PENALTY CLAUSES: A HAPHAZARD HISTORY

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The penalty rule in England is an ancient, haphazardly constructed edifice which has not weathered well.[1]

In their recent polemic, *The History Manifesto,*[2] Guldi and Armitage argue that 'to combat the short-termism of our time, we urgently need the wide-angle, long-range views only historians can provide'.[3] Doctrinal law is well suited to this sort of approach. This was acknowledged by the High Court of Australia in *Andrews v Australia and New Zealand Banking Group Ltd* where it was said that '[a]n understanding of the penalty doctrine requires more than a brief backward glance'.[4] However in looking backwards we need to be careful not to expect too much especially the further back we go. The history of the common law relating to penalties has received rather less attention from legal historians than the equitable doctrine. But it remains highly relevant especially if one takes the view that there is a narrower common law doctrine of penalties (confined to cases of breach of contract) which continues to exist alongside a broader equitable approach.[5]

Writing in the 1260s, the author of *Bracton*, advised adding a penalty when the amount of the damages is uncertain.[6] The passage was borrowed from Justinian's *Institutes*[7] but it reminds us that these types of arrangements have legitimate practical value. Covenant was the dominant contract action at the time and based on agreement. When an agreement was broken juries determined the amount of loss. To begin with an informal

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[1] *Cavendish Square Holding BV v Talal El Makdessi* [2016] AC 1172, 1192 [3] (Lords Neuberger and Sumption).

[2] Jo Guldi and David Armitage, *The History Manifesto* (Cambridge University Press, Cambridge, 2014).

[3] Ibid. 125.

[4] (2012) 247 CLR 205, 218 [14]. For an examination in more detail of the use and misuse of legal history in the context of penalties and more broadly see: W Swain, 'The Use and Misuse of History in the High Court of Australia' in S McKibben, J Patrick, M Harmes (eds.) *The Impact of Law's History The Past is Prologue* (Palgrave Macmillan, London 2022) 179-200.

[5] *Paciocco v Australian and New Zealand Banking Group Ltd* (2016) 258 CLR 525, 569, [125]–[126], (Gageler J).

[6] SE Thorne (trans.), Bracton, *On the Laws and Customs of England* (Belknap Press, Cambridge, Mass. 1968) vol 2, 285.

[7] Inst 3.15.7.

agreement was sufficient, but a deed could be used to fix the loss beforehand. In time a deed became mandatory[8] and claims for fixed sums began to be channelled into the action of debt where the use of money bonds (and conditional bonds more generally) become a key element in the story of penalties. The basis of the obligation was the bond itself. Failure to perform the condition should not be equated with breach of contract in the modern sense. Performance merely provides the condition of defeasance. There was no scope to award a lower sum than the one stated in the bond. The action of debt was based on an entitlement rather than loss. A bond was a powerful device. It was no use pleading that the debt was paid if the bond hadn't been formally cancelled even where an uncancelled bond was stolen back from the debtor.[9] Few defences were available against a bond.[10]

Some defendants tried to argue that a penalty was usurious and unenforceable without much success.[11] In *Umfraville v Lonstede*[12] Bereford CJ's language suggests he was hostile to penalties[13] but the decision is arguably less about the legitimacy of penalties, than whether the defendant had tried to perform and so met the conditions of the bond. The absence of loss was another justification for the plaintiff to accept the tendered document rather than something going to the character of the bond. Similarly, in a yearbook case of a simple loan it was alleged that the debtor was ready to pay on the appointed day and desired to tender payment now.[14] *Umfraville v Lonstede* is one piece of evidence. There are other precedents too, but Dr Turner regards these as fragmented practices which may on occasion have diluted the impact of penalties. This is a long way from a doctrine of penalties in the common law.

Relief from penalties was undoubtedly granted in Chancery from the sixteenth century in exceptional cases[15] and as a matter of course from the seventeenth century.[16] Critically Dr Turner rejects the view of earlier legal historians, including Brian Simpson, that there was a convergence between the common law and equity during

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[8] By the 1340s a deed was mandatory in covenant: D Ibbetson, 'Words and Deeds: The Action of Covenant in the Reign of Edward I' (1986) 4 Law and History Review 71.
[9] *Donne v Cornwall* (1486) YB 1 Hen VII f 14, John Baker, *Baker and Milsom Sources of English Legal History Private Law to 1750* (2nd edn, Oxford University Press, Oxford) 283-84.
[10] AWB Simpson, *A History of the Common Law of Contract* (Oxford University Press, Oxford, 1986) 98-101 discussing *non est factum* and duress.
[11] J Biancalana, 'Contractual Penalties in the King's Court 1260-1360' [2005] Cambridge Law Journal 212. A penalty was not as such a payment for use of the money see, *Scott v Hamon* (1313-14) 27 SS 27.
[12] YB 2 Edw II 132; (1308) 19 SS 58. On the facts of the case, see Biancalana ibid. 237.
[13] Bereford CJ was rather prone to this kind of pithy and slightly irritable form of expression, see W Bolland, *Chief Justice Sir William Bereford* (Cambridge University Press, Cambridge, 1924) 25-32.
[14] (1344) YB 18 Edw III 66.
[15] EG Henderson, 'Relief from Bonds in the English Chancery: Mid-Sixteenth Century' (1974) 4 American Journal of Legal History 18.
[16] DEC Yale, *Lord Nottingham's Chancery Cases* (Selden Society, London, 1961) 15–16.

the seventeenth century.[17] The commonly held view may indeed be too glib. Simpson certainly failed to provide much evidence.

There may be something in the substantive basis of contract claims at this time which provides another insight. The action of debt was based on an entitlement (the sum in the bond) within this mindset it is difficult for a court to award less than the stated amount. No jury was used in debt and there was no discretion about the amount to be awarded. In contrast by the sixteenth century assumpsit had become popular enforcing informal contracts (those without a deed). An examination of assumpsit cases in which there was a promise to pay a sum of money shows that juries were prepared to award a lower sum – perhaps reflecting the actual loss rather than a penalty.[18] The award of damages fell within the discretion of a jury and judges were perfectly clear that it was not appropriate to interfere.

Legislative reform may be critical in the development of a penalties doctrine.[19] As a result of statute, on payment of the principal, interest and costs into court, the debt came to be deemed discharged. The sum paid into court acted as a security. At the trial, the question of loss was put to a jury who made an award based on loss suffered instead of the amount stated in the bond. When the legislation applied[20] it changed the character of debt from an entitlement to one that was in substance an action for damages for loss suffered.[21] More crudely it closed the gap between debt and assumpsit.

By the sixteenth century assumpsit had become popular enforcing informal contracts. Debt claims continued to be brought but the action was less significant than it once had been. From the eighteenth-century new modes of raising credit became popular and these fell within assumpsit.[22] It was always possible that juries in assumpsit might award sums lower than the penalty. But during the early nineteenth century common law judges went

[17] For example, AWB Simpson, *A History of the Common Law of Contract* (Oxford University Press, Oxford, 1986) 121, 'the common law courts soon followed the example of Chancery'.
[18] DJ Ibbetson, 'The assessment of contractual damages at common law in the late sixteenth century' in Matthew Dyson and David Ibbetson (eds), *Law and Legal Process* (Cambridge University Press, Cambridge, 2013) 126, 140.
[19] *Administration of Justice Act* (1696) 8 & 9 Wm 3, c 11, s 8; *Perpetuation and Amendment of Acts* (1704) 4 Anne, c 16, ss 12–13.
[20] Where the action fell within the legislation its application was eventually mandatory in King's Bench as well as the Common Pleas: *Roles v Rosewell* (1794) 5 TR 538; *Hardy v Bern* (1794) 5 TR 636.
[21] For a discussion of this important point see DJ Ibbetson, *A Historical Introduction to the Law of Obligations* (Oxford University Press, Oxford, 1999) 150–51.
[22] Notably through negotiable instruments and changes in banking practice, see James Rogers, *The Early History of the Law of Bills and Notes* (Cambridge University Press, Cambridge, 1995) 112–16.

further and began to develop legal rules around penalties beyond the statutes. This situation was one of the many examples of a hardening of the boundary between law and fact that began to occur during the early nineteenth century.[23] The same approach can be seen in the way that the broader rules for the assessment of damages came to be expressed as legal rules.[24] The immediate challenge was to define an illegitimate penalty. In *Astley v Weldon*,[25] Lord Eldon observed that, having reviewed the authorities, that he was 'much embarrassed in ascertaining the principle upon which those cases were founded'.[26] Equity and the statutes were different but there were parallels. Both forms of relief rested on the basic idea that if a sum was fixed in advance by the parties, then it should reflect the actual amount of loss suffered. The similarity was commented on at the time. Chambre J noted that, 'The Legislation has now adopted this practice, and affords the same benefit to Defendants in actions at law'.[27] Fashioning a more general principle was more difficult. As Lord Eldon explained a clause was not a penalty simply because the parties had agreed to pay a 'very enormous and excessive' sum.[28] This was to confuse the penalties doctrine with an unconscionable bargain doctrine.[29]

The agreement in *Astley v Weldon* itself set out a list of conditions on both sides and stated that, 'either of them neglecting to perform that agreement should pay the other £200'. As Chambre J explained:

> In this case it is impossible to garble the covenants, and to hold that in one case the Plaintiff shall recover only for the damages sustained, and in another that he shall recover the penalty: the concluding clause applies equally to all the covenants.[30]

The way that this contract was drafted meant that the amount payable could not conceivably reflect the actual loss suffered because the same amount was paid irrespective of the breach, whether it was serious or trivial. Rather than merely looking at the wording used it was necessary to look at the substance of the agreement. Merely labelling a clause 'liquidated damages' did not prevent it from amounting to a penalty. The position set out in *Astley v Weldon* is still some way away from Lord Dunedin's speech in *Dunlop Pneumatic Tyre Co v New*

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[23] W Swain, *The Law of Contract 1670-1870* (Cambridge University Press, Cambridge, 2015) 27-29.
[24] *Robinson v Harman* (1848) 1 Ex 850; *Hadley v Baxendale* (1854) 9 Ex 341; 2 CLR 517; 23 LJEx 179; 18 Jur 358; 2 WR 302; 23 LT 69.
[25] (1801) 2 B & P 345.
[26] (1801) 2 B & P 345, 350.
[27] (1801) 2 B & P 345, 354.
[28] (1801) 2 B & P 345, 351.
[29] For a period in a situation in which a contract was very unequal Chancery might refuse to enforce the contract if the inequality was sufficient to amount to fraud, see W Swain, 'Reshaping Contractual Unfairness in Eighteenth and Nineteenth Century England' (2014) 35 Journal of Legal History 131, 132-133.
[30] *Astley v Weldon* (1801) 2 B & P 345, 354.

Garage & Motor Co Ltd,[31] which has been described as a 'a quasi-statutory code'.[32] The influence of the earlier legislation on developing a common law penalty doctrine was evident in *Davies v Penton*[33] where Abbot CJ pointed out had this been a claim in debt rather than assumpsit the plaintiff would only have recovered their actual loss. As Tindal CJ there was 'nothing illegal or unreasonable in the parties, by their mutual agreement, settling the amount of damages, uncertain in their nature, at any sum upon which they may agree',[34] but it was prohibited to include a clause that covered any breach (whether serious or trivial) by either party.

By the 1820s common law judges were treating the distinction between penalties and liquidated damages as turning on party intention.[35] The assertion in *Andrews* that, prior to the *Judicature Acts*, the common law penalty doctrine did 'not somehow supplant the equity jurisdiction'[36] was technically correct. Frederick Pollock, one of the leading writers on classical contract law, described the main application of equitable doctrine as relating to mortgage transactions.[37] In so far as there was any convergence between equity and the common law it occurred late on and in a different form. Common law judges in cases like *Astley v Weldon* were quite prepared to refer to equitable authorities. The importance of the legislation was also recognised. Lord Mansfield termed the 1696 legislation, 'a very beneficial remedy and a very just one'.[38] Statute law relating to contract was rare before the late nineteenth century but this isn't the only case where it was fundamental.[39] The emergence of a general common law doctrine of penalties was less a simple borrowing from equity in the seventeenth century (or at least not a direct borrowing) than a consequence of statutory reforms of conditional bonds combined with the growing dominance of the action of assumpsit.

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[31] [1915] AC 79.
[32] *Cavendish Square Holding BV v Talal El Makdessi* [2016] AC 1172, 1199 [22], Lords Neuberger and Sumption
[33] (1827) 6 B & C 216.
[34] *Kemble v Farren* (1829) 6 Bing 141, 148.
[35] J Chitty, *A Practical Treatise on the Law of Contracts, Not Under Seal* (2nd edn, S Sweet, London, 1834).
[36] *Andrews v Australia and New Zealand Banking Group Ltd* (2012) 247 CLR 205, 232 [61].
[37] Frederick Pollock, *Principles of Contract at Law and in Equity* (Stevens and Sons, London, 1876), 417.
[38] *Collins v Collins* (1759) 2 Burr 820, 825.
[39] But the role of legislation in this area should not be entirely forgotten. Aside from the Statute of Frauds (1677) 29 Car II c 3 claims of this sort underestimate the extent to which statute was relevant in loan transactions and pawnbroking and in the regulation of negotiable instruments.