 387-388 (Viscount Simonds); \textit{Philip Bernstein (Successors) Ltd v Lydiate Textiles} (unreported, Court of Appeal UK, Diplock LJ, 26 June 1962); \textit{United Dominions Trust (Commercial) Ltd v Ennis} [1968] 1 QB 54, 66-67; [1967] 2 All ER 345, 349-350 (Harman LJ); \textit{IAC (Leasing) Ltd v Humphrey} (1972) 126 CLR 131, 140-144 (Walsh J, Barwick CJ and McTiernan J agreed); \textit{Export Credits Guarantee Department v Universal Oil Products Co} [1983] 1 WLR 399, 404; 2 All ER 205, 224 (Lord Roskill with whom Lords Diplock, Elwyn-Jones, Keith of Kinkel and Brightman agreed); \textit{AMEV-UDC Finance Ltd v Austin} (1986)
of which stated that the Doctrine has no application to a provision requiring payment of a sum, on the occurrence of an event other than breach of contract.\textsuperscript{217}

Further, Gordon J noted\textsuperscript{218} that Lord Dunedin’s formulations from \textit{Dunlop} including the requirement of breach, was also adopted in Canada,\textsuperscript{219} New Zealand\textsuperscript{220} and Hong Kong.\textsuperscript{221} Gordon J also decided that the late penalty fees were capable of attracting the application of the Doctrine. There was nothing exceptional about this decision. As stated by Gordon J:\textsuperscript{222}

The law of penalties, confined (as it is) to payments for breach of contract, is a narrow exception to the general rule whereby the law seeks to preserve freedom of contract.

Despite these conclusions, Gordon J’s decision was appealed to the High Court.

\textbf{B The High Court Decision}

The High Court began by summarising what it considered to be the settled aspects of the Doctrine.\textsuperscript{223} This included the characterisation that a penalty is a punishment for the non-observance of a contractual obligation, and upon such breach, imposes an ‘additional or different liability’.\textsuperscript{224} A contractual term prima facie imposes a penalty if it is collateral to a primary obligation, and upon failing to observe that primary obligation the collateral stipulation imposes an additional detriment (the

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\textsuperscript{218} See ibid 631-632 [60].


\textsuperscript{221} See Philips Hong Kong Ltd v Attorney General of Hong Kong [1993] 1 HKLR 269, 277-278; Re Mandarin Container [2004] 3 HKLRD 554, 559 cited in Andrews v Australia and New Zealand Banking Group Ltd (2011) 288 ALR 611, 631-632 [60].

\textsuperscript{222} Andrews v Australia and New Zealand Banking Group Ltd (2011) 288 ALR 611, 636 [78].


penalty) as against the first party to the benefit of the second.\textsuperscript{225} This collateral stipulation is described as security for and in terrorem of satisfying the primary obligation.\textsuperscript{226} The court will only enforce such a clause to the extent of compensation for any prejudice the party suffered as a result of the failure to observe the primary stipulation.\textsuperscript{227} The High Court stated that as a matter of construction used since \textit{Peachy v Duke of Someret},\textsuperscript{228} the Doctrine does not apply if the damage incurred due to the failure of the primarily stipulation cannot be evaluated in monetary terms: ‘it is the availability of compensation which generates the “equity” upon which the court intervenes; without it, the parties are left to their legal rights and obligations’.\textsuperscript{229} The primary obligation\textsuperscript{230} and penalty need not be the payment of money.\textsuperscript{231} The primary obligation can be the occurrence or non-occurrence of an event\textsuperscript{232} whilst the penalty could be the transfer or use of property.\textsuperscript{233} The High Court’s initial identification of a penalty is in alignment with a century of case law.

The High Court then referred to Gordon J’s decision and that in ‘reaching her conclusion respecting the scope of the penalty doctrine… [Gordon J] with respect quite properly followed… the New South Wales Court of Appeal [decision] in \textit{Interstar}’.\textsuperscript{234} The High Court thereby acknowledged that the application of the Doctrine was confined to instances of breach up until this point. Otherwise, presumably the High Court would have stated Gordon J had erred in her decision by misconstruing the scope of the Doctrine. However, the High Court stated that


\textsuperscript{227} \textit{Andrews v Australia and New Zealand Banking Group Ltd} (2012) 247 CLR 205, 216-217 [10].

\textsuperscript{228} (1720) 1 Str 447; 93 ER 626.


\textsuperscript{230} Ibid 217 [12] citing Story, above n 59, [1314].

\textsuperscript{231} \textit{Andrews v Australia and New Zealand Banking Group Ltd} (2012) 247 CLR 205, 217 [12].

\textsuperscript{232} Ibid citing Story, above n 59, [1314].

\textsuperscript{233} \textit{Andrews v Australia and New Zealand Banking Group Ltd} (2012) 247 CLR 205, 217 [13] citing \textit{Jobson v Jobson} [1989] 1 WLR 1026, 1034-1035, 1039; 1 All ER 621, 628, 632 (Dillon LJ and Nicholls LJ) commenting that ‘such a distinction would elevate form over substance’. See also \textit{Forestry Commission (NSW) v Stefanetto} (1976) 133 CLR 507, 519-521 (Mason J).

\textsuperscript{234} \textit{Andrews v Australia and New Zealand Banking Group Ltd} (2012) 247 CLR 205, 221-222 [29].
the applicants seek to challenge the decision of *Interstar*, and that the challenge should succeed.\(^{235}\)

In support of this decision, the High Court discussed that the word “condition”, with respect to penal bonds, was not used in the same manner that “condition” and “warranty” are used today with respect to contracts.\(^{236}\) The High Court decided ‘while the obligation under a bond may be said to be conditioned upon the occurrence of a particular event… the term “condition” is not used… with respect to breaches of contract’.\(^{237}\) The High Court then quoted\(^{238}\) from *A Treatise on the Law of Contracts*:\(^{239}\)

> The common early form of contractual obligation was a bond upon condition, so that in the early books the word “obligation” without more is used to designate such a bond. The purpose of the bond obviously was, and still is, to secure performance of the condition, but instead of attempting to secure this result by exacting a promise from the obligor to perform the condition, there is an acknowledgment of indebtedness - in effect a *promise to pay a sum of money if the condition is not performed*.

However, this quote provides evidence of the promissory nature of the bond. The bond constituted a promise to meet an obligation, where failing to do so, would require compensation in the form of the bond which acted like a liquidated damages clause. The bond was to ensure performance of the obligation and failing that, reduce the time and cost in exacting damages. Clearly, damages only flow from an event of breach, otherwise, how is loss to have occurred?

The High Court cited *Parks v Wilson*\(^{240}\) and *Prebble v Boghurst*,\(^{241}\) where the obligation contained within the bond was the settlement or conveyance of an interest or estate in land, which equity may treat as evidence of an agreement to convey.\(^{242}\) In these instances, specific performance was enforced as damages were

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\(^{235}\) Ibid 223 [32].

\(^{236}\) See ibid 223-224 [33]-[35].


\(^{238}\) Andrews v Australia and New Zealand Banking Group Ltd (2012) 247 CLR 205, 224 [36].


\(^{240}\) (1723) 10 Mod 515, 518; 88 ER 832, 833.

\(^{241}\) (1818) 1 Swans 309, 318-319; 36 ER 402, 407-408.

considered inadequate and paying the bond insufficient. The High Court stated ‘these cases do not establish any general proposition as to the contractual character of the condition in a bond’. The High Court did not refer to any evidence in support of this proposition. However, these cases did demonstrate the contractual nature of the bond (see Chapter II). In *Parks v Wilson*, the Court stated as much: ‘The authorities are many in this Court, that *bonds have been considered as evidences of agreements*, and obligors held to a specific performance, and not allowed to forfeit the penalty’. If it was not contractual in nature, specific performance would not be available. Specific performance can only be granted upon breach where damages are available, but considered inadequate. Damages can only flow from an event occasioning loss such as breach. This conflicted reasoning demonstrates why the decision in *Andrews* confused the legal community. If the High Court had cited cases where bonds were held not to be of a contractual nature, this would have assisted their reasoning. However, it appears such cases do not exist.

The High Court in *Andrews* referred to Brereton J’s decision in *Integral*, in support of their conclusion, but as stated previously, this decision was overturned for reasons already mentioned. How the stipulated sum can be assessed against damages incurred, in determining whether it constitutes a penalty, if the occurrence of an event allowing for termination is not a breach of contract, where loss is not determinable or assignable, is a problematic issue the Court failed to discuss. How could you determine whether the fee was out of all proportion? In *Lordsvale Finance plc v Bank of Zambia* Colman J relevantly stated that *Dunlop* demonstrated:

> That the contractual function is deterrent rather than compensatory can be deduced by comparing the amount that would be payable on breach with the loss that might be sustained if breach occurred.

For this reason, breach has always been an essential element.

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243 Ibid.
244 (1723) 10 Mod 515.
245 *Parks v Wilson* (1723) 10 Mod 515, 518 (emphasis added).
The High Court in *Andrews* further rejected the proposition in *Interstar* that the Doctrine disappeared from equity due to absorption into the common law action of assumpsit.\(^{249}\) This is a fairly uncontentious aspect of *Andrews*.\(^{250}\) Given the concurrent administration of law and equity, the High Court’s reasoning is logical. Prior to the *Judicature Acts*, the Common Pleas began enforcing at law what equity would have enforced in Chancery (see Chapter II). This was simply to streamline procedures.\(^{251}\) However, the Doctrine still existed in equity; at times, the plaintiff would pursue the grant of injunction, which was only available in equity prior to the *Judicature Acts*. The High Court also referred to *Dunlop*, ‘where in the one court and in the same proceeding, legal and equitable remedies were sought by the plaintiff and the defendant raised the penalty doctrine in its defence’.\(^{252}\) However, although the Doctrine originated in equity and retained its equitable jurisdiction, this does not further the argument that the Doctrine has always applied in instances other than breach of contract.

The High Court also referred to *AMEV-UDC*\(^ {253}\) where Mason and Wilson JJ stated ‘relief was granted, in the case of penal bonds, where there was no express contractual promise to perform the condition (see *Hardy*\(^ {254}\)), though it seems such a promise could in many cases readily be implied’.\(^ {255}\) The High Court believed Brereton J understood the significance of the statement in *AMEV-UDC*,\(^ {256}\) when Brereton J determined that:\(^ {257}\)

\[T]\heir Honours' judgment does not decide that relief against a penalty is available only when it is conditioned upon a breach of contract; to the contrary, it suggests that relief may be granted in cases of penalties for non-performance of a condition, although there is no express contractual promise to perform the condition.

\(^{249}\) *Andrews v Australia and New Zealand Banking Group Ltd* (2012) 247 CLR 205, 228 [51].

\(^{250}\) Gordon J had also rejected this proposition at first instance.

\(^{251}\) This also saved the parties time and money.

\(^{252}\) *Andrews v Australia and New Zealand Banking Group Ltd* (2012) 247 CLR 205, 236 [77].

\(^{253}\) (1986) 162 CLR 170.

\(^{254}\) (1783) 1 Cox Eq Cas 26; 29 ER 1046.

\(^{255}\) *AMEV-UDC Finance Ltd v Austin* (1986) 162 CLR 170, 190.

\(^{256}\) (1986) 162 CLR 170.

\(^{257}\) *Integral Home Loans Pty Ltd v Interstar Wholesale Finance Pty Ltd* [2007] NSWSC 406, [57].
However, Mason and Wilson JJ supported the conclusion that the Doctrine only applies to sums that the parties have agreed are to be paid upon breach of contract.\footnote{AMEV-UDC Finance Ltd v Austin (1986) 162 CLR 170, 184, 189-90 cited in Andrews v Australia and New Zealand Banking Group Ltd (2011) 288 ALR 611, 633.} Dawson J relevantly stated:\footnote{AMEV-UDC Finance Ltd v Austin (1986) 162 CLR 170, 211 (emphasis added) cited in Andrews v Australia and New Zealand Banking Group Ltd (2011) 288 ALR 611, 633.}

Treatment of the termination of an agreement upon breach in the same way as the breach itself for the purpose of determining whether a stipulated payment is capable of amounting to a penalty has \textit{no extended application}. It would seem clear that a provision calling for the payment of money by one party on the occurrence of a specified event, \textit{rather than upon breach by that party}, \textit{cannot be a penalty}.\footnote{Hardy v Martin (1783) 1 Cox 26, 26. This case is also referred to by the High Court in Andrews and Brereton J in \textit{Integral}.}

The case referred to above by Mason and Wilson JJ is \textit{Hardy}.\footnote{Hardy v Martin (1783) 1 Cox 26, 26.} It involved the sale of the lease and good-will of a shop to the defendant for £300 with a bond to the defendant of £600.\footnote{Ibid.} The condition provided that the plaintiff should not for 19 years ‘sell any quantity of brandy less than 6 gallons within the cities of London or Westminster, or within 5 miles thereof’,\footnote{Ibid 27.} else the bond would become void. Lord Loughborough correctly stated that ‘this is… an agreement not to sell brandy, with a penalty for selling it’.\footnote{Cavendish Square Holding BV v Makdessi [2015] UKSC 67 (4 November 2015) [75] (Lord Neuberger and Lord Sumption), [179]–[180] (Lord Mance), [274] (Lord Hodge). See also Paciocco v Australia and New Zealand Banking Group Limited (2016) 333 ALR 569, 583.}

The plaintiff in \textit{Hardy} had undertaken an obligation we now describe as a restraint of trade. Although the word “must” was not used, an obligation still remained not to sell brandy in the manner specified; this obligation was enforced by the bond. \textit{Hardy} is similar to \textit{Cavendish} where non-competition provisions protected the purchaser’s interests in the goodwill of the business, critical to the value of the business, and held not to be a penalty.\footnote{Cavendish Square Holding BV v Makdessi [2015] UKSC 67 (4 November 2015) [75] (Lord Neuberger and Lord Sumption), [179]–[180] (Lord Mance), [274] (Lord Hodge). See also Paciocco v Australia and New Zealand Banking Group Limited (2016) 333 ALR 569, 583.} \textit{Hardy} is not, however, analogous to \textit{Andrews} where fees became due following a decision by ANZ. In \textit{Hardy} the plaintiff took unilateral action to trade against the condition agreed which caused the bond to fall due. As Lord Loughborough stated ‘the penalty is never considered in this court, as the price for doing what a man has expressly agreed not to do. The
court will restrain him from setting up a trade in opposition to his own agreement, although he has paid the penalty." This demonstrates the promissory nature of the bond as the plaintiff was estopped from trading because there was an ‘agreement not to do a thing, with a penalty for doing it.’ The court held *quantum damnificatus* to be determined. In light of these facts, it does not follow that this case provides authority for the proposition that the Doctrine applied in instances other than breach. As already established, bonds were of a promissory nature. The court in *Hardy* relevantly referred to *Rolfe v Peterson*, which involved land, demised to a lessee. If the land was used in a particular way, he was to pay one rent, but if used in another way, a different rent. *Hardy* distinguished this case as it did not involve an ‘agreement not to do a thing, with a penalty for doing it.’ Accordingly, equity would not intervene as the agreement lacked the required promissory nature.

The High Court in conclusion held that the Court of Appeal’s view in *Interstar* regarding the constraints of the Doctrine should not be accepted. The High Court determined that Gordon J erred when deciding that the fees could not be characterised as a penalty in the absence of a contractual breach or an obligation to avoid the event upon which the fees were charged. However, it is the obligation or breach which assigns liability in order for losses to be attributed to a particular party. Without this liability, damages cannot attach and damages are required in order for compensation to be made available. As stated above, monetary compensation allows equity a “handle” with which to intervene. Without compensation, no comparison can be made with the stipulated sum and the Doctrine cannot apply. The High Court’s conclusion in *Andrews* that the Doctrine can apply

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265 *Hardy v Martin* (1783) 1 Cox 26, 26-27.  
266 Ibid 27.  
267 An issue directed by a court of equity to be tried in a court of law, to ascertain before a jury the amount of damages suffered by the non-performance or breach of contract. The court will grant relief upon payment of damages once ascertained.  
268 *Hardy v Martin* (1783) 1 Cox 26, 27.  
269 (1772) 6 Bro PC 470.  
270 *Hardy v Martin* (1783) 1 Cox 26, 27.  
271 Ibid.  
272 *Hardy v Martin* (1783) 1 Cox 26, 27.  
273 Ibid.  
276 Ibid.
in instances other than breach,\textsuperscript{277} or without an obligation, appears to go against the fundamental principles of the Doctrine. However, the High Court is well within its power to reformulate the Doctrine. As Australia and the United Kingdom share a jurisdictional history with respect to the Doctrine, it is now appropriate to evaluate the United Kingdom Supreme Court decision in \textit{Cavendish} which commented on the decision of \textit{Andrews}.

V Cavendish v Makdessi

In Cavendish278 the United Kingdom Supreme Court discussed the extended application of the Doctrine in Andrews. This case involved the defendant selling a controlling interest in an advertising company to the plaintiff.279 The agreement provided that the plaintiff would pay up to $147 million in instalments, depending on the calculated profits.280 This largely reflected the goodwill.281 The parties further agreed282 that for a period of time following the sale the defendant was not to compete with his old business, otherwise he would be disentitled to further payments.283 The plaintiff also had an option284 to buy the defendant’s remaining shares at a price excluding goodwill.285 The defendant breached the non-competition clause.286 The plaintiff sought a declaration that the defendant was not entitled to additional payments and was required to sell his shares.287

At first instance Burton J held the clauses were not penal and made the declarations sought.288 On appeal, the clauses were held to constitute a penalty as the clauses acted as a deterrent and were not genuine pre-estimates of loss.289 On appeal to the Supreme Court, the plaintiff claimed that the clauses were not penalties and that the Doctrine should be abolished or restricted with respect to commercial transactions between parties of equal bargaining power, acting upon skilled legal advice.290 The Supreme Court held that the clauses were not penalties.291 The Court determined that the plaintiff had a legitimate interest in the non-competition clauses being observed, which extended beyond recovery of loss because the defendant’s loyalty was critical to the goodwill, which was critical to the value of the business.292

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279 Ibid [46].
280 Ibid [48]-[49].
281 Ibid [51].
282 Under clause 5.1.
283 Cavendish Square Holding BV v Makdessi [2015] UKSC 67 (4 November 2015) [51]-[52].
284 Under clause 5.6.
285 Cavendish Square Holding BV v Makdessi [2015] UKSC 67 (4 November 2015) [55], [63].
286 Ibid [59]-[60].
287 Ibid [63].
288 Cavendish Square Holdings BV v Makdessi [2012] EWHC 3582 (Comm), [68].
290 Cavendish Square Holding BV v Makdessi [2015] UKSC 67 (4 November 2015) [36], [126].
Court held both parties were sophisticated and commercially experienced, bargaining on equal terms with expert legal advice. For this reason, the parties were ‘the best judges of the degree to which each of them should recognise the proper commercial interests of the other’.  

The Court held ‘that a provision could not be a penalty unless it provided an exorbitant alternative to common law damages. This meant it had to be a provision operating on a breach of contract’. Lord Neuberger PSC and Lord Sumption JSC referred to the House of Lords decision in *Export Credits Guarantee Department v Universal Oil Products Co*, stating this is settled law in England. As stated by Lord Roskill:

> [P]erhaps the main purpose, of the law relating to penalty clauses is to prevent a plaintiff recovering a sum of money in respect of a breach of contract committed by a defendant which bears little or no relationship to the loss actually suffered by the plaintiff as a result of the breach by the defendant. But it is not and never has been for the courts to relieve a party from the consequences of what may in the event prove to be an onerous or possibly even a commercially imprudent bargain.

The Supreme Court determined the reason for this is that:  

> [T]he courts do not review the fairness of men's bargains... The penalty rule regulates only the remedies available for breach of a party's primary obligations, not the primary obligations themselves.

Lord Neuberger PSC and Lord Sumption JSC stated that at times, the application of the Doctrine could depend on how the obligation is framed within the instrument. This was explained well:

> [W]here a contract contains an obligation on one party to perform an act, and also provides that, if he does not perform it, he will pay the other party a specified sum...

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293 Ibid.
295 Lord Carnwath JSC agreed.
297 *Export Credits Guarantee Department v Universal Oil Products Co* [1983] 1 WLR 399, 403 (the rest of the committee agreed). Lord Hodge JSC also further pointed out that the Scottish authorities are to the same effect.
299 Either as a primary obligation, or secondary obligation, providing for a contractual alternative to damages; *Cavendish Square Holding BV v Makdessi* [2015] UKSC 67 (4 November 2015) [14].
300 *Cavendish Square Holding BV v Makdessi* [2015] UKSC 67 (4 November 2015) [14].
of money, the obligation to pay the specified sum is a secondary obligation which is capable of being a penalty; but if the contract does not impose (expressly or impliedly) an obligation to perform the act, but simply provides that, if one party does not perform, he will pay the other party a specified sum, the obligation to pay the specified sum is a conditional primary obligation and cannot be a penalty.

However, Lord Neuberger PSC and Lord Sumption JSC relevantly pointed out that the consequences of this are mitigated, as classifying the terms used depends on substance and not form, or the label used by parties.301

The Court held that the parties’ bargaining positions are an important consideration. Lord Neuberger PSC and Lord Sumption JSC stated with respect to a ‘negotiated contract between properly advised parties of comparable bargaining power, the strong initial presumption must be that the parties themselves are the best judges of what is legitimate in a provision dealing with the consequences of breach’.302 Lord Mance JSC stated the extent of which parties negotiated with legal advice and at arm’s length, must be a relevant factor in deciding what is extravagant or unconscionable.303 Considering the parties’ bargaining power was also discussed in Philips Hong Kong Ltd v Attorney General of Hong Kong,304 where Lord Woolf considered whether ‘one of the parties to the contract is able to dominate the other as to the choice of the terms of a contract’ in deciding whether a clause constituted a penalty.305 Lord Neuberger PSC and Lord Sumption JSC referred to Mason and Wilson JJ’s view in AMEV-UDC,306 where courts are able to ‘strike a balance between the competing interests of freedom of contract and protection of weak contracting parties’.307 In Workers Trust & Merchant Bank Ltd v Dojap Investments Ltd,308 Lord Browne-Wilkinson also supported considering the parties’ bargaining

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301 Ibid [15]. See also Campbell Discount Co Ltd v Bridge [1962] AC 600, 622.
303 Ibid [152] (Lord Mance JSC).
305 However, this did not mean the courts could thereby adopt some broader discretionary approach; Philips Hong Kong Ltd v Attorney General of Hong Kong [1993] 61 BLR 41, 57-59.
positions. Unfortunately the Court in *Andrews* did not consider the bargaining position of the parties and the use of standard form contracts in relation to the question of penalties. The position taken by the United Kingdom in this respect is beneficial to construing whether a clause constitutes a penalty.

The Supreme Court stated ‘until recently, the law in Australia was the same as it was in England’, and that *Andrews* signalled ‘a radical departure from the previous understanding of the law’. Although Lord Neuberger PSC and Lord Sumption JSC admitted whether the Doctrine applies can occasionally turn on a somewhat formal distinction, their Honours agreed this anomaly is justified for infringing upon freedom of contract and ought not to be extended, at least not by the judiciary as opposed to the legislative. Lord Neuberger PSC and Lord Sumption JSC drew an analogy between *Andrews* and the *Office of Fair Trading v Abbey National plc* which are factually similar. However, in that case, the banking fees could not be characterised as a penalty given no breach of contract had arisen. The Court disagreed with the reasoning in *Andrews* and determined that the United Kingdom jurisdiction should not follow Australian law, because aside from ‘its inconsistency with established and unchallenged House of Lords authority… the reasoning in… *Andrews*… [is] entirely historical, [but] is not in fact

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314 This case involved the application of the penalty doctrine to contractual bank charges payable when the bank bounced a cheque, or when the bank allowed the customer to draw in excess of their available funds or of their agreed overdraft limit. These may be regarded as banking irregularities, but they did not involve any breach of contract by the customer. See also *Cavendish Square Holding BV v Makdessi* [2015] UKSC 67 (4 November 2015) [41] (Lord Neuberger of Abbotsbury PSC and Lord Sumption JSC with whom Lord Carnwath JSC agreed).

consistent with the equitable rule as it developed historically’. 316 Lord Neuberger PSC and Lord Sumption JSC held the equitable jurisdiction to relieve against penalties arose in the event of a failure to perform a contractual obligation and thus, breach of that contractual obligation was a required element. 317

Lord Hodge JSC also held the ‘rule against penalties applies only in the context of a breach of contract’. 318 Lord Hodge JSC referred to the ‘controversial decision’ 319 of Andrews, ‘satisfied that the rule against penalties in both English and Scots law has applied only in relation to secondary obligations – penal remedies for breach of contract’.320 In Scotland, the Doctrine has no application in cases not involving breach of contract. 321 Lord Hodge JSC stated no freestanding equitable jurisdiction exists with which to apply the Doctrine to instances other than breach of contract. 322 Lord Hodge JSC concluded the correct test in determining whether a provision constitutes a penalty, is whether an ‘extravagant disproportion [exists] between the stipulated sum and the highest level of damages that could possibly arise from the breach’. 323

Lord Mance JSC also stated in relation to Andrews:324

I do not see the distinction between situations of breach and non-breach as being without rational or logical underpinning. It is true that clever drafting may create apparent incongruities in particular cases. But in most cases parties know and reflect in their contracts a real distinction, legal and psychological, between what… a party can permissibly do and what… constitutes a breach and may attract a liability to damages for – or even to an injunction to restrain – the breach.

318 Ibid [239] (emphasis added). See also Export Credits Guarantee Department v Universal Oil Products Co [1983] 1 WLR 399, 403 (Lord Roskill).
320 Ibid [241].
321 Ibid [239] (Lord Hodge JSC) citing Granor Finance Ltd v Liquidator of Eastore Ltd 1974 SLT 296, 298 (Lord Keith). See also EFT Commercial Ltd v Security Change Ltd 1992 SC 414 where this position has been affirmed.
323 However, in other circumstances the ‘contractual provision that applies on breach is measured against the interest of the innocent party… and the court asks whether the remedy is exorbitant or unconscionable’; Ibid [255] (Lord Hodge JSC).
The Court further stated that if a distinct equitable jurisdiction to relieve against penalties subsisted, broader than the common law, it left no trace aside from three possible exceptions since the “fusion” of law and equity in 1873. However, Lord Neuberger PSC and Lord Sumption JSC cited each case explaining why these cases are not on point or why it was decided incorrectly. For example, in In re Dagenham (Thames) Dock Co; Ex p Hulse Sir James and Sir Mellish LJJ treated the clause as a forfeiture, and therefore the purchaser in the same way as a mortgagor in possession requesting additional time to pay. In In Robophone Facilities Ltd v Blank, the exception was ‘no more than an unsupported throw-away line [by] Diplock LJ… where he said it was “by no means clear” whether penalty clauses “are simply void”, but, on analysis, he was dealing with a rather different point’. Lord Hodge JSC concluded that a penalty clause is unenforceable and that Jobson v Johnston should be overruled given the Court was incorrect to have modified a penalty clause. ‘The treatment of a penalty clause as partly enforceable… is contrary to consistent modern authority’. Lord Neuberger PSC and Lord Sumption JSC with respect to this point, mentioned that the law of penalties is the same in England and Scotland and yet, equity has never been a distinct branch of law within the Scotland jurisdiction. Lord Mance JSC further pointed out that other common law countries including Canada, Scotland, New Zealand, Singapore, Hong Kong and New York have a Doctrine broadly in alignment with the Doctrine to that of the United Kingdom.

325 Ibid [43].
326 In re Dagenham (Thames) Dock Co; Ex p Hulse (1873) LR 8 Ch App 1022; Robophone Facilities Ltd v Blank [1966] 3 All ER 128; Jobson v Johnson [1989] 1 WLR 1026.
327 (1873) LR 8 Ch App 1022.
328 [1966] 3 All ER 128.
332 Ibid [87].
In conclusion, the Supreme Court importantly stated with respect to *Andrews* that:335

[T]he High Court’s redefinition of a penalty is, with respect, difficult to apply to the case to which it is supposedly directed, namely where there is no breach of contract. It treats as a potential penalty any clause which is “in the nature of a security for and in terrorem of the satisfaction of the primary stipulation.” By a “security” it means a provision to secure “compensation … for the prejudice suffered by the failure of the primary stipulation”. This analysis assumes that the “primary stipulation” is some kind of promise, in which case its failure is necessarily a breach of that promise. If, for example, there is no duty not to draw cheques against insufficient funds, it is difficult to see where compensation comes into it, or how bank charges for bouncing a cheque or allowing the customer to overdraw can be regarded as securing a right of compensation. Finally, the High Court's decision does not address the major legal and commercial implications of transforming a rule for controlling remedies for breach of contract into a jurisdiction to review the content of the substantive obligations which the parties have agreed. Modern contracts contain a very great variety of contingent obligations... There are 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… 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... The potential assimilation of all of these to clauses imposing penal remedies for breach of contract would represent the expansion of the courts’ supervisory jurisdiction into a new territory of uncertain boundaries, which has hitherto been treated as wholly governed by mutual agreement.

As Australia and the United Kingdom share a jurisdictional history regarding the Doctrine, these differences’ of opinion are significant. The Supreme Court identified the inherent problems associated with extending the Doctrine and refused to do so. It is now appropriate to evaluate the High Court decision in *Paciocco* which reflected upon the decisions of *Andrews* and *Cavendish*.

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VI PACIOCCO v ANZ

A Case Facts

The decision in Paciocco was handed down after Andrews and Cavendish. Paciocco was a highly anticipated decision because the Australian High Court would confirm or overrule the decision of Andrews which extended the application of the Doctrine. Paciocco involved consumer credit card fees charged by ANZ and is factually similar to Andrews. Mr Paciocco argued the various honour, dishonour and non-payment fees charged by ANZ were void as penalties, or alternatively, contravened statutory provisions relating to unconscionable conduct and unfair contract terms.336 The late payment fees are charged to customers who are late in making their monthly repayments and is charged regardless of the outstanding monthly payment amount.337 The late payment fees incurred by Mr Paciocco were the sum of $35 (charged until December 2009) and $20 (charged from December 2009). ANZ argued that the late payments impacted upon ANZ through operational costs, loss provisioning and increases in regulatory capital costs.338 Operational costs included costs incurred in ensuring late payments were made, such as administration costs and costs of staff contacting Mr Paciocco.339 Loss provisioning costs and increases in regulatory capital costs were described as impacting on ANZ’s financial interests.340 ANZ is required to hold regulatory capital in order to cover unexpected losses.341 The required regulatory capital increases when risk of default increases.342 Although a valid liquidated damages clause is usually a pre-estimate of the damage likely to be incurred in instances of default, ANZ did not determine the late payment fee by estimating losses it might incur because of Mr Paciocco’s delayed payments:343 ANZ admitted the fees were not genuine pre-estimates of damage.344 This admission is important because a presumption arises

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336 Paciocco v Australia and New Zealand Banking Group Ltd (2016) 333 ALR 569, 569.
337 Ibid 575 [12].
338 Paciocco v Australia and New Zealand Banking Group Ltd (2014) 309 ALR 249, 284 [141]. See also Ibid 585 [58].
340 Ibid 586.
341 Ibid.
342 Ibid.
343 Ibid 575 [12].
344 Paciocco v Australia and New Zealand Banking Group Ltd (2014) 309 ALR 249, 281 [125], 292 [184]; Ibid 576 [13].
that the fee constitutes a penalty. The costs clearly identified as arising from Mr Paciocco’s late payments amounted to approximately $3.\textsuperscript{345}

Mr Regan gave evidence for Mr Paciocco regarding costs ANZ incurred due to the late payments, whilst Mr Inglis gave evidence for ANZ.\textsuperscript{346} Mr Regan calculated costs as including those incurred by ANZ in ensuring the late payments were made, such as operational costs and administration costs.\textsuperscript{347} Mr Inglis calculated ANZ’s incurred costs by taking into account operational costs, loss provisioning and capital regulatory costs.\textsuperscript{348} Mr Inglis calculated costs at a figure ‘significantly greater’\textsuperscript{349} than the late penalty fees, taking into account impacts on or costs to financial interests.\textsuperscript{350} Mr Inglis calculated costs of breach to be as high as $147, which was described as ‘overly generous’.\textsuperscript{351} At first instance Gordon J pointed out that ‘in a competitive financial market, it is difficult to accept that a prudent bank would allow exception fee events to occur at all if the costs of each event far outstripped the amount of the fee’.\textsuperscript{352} Relevantly, Mr Inglis took into account provision and regulatory capital costs which he accepted were not actually incurred, both generally and specifically with respect to some of the exception fee events.\textsuperscript{353} Gordon J did not accept regulatory capital could be taken into account in calculating damages resulting from the late payment.\textsuperscript{354}

Banks seek damages limited to the sums outstanding, enforcement costs and interests. No one has suggested that a bank would be entitled to recover an increase in provisioning or the cost of its regulatory capital.\textsuperscript{355}

\textsuperscript{345} Paciocco v Australia and New Zealand Banking Group Ltd (2014) 309 ALR 249, 251.
\textsuperscript{346} Ibid 283. See also Paciocco v Australia and New Zealand Banking Group Ltd (2016) 333 ALR 569, 585-586 [59].
\textsuperscript{348} Paciocco v Australia and New Zealand Banking Group Ltd (2014) 309 ALR 249, 284.
\textsuperscript{349} Ibid 289 [170] (Gordon J).
\textsuperscript{350} See ibid 284. See also Paciocco v Australia and New Zealand Banking Group Ltd (2016) 333 ALR 569, 585-586 [59].
\textsuperscript{351} Paciocco v Australia and New Zealand Banking Group Ltd (2014) 309 ALR 249, 289 [170]–[171]. See also Paciocco v Australia and New Zealand Banking Group Ltd (2016) 333 ALR 569, 587 [68].
\textsuperscript{352} Paciocco v Australia and New Zealand Banking Group Ltd (2014) 309 ALR 249, 289 [170].
\textsuperscript{353} Ibid 290 [171].
\textsuperscript{354} Ibid 287 [155]. See also Paciocco v Australia and New Zealand Banking Group Ltd (2016) 333 ALR 569, 586 [64]-[65].
\textsuperscript{355} Ibid.
Traditionally courts have only enforced damages, costs and interest when the Doctrine has applied. Gordon J referred to Andrews and Dunlop in determining that the late payment fees constituted a penalty.\footnote{356 See Paciocco v Australia and New Zealand Banking Group Ltd (2014) 309 ALR 249, 256 [4], 259-261.} The question was ‘to what extent (if any) did the amount stipulated to be paid exceed the quantum of the relevant loss or damage which can be proved to have been sustained by the breach, or the failure of the primary stipulation, upon which the [collateral] stipulation was conditioned.\footnote{357 Ibid 292 [184].} Gordon J held the late payment fee was in terrorem, or security for, satisfaction of the primary stipulation and was extravagant and unconscionable.\footnote{358 Ibid 256 [4].} Gordon J held that the honour, dishonour and overlimit fees were not penalties as they were not payable upon breach of contract.\footnote{359 Ibid 294 [198], 305 [249], 306 [260], 306 [271].} Gordon J held that the fees did not contravene the statutory provisions identified.\footnote{360 Ibid.}

On appeal, the Full Court of the Federal Court held that the late payment fees did not constitute a penalty and did not contravene statutory categories of unconscionable conduct or unfair contract terms.\footnote{361 Paciocco v Australia and New Zealand Banking Group Ltd (2015) 321 ALR 584, 585.} The Full Court considered Gordon J had erred when she accepted and applied evidence that ANZ could only have suffered direct costs associated with recovering the minimum payment outstanding as a result of the late payments.\footnote{362 Ibid 604.} The Full Court held other evidence given for ANZ which determined costs more broadly regarding ANZ’s financial interests, should be taken into account instead.\footnote{363 Ibid 622 [153].} The Full Court held that this demonstrated ANZ’s legitimate interests in performance of the payment terms and that the fees could not be characterised as penalties.\footnote{364 Ibid 585, 629.} The Full Court agreed with Gordon J regarding the remaining fees. Mr Paciocco appealed the Full Court’s decision on the late payment fees to the High Court.\footnote{365 Paciocco v Australia and New Zealand Banking Group Ltd (2016) 333 ALR 569, 571-572.} The conclusion regarding the other fees was not challenged.\footnote{366 Ibid 572.}
B Andrews Confirmed

Commentators hoped the High Court decision of Paciocco would clarify the decision of Andrews regarding the current application of the Doctrine. Only French CJ commented on Andrews who stated Gordon J had correctly followed Interstar\(^\text{367}\) in Andrews: \(^\text{368}\) this confirms, as did the High Court in Andrews, that prior to Andrews the scope of the Doctrine was limited in application to breach of contract. The appeal in Paciocco involved characterisation of a clause enlivened upon breach of contract if enforceable. \(^\text{369}\) As the applicability of the Doctrine in instances other than breach was not an issue before the High Court, it appears no in depth analysis was made. However, French CJ stated a ‘difference has emerged since the decision in Andrews between the Supreme Court of the United Kingdom and this Court in relation to the scope of the law relating to penalties’ \(^\text{370}\) and that it is ‘desirable to say something about the fact of divergence between our jurisdictions’. \(^\text{371}\)

French CJ confirmed the decision of Andrews and Dunlop as providing the governing principles regarding the application of the Doctrine in instances of breach. \(^\text{372}\) French CJ commented on the decision of Cavendish stating a shared heritage does not import the necessity of developments proceeding on similar lines. \(^\text{373}\) French CJ did not address the comments made in Cavendish regarding the decision of Andrews having radically departed from the previous understanding of the law. \(^\text{374}\) Instead, CJ French referred to the separate jurisdictions and that ‘the common law in Australia is the common law of Australia’. \(^\text{375}\) Whilst a valid point, it may have been beneficial if these comments had been addressed directly. Identifying that the Doctrine had been extended or is believed to have been extended, and explaining why this was required would have provided answers sought after since Andrews. French CJ only noted ‘more than one account of its construction and more than one view of whether it should be abrogated or extended or subsumed by legislative


\(^{368}\) Paciocco v Australia and New Zealand Banking Group Ltd (2016) 333 ALR 569, 572 [3].

\(^{369}\) Ibid 572-573.

\(^{370}\) Ibid 573 [6].

\(^{371}\) Ibid.

\(^{372}\) Ibid 573 [5].

\(^{373}\) French CJ also stated that the ‘emphatic disagreement between our jurisdictions in relation to the common law and equitable doctrines, while infrequent, is not novel’; Ibid 574 [7].

\(^{374}\) See Cavendish Square Holding BV v Makdessi [2015] UKSC 67 (4 November 2015) [41].

reform is reasonably open’. French CJ concluded that perhaps in Australia ‘statutory law reform offers more promise than debates about the true reading of English legal history’.

C The High Court’s Decision

The High Court determined the nature of the loss regarding the late payment fees was the same in kind as the loss sustained in Dunlop and Clydebank. Arguably, this loss is not analogous. The loss sustained in Dunlop regarding direct damages flowing from breach was intangible. In actuality the dealers were short changing themselves by selling products at a price less than the list price. As Lord Atkinson articulated in Dunlop, ‘in the sense of direct and immediate loss the appellants lose nothing by such a sale. It is the agent or dealer who loses by selling at a price less than that at which he buys’. The damages were of a different kind, constituting a legitimate interest that went to their distribution systems. As the damages sustained could not be ascertained in monetary terms the court would not grant equitable relief by way of the Doctrine. As stated by the Court in Cavendish, the ‘£5 was not a penalty on the ground that an exact pre-estimate of loss was impossible’. As the High Court stated in Andrews, ‘it 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’.

In comparison with the intangible loss sustained in Dunlop, the loss sustained by ANZ was calculated to $3. As the late payment fees were $35 and $20 respectively, these fees are arguably extravagant and unconscionable with respect to the greatest loss that could conceivably be proved. Gordon J had, arguably

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376 Paciocco v Australia and New Zealand Banking Group Ltd (2016) 333 ALR 569, 575 [10].
377 Ibid.
379 Ibid 92, 96 (Lord Atkinson), 99 (Lord Parker of Waddington).
380 Ibid 96 (Lord Atkinson).
correctly, reached this conclusion. Granted, the fact ANZ did not pre-estimate the
damage is not proof itself that the fees constitute a penalty. However, the High
Court’s decision that the late payment fees did not constitute a penalty rested on the
idea that ANZ had a legitimate interest in ensuring customers pay on time. They
may do, but this interest is too far removed from losses sustained when actual
damages can be determined in monetary terms. This is where Dunlop and Paciocco
are distinguished.

In typical penalty cases, ‘the court compares what would be recoverable as
unliquidated damages with the sum of money stipulated as payable on breach’.384
As damages sustained by ANZ could be ascertained, the stipulated sum should be
compared as against these damages. As the sum must be extravagant and out of all
proportion, an amount greater than the actual loss suffered may not necessarily
amount to a penalty.385 However, the $35 charged is 1166% greater than the loss
incurred: the $35 is arguably extravagant and out of all proportion. The same can
be said of the $20. Although the sums themselves may not seem large, the sum
recovered is so far above the identifiable loss that it is unconscionable.

The High Court stated that looking forward from the time the contract was made as
to possible costs is important.386 Whether the provision constitutes a penalty is
judged ‘as at the time of the making of the contract, not as at the time of breach’.387
However, the fee of $35 and $20 is so extravagant when compared to the $3 loss,
that it cannot constitute a genuine forward-looking estimate. The subjective
intention of the party is also irrelevant,388 although ANZ already admitted the fees
were not a forward-looking estimate. The High Court determined it was wrong to

384 Ringrow Pty Ltd v BP Australia Pty Ltd (2005) 224 CLR 665 [21]. See also Paciocco v Australia and
New Zealand Banking Group Ltd (2016) 333 ALR 569, 640 [320].
385 See Paciocco v Australia and New Zealand Banking Group Ltd (2016) 333 ALR 569, 584 [53]-
[54] (Kiefel J). See also Ringrow Pty Ltd v BP Australia Pty Ltd (2005) 224 CLR 656, 669 [31]-[32]
where exceptions from freedom of contract ‘require good reason to attract judicial intervention to
set aside the bargains upon which parties of full capacity have agreed’, which is why the penalties
doctrine is an exceptional rule expressed in exceptional language.
386 See Paciocco v Australia and New Zealand Banking Group Ltd (2016) 333 ALR 569, 586 [62],
619 [236].
387 See Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd [1915] AC 79, 87 (Lord
Dunedin).
388 Paciocco v Australia and New Zealand Banking Group Ltd (2016) 333 ALR 569, 621 [243] citing
compare the actual loss with the stipulated sum.\textsuperscript{389} This defies common sense. Although correct to ‘assess that loss by reference to the economic interests to be protected’,\textsuperscript{390} ANZ’s economic interests is recouping costs associated with the late payment. How else can you determine whether the sum is out of all proportion without comparing the two?

The loss incurred by ANZ is arguably not of the loss in kind as determined in \textit{Clydebank} either. \textit{Clydebank} (see Chapter II) involved the Spanish Government contracting to build four torpedo boats.\textsuperscript{391} These warships were delivered many months late.\textsuperscript{392} As stated by the Earl of Halsbury LC, the damages were not ascertainable in kind as compared to a ‘commercial vessel [which] is ascertainable in money’.\textsuperscript{393} As the loss was not ascertainable, the equitable relief of the Doctrine was not applicable. It is only by comparing the greatest loss that could be proved to have followed from the breach, that a court can determine whether the stipulated sum is extravagant in comparison. If losses cannot be calculated, a court cannot determine whether the clause was unreasonable and parties are left to their agreement. In comparison, ANZ’s losses can be ascertained in monetary value. Relief against the late payment fees should have been provided. The High Court’s rationale\textsuperscript{394} in respect of not requiring losses to have flowed is also flawed. How else will the court determine whether the sum is out of all proportion without losses to compare against? As stated by Kiefel J:\textsuperscript{395}

\[\text{[E]quity’s jurisdiction was considered not to extend to a case when compensation was not thought to be possible, as is the case when damages could not be assessed. In these circumstances the parties would be left to their bargain.}\]

\textsuperscript{389} See for example, \textit{Paciocco v Australia and New Zealand Banking Group Ltd} (2016) 333 ALR 569, 600.
\textsuperscript{390} Ibid 593.
\textsuperscript{391} \textit{Clydebank Engineering & Shipbuilding Co Ltd v Yzquierdo y Castaneda} [1905] AC 6, 6-7.
\textsuperscript{392} Ibid.
\textsuperscript{393} Ibid 12.
\textsuperscript{395} \textit{Paciocco v Australia and New Zealand Banking Group Ltd} (2016) 333 ALR 569, 583 [49].
A presumption exists that a sum constitutes a penalty when a sum is made payable on the occurrence of one or more of several events, some of which may occasion serious and others but trifling damage. Despite differences in the monthly repayment amounts and time taken to repay, the late payment fee remained the same which points to the presumption of a penalty. Although a presumption can be rebutted by evidence to the contrary, Gordon J relevantly stated the ‘same fee was payable regardless of whether the customer was 1 day or 1 week late (or longer), and regardless of whether the amount overdue was $0.01 (trifling), $100, [or] $1000’. An example includes charges of $20 made to Mr Paciocco’s credit card account. One charge was made when the outstanding monthly balance was $268 with a minimum monthly repayment of $10. Another charge was made when the outstanding monthly balance was $4,055 with a minimum monthly repayment of $80. This variance, especially the repayment of $10 whilst incurring a $20 fee, demonstrates why this presumption should apply.

D The High Court’s Reasoning

I Kiefel J

The High Court referred to a number of cases in concluding that the late payment fee was not a penalty. Dunlop was referred to in respect of protecting interests said to be ‘different from, and greater than, an interest in compensation for loss caused directly by the breach of contract’. Kiefel J held that the question is ‘whether a provision for the payment of a sum of money on default is out of all proportion to the interests of the party which it is the purpose of the provision to protect’. Kiefel J held ANZ had an interest in receiving timely credit repayments. Kiefel J further

396 See Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd [1915] AC 79, 87 (Lord Dunedin).
398 Paciocco v Australia and New Zealand Banking Group Ltd (2016) 333 ALR 569, 590 [89].
399 Ibid.
400 An additional example includes when the outstanding monthly balance was $2,145 with a minimum monthly repayment of $43: Ibid.
402 Ibid 580 [29]. Kiefel J further determined that Lord Atkinson’s statement was important regarding whether the stipulated sum was commensurate with the interest protected by the agreement: Ibid 579 [28] citing Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd [1915] AC 79, 91-92.
403 See also Paciocco v Australia and New Zealand Banking Group Ltd (2016) 333 ALR 569, 585 [58].
described Lord Dunedin’s rule that a sum will constitute a penalty if ‘extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach’, as ‘unduly restrictive’ if only damages directly flowing from breach can be considered. That may be so, but the Doctrine has always had a narrow application, for it otherwise undermines contractual certainty.

ANZ claimed in its defence that costs incurred due to late payments were very difficult to calculate. Although measuring the loss ANZ sustained may be difficult, it is not practicably impossible as has been the test in previous cases. These costs are therefore not in a similar nature as the losses in Dunlop which were ‘practically impossible’ to calculate and Clydebank which were unquantifiable. Kiefel J stated the courts in Dunlop and Clydebank found the damage was capable of estimation with little precision, but not impossible to estimate. Although the courts in Dunlop and Clydebank left the parties to their agreement, Kiefel J stated this did not occur as the court determined whether the fee was unconscionable. This is not entirely accurate. The reason the Court determined whether the fee was extravagant in Dunlop was because it had fallen within the presumption of being a penalty, as the same fee was stipulated in respect of different events of varying significance; requiring this presumption to be rebutted. In Dunlop it was decided that when ‘damages caused by a breach of contract are incapable of being ascertained, the sum made by the contract payable on such a breach is to be regarded as liquidated damages’. As the Court determined that ‘any accurate pre-estimate of damage would be practically impossible’, the sum was found not to be a penalty.

405 Paciocco v Australia and New Zealand Banking Group Ltd (2016) 333 ALR 569, 580 [33].
406 See ibid 585 [57].
408 Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd [1915] AC 79, 102 (Lord Parmoor) (emphasis added).
409 Clydebank Engineering & Shipbuilding Co Ltd v Yzquierdo y Castaneda [1905] AC 6, 12.
410 Paciocco v Australia and New Zealand Banking Group Ltd (2016) 333 ALR 569, 583 [49].
411 Ibid.
412 See ibid 583 [50].
413 Ibid.
415 Ibid 102 (Lord Parmoor) (emphasis added).
II Gageler J

Gageler J referred to Clydebank and Dunlop in determining that the stipulation may protect the party’s interests in contractual performance which are ‘intangible and unquantifiable’. As ANZ’s loss was quantifiable, it makes no sense to draw analogies between Clydebank and Dunlop, with Paciocco. Gageler J also reasoned Lord Dunedin’s use of “damage” as opposed to “damages” meant it was not a reference to the amount of compensation the party would be entitled to in an action for breach of contract. However, it appears “damage” is used in reference to the loss suffered flowing from breach. Lord Dunedin’s reference to ‘greatest loss that could conceivably be proved to have followed from the breach’ appears to invalidate Gageler J’s reasoning as this directly refers to compensatory damages.

III Keane J

Keane J admitted a ‘large disparity [exists] between the late payment fee charged by ANZ [with respect to Mr Regan’s calculations] and the expenses actually incurred’. ‘[I]ndicia which could not be ignored’ and pointed to a penalty included this large disparity, the primarily stipulation being the payment of money and the late payment fees not varying with the amount overdue or length of payment delay. Keane J also discussed that ANZ’s legitimate interests were not confined to the reimbursement of expenses directly occasioned by the customers default and maintenance or enhancement of the revenue stream explains the late payment fee. However, when he accepted ANZ’s interest in making a profit which is not confined to the reimbursement of expenses, this constitutes a contradiction when also accepting Mr Inglis’s evidence of ANZ’s costs of up to $147, as the High Court had, which far exceeded the late payment fee.

As Gordon J pointed out, ANZ’s priority is to make a profit so why would ANZ incur losses every time a payment was late? During the financial year which ended September 2009, ANZ charged the late payment fee on 2.4 million occasions:

417 Ibid 600 [145].
419 Paciocco v Australia and New Zealand Banking Group Ltd (2016) 333 ALR 569, 614 [215].
420 Ibid 605 [168] (Gageler J).
421 Ibid 614 [216].
ANZ’s revenue from charging the late payment fee was about $75 million. For this reason, Mr Regan’s evidence should be preferred to Mr Inglis’s evidence. ANZ’s interest in making a profit is true for every commercial enterprise and therefore unexceptional. A business’s interest in making a profit should not justify the use of what would otherwise be a penalty. Nevertheless, the losses actually sustained by ANZ at $3 are out of all proportion to the late payment fees of $35 and $20: arguably this fee is collateral to the primary obligation of paying on time and only exists to ensure performance of the primary obligation. The late payment fee should therefore be unenforceable.

Keane J stated perhaps ‘other laws concerned with the unfair or unreasonable use of superior bargaining power’ will affect the validity of a provision that may not otherwise constitute a penalty. The problem with statutory provisions that protect against unfair contract terms or unconscionability is that they look to the way in which a bargain was agreed. This is why the statutory arguments raised by Mr Paciocco failed. This also demonstrates why Australia should consider reforming the Doctrine to allow the parties’ bargaining positions to be taken into account. Keane J mentioned the Doctrine does not operate to displace the parties’ freedom to allocate themselves their rights and liabilities. However, this is not applicable if a standard form contract is used or the parties’ bargaining powers are unequal, such as in Paciocco. The Doctrine assumes parties freely negotiate their agreement which is not always correct. Mr Paciocco had no ability to negotiate his rights – this was pre-determined by ANZ. It would therefore be beneficial if courts considered the bargaining positions when construing whether a clause constitutes a penalty.

Keane J compared Paciocco to ParkingEye Ltd v Beavis where £85 was charged to customers who overstayed the free two hours parking, reducible to £50 if paid within 14 days. The comparison his Honour drew was that although the carpark operator did not suffer a loss from customers who overstayed the two hour free parking, the carpark operator had a legitimate interest in charging the fee.

422 Ibid 591 [97], 650 [369].
423 Ibid 616 [221].
424 See ibid 570.
425 Ibid 616 [221].
427 Paciocco v Australia and New Zealand Banking Group Ltd (2016) 333 ALR 569, 627 [266].
However, this comparison cannot be drawn: ANZ did suffer loss as a result, ascertainable in monetary terms. This case is not analogous and can be distinguished.

IV Nettle J

Nettle J referred to Ringrow\(^{428}\) where the High Court re-articulated the Dunlop tests:\(^{429}\) a penalty is ‘out of all proportion’\(^{430}\) to the ‘greatest loss that could conceivably be proved to have followed from the breach’.\(^{431}\) Nettle J importantly stated:\(^{432}\)

> [W]here a bargain is for the provision of a credit card facility made available at an agreed rate of interest, the lender’s only legitimate interest in the enforcement of the primary obligation is repayment of the facility with interest at the agreed rate plus adequate recoupment of any costs imposed on the lender as a result of the customer’s failure to adhere to the terms of the facility… [T]he lender’s interest to be protected by the bargain does not extend to the payment of a liquidated sum that is disproportionate to any amount of additional costs imposed on the lender by reason of the breach.

This statement demonstrates why Paciocco should have been decided differently. Nettle J also referred to Cavendish and Dunlop where the parties’ interests were unable to be compensated,\(^ {433}\) and determined that ANZ did not establish such a broad legitimate interest: ‘there is no evidence or other indication of any interest to be protected by the timeous performance of the Monthly Payments obligation apart from the avoidance of costs’.\(^ {434}\) This observation is accurate. Nettle J determined the Doctrine’s primary purpose is to prevent a party recovering a sum on breach of contract which bears little or no relationship to the loss actually suffered as a result.\(^ {435}\) Nettle J concluded in reference to AMEV-UDC,\(^ {436}\) which was re-affirmed in Andrews, that ‘there seems to have been no instance of equity awarding

\(^{428}\) (2005) 224 CLR 656.

\(^{429}\) Paciocco v Australia and New Zealand Banking Group Ltd (2016) 333 ALR 569, 639 [318].

\(^{430}\) Ringrow Pty Ltd v BP Australia Pty Ltd (2005) 224 CLR 656, 667 [27].

\(^{431}\) Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd [1915] AC 79, 87 (Lord Dunedin).

\(^{432}\) Paciocco v Australia and New Zealand Banking Group Ltd (2016) 333 ALR 569, 639 [323].

\(^{433}\) Ibid 641 [325].

\(^{434}\) Ibid 641 [324].


\(^{436}\) (1986) 162 CLR 170, 190.
compensation over and above the amount awarded as common law damages, other than cases in which equity would not relieve against the penalty.\(^{437}\)

In determining which *Dunlop* tests applied, Nettle J concluded Gordon J was correct in applying test 4(a) and test 4(c).\(^{438}\) Test 4(a) encompasses whether the late payment fee was extravagant in comparison with the greatest loss that could conceivably be proved to have followed from the breach.\(^{439}\) Test 4(c) includes that a presumption arises that the payment is a penalty due to the late payment fee being the same in amount, irrespective of the monthly payment amount required to be paid and the extent of lateness in payment.\(^{440}\) With respect to “greatest amount of damage”, Nettle J stated that in accordance with *Chitty on Contracts*,\(^{441}\) “the word “damage” in this context means “net loss” after taking account of the claimant’s expected ability to mitigate”.\(^{442}\) This is similar to what was proposed earlier in this Chapter. Nettle J also disagreed with the Full Court that Gordon J took an ex post approach to identifying the conceivable loss.\(^{443}\) He reasoned that because Gordon J concluded the late payment fee was a fixed amount irrespective of the magnitude and duration of the late payment, no ex facie relationship between the fee and resulting loss existed which gave rise to the presumption of a penalty.\(^{444}\) In determining whether the presumption was rebutted, Gordon J had compared the fee with the amount recoverable as damages.\(^{445}\) Gordon J completed this process in accordance with test 4(a) and test 4(c). Nettle J’s conclusion that Gordon J had not undertaken an ex post approach is logical after considering no ex facie relationship between the fee and resulting loss existed.

\(^{437}\) *Paciocco v Australia and New Zealand Banking Group Ltd* (2016) 333 ALR 569, 642 [330].  
\(^{438}\) Ibid 644 [338]-[339].  
\(^{439}\) *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd* [1915] AC 79, 87 (Lord Dunedin).  
\(^{440}\) Ibid 87 (Lord Dunedin).  
\(^{441}\) Hugh Beale (ed), *Chitty on Contracts* (Sweet & Maxwell Ltd, 32nd ed, 2015) vol 1, 1922 [26-187].  
\(^{442}\) *Paciocco v Australia and New Zealand Banking Group Ltd* (2016) 333 ALR 569, 645 [341].  
\(^{443}\) Ibid 645-646 [345].  
\(^{444}\) Ibid.  
\(^{445}\) Ibid.
Nettle J critiqued Mr Inglis’s evidence and identified problems associated with his calculations. This included that a provision for bad debts was not an incurred loss and was only an estimate regarding future loss, which may or may not be incurred. A further problem included that Mr Inglis made numerous calculations on a per account basis as opposed to a per late payment basis, which was used for his other calculations. Nettle J also recognised Mr Paciocco had no ability to negotiate the contract due to ANZ’s bargaining power and the standard form contract. This factor was discussed earlier in this Chapter. Only Nettle J concluded, correctly, in the author’s view, that the late payment fee constituted a penalty and that the Full Court’s decision should be set aside.

E Policy Decision

The High Court dismissed the appeal. The arguably incorrect decision of determining that the late payment fees did not constitute a penalty was based in policy. If these late payment fees were held to be unenforceable, ‘interest rates or other charges could be expected to rise at the expense of those customers who adhere to their contractual engagements’. Protection against losses and the possibility of risk would have to be reassigned, most likely to the regular customer in increased interest rates who has not failed to make repayments in time. Further, many cases may then have come before the courts, not only regarding ANZ but other different lending institutions charging similar fees. In light of French CJ’s comments and the arguably incorrect decision of Paciocco, it is now appropriate to evaluate the various reforms proposed to the Doctrine.

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446 See ibid 646 [364], 650-651 [369]-[371].
447 Ibid 647 [352].
448 Ibid 649 [364].
449 Ibid 650 [368].
450 Ibid 651 [371].
451 Ibid 651 [376].
452 Ibid 569.
453 Ibid 617 [224] (Keane J).
454 Ibid 616 [223], 627 [264].
455 The credit card contracts entered into between ANZ and Mr Paciocco were on terms and conditions relevantly no different from the terms and conditions on which ANZ entered into credit card contracts with each of the other holders of consumer credit card accounts, of which there were millions: Ibid 605 [167] (emphasis added).
VII REFORMS

French CJ confirmed the decision of Andrews and Dunlop in Paciocco as providing the governing principles regarding the Doctrine’s application.\textsuperscript{456} French CJ therefore confirmed the application of the Doctrine in instances other than breach. As stated by French CJ, ‘more than one account of its construction and more than one view of whether it should be abrogated or extended or subsumed by legislative reform is reasonably open’.\textsuperscript{457} Although, the High Court extended the Doctrine in Andrews, French CJ suggested statutory law reform.\textsuperscript{458} Other reforms have also been suggested over the years. It is now appropriate to consider each reform in turn and explore whether these reforms may be beneficial, given the recent reformulations by the High Court.

A Legislative Reform

French CJ suggested statutory law reform.\textsuperscript{459} However, the Earl of Halsbury L.C. encapsulated in Clydebank\textsuperscript{460} the problem created by attempting to codify the Doctrine: ‘[I]t is impossible to lay down any abstract rule as to what it may or it may not be extravagant or unconscionable to insist upon without reference to the particular facts and circumstances which are established in the individual case’.\textsuperscript{461} The difficulty of creating statutory regulation broad enough to cover the field of what could constitute a penalty, yet specific enough to apply in every circumstance, is one of the reasons statutory reform is difficult. What does or does not constitute a penalty is specific to the facts and circumstances of the case, something which the presiding judge evaluates. Relevantly, the Scottish Law Commission’s Report on Penalty Clauses (1999) recommended the retention of judicial control over penalties.\textsuperscript{462} Further, this recommendation concluded that ‘[j]udicial control over contractual penalties should apply whatever form the penalty takes’.\textsuperscript{463}

\begin{footnotesize}
\textsuperscript{456} Paciocco v Australia and New Zealand Banking Group Ltd (2016) 333 ALR 569, 573 [5].
\textsuperscript{457} Ibid 575 [10].
\textsuperscript{458} Ibid.
\textsuperscript{459} Ibid.
\textsuperscript{460} [1905] AC 6.
\textsuperscript{461} Clydebank Engineering & Shipbuilding Co Ltd v Yzquierdo y Castaneda [1905] AC 6, 10. See also Cavendish Square Holding BV v Makdessi [2015] UKSC 67 (4 November 2015) [293] (Lord Clarke of Stone-Cum-Ebony JSC who agreed with the Earl of Halsbury LC).
\end{footnotesize}
One benefit of statutory law reform would be the added certainty that would come with codifying the rules of application, in light of the recent High Court decisions. It is difficult to ascertain with certainty the reasons why French CJ suggested statutory reform as the most appropriate step as he gave no reasons for that view. A primary reason is presumably to solidify the extension of the Doctrine following *Andrews* and *Paciocco*. Statutory reform may alleviate any remaining confusion regarding the rules of application. However, if statutory reform would only provide a reiteration of the principles formulated in *Andrews* and *Paciocco*, it may not offer much value, and, depending on how the legislation is drafted, may in fact restrict the application of the Doctrine. In this respect, it may be best if judicial control over penalties remain. Further, there appears to be a general consensus within the European Civil Codes towards recognising the value of retaining judicial control of disproportionate, excessive, or unreasonable penalties.\(^{464}\) Examples include the Council of Europe's Resolution 78 (3) of 20 January 1978 on Penal Clauses in Civil Law,\(^ {465}\) the *Principles of European Contract Law* (2002),\(^ {466}\) the UNCITRAL Uniform Rules on Contract Clauses for an Agreed Sum Due upon Failure of Performance (1983)\(^ {467}\) and the *UNIDROIT Principles of International Commercial Contracts* (2010).\(^ {468}\) All contain provisions for judicial control.\(^ {469}\) Ultimately however, recommending statutory law reform depends on the terms of the proposed legislation, without which, it is difficult to conclude with certainty.

B Abrogated

The Doctrine has existed in England, as well as Scotland, since the 16th century.\(^ {470}\) However, it has been argued, as in the first appeal of *Cavendish*,\(^ {471}\) that the Doctrine should be abrogated.\(^ {472}\) The applicant argued that the rule is antiquated, anomalous

\(^{465}\) Article 7.
\(^{466}\) Article 9:509.
\(^{467}\) Article 8.
\(^{468}\) Article 7.4.13.
\(^{469}\) See *Cavendish Square Holding BV v Makdessi* [2015] UKSC 67 (4 November 2015) [164] (Lord Mance JSC).
and unnecessary, especially given the statutory regulation in this area.\textsuperscript{473} However, the Court concluded ‘we do not consider that judicial abolition would be a proper course for this court to take’.\textsuperscript{474} The Australian High Court in \textit{Ringrow} relevantly pointed out that the Doctrine ‘has been applied countless times in this and other courts’.\textsuperscript{475} As the Doctrine still finds application today, such as in \textit{Andrews} and \textit{Paciocco}, the Doctrine cannot be characterised as unnecessary. As Lord Mance JSC stated, ‘there would have to be shown the strongest reasons for so radical a reversal of jurisprudence which goes back over a century in its current definition and much longer in its antecedents’.\textsuperscript{476}

One argument for abrogating the Doctrine is that statutory regulation exists which did not exist at the time of the Doctrine’s inception.\textsuperscript{477} In the United Kingdom, for example, penalty clauses were controlled by the Unfair Terms in Consumer Contracts Regulations 1999 and Consumer Protection from Unfair Trading Regulations 2008.\textsuperscript{478} However, these Regulations only applied to consumer contracts and the control of unfair terms did not apply to contracts individually negotiated.\textsuperscript{479} This last limitation was sensibly removed by introducing the Consumer Rights Act 2015.\textsuperscript{480} However, these statutory regulations still only apply to consumer contracts. Non-consumer contracts not regulated by statute are regulated by the Doctrine. Notably, neither the English Law Commission in 1975\textsuperscript{481} nor the Scottish Law Commission in 1999,\textsuperscript{482} recommended abrogating the


\textsuperscript{474} Ibid.


\textsuperscript{476} \textit{Cavendish Square Holding BV v Makdessi} [2015] UKSC 67 (4 November 2015) [162].


\textsuperscript{478} \textit{Cavendish Square Holding BV v Makdessi} [2015] UKSC 67 (4 November 2015) [167] (Lord Mance JSC), [260] (Lord Hodge JSC).

\textsuperscript{479} Ibid.

\textsuperscript{480} Ibid.


Doctrine. In *Cavendish*, the court refused to abolish the Doctrine, stating that it ‘had a useful role to play in protecting people against some categories of oppressive bargain which were not subject to statutory regulation’. Further, the United Kingdom has similar statutory regulation to Australia. The Court’s reasons in *Cavendish* for deciding against abrogating the Doctrine despite statutory regulation is therefore relevant in considering such reform in Australia.

In Australia, similar statutory regulation exists, including prohibitions against unconscionable conduct and unfair contract terms under the *Australian Consumer Law* (contained in Schedule 2 of the *Competition and Consumer Act 2010* (Cth)). Sections 20-21 prohibit unconscionable conduct whilst s 22(1)(a) allows the court to consider the parties’ relative bargaining positions when assessing unconscionability. However, this provision applies to contracts for the supply or acquisition of goods or services and excludes public listed companies. Section 23 prohibits unfair contract terms in standard form contracts. Section 25(c) states ‘a term that penalises, or has the effect of penalising, one party (but not another party) for a breach or termination of the contract’ is an example of a term that may be unfair. However, this provision only applies to consumer contracts and small business contracts involving the supply of goods or services, or a sale or grant of an interest in land. Parties and contracts which fall outside these categories are not protected by this legislation. Statutory regulation did not provide protection in situations such as those dealt with in *Andrews* and *Paciocco*. For this reason, statutory regulation in this area may not be sufficient to cover the field. Notably, the Law Reform Commission of Victoria provided a discussion paper on the Doctrine in 1988, and stated that any associated problems of the Doctrine could be ‘resolved without abandoning the rule against penalties’. Ultimately, the Law Reform Commission of Victoria recommended a more flexible rule be

483 See *Cavendish Square Holding BV v Makdessi* [2015] UKSC 67 (4 November 2015) [38] (Lord Neuberger of Abbotsbury PSC and Lord Sumption JSC with whom Lord Carnwath JSC agreed), 1439-1440 [163] (Lord Mance JSC), 1468 (Lord Hodge JSC).
484 See *Competition and Consumer Act 2010* (Cth) sch 2 (*Australian Consumer Law*) ss 20-21, 23.
486 See *Competition and Consumer Act 2010* (Cth) sch 2 (*Australian Consumer Law*) s 23.
implemented, where courts have the discretion to set aside provisions which are ‘unconscionable in all the circumstances’.489

A party to a commercial contract may still be vulnerable as ‘there remain significant imbalances in negotiating power in the commercial world’.490 The Doctrine also protects vulnerable commercial parties who do not receive protection under the statutory regulation. The Doctrine provides an avenue of relief for such parties that may be otherwise unavailable. Further, the Australian High Court chose to extend the Doctrine in Andrews, in spite of statutory regulation. This demonstrates the Doctrine’s continuing relevance and importance.

Although justified criticisms regarding the Doctrine exist, such as that it infringes upon freedom of contract, the Doctrine is consistent with other well established principles which allow the court to decline in giving full force to contractual stipulations.491 Examples of such include equity of redemption, relief from forfeiture and refusing to grant specific performance.492 In Cavendish, the party’s argument for abolishing the Doctrine depended heavily upon anomalies in the operation of the law. The Court in Cavendish held that many of these anomalies are best addressed ‘by a realistic appraisal of the substance of contractual provisions operating on breach, and by taking a more principled approach to the interests that may properly be protected by the terms of the parties’ agreement’.493 Further, utility exists in allowing parties the opportunity to sensibly agree for themselves the consequences of breach in order to avoid expensive disputes.494 The premise of liquidated damages is still of value to parties.

Finally, the Doctrine is common to almost all major law systems in the western world and has been adopted, albeit with some variants, in all common law

490 ‘Small businesses often contract with large commercial entities and have little say as to the terms of their contracts’; Cavendish Square Holding BV v Makdessi [2015] UKSC 67 (4 November 2015) [262] (Lord Hodge JSC).
492 Ibid.
493 Ibid.
494 See ibid [266] (Lord Hodge JSC).
jurisdictions including the United Kingdom, Canada,\(^{495}\) New Zealand, Singapore, Hong Kong and the United States.\(^{496}\) An example from United States is § 2-718(1) of the *Uniform Commercial Code* which states that liquidated damages must be at a level considered reasonable in light of anticipated or actual harm caused by breach of contract and that a ‘term fixing unreasonably large liquidated damages is void as a penalty’.\(^{497}\) A corresponding penalty rule derived from Roman law by Pothier\(^{498}\) is also found in the Civil Codes of France,\(^{499}\) Germany,\(^{500}\) Switzerland,\(^{501}\) Belgium\(^{502}\) and Italy.\(^{503}\) These Codes allow for modification of contractual penalties if they are manifestly excessive or disproportionately high.\(^{504}\) The Doctrine was also included in attempts to codify contract law internationally. As noted above, this includes the *UNIDROIT Principles of International Commercial Contracts* (2010)\(^{505}\) and the UNCITRAL Uniform Rules on Contract Clauses for an Agreed Sum Due upon Failure of Performance (1983).\(^{506}\) Further, the Draft Common Frame of Reference (2009) provides for reducing payments for non-performance of a contract if grossly excessive.\(^{507}\) The Committee of Ministers of the Council of Europe in January 1978 also recommended various common principles.\(^{508}\) One such was that a sum payable on breach of contract could be reduced by the court when


\(^{496}\) *Cavendish Square Holding BV v Makdessi* [2015] UKSC 67 (4 November 2015) [37], [166], [264].

\(^{497}\) *Uniform Commercial Code* § 2-718(1) (2002).


\(^{499}\) *Code Civil* [Civil Code] (France) art 1152 cited in *Cavendish Square Holding BV v Makdessi* [2015] UKSC 67 (4 November 2015) [37], [265].

\(^{500}\) *Bürgerliches Gesetzbuch* [Civil Code] (Germany) §§343, 348 (non-commercial contracts only) cited in *Cavendish Square Holding BV v Makdessi* [2015] UKSC 67 (4 November 2015) [37], [265].

\(^{501}\) *Code Civil Suisse* [Swiss Civil Code] (Switzerland) art 163.3 cited in *Cavendish Square Holding BV v Makdessi* [2015] UKSC 67 (4 November 2015) [37], [265].

\(^{502}\) *Code Civil* [Civil Code] (Belgium) art 1231 cited in *Cavendish Square Holding BV v Makdessi* [2015] UKSC 67 (4 November 2015) [37], [265].

\(^{503}\) *Codice Civile* [Civil Code] (Italy) art 1384 cited in *Cavendish Square Holding BV v Makdessi* [2015] UKSC 67 (4 November 2015) [37], [265].

\(^{504}\) *Cavendish Square Holding BV v Makdessi* [2015] UKSC 67 (4 November 2015) [265] (Lord Hodge JSC).\(^{505}\) Article 7.4.13; Ibid [37].

\(^{506}\) Article 6; *Cavendish Square Holding BV v Makdessi* [2015] UKSC 67 (4 November 2015) [37].


manifestly excessive. The global commonality of the Doctrine and the principles of which it is founded demonstrates its necessity, relevance and value within the law broadly. For these many reasons, abrogating the Doctrine in Australia would be detrimental to our legal system and to vulnerable parties. Abrogating the Doctrine is therefore not recommended.

C Subsuming the Doctrine

Some commentators suggested subsuming the Doctrine into the principle of unconscionability. One reason for this includes that conscience and fairness is at the heart of the Doctrine and the reason for court intervention. However, courts are more likely to find unconscionable conduct where procedural unfairness resulted in formation of the contract: Within the principle of unconscionability, the distinction between procedural unfairness and substantive unfairness is evident. Procedural unconscionability refers to unfair negotiating processes and methods of forming contracts. Relevant factors include ‘absence of meaningful choice, superiority of bargaining power, [use of] an adhesion contract, unfair surprise, sharp practices or deception’. Substantive unconscionability refers to

509 Article 7; Ibid.
512 Gray, ‘Contractual Penalties in Australian Law After Andrews: An Opportunity Missed’, above n 158, 20. See, eg, Commercial Bank of Australia v Amadio (1983) 151 CLR 447. Unconscionable conduct, undue influence and duress are generally unhelpful with respect to penalties as these involve parties exploiting or taking unfair advantage of someone in a position of vulnerability or special disadvantage: A penalty may exist without satisfying the requirements of these principles. ‘The High Court has taken a relatively narrow view of these requirements, emphasising that the disadvantage must be special, and refusing to accept evidence that one party has taken advantage of a superior bargaining position as being sufficient to attract the doctrine’: Gray, ‘Contractual Penalties in Australian Law After Andrews: An Opportunity Missed’, above n 158, 20-21 citing Australian Competition and Consumer Commission v CG Berbatis Holdings Pty Ltd (2003) 214 CLR 51, 64-65 (Gleeson CJ), 77 (Gummow and Hayne JJ), 105 (Callinan J), contra 96 (Kirby J); Rick Bigwood, ‘Curbing Unconscionability: Berbatis in the High Court of Australia’ (2004) 28(1) Melbourne University Law Review 203.
515 Standard form contract.
516 Peden, above n 514, 25.
unfair substantive terms of the contract and overall unjust results. Whether substantive unconscionability exists varies according to the commercial setting in which the contract is formed. Some factors include the ‘relationship between price and consideration received, whether onerous terms bear a reasonable relationship to business risks, and the relative fiscal positions of the parties’. In application to the Doctrine, unconscionability could specifically refer to the agreed sum, relationship of the parties, together with unfair compulsion of performance. In order to subsume the Doctrine into the principle of unconscionability, commentators such as Gray have suggested the court consider the content of substantive clauses rather than only procedural matters.

An argument against this proposal includes that ‘it is unsatisfactory to make general appeals to fairness or unconscionability’ with respect to the Doctrine. The Doctrine must be principled and based on clear policy foundations instead. A relevant problem associated with this reform is that the protection provided under the Australian Consumer Law does not apply to all types of parties and contracts. An example includes s 23 which prohibits unfair contract terms in standard form contracts. This provision only applies to consumer contracts and small business contracts involving the supply of goods or services, or a sale or grant of an interest in land. Gaps in the legislation therefore exist with which the Doctrine plays an important role in providing protection that would not exist if subsumed into the unconscionability principle. A further problem includes that this proposed reform would require the courts to take a substantive approach to the

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517 Ibid. See also Clark, above n 514, 30.
518 Peden, above n 514, 25. An example includes whether it is a commercial or consumer contract.
519 Peden, above n 514, 25.
520 Under substantive fairness.
521 Including any inequality of bargaining power.
522 Baron, above n 511, 291-292.
525 Ibid.
526 Competition and Consumer Act 2010 (Cth) sch 2.
527 Sections 20-21 prohibits unconscionable conduct but only applies to contracts for the supply or acquisition of goods or services and excludes public listed companies. Section 23 prohibits unfair contract terms in standard form contracts but this provision only applies to consumer contracts and small business contracts involving the supply of goods or services, or a sale or grant of an interest in land.
528 See Competition and Consumer Act 2010 (Cth) sch 2 (Australian Consumer Law) s 23.
contract in determining whether it is unconscionable. This goes against the freedom of contract principle. As stated by Lord Roskill, ‘it is not and never has been for the courts to relieve a party from the consequences of what may in the event prove to be an onerous or possibly even a commercially imprudent bargain’.\textsuperscript{529} The courts role is supervisory. As Callinan J observed, ‘courts are not armed with a general power to set aside bargains simply because in the eye of a particular judge, they might appear to be unfair, harsh or unconscionable’.\textsuperscript{530} The courts are not meant to undertake a review of the substantive terms of the contract themselves. As Manly noted, it ‘is a well-established principle of the common law that it is not for the courts to rewrite contracts’.\textsuperscript{531} Gray’s suggestion that the ‘law needs to abandon its traditional reluctance when dealing with unconscionability principles to consider substantive unconscionability, while continuing to uphold freedom of contract’\textsuperscript{532} is in itself a contradiction. Unfortunately, one cannot be upheld if the other is. This proposed reform is therefore, not recommended.

\textbf{D Extended}

As the Australian High Court has already extended the scope of the Doctrine, the arguments surrounding extension are no longer of practical significance. However, it is relevant to briefly identify the benefits and detriments associated with this reform given it has been implemented. In comparison, the court in \textit{Cavendish} declined to follow the Australian High Court and held that the Doctrine should not be extended to include clauses which ‘imposed onerous obligations on a party on certain contingencies which did not involve a breach of contract, since the courts had no power at common law to regulate the parties’ primary obligations’.\textsuperscript{533} This

\textsuperscript{529} \textit{Export Credits Guarantee Department v Universal Oil Products Co} [1983] 1 WLR 399, 403 (Lord Roskill with whom Lords Diplock, Elwyn-Jones, Keith and Brightman agreed). See also Richard Manly, ‘The Penalty Doctrine: Andrews v Australia and New Zealand Banking Group Ltd’ (2012) 7(2) \textit{Construction Law International} 35, 36: ‘Courts have consistently rejected a jurisdiction in equity to interfere with contractual freedom on the generalized ground that the provision in question is harsh or constitutes a hard bargain’; \textit{Andrews v Australia and New Zealand Banking Group Ltd} (2011) 288 ALR 611, 637 [79] (Gordon J) citing \textit{Bridge v Campbell Discount Co Ltd} [1962] AC 600, 614 (Viscount Simonds), 626 (Lord Radcliffe); 1 All ER 385, 388 (Viscount Simonds), 398 (Lord Radcliffe); \textit{Export Credits Guarantee Department v Universal Oil Products Co} [1983] 1 WLR 399, 404; 2 All ER 205, 224 (Lord Roskill).

\textsuperscript{530} Baron, above n 511, 291 quoting \textit{Australian Competition and Consumer Commission v CG Berbatis Holdings Pty Ltd} (2003) 214 CLR 51, 110.

\textsuperscript{531} Manly, ‘Substance over Form: Australia’s Highest Court Reconsiders the Penalty Doctrine’, above n 107, 22.


\textsuperscript{533} \textit{Cavendish Square Holding BV v Makdessi} [2015] UKSC 67 (4 November 2015) [1].
is a valid concern, as it is not for the judiciary to determine the astuteness of contractual bargains. This is a primary reason why extending the Doctrine to apply in instances other than breach has received criticism. As Mason and Wilson JJ stated in *AMEV-UDC*, the courts have always ‘maintained a supervisory jurisdiction, not to rewrite contracts imprudently made, but to relieve against provisions which are so unconscionable or oppressive that their nature is penal rather than compensatory’. Palmer relevantly suggested that the ‘parties’ stipulated remedies cannot extend beyond the courts’ own [remedial] limits, otherwise the institution of contracting itself is threatened by the loss of the courts’ ability to supervise and enforce the bargain’. The Doctrine protects the court’s remedial jurisdiction. The unenforceability of penalties ensures the judiciary maintain their function of governing relief which cannot be avoided or overridden by contractual stipulations. The court in *Cavendish* also raised a valid point:

There is a fundamental difference between a jurisdiction to review the fairness of a contractual obligation and a jurisdiction to regulate the remedy for its breach. Leaving aside challenges going to the reality of consent, such as those based on fraud, duress or undue influence, the courts do not review the fairness of men’s bargains either at law or in equity. The penalty rule regulates only the remedies available for breach of a party’s primary obligations, not the primary obligation themselves.

A problem identified with respect to extending the scope of the Doctrine, is that this further interferes with freedom of contract and further undermines the certainty

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536 Palmer, above n 158, 306. Palmer further observes: ‘Agreed remedies save significant time and cost for both the court and the parties at the point of breach and promote certainty, so long as they are consistent with (and do not usurp) the court's remedial jurisdiction...The law's tolerance of limitation and exclusion clauses does not undermine this reasoning. Penalty clauses threaten the courts' ability to enforce contracts because they overcompensate the innocent party, something that the law of contract does not allow a court to do... The court cannot impose a secondary obligation to overcompensate and thus it cannot logically enforce the term’; Palmer, above n 158, 315.
537 Palmer further stated that ‘he or she is under a secondary obligation to make good any loss arising from breach of the primary obligation. These secondary obligations are the domain of the court. Were one party permitted to stipulate that the other is obliged to pay damages which are excessive in comparison with what a court would or could award, the term would place a court called upon to enforce it in a position of inherent contradiction’; Palmer, above n 158, 313-314.
539 See, eg, Harder, above n 477, 59: ‘Despite the problems that a restriction of the rule against penalties to instances of breach creates, it is necessary to keep the rule against penalties within a
with which parties are entitled to contract. Extending the Doctrine to apply in instances other than breach means that the ‘penalty doctrine is more likely to be invoked’ creating further uncertainty within contracts. ‘The law of penalties is a narrow exception to the general rule that the law seeks to preserve freedom of contract, allowing parties the widest freedom, consistent with other policy considerations, to agree upon the terms of their contract’. As Lord Woolf stated in Philips Hong Kong Ltd v Attorney General of Hong Kong: ‘the court has to be careful not to set too stringent a standard and bear in mind that what the parties have agreed should normally be upheld. Any other approach will lead to undesirable uncertainty especially in commercial contracts’. Allowing parties the freedom to contract results in their ability to ‘determine more precisely their rights and liabilities consequent upon breach or termination, and thus enables them to provide for compensation in situations where loss may be difficult or impossible to quantify... avoid[ing] costly and time-consuming litigation’. In Cavendish, Lord Clarke further stated that although the application of the Doctrine can turn on questions of drafting, despite taking a substantive approach, this ‘can be justified by the fact that the rule “being an inroad upon freedom of contract which is inflexible… ought not to be extended”, at least by judicial, as opposed to legislative, decision-making’.

Despite these criticisms, benefits in extending the Doctrine also exist. An example includes the irregularity identified by Lord Denning in Bridge v Campbell confined territory. A major extension of its scope would turn the rule against penalties into a crude instrument of checking the fairness of contract terms in general, which would be a drastic limitation of freedom of contract’.

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543 Ibid quoted in Cavendish Square Holding BV v Makdessi [2015] UKSC 67 (4 November 2015) [33]. See also AMEV-UDC Finance Ltd v Austin (1986) 162 CLR 170, 194 (Mason and Wilson JJ) where it was stated that ‘the courts should not, however, be too ready to find the requisite degree of disproportion lest they impinge on the parties’ freedom to settle for themselves the rights and liabilities following a breach of contract’.
544 AMEV-UDC Finance Ltd v Austin (1986) 162 CLR 170, 193 (Mason and Wilson JJ).
546 ‘It also affords greater protection to a promisor who breaches the contract than to a promisor who acts in accordance with the contract where the impugned obligation can be independently triggered by a breach and an event that can occur without breach, such as the exercise of an option’: Harder, above n 477, 58-59.
Discount Co Ltd with respect to the Doctrine only applying in instances of breach of contract: ‘let no one mistake the injustice of this. It means that equity commits itself to this absurd paradox: it will grant relief to a man who breaks his contract but will penalise the man who keeps it’. This observation is correct but the reason behind this is valid: courts are meant to regulate the remedy for breach as opposed to reviewing the substantive fairness of agreements. Extending the Doctrine means that this anomaly will no longer arise. ‘With skilful drafting, remedial clauses can be converted into primary obligations or conditional collateral obligations that are out of reach of the rule against penalties’.

Another benefit in extending the Doctrine is that parties can no longer easily circumvent or avoid the application of the Doctrine by clever drafting. Further, support for extending the Doctrine is present in other jurisdictions. Reports conducted prior to statutory regulation by the English Law Commission in 1975 and the Scottish Law Commission in 1999 recommended that the application of the Doctrine be expanded to include

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547 [1962] AC 600; 1 All ER 385.
548 Bridge v Campbell Discount Co Ltd [1962] AC 600, 629; 1 All ER 385, 389.
550 See Cavendish Square Holding BV v Makdessi [2015] UKSC 67 (4 November 2015) [40], [130] [258]; Harder, above n 477, 58-59; ‘It facilitates a circumvention of the rule against penalties since the structure of an option or an indulgence may be used for what is in substance an obligation triggered by breach’; Patrick Easton, ‘Penalties Percolating through the Construction Industry: Andrews v Australia and New Zealand Banking Group Ltd (2013) 29 Building and Construction Law Journal 233, 239. Contra ‘The problem of evasion of the rule by clever drafting is probably not resolvable and it would create huge uncertainty and transactional expense if all contractual clauses could be subjected to the scrutiny of the court’: Palmer, above n 158, 318 citing Bobby Lindsay, ‘Penalty Clauses in the Supreme Court: A Legitimately Interesting Decision?’ (2016) 20 Edinburgh Law Review 204, 207.

Further, the court in Cavendish identified in situations where it is clear that the parties have avoided the penalty doctrine’s application, and that the substance of the contractual stipulation is to impose a punishment for breach, the courts ability to focus on the substance of the term should enable the court to identify a disguised penalty and intervene: Cavendish Square Holding BV v Makdessi [2015] UKSC 67 (4 November 2015) [258] (Lord Hodge JSC) citing interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd [1989] QB 433, 445-446 (Bingham LJ). ‘In the United Kingdom, concerns over attempts to redraft provisions to form additional services caused the Office of Fair Trading to release a position statement in 2006, which stated that attempts that restrict or restructure accounts in order to present events of default spuriously as additional services for which a charge may be made should be viewed as disguised penalties’: Patrick Easton, ‘Penalties Percolating through the Construction Industry: Andrews v Australia and New Zealand Banking Group Ltd (2013) 29 Building and Construction Law Journal 233, 240. This provides one reason why extending the penalty doctrine is less desirable in the United Kingdom as opposed to Australia given this potential benefit already exists.

circumstances other than breach of contract.553 Many national European legal systems contain similar provisions.554 An example includes the laws in France of 9 July 1975 and 11 October 1985 which amended article 1152 of the Code Civil.555

Although the Australian High Court already extended the Doctrine, hopefully Australian courts will still consider the importance of freedom of contract when applying it. As Diplock LJ stated in Robophone Facilities Ltd v Blank556 ‘the court should not be astute to descry a penalty clause’.557 Given the policy decision in Paciocco, it appears courts are not particularly willing to declare that a penalty exists, despite use of a standard form contract, which means the courts are not infringing upon freedom of contract in the truest sense. However, if bargaining power and use of a standard form contract had been considered, ideally Paciocco would have been decided differently. Protecting weaker parties while allowing parties the freedom to contract in order to create commercial certainty is a fine line. As stated by Gleeson CJ and Gummow, Kirby, Hayne, Callinan and Heydon JJ in Ringrow:558

> Exceptions from that freedom of contract require good reason to attract judicial intervention to set aside the bargains upon which parties of full capacity have agreed. That is why the law on penalties is, and is expressed to be, an exception from the general rule. It is why it is expressed in exceptional language.

E Taking into Account the Bargaining Position of the Parties

A problem with the Doctrine is that the rules are premised on the assumption that the parties have freely agreed the terms of their contract. However, a party’s bargaining power impacts upon their ability to contract feely. A powerful party will be in a position to influence the terms of the agreement at the weaker party’s

555 Code Civil [Civil Code] (France). This reversed the effect of Cour de cassation [French Court of Cassation] decision in Paris frères c Dame Jaillard Civ 14 February 1866; Ibid.
557 Ibid.
558 Ringrow Pty Ltd v BP Australia Pty Ltd (2005) 224 CLR 656, 669 [32].
expense. Taking into account the parties’ bargaining positions is a relevant proposed reform that Australia could implement. As recognised in *Cavendish*, ‘there remain significant imbalances in negotiating power in the commercial world. Small businesses often contract with large commercial entities and have little say as to the terms of their contracts’. In *Cavendish*, the bargaining positions of the parties was a relevant consideration when the court construed whether or not the clause constituted a penalty. The Court held that the parties were ‘sophisticated, successful and experienced commercial people bargaining on equal terms over a long period with expert legal advice’ and ‘were the best judges of the degree to which each of them should recognise the proper commercial interests of the other’. The Court concluded that in a contract negotiated between parties of equal or comparable bargaining power, the initial presumption must be that the parties themselves are best equipped at determining the consequences of breach.

In *AMEV-UDC* Mason and Wilson JJ also identified the nature of the relationship between contracting parties as a relevant factor regarding the unconscionableness in enforcing the relevant clause. In *Philips Hong Kong Ltd v Attorney General of Hong Kong* Lord Woolf suggested that a relevant consideration when applying the Doctrine included situations where one party was able to dominate the other regarding choice of contract terms. Lord Woolf qualified this suggestion by stating that the courts could not thereby adopt some broad discretionary approach in deciding whether a clause is penal. He saw this as striking a ‘balance between the competing interests of freedom of contract and protection of weak contracting parties’. The parties’ bargaining position as a relevant consideration was also supported by Lord Browne-Wilkinson in *Workers*

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560 Ibid [75].
561 Ibid.
567 *Cavendish Square Holding BV v Makdessi* [2015] UKSC 67 (4 November 2015) [35].
Kirby P in *Citcorp Australasia Ltd v Hendry* lamented that no authority existed for taking into account the parties’ bargaining position when assessing whether the clause constituted a penalty. Kirby P commented that the current law was unsatisfactory and considering the parties’ bargaining power was one change he would contemplate if free from authority to do so. Relevantly, the Law Reform Commission of Victoria recommended implementing Kirby P’s suggestion, in that the courts be given the discretion to set aside provisions which are ‘unconscionable in all the circumstances’.

The rules of the Doctrine are also premised on the assumption that parties have freely negotiated individual terms of their contract. However, standard form contracts are frequently used which do not allow the parties to negotiate the terms of their agreement. Examples where this issue has arisen include *Andrews* and *Paciocco*. Diplock LJ recognised this problem in *Robophone Facilities Ltd v Blank* where he noted that many contracting parties could not contract à la carte but had to accept the table d’hôte of the standard term contract. Other jurisdictions have recognised the relevance of the standard form contract. In Germany, the *Civil Code* empowers the court to reduce any penalty to an appropriate amount under section 343. Section 343 applies to non-business contracts whilst commercial

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570 (1985) 4 NSWLR 1.
571 *Citcorp Australasia Ltd v Hendry* (1985) 4 NSWLR 1, 23 cited in Baron, above n 511, 297.
572 *Citcorp Australia Ltd v Hendry* (1985) 4 NSWLR 1, 22–23 (Kirby P): ‘Thus, the endeavour by a finance house, in a printed form, to impose conditions for breach upon a B consumer borrowing a small sum, without the benefit of legal advice, would be treated differently to a commercial enterprise borrowing large sums for a business venture upon which it has the advantage of legal advice’. ‘This would enable the court to adopt a ‘more sensitive and discriminating approach’ so that where a party had commercial experience and the advantage of legal advice the court need not arrive at the same result as it would [if] faced with a different relationship’: Lanyon, above n 524, 258 citing *AMEV Finance Ltd v Artes Studios Thoroughbreds Pty Ltd* (1989) 15 NSWLR 564.
575 See *Paciocco v Australia and New Zealand Banking Group Limited* (2016) 333 ALR 569, 588 [77] where the terms and conditions on which ANZ contracted with Mr Paciocco were contained within three standard form documents.
577 Cited in *Cavendish Square Holding BV v Makdessi* [2015] UKSC 67 (4 November 2015) [257] (Lord Hodge JSC); *Tasmania v Leighton Contractors Pty Ltd* [2005] TASSC 133 [40].
578 *Bürgerliches Gesetzbuch* [Civil Code] (Germany) (‘BGB’).
contracts are exempt under the *Commercial Code*.\(^{579}\) Importantly, this exemption does not include standard form contracts.\(^{580}\) Germany has recognised that the use of standard form contracts requires a different approach as the parties have not feely negotiated the terms of their agreement. Courts do not recognise the effect of a standard form contract when applying the Doctrine in Australia.\(^{581}\) However, the court taking into account the parties’ bargaining positions allows the use of standard form contracts to become a relevant factor. As these considerations are procedural and not substantive, they do not infringe upon freedom of contract or the supervisory role of the courts. This thereby avoids the associated problems of subsuming the Doctrine into the principle of unconscionability. Further, although these factors should be considered, these factors are not determinative.\(^{582}\)

Considering the parties’ bargaining positions does not reformulate the Doctrine to exclude commercial transactions altogether where parties are of equal bargaining power. The bargaining positions are part of the surrounding circumstances that a court will evaluate in determining whether a clause constitutes a penalty. A presumption arises that the clause is not a penalty if parties are of equal bargaining power\(^{583}\) and had obtained skilled legal advice,\(^{584}\) as determined in *Cavendish*. If the Doctrine excluded commercial transactions made by parties of equal bargaining power in receipt of skilled legal advice, an extra expense would be incurred by requiring the court to first conclude on theses matters.\(^{585}\) This is undesirable and not proposed. Considering the relative bargaining power and any receipt of legal advice provides valuable indicia, but is not determinative. Inequality of bargaining power

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\(^{579}\) *Handelsgesetzbuch* [Commercial Code] (Germany) (‘HGB’). See §248.

\(^{580}\) See *Cavendish Square Holding BV v Makdessi* [2015] UKSC 67 (4 November 2015) [165] (Lord Mance JSC).

\(^{581}\) McDougal J suggests that ‘a less liberal view should be taken to contracts of adhesion, on a ‘take it or leave it’ basis, where in reality there is no open and balanced negotiation… Despite the fact that one party was a large corporation in this case [Paciocco], the majority thought there was no inequality of bargaining power between the parties’: McDougall, above n 540, 11.

\(^{582}\) A clause may not necessarily be a penalty despite parties having unequal bargaining power, or having used a standard form contract; this is why these factors are not determinative. However, these factors are relevant and should be considered.

\(^{583}\) See, eg, Baron, above n 511, 307: ‘agreed sums in contracts between sophisticated commercial parties should be slow to attract judicial intervention’.

\(^{584}\) See, eg, *GSA Group v Seibe PLC* (1993) 30 NSWLR 573, 579 (Rogers CJ): ‘The courts should not be too eager to interfere in the commercial conduct of the parties, especially where all of the parties are wealthy, experienced, commercial entities able to attend to their own interests’ quoted in Baron, above n 511, 307.

\(^{585}\) *Cavendish Square Holding BV v Makdessi* [2015] UKSC 67 (4 November 2015) [267] (Lord Hodge JSC).
or lack of legal advice does not necessarily mean that the clause constitutes a penalty; which is why these are not determinative factors. This view has also been adopted in the United States.\textsuperscript{586} \textit{JKC Holding Co LLC v Washington Sports Ventures Inc}, 264 F 3d 459 (4th Cir, 2001) provides an example of that, where the ‘quality and quantity of lawyers working on its behalf, the sophistication of the parties and the parity of their bargaining power’ was considered.\textsuperscript{587} The court concluded that claiming the provision to be ‘illegal and imposed… in terrorem [was] unsubstantiated by the evidence and defie[d] common sense’.\textsuperscript{588} A further example is provided by the recent New Zealand decisions, which adopted the United Kingdom position in considering bargaining power.

In \textit{Torchlight Fund No1 LP (in rec) v Johnstone}\textsuperscript{589} the New Zealand High Court adopted the proposition from \textit{Cavendish} which included ‘an assessment of the relationship between the parties… and the bargaining position of the parties.’\textsuperscript{590} In this case,\textsuperscript{591} one party was ‘sophisticated and experienced in business’\textsuperscript{592} whilst the other received ‘financial and legal advice throughout’.\textsuperscript{593} The court determined that the case was at the ‘opposite end of the factual spectrum to cases with the consumer protection flavour of \textit{Andrews} and \textit{Paciocco}\textsuperscript{594} and that ‘both parties should be free to set whatever terms they wished’.\textsuperscript{595} Although this was a relevant factor, it was not determinative as the court held the clause was a penalty based on the extravagance of the stipulated sum in comparison with the greatest likely loss.\textsuperscript{596} In the appeal of \textit{Wilaci Pty Ltd v Torchlight Fund No 1 LP (in rec)},\textsuperscript{597} the New Zealand

\textsuperscript{586} See e.g, Posner J in \textit{Lake River Corp v Carborundum Co}, 769 F 2d 1284 (7th Cir, 1985) cited in Baron, above n 511, 307. See also \textit{Wallace Real Estate Inc v Groves}, 124 Wash 2d 881, 881 P 2d 1010 (1994) where the court stated that the sophistication of the parties ‘may point to the increased enforceability of liquidated damages provisions in commercial agreements’; Goetz and Scott, above n 277 cited in Baron, above n 511, 308.

\textsuperscript{587} Quoted in Baron, above n 511, 307-308.

\textsuperscript{588} Quoted in Baron, above n 511, 307-308.

\textsuperscript{589} [2015] NZHC 2559.

\textsuperscript{590} \textit{Torchlight Fund No1 LP (in rec) v Johnstone} [2015] NZHC 2559, [158].

\textsuperscript{591} Although the loan in this case was governed by New South Wales law, the same principles will likely apply to those contracts governed by New Zealand law. See discussion: Sean Gollin, Jane Standage and Mihai Pascariu, \textit{New Zealand Court of Appeal Guidance on Penalty Law} (3 May 2017) MinterEllisonRuddWatts <https://minterellison.co.nz/our-view/new-zealand-court-of-appeal-guidance-on-penalty-law>.

\textsuperscript{592} \textit{Torchlight Fund No1 LP (in rec) v Johnstone} [2015] NZHC 2559, [158].

\textsuperscript{593} Ibid.

\textsuperscript{594} Ibid [160].

\textsuperscript{595} Ibid.

\textsuperscript{596} Ibid [187].

\textsuperscript{597} [2017] NZCA 152.
Court of Appeal confirmed the importance of the parties’ bargaining positions and the commercial context of the relevant agreement in concluding that the clause did not constitute a penalty:598

Both parties were substantial commercial entities. Each was economically astute. Each was independently advised. The transaction was negotiated over a period of weeks. There was no disparity of bargaining power. Compelling reason would be needed why ordinary principles of freedom of contract should not apply to such parties.

New Zealand has therefore adopted the United Kingdom approach in considering the parties’ bargaining power with respect to penalties. This decision is persuasive. The parties’ bargaining positions are not currently considered in Australia when construing whether or not a clause constitutes a penalty but is a beneficial reform and one that Australian courts should adopt. The author would also recommend, prior to implementing any reform, that a report by the Australian Law Reform Commission into the benefits and detriments together with recommendations should also be conducted.599

598 Ibid [91].
599 See also Carter et al, ‘Contractual Penalties: Resurrecting the Equitable Jurisdiction’, above n 158, 128.
VIII CONCLUSION

The penalty doctrine has a rich history, originating in England from the 13th century and slowly developing into a principled area of law by the 20th century. Various rules were formulated, including that breach of contract was a necessary element, in order that the compensation thus available could fall foul of the Doctrine. If compensation was not available or could not be ascertained, equity would not intervene to relieve against the penalty. Despite these principles of application, the Australian High Court in *Andrews* held that the Doctrine had always applied in instances other than breach of contract. The High Court, in reality, radically transformed the Doctrine and the way it has been understood to operate by extending the scope of the Doctrine to apply in instances other than breach of contract. The decision of *Andrews* was criticised from various commentators as no reason was given for this modification.

Although the United Kingdom Supreme Court in *Cavendish* criticised the decision of *Andrews* and refused to extend the application of the Doctrine in the United Kingdom, the Australian High Court confirmed the decision of *Andrews* in the decision of *Paciocco*. The High Court thereby confirmed the extended application of the Doctrine to instances other than breach of contract. This extended application infringes upon freedom of contract and also requires the courts to review the fairness of the contractual agreement itself, rather than reviewing the remedies available upon breach. This extends the judiciary’s supervisory role into an unprecedented area. Although the extended application of the Doctrine prevents parties from avoiding the Doctrine’s application through clever drafting, this occasional anomaly is justified in order to protect the parties’ rights to contract freely.600 Further, although a variety of clauses could now fall within the scope of the Doctrine,601 the policy decision of *Paciocco* appears to demonstrate the Court’s reluctance to find that a penalty exists, even though the contract was not freely negotiated.

600 *Cavendish Square Holding BV v Makdessi* [2015] UKSC 67 (4 November 2015) [43].
As obiter in *Paciocco*, French CJ suggested that statutory reform may be the appropriate way forward, even though the High Court had already reformulated the Doctrine in *Andrews*. The efficacy of any statutory reform depends primarily on the terms of the proposed legislation. As there is no current draft bill it is difficult to come to any conclusions. Other reforms have also been suggested over the years. Reform by way of abrogating the Doctrine or subsuming it into the principle of unconscionability is rejected as the problems associated with these reforms outweigh any potential benefits. The author instead proposes taking into account the parties’ bargaining position in accordance with the United Kingdom position, which has also recently been implemented in New Zealand. This includes the court considering whether a standard form contract was used, whether the parties are commercially sophisticated and of equal bargaining power, and whether the parties were acting on skilled legal advice. Although relevant to a decision, these factors would not be determinative. As these considerations are procedural and not substantive, they do not infringe upon freedom of contract or the supervisory role of the courts. If these factors were already considered relevant within the Australian jurisdiction, *Paciocco* may have been decided differently.

Although this area of law has created uncertainty in recent years, the Doctrine has existed for centuries and should continue to exist as long as it remains useful. The Doctrine provides value to the law and to contracting parties. Whether the Doctrine will be further reformed in light of the recent uncertainty that has arisen following the decision of *Andrews*, is a matter yet to be determined.

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