

What is a 'penalty'?

07 JANUARY 2016

Paul Brecknell

PARTNER | UK

CATEGORY:

ARTICLE

When you leave your car parked in a private car park for a few minutes longer than the permitted time, you may not expect a hefty financial penalty. Nor, for that matter, would you expect it to cause seven law lords to consider in a judgement of 123 pages the principles applying to the law of penalties. However, that is what happened.

The appeals in *Cavendish Square Holdings BV v Talal El Makdessi* and *ParkingEye Limited v Beavis* were heard together. They categorise provisions designed to trigger a consequence as being of three types:

- X must do Y. If X defaults, he must pay £Z (contractual obligation to pay)
- If X does not do Y, X must pay £Z (contingent payment)
- If X does not do Y, X must forfeit a right OR there will be a 'price adjustment' ie forfeiture of the right to proceed at the original price (forfeiture of a right).

The Court recognised that such analysis looks more like an exercise in semantics than anything of more substance.

For many years, when looking at provisions of this kind, the courts have sought to discriminate between a 'genuine pre-estimate of loss' and a 'penalty'. That is why a lawyer acting for a seller may caution against taking a deposit which is disproportionately large. (There is no 'magic' in the figure of 10%, but it has become the supposedly safe 'default' figure.)

In light of these new judgements, the 'test' is now whether 'a secondary obligation which imposes a detriment on the contract-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation'. This leads to some difficulties as, for example, it is not obvious how a price adjustment clause can be viewed as a provision which is 'secondary'.

Other guidance given was that the courts would look to distinguish between a 'disguised punishment' and a provision that reflects a 'legitimate interest'. The relative sophistication of the negotiating parties would also be relevant. In the *ParkingEye* case, the high charge imposed on the motorist who overstayed his welcome was seen to protect a 'legitimate interest' because it acted as a deterrent and so influenced the conduct of the other party to the contract, the motorist.

So, in summary, to be enforceable such a provision must protect a 'legitimate interest' and must not be 'disproportionate', 'extravagant' or 'unconscionable'.

Authors

Paul Brecknell

PARTNER | LONDON

Real estate

 +44 20 7597 6037

 paul.brecknell@withersworldwide.com