

An Examination of Judicial Reasoning— When a Penalty Is Not a Penalty

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ABSTRACT

This Article reviews the landmark decision of the United Kingdom Supreme Court involving two cases collectively known as Cavendish-ParkingEye. The decision represents an assault on the common law’s penalty rule, which invalidates liquidated damages clauses that are determined to be penalties. The Court upheld two clauses that would have been deemed unenforceable penalties under traditional criteria and instead adopted a broader ‘commercial justification’ standard. However important the Court’s decision is as it relates to substantive law, more importantly, this Article focuses on using the decision as a case study of common law reasoning. It points out the particularity of common law reasoning’s obsession with the principle of precedent. In the end, the Court is led astray in providing clear guidance to future courts by its tortured attempt to pay homage to longstanding caselaw. This restraint prevented the Court from doing what all indications show it wanted to do—abolish the penalty rule.

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INTRODUCTION

One of the major differences between the civil and common laws of contract is related to the enforceability of liquidated damages or penalty clauses.¹ Generally speaking, such clauses are enforceable under the civil law and unenforceable under the common law.² A number of civil law countries tend to enforce penalties unless they are deemed to be “manifestly excessive.”³ U.S. and British common law have remained true to the old adage that the common law “abhors penalties.”⁴ As this phrase relates to contract law, contract damages

¹ Liquidated damages refer to a provision in a contract in which the parties agree to prevent litigation on the issue of damages in the event of breach. It is sometimes labeled as a stipulated damage clause or agreed damages provision. The law of liquidated damages refers to the peculiar body of principles developed by the common law that provide roadblocks to the parties [sic] ability to draft clauses that will be judicially enforced. Liquidated damages clauses will be used interchangeably with penalties or *penalty clauses*. Liquidated damages clause is the more generic label with penalty being a sub-set. Also, penalty is used to designate those liquidated damages clauses that are unreasonable and unenforceable.

Larry A. DiMatteo, *A Theory of Efficient Penalty: Eliminating the Law of Liquidated Damages*, 38 AM. BUS. L.J. 633, 633 n.1 (2001).

² See Ignacio Marín García, *Enforcement of Penalty Clauses in Civil and Common Law: A Puzzle to Be Solved by the Contracting Parties*, 5 EUR. J. LEGAL STUD. 95, 96 (2012).

³ See, e.g., *id.* at 103–04. For a comparison of the civil and common laws on the enforceability of penalties, see generally *id.* (discussing the need for transnational contract rules to address the conflict between civil and common law traditions). See also Larry A. DiMatteo, *Enforcement of Penalty Clauses: A Civil-Common Law Comparison*, 10 INTERNATIONALES HANDELSRECHT 193, 198–99 (2010); Ugo Mattei, *The Comparative Law and Economics of Penalty Clauses in Contracts*, 43 AM. J. COMP. L. 427, 438 (1995).

⁴ DiMatteo, *A Theory of Efficient Penalty*, *supra* note 1, at 635. Theodore F.T. Plucknett traces the role of equity in the formation of the penalty rule to a 1309 case in which the court reasoned, “[T]his is not properly a debt but a penalty; and with what equity . . . can you demand this penalty?” THEODORE F.T. PLUCKNETT, *A CONCISE HISTORY OF THE COMMON LAW* 677 (5th

are deemed to be solely compensatory in nature while penalties are inherently supracompensatory, and thus void as a matter of law.⁵ However, the rationales and the caselaw supporting the unenforceability of penalties have become a chaotic mess.⁶

Recently, some American courts have begun to reassess the strict approach to the unenforceability of liquidated damages clauses qua penalties.⁷ The United Kingdom Supreme Court, in the 2015 case consolidating *Cavendish Square Holding BV v. El Makdessi and ParkingEye Ltd. v. Beavis* (“*Cavendish-ParkingEye*”),⁸ offered the most recent challenge to the absoluteness of the penalty rule. However, the Court’s reasoning could have provided better guidance by taking the bold but necessary step of eliminating the penalty rule in total. Instead, the Court continued the common law’s tradition of incremental change to allow the common law to be characterized as overwhelmingly certain and predictable.⁹ This is unfortunate because the Court clearly sees the irrationality in making the prohibition of contractual penalties a per se rule. Moreover, such incrementalism often proves to be counterproductive because it makes the common law less certain and predictable. While the *Cavendish-ParkingEye* analysis provides a robust examination of the oversimplification of the dichotomy of illegal penalties versus enforceable liquidated damages, it fails to complete the journey that must necessarily be undertaken. In the end, it leaves more questions than answers, which a full repeal of the penalty rule would have prevented, and little guidance as to what factors should determine whether a penalty is enforceable in the future. In-

ed. 1956); see also William H. Loyd, *Penalties and Forfeitures*, 29 HARV. L. REV. 117 (1915) (tracing the evolution of forfeiture and penalty rules).

5 See Larry A. DiMatteo, *Penalties as Rational Response to Bargaining Irrationality*, 2006 MICH. ST. L. REV. 883, 885 n.7.

6 See *infra* Part I.

7 Professor Shiffrin notes that “both [American] courts and commentators are increasingly adopting a more permissive posture toward remedial clauses [penalty clauses] and signaling a greater willingness to enforce them.” Seana Valentine Shiffrin, *Remedial Clauses: The Over-privatization of Private Law*, 67 HASTINGS L.J. 407, 410 (2016); see also E. ALLAN FARNSWORTH, *CONTRACTS* § 12.18 (3d ed. 1999) (“[T]he trend favors . . . freedom of contract through the enforcement of stipulated damage provisions as long as they do not clearly disregard the principle of [just] compensation.”).

8 *Cavendish Square Holding BV v. El Makdessi (Cavendish-ParkingEye)* [2015] UKSC 67 (appeals taken from Eng.); see also Edwin Peel, *Unjustified Penalties or an Unjustified Rule Against Penalties?*, 130 LAW Q. REV. 365 (2014) (case note on the decision of the court of appeal in *El Makdessi v. Cavendish Square Holdings BV* [2013] EWCA (Civ) 1539).

9 See NEIL DUXBURY, *THE NATURE AND AUTHORITY OF PRECEDENT* (2008). Duxbury dramatically notes the problem of sudden change in the common law as “the danger of surprise precedents—unexploded land mines, ready to do damage.” *Id.* at 6 (quoting JOHN P. DAWSON, *THE ORACLES OF THE LAW* 84 (1968)).

stead, we are left with arguably the right outcome, but a muddled approach that rests on the continued recognition of the penalty rule. The case's contraction of the rule is premised on the posturing of the meaning of penalty: when is a penalty not really a penalty? That said, there is much to like about the Court's reasoning, and in whole its decision is a move in the right direction.

Part I of this Article briefly examines the history and content of the penalty rule in the United States and the United Kingdom. Part II examines in detail the *Cavendish-ParkingEye* cases as well as the preceding jurisprudence. Part III examines and summarizes the judicial reasoning employed in upholding the clauses in *Cavendish-ParkingEye*. Parts II and III combined provide a lengthy discussion, which acts as a case study in common law legal reasoning. Part IV offers a way forward given the history of the penalty rule and the rationales for greater flexibility in its application offered in *Cavendish-ParkingEye*.

This Article concludes that the outcome in the *Cavendish* case is the correct one, and that although the outcome in *ParkingEye* is likely the correct one, it needs further analysis. The enforcement of the alleged penalties in these two cases, and the loosening of the penalty rule to allow their enforcement—especially in the former case—is especially enlightening.¹⁰ Some of the reasoning the Court employed in reaching its conclusions, however, is a bit convoluted due to the Court's reluctance to jettison century-old precedent. This reluctance unfortunately leads to confusion and unnecessary complication, and thereby provides unguided discretion to future courts regarding the true status of the penalty rule in the common law. The Court seems to be tempted to overturn the penalty rule, as it pays homage to the civilian approach and reiterates the core presumption of enforceability aligned with the common law's general principle of freedom of contract.¹¹ Succumbing to this temptation would have been a simpler and better approach.

¹⁰ The author is a longtime advocate for the abolishment of the penalty rule. See DiMatteo, *supra* note 1; DiMatteo, *supra* note 5.

¹¹ The *Cavendish-ParkingEye* Court mistakenly asserts that the penalty rule is a universal concept found in the common and civil law. In fact, the civil law has historically enforced penalties. The Court interprets the modern civil law approach of granting discretion to courts to reduce penalties if they are deemed to be “manifestly excessive” as equivalent to the common law's penalty rule. *Cavendish-ParkingEye* [2015] UKSC 67 [37]. In fact, it is quite the opposite; whereas the common law presumes the unenforceability of penalties under the just compensation principle, the civil law presumes penalties to be enforceable. See Francesco Paolo Patti, *Penalty Clauses in Italian Law*, 23 EUR. REV. PRIV. L. 309, 310–11 (2015). Penalties may serve “a double function, both coercive and compensatory.” *Id.* at 314 (citing 3 LODOVICO BARASSI, LA

I. LAW OF LIQUIDATED DAMAGES

This Part reviews the penalty rule in American and British contract law. It also examines the relationship between the penalty rule and the doctrine of unconscionability in American law, as well as the relationship between the penalty rule and the UK Contract Terms in Consumer Contracts Regulation. These two distinctions are important to understand: First, The U.S. common law recognizes the doctrine of unconscionability, while English common law does not; thus, if the penalty rule were abolished in American common law, the unconscionability doctrine would be in place to police liquidated damages clauses just like it does with other contract terms. Second, while the UK does not recognize the unconscionability doctrine, it has sui generis regulations, stemming from its European Union obligations, that police consumer contracts under a principle of fairness. As noted in *Cavendish-ParkingEye*, a penalty clause may have to meet the thresholds of both the penalty rule and the fairness principle. This Part will bring these distinctions and their importance into clearer focus.

A. *The Penalty Rule in English Common Law*

The early recognition of the penalty rule was found in the courts of equity. By the beginning of the sixteenth century, defeasible bonds were used to secure performance obligations sounding in damages, which “enabled the holder of the bond to bring his action in debt, which made it unnecessary for him to prove his loss and made it possible to stipulate for substantially more than his loss.”¹² The equity courts took issue with this abuse, while the common law enforced the bonds according to their letter, equity “restrained its enforcement . . . on terms that the debtor paid damages, interest and costs.”¹³

TEORIA GENERALE DELLE OBBLIGAZIONI 480 (1948)). “A penalty clause serves to strengthen a contractual relationship and quantify damages in advance” *Id.* at 315. I would submit that the manifestly excessive standard to be akin to the American doctrine of unconscionability. Although the modern trend in Italian law is to focus on the compensatory function of penalty clauses, other functions are still recognized and supracompensatory penalties are generally enforceable, especially based on these other functions: “Notwithstanding that, in checking the amount of the penalty all other circumstances (in particular, idiosyncratic interests) should be taken into account.” *Id.* at 325. It is these other functions that the UK Supreme Court finds in *Cavendish-ParkingEye* (general schemes—the protection of goodwill and the management of a parking garage).

¹² *Cavendish-ParkingEye* [2015] UKSC 67 [4].

¹³ *Id.* (citing *Slooman v. Walter* (1783) 28 Eng. Rep. 1213, 1214; 1 Bro. CC 418, 419).

The common law rule came into being largely due to the enactment of the Administration of Justice Act of 1705,¹⁴ which “allowed the defendant in an action on the bond to pay the amount of the actual loss, together with interest and costs, into court, and rely on the payment as a defence.”¹⁵ As a result, beginning in the late eighteenth century, “equitable jurisdiction was rarely invoked, and the further development of the penalty rule was entirely the work of the courts of common law.”¹⁶

Thus, during the nineteenth and twentieth centuries, common law revisited the penalty rule from time to time: the common law courts accepted the idea of penalties as secondary obligations, but viewed them as still an expression of the parties’ intent that therefore were due strict enforcement. However, penalties were not to be enforced if the intent was to penalize a breach, not as a matter of lack of consent or rationality, but because of public policy.¹⁷ The common law, beginning in the early nineteenth century, developed the liquidated damages-penalty distinction. Thus, stipulated damages that were deemed to be reasonable estimates of foreseeable damages were enforceable, but clauses in which the stipulated amount was disproportionate to actual damages were unenforceable penalties.¹⁸

The *Cavendish-ParkingEye* Court provides an analysis of the current framework posed by the law of penalties: “In what circumstances is the rule engaged at all? And what makes a contractual provision penal?”¹⁹ Regarding the first question, the Court reviews the distinction between secondary obligations and conditional primary obligations, the relationship between penalty and forfeiture clauses, and the recognition of deposits and transfer of assets as penalties. The Court devolves to the archaic distinction, at least from an American perspective, between a secondary obligation (penalty clause) and conditional primary obligation (alternative contract).²⁰ If the payment of a sum of money is to encourage performance or to punish breach, then the pay-

¹⁴ 4 & 5 Ann. c. 3 (Eng.).

¹⁵ *Cavendish-ParkingEye* [2015] UKSC 67 [6].

¹⁶ *Id.*

¹⁷ *See id.* [7]. “The classic form of penalty clause is one which provides that upon breach of a primary obligation under the contract a secondary obligation shall arise on the part of the party in breach to pay to the other party a sum of money . . .” *Id.* [9] (quoting *Scandinavian Trading Tanker Co. A.B. v. Flota Petrolera Ecuatoriana (The “Scaptrade”)* [1983] 2 AC 694 (HL) 702 (appeal taken from Eng.)).

¹⁸ *See id.* [8] (citing *Kemble v. Farren* (1829) 130 Eng. Rep. 1234; 6 Bing. 141; *Astley v. Weldon* (1801) 126 Eng. Rep. 1318; 2 Bos. & Pul. 346).

¹⁹ *Id.* [11].

²⁰ *See Benjamin Alarie & James Dinning, Remedies and Alternative Contracts*, 44 Am.

ment is an unenforceable secondary obligation (penalty). However, if the payment is viewed as an alternative means of promise or an independent conditional primary obligation, then it is fully enforceable.²¹ Is this a substantive difference? The Court readily admits that this is a “framing” issue—depending on how the stipulated sum is presented in the contract determines whether it is a secondary or conditional primary obligation.²² The Court notes that such formal distinctions have not prevented the courts from holding a stipulated amount as a penalty whether framed as a secondary or conditional primary obligation.²³

The second question involves determining the criteria to be used in distinguishing an enforceable liquidated damages clause from an illegal penalty. Lord Halsbury in the 1905 case of *Clydebank*²⁴ warned that there should be a high threshold before a court intervenes in the enforcement of an express term in a contract.²⁵ He set that threshold as a stipulated amount that is determined to be “unconscionable and extravagant, and one which no Court ought to allow to be enforced.”²⁶ Lord Dunedin, in the 1915 case of *Dunlop Pneumatic Tyre Co. v. New Garage & Motor Co.*,²⁷ reiterates Halsbury’s unconscionable and extravagant criteria.²⁸ However, Dunedin goes a step further by formulating four scenarios that satisfy the unconscionable-extravagant standard: (1) an amount greater than any possible or foreseeable loss that would occur from breach, (2) a breach constituting the nonpayment of money, (3) a stipulated amount that would be applicable to different types of nonperformance for which some types would result in it being penal, and (4) a case in which the inability to precisely estimate damages is not sufficient to protect a clause from being penal in nature.²⁹ Each scenario supports a presumption of unenforceability. The essence of Dunedin’s criteria and the English penalty rule is dissected later in Part II’s coverage of *Cavendish-ParkingEye*.

BUS. L.J. 639 (2007) (discussing enforceability of contracts which allow a party to choose alternative performances, such as performance or payment).

²¹ *Cavendish-ParkingEye* [2015] UKSC 67 [13]–[14].

²² *Id.* [14].

²³ *See id.* [15].

²⁴ *Clydebank Eng’g & Shipbldg. Co. v. Yzquierdo y Castaneda* [1905] AC 6 (HL) (appeal taken from Scot.).

²⁵ *See id.* at 10.

²⁶ *Id.*

²⁷ [1915] AC 79 (HL) (appeal taken from Eng.).

²⁸ *See id.* at 87.

²⁹ *See id.* at 87–88.

Concerning the scope and application of the penalty rule, Lord Hodge approaches the penalty rule based upon the construction of a contract term as an unenforceable penalty clause and not an enforceable liquidated damage clause.³⁰ First, stipulated damage amounts that are held to be unconscionable and extravagant are unenforceable. This determination is based upon the circumstances at the time of contracting with the amount fixed higher than any conceivable damages that would occur from breach. Second, a stipulated amount is presumed to be unenforceable if it lacks granularity—a single sum is set for various types of breach, including both material and minor breaches. Third, where actual damages are difficult to value or prove, there is a presumption that the stipulated damages are likely intended to have been an attempt to pre-estimate damages. Hodge concludes that the dichotomy between clauses intended to deter breach by having an *in terrorem* effect and clauses aimed at pre-estimating damages is no longer useful in advancing the rationales of the penalty rule.³¹ Instead, he argues for a *new* approach that should make the first proposition the core basis of the penalty rule—clauses that set a sum exceeding any conceivable harm produced by a breach should constitute penalties.³² This line of reasoning will be more fully explored in Parts II and III.

B. The Penalty Rule in the United States: Common Law and the Uniform Commercial Code

The traditional American common law framework is that liquidated damages clauses are presumed to be penalties and are only enforceable in cases where damages are difficult to prove or calculate, and the stipulated amount is a reasonable estimate of damages at the time of contracting and proves not to be punitive in nature.³³ For a clause to be enforceable: first, actual damages must be uncertain or difficult to prove, and second, the stipulated amount must be a reasonable approximation of the actual damages.³⁴ This simple statement of the penalty rule masks a maze of confusion. First, if damages are un-

³⁰ See *Cavendish-ParkingEye* [2015] UKSC 67 [220]–[221] (appeals taken from Eng.) (Lord Hodge SCJ).

³¹ See *id.* [221].

³² See *id.*

³³ Professor Shiffrin describes the rule as follows: “[T]he traditional common law approach in the United States [] strongly presumes these clauses are unenforceable, except when actual damages would be difficult to calculate *and* when the stipulations represent reasonable and nonpunitive estimates of damages.” Shiffrin, *supra* note 7, at 409.

³⁴ See *id.* at 414–15.

certain or difficult to prove, how can there be a reasonable estimate of actual damages? The answer is that the reasonableness test is elastic when the elements of uncertainty or difficulty exist. Second, a great deal of confusion is caused by whether the reasonableness determination should be assessed at the time of contracting, at the time of breach, or both. If one has to choose, the time of contracting is the most appropriate perspective in determining the reasonableness of the stipulated sum, as it is in English law. In fact, some American courts require the estimate to be reasonable at the time of contracting *and* at the time of breach. This may be called the “second look” approach—if plausibly reasonable at the time of contracting, the clause must meet a secondary threshold of reasonableness at the time of breach.³⁵

In American common law and pursuant to the Uniform Commercial Code (“UCC”), many statements of law against penalties and requirements for enforceability seem almost silly. First, a brief explanation on terminology: because penalties are unenforceable, common law contract drafters rarely use the word penalty or penalties, but instead, use the rubric of the liquidated damages clause.³⁶ Many liquidated damages clauses are disguised penalties that courts must then weed out and invalidate. From a public policy perspective, liquidated damages or pre-agreed damages for breach should be encouraged. If the parties stipulate the damage amount in the contract, then unnecessary litigation may be avoided.³⁷ In reality, given the common law’s penalty rule, the liquidated damages clause breeds litigation as the parties dispute whether the amount set is a reasonable estimate of damages (at the time of the conclusion of the contract), or whether it represents supracompensatory damages at the time of breach.³⁸

Second, as noted above, in American law, two tests of enforceability are seemingly in direct conflict—the clause must be a reasonable estimate of damages, but the damages must also be of a type that is difficult to calculate. The parties are required to estimate damages that would be incurred by a future breach and at the same time not set

³⁵ See Trey Qualls, Note, *Take a Second-Look at Liquidated Damages in Texas (Regardless of What the Texas Supreme Court Says)*, 67 BAYLOR L. REV. 666 (2015) (reviewing the evolution of the penalty rule in Texas law). “While its decision did little to alleviate the confusing language courts have used in dealing with this issue, one thing it appears the court did resolve is that Texas follows the second-look approach to the reasonableness analysis.” *Id.* at 697 (citing FPL Energy, L.L.C. v. TXU Portfolio Mgmt. Co., 426 S.W.3d 59, 72 (Tex. 2014)).

³⁶ DiMatteo, *supra* note 3, at 200.

³⁷ *Id.* at 194.

³⁸ Cf. Qualls, *supra* note 35, at 697.

an arbitrary amount meant to “encourage” performance or punish the breaching party. The best rationale that can be offered for the difficulty of proof test is that it allows the courts to recognize that future damages and certain types of damages are hard to estimate or calculate; therefore, greater leeway should be given to enforcing liquidated damages clauses that attempt to estimate such types of damages.

Third, liquidated damages that encourage performance are automatically punitive in nature since enforceable liquidated damages may only have the purpose of compensating the nonbreaching party. Equating encouragement of performance with penalty is hard to sustain. English law seems to avoid making that mistake by recognizing that encouraging performance is not always an improper purpose for having a liquidated damages clause. The author has previously argued that not all penalties are equal, and that some are reasonable, rational, and efficient.³⁹ This conclusion was based on the idea that penalties often serve functions other than deterring a party from not performing or punishing a party in case of breach.⁴⁰ These other functions include: signaling that the party willing to pay penalties is trustworthy, allocating the risk of breach to the most efficient insurer, and allowing a party to overcome irrational biases in order to make a more rational choice in entering the contract.⁴¹ In its place would be a rule similar to that found in the civil law’s adoption of a “manifestly excessive” standard.⁴² In the American case, penalties would be enforceable unless they violate the doctrine of unconscionability. The rationales for this argument included the fact that common law damages are inherently undercompensatory, and serve functions other than deterrence or punishment. For example, under the American rule of legal costs, each party must pay its own costs.⁴³ Therefore, a damage award that does not take into account the legal costs of the winning party, along with the inconvenience, emotional distress, and loss of productivity produced by prolonged litigation, is undercompensatory.

³⁹ See DiMatteo, *supra* note 1; DiMatteo, *supra* note 5.

⁴⁰ See Larry A. DiMatteo, *Behavioural Case for Contractual Penalties Under the Common Law*, 23 EUR. REV. PRIV. L. 327 (2015) (using insights from behavioral law and economics to show that penalties serve other functions and that they are not intended to punish the non-performing party).

⁴¹ “Enforcing penalties can be justified using a number of rationales including: providing beneficial incentives, providing inexpensive insurance, producing efficient breaches, providing truly compensatory damages, . . . reflecting the experiential quality of contracting, honoring the consent of the parties, and making contract law more efficient.” DiMatteo, *supra* note 5, at 906.

⁴² See *supra* note 3 and accompanying text.

⁴³ DiMatteo, *supra* note 3, at 196.

C. *Relationship Between the Penalty Rule and Unconscionability*

Unconscionability was a principle of equity, and it still persists in decisions relating to issuing the equitable remedies of specific performance and injunctions. A number of pre-UCC cases involved the use of unconscionability to invalidate penalty clauses. In *Greer v. Tweed*,⁴⁴ the court explained the evolution of equitable unconscionability in invalidating a liquidated damages clause that stipulated a per diem amount for each day of delayed performance (delivery of manuscript to publisher):

First, the contract, if it be construed as claimed, according to its literal terms, is well described, in the language of Judge Story, as “such as no man in his senses and not under delusion would make on the one hand, and as no honest or fair man would accept, on the other.” It is so extortionate and unjust that it raises the presumption[n] of deceit and fraud in its inception. The distinction between legal and equitable remedies is abolished in our system of jurisprudence, and such relief is to be afforded, whether formerly peculiar to a court at law or to one in equity, as is appropriate to the case presented; but even courts of law take notice of the inequitable and unconscientious character of such agreements, declare them void and remit the claimant to such damages as afford him a reasonable and just compensation for any injury he has sustained.⁴⁵

In the 1924 case of *Marshall Milling Co. v. Rosenbluth*,⁴⁶ the court again applied the principle of unconscionability to a liquidated damages clause. The court held:

To permit the plaintiff under such circumstances to recover, in addition to the amount ordinarily allowed as compensatory damages, a penalty of *two cents per bushel per month for four months*, on account of such delay on the part of the plaintiff, would, in our view, be unreasonable and unconscionable.⁴⁷

Even though the principle of unconscionability was not fully accepted into the common law of contracts due to the law’s elimination of the adequacy of consideration requirement (relative equality or fairness in the exchange), this was formerly changed through its recog-

⁴⁴ 13 Abb. Pr. (n.s.) 427 (N.Y.C.P. 1872).

⁴⁵ *Id.* at 429 (citation omitted) (quoting 1 JOSEPH STORY, COMMENTARIES ON EQUITY JURISPRUDENCE, AS ADMINISTERED IN ENGLAND AND AMERICA 214 (4th ed. 1846)).

⁴⁶ 231 Ill. App. 325 (1924).

⁴⁷ *Id.* at 337.

dition in the UCC and the Restatement of Contracts.⁴⁸ However, the principle remains an unrecognized informal principle in English common law. Thus, today, a distinction can be made between the doctrine of unconscionability in American law and the labelling of something as unconscionable under English common law.

The difference between the American and British approaches is described in Official Comment 1 of section 2-302 of the UCC:

In the past such policing has been accomplished by adverse construction of language, by manipulation of the rules of offer and acceptance or by determinations that the clause is contrary to public policy or to the dominant purpose of the contract. This section is intended to allow the court to pass directly on the unconscionability of the contract or particular clause therein and to make a conclusion of law as to its unconscionability.⁴⁹

Arguably, the statement beginning “in the past” describes the current state of English common law, where there is no formal doctrine of unconscionability. The use of unconscionability as a “floating” construct is seen in the “unconscionable and extravagant” criteria used in English law’s application of the penalty rule.⁵⁰

American courts eventually recognized the distinction between procedural and substantive unconscionability, with mainstream opinions holding that for a contract or a contract term to be considered grossly unfair, evidence of both forms of unconscionability is needed.⁵¹ This dual requirement does not mean there are equal evidentiary thresholds for both types of unconscionability, but strong evidence of one and some evidence of the other is required.⁵² The author has previously argued that the key part of the equation is procedural unconscionability—an unconscionable clause may still be enforced if

⁴⁸ U.C.C. § 2-302 (AM. LAW INST. & UNIF. LAW COMM’N 2014); RESTATEMENT (SECOND) OF CONTRACTS § 208 (AM. LAW INST. 1981).

⁴⁹ U.C.C. § 2-302 cmt. 1.

⁵⁰ See *Cavendish-ParkingEye* [2015] UKSC 67 [19]–[35] (appeals taken from Eng.).

⁵¹ An early, and by far the most influential discussion of the procedural-substantive unconscionability as essential components of the unconscionability doctrine, is Arthur Allen Leff, *Unconscionability and the Code—The Emperor’s New Clause*, 115 U. PA. L. REV. 485 (1967). The classic case on unconscionability is the case of *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445 (D.C. Cir. 1965). “Unconscionability has generally been recognized to include an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party.” *Id.* at 449.

⁵² *Dean Witter Reynolds, Inc. v. Superior Court*, 259 Cal. Rptr. 789, 795 (Ct. App. 1989) (“Presumably both procedural and substantive unconscionability must be present before a contract will be held unenforceable. However, a relatively larger degree of one will compensate for a relatively smaller degree of the other.”).

it was the product of true consent.⁵³ In English law, the concept of “unconscionable and extravagant” as applied to penalty clauses focuses on the substantive part of the equation—whether a clause is grossly unfair (stipulated sum is grossly disproportionate to actual damages).⁵⁴ However, in *Cavendish-ParkingEye*, the Court highlights numerous procedural elements found in the facts. In *Cavendish*, the parties were noted as being sophisticated and represented by lawyers, and the contract was a product of lengthy negotiations.⁵⁵ In *ParkingEye*, the Court gave great weight to the signage in the parking garage, noting the size of the lettering of the eighty-five pound overstaying charge and the conspicuousness of the signs throughout the garage.⁵⁶ This indicates that the notion of consent plays an important role in determining if something is unconscionable and extravagant, and that somehow, the disproportionality of a penalty is mollified by evidence of consent factors.⁵⁷ In essence, the analysis tracks the substantive (disproportionality) and procedural (process or consent factors) elements of the American unconscionability doctrine. This is the basis for the recommendation in Part IV for eliminating the penalty rule and replacing it with a policing doctrine such as unconscionability.

D. *Relationship Between the Penalty Rule and UK Regulations on Unfair Terms in Consumer Contracts*

The common and civil law systems have converged in the area of consumer contracts through the enactment of the EU Unfair Terms in Consumer Contracts Directive,⁵⁸ subsequently adopted in UK law as the Unfair Terms in Consumer Contracts Regulation (“UTCCR”).⁵⁹ The Directive provides a list of terms that are deemed to be unfair when placed in consumer contracts including a term “requiring any consumer who fails to fulfil his obligation to pay a disproportionately high sum in compensation.”⁶⁰ This type of consumer protection through standard form regulations can be interpreted in a number of

⁵³ Larry A. DiMatteo & Bruce Louis Rich, *A Consent Theory of Unconscionability: An Empirical Study of Law in Action*, 33 FLA. ST. U. L. REV. 1067, 1110–13 (2006).

⁵⁴ See *Cavendish-ParkingEye* [2015] UKSC 67 [19]–[35] (explaining the elements necessary in making contractual provisions penal).

⁵⁵ *Id.* [75].

⁵⁶ *Id.* [90]–[91].

⁵⁷ DiMatteo & Rich, *supra* note 53, at 1110–11.

⁵⁸ Council Directive 93/13, 1993 O.J. (L 95) 29 (EC), amended by Council Directive 2011/83, 2011 O.J. (L 304) 64 (EU).

⁵⁹ The Unfair Terms in Consumer Contracts Regulations 1999, SI 1999/2083 (UK).

⁶⁰ Council Directive 93/13, at Annex ¶ 1(e).

ways. First, it adopts the civil law rule that penalties are enforceable with the Directive's "disproportionately high" language replacing the more common "manifestly excessive" language.⁶¹ Alternatively, it reverses the civil law's presumption of enforceability to a presumption of nonenforceability as an unfair term. The more reasonable interpretation is the latter one given the Directive's aims at protecting consumers. The *Cavendish-ParkingEye* Court recognizes this development,⁶² but the question remains: does the protection of the most vulnerable group—i.e., consumers—from penalties diminish the need for the penalty rule in nonconsumer contracts? The Court rejects this move by rightly recognizing that power bargaining disparities can be found in commercial contracts (small enterprise versus large company), as well as in consumer contracts, therefore requiring the need to maintain the penalty rule.⁶³ However, there is no plausible reason for applying the penalty rule to parties of relatively equal bargaining power. In the end, based on historical anachronism and deft avoidance of the cogent arguments lodged against the penalty rule, the Court elects not to abrogate the rule.⁶⁴

The *Cavendish-ParkingEye* Court, without Lord Toulson, deftly avoids the sweep of the UTCCR's fairness test and the fact that the remedial (penalty) clause is listed as one of the clauses presumed to be unenforceable. Instead, the Court relies on the consent factors noted above in each case and applies its new test of legitimate commercial justification to hold that the liquidated damages clause in the consumer contract in *ParkingEye* was neither a penalty nor unfair under the UTCCR.⁶⁵ Its commercial justification approach makes no distinction between commercial and consumer contracts. This is odd given the wealth of EU consumer protection laws, subsequently adopted into UK law, and which are premised upon the merchant-consumer distinction.

Lord Toulson, concurring in *Cavendish* but dissenting in part in *ParkingEye*, takes issue with the reasoning used by his compatriots regarding the applicability of the UTCCR. He asserts that sums that are unconscionable and extravagant should not be enforced in consumer contracts, but, that in a contract between two commercial par-

⁶¹ *Id.*

⁶² *Cavendish-ParkingEye* [2015] UKSC 67 [38] (appeals taken from Eng.) (Lords Neuberger P & Sumption SCJ).

⁶³ *Id.*

⁶⁴ *Id.* [39].

⁶⁵ *Id.* [104].

ties, the reduction of price based upon the harm to goodwill is a valuation best left to the parties.⁶⁶ For *ParkingEye*, Toulson sees the UTCCR as key by arguing that the clause in the case is subject to the fairness test.⁶⁷ He argues that the eighty-five pound charge is “simply a penalty” whose enforcement depends on whether it could be deemed fair under the Regulation.⁶⁸ The fairness test looks very much like the American doctrine of unconscionability in that it generally requires a finding of procedural and substantive unconscionability.

Previously, in *Director General of Fair Trading v. First National Bank plc*,⁶⁹ Lord Bingham had asserted that the fairness inquiry is “a composite test, covering both the making and the substance of the contract.”⁷⁰ He listed a number of procedural factors to be considered in making the unfairness determination in consumer contracts, such as whether the trader or merchant takes “advantage of the consumer’s necessity, indigence, lack of experience, unfamiliarity with the subject matter of the contract, [or] weak bargaining position.”⁷¹ Despite the conspicuousness of the signage in *ParkingEye*, the consumer had no opportunity to negotiate regarding the penalty charge. The signage was similar to a form contract and did not amount to an individually negotiated clause needed to overcome the unfairness of the charge based upon consent factors.

Lord Toulson builds the case for unfairness in *ParkingEye* by referencing the “but if represented by a lawyer” test offered by Lord Millet in the *Director General* case, in which the interpreter takes the perspective of whether the clause is reflective of what a party adversely impacted by the term would have negotiated if he possessed relative equal bargaining power “or his lawyer” might reasonably have been expected to object to it.⁷² Toulson concludes by melding the regulation with the penalty rule that a reasonable consumer with a degree of negotiating power or her lawyer would not have negotiated such a punitive charge: “[I]t follows that the £85 penalty clause created a significant imbalance within the meaning of the regulation, because it far exceeded any amount which was otherwise likely to be

⁶⁶ *Id.* [293]–[294] (Lord Toulson SCJ, dissenting in part in *ParkingEye*).

⁶⁷ *Id.* [300].

⁶⁸ *Id.* [301].

⁶⁹ [2001] UKHL 52, [2002] 1 AC 481 (appeal taken from Eng.) (Lord Bingham of Cornhill).

⁷⁰ *Id.* [17] (cited in *Cavendish-ParkingEye* [2015] UKSC 67 [304]).

⁷¹ *Id.*

⁷² See *Cavendish-ParkingEye* [2015] UKSC 67 [305] (quoting *Director General* [2001] UKHL 52 [54] (Lord Millett)).

recoverable as damages for breach of contract”⁷³ He notes, however, that the fairness test and the penalty rule are different in application; a clause that fails the fairness test is not always a penalty under the penalty rule.⁷⁴

In sum, the fairness test has a lower threshold than the penalty rule, and thereby captures a broader group of clauses than the penalty rule grabs within its sweep. This is partially an issue of the burden of proof, with the burden under the penalty rule placed on the affected party to show the exorbitance of the stipulated sum, in contrast to the fairness test, under which the supplier of the term has the burden of showing its fairness—that the term is one in which the consumer would have negotiated and agreed to on “level terms.”⁷⁵ The *Cavendish-ParkingEye* decision increases the burden on the consumer to prove that a term is a penalty. Hence, under the Toulson approach, the merchant may still be able to escape the grasp of the penalty rule, but not that of the regulation.

The Toulson opinion also re-emphasizes the need for granularity where penalty clauses treat all types of circumstances or breaches the same despite the fact that they may produce a range of actual damages.⁷⁶ Instead of merely tying a clause to a commercial interest or justification, the party claiming the penalty must show, at least in a consumer contract, that the clause was constructed to be flexible or adjustable to the actual consequences of the range of possible breaches.⁷⁷ This does not necessarily mean that the stipulated sums need be a reasonable estimate, but that the clause recognizes that not all breaches are created equal relative to the loss incurred or the interest to be protected.⁷⁸

An interesting aside is the embrace of the distinction in the now-shuttled revision of UCC Article 2.⁷⁹ Proposed revised section 2-718(1) would have eliminated the elements of difficulty of proof and the inability to obtain an adequate remedy for the enforceability of liquidated damages clauses in commercial contracts, but would have retained them for consumer contracts, thereby lowering the eviden-

⁷³ *Id.* [307].

⁷⁴ *Id.* [309].

⁷⁵ *Id.*

⁷⁶ Lord Toulson states: “The point is that the penalty clause makes no allowance for circumstances, allows no period of grace and provides no room for adjustment.” *Id.* [310].

⁷⁷ *See id.*

⁷⁸ *See id.*

⁷⁹ Proposed Amendments to U.C.C. Art. 2—Sales (AM. LAW INST., Tentative Draft 2001).

tiary threshold to enforce such clauses in commercial contracts.⁸⁰ The revision also would have eliminated the concluding sentence: “A term fixing unreasonably large liquidated damages is void as a penalty.”⁸¹ This elimination is explained in the Preliminary Comment as follows: “If the liquidated damages are reasonable in light of the anticipated harm the term should be enforced even if the actual harm is small; the penalty language of the former law could have been construed to contradict that outcome.”⁸² This assumes that the jurisprudence treats the reasonableness at the time of contracting and reasonableness at the time of breach as either/or propositions. In fact, many courts have required that the stipulated sum be reasonable at the time of contracting and at breach as compared to actual damages.

In the end, as will be discussed below, the merchant and consumer contracts distinction retains explanatory power, although the *Cavendish-ParkingEye* Court is correct in noting that similar bargaining power disparities found in consumer contracts are often replicated in commercial contracts involving large and a small companies.⁸³ However, the Court does not adequately address this distinction in applying the UTCCR, a law premised on the special nature of consumer contracts. These and other issues will become more apparent in the review of *Cavendish-ParkingEye* in Part II. Lord Hodge rightly notes, however, that the 2015 Consumer Rights Act has greatly diminished the relevance of the penalty rule in consumer contracts,⁸⁴ and focuses on the *Cavendish* appeal by posing three questions: (1) What is the scope of the penalty rule? (2) How should the rule be applied in the case at hand? and (3) Should the rule be abolished?⁸⁵

II. *CAVENDISH AND PARKINGEYE: WHEN A PENALTY IS NOT A PENALTY*

Cavendish-ParkingEye is a relatively rare example of the UK Supreme Court providing a consolidated decision on the appeals of two distinct and unrelated cases. Their only similarity was that each of the contracts at bar involved the issue of whether certain provisions were unenforceable penalty clauses. *Cavendish* involved a commercial con-

⁸⁰ See *id.* § 2-718(1).

⁸¹ *Id.*; see also U.C.C. §2-718(1) (AM. LAW INST. & UNIF. LAW COMM'N 2014) (current language).

⁸² Proposed Amendments to U.C.C. Art. 2—Sales § 2-718 preliminary cmt. 3.

⁸³ See *Cavendish-ParkingEye* [2015] UKSC 67 [38] (Lords Neuberger P & Sumption SCJ).

⁸⁴ *Id.* [260] (Lord Hodge SCJ).

⁸⁵ *Id.* [217].

tract while *ParkingEye* involved a consumer contract.⁸⁶ *Cavendish* involved a provision that called for a substantial reduction in the purchase price of a company in the event the seller breached the provisions protecting the company's goodwill value.⁸⁷ In contrast, *ParkingEye* involved consumer use of a parking garage attached to a shopping center for which the shoppers were charged a substantial penalty for staying past the allotted two hours of free parking.⁸⁸ By pairing the appeals, it is likely the Court intended to give the penalty rule a "fresh look," in the words of Karl Llewellyn.⁸⁹

The decision is written in four chapters: Lords Neuberger and Sumption's forty-nine page majority opinion; Lord Mance's forty-five page concurrence; Lord Hodge's twenty-three page concurrence; and Lord Toulson's seven page partial dissent. All of the opinions agree that in commercial contracts, restricting the reach of the penalty rule enforces the core principle of common law contracts—freedom of contract.⁹⁰ Moreover, they all agree that a broader approach to justifying penalty clauses (determined as such under current common law rules) is attainable by the fabrication of a legitimate commercial interest or justification test in commercial and consumer contracts. Lord Hodge provides the added perspective of Scottish law and agrees that the "majority" opinion is the proper approach for Scottish law as well.⁹¹ Lord Toulson concurs with the majority in *Cavendish*, but dissents in the *ParkingEye* case.⁹² But, as discussed above, his dissent is focused on the noncompliance of the *ParkingEye* clause with the UTCCR.⁹³ He agrees in principle with the majority's broader approach, through which would-be penalties may be enforceable if they serve a legitimate interest or function.⁹⁴

A. Rationale for the Penalty Rule

The basic rationale for the penalty rule is that contract damages should not be punitive in nature.⁹⁵ Thus, a contract provision that al-

⁸⁶ *Id.* [1] (Lords Neuberger P & Sumption SCJ).

⁸⁷ *Id.* [46]–[60].

⁸⁸ *Id.* [91].

⁸⁹ KARL N. LLEWELLYN, *THE COMMON LAW TRADITION: DECIDING APPEALS* 293 (1960).

⁹⁰ *See Cavendish-ParkingEye* [2015] UKSC 67 [100] (Lords Neuberger P & Sumption SCJ); *id.* [130] (Lord Mance SCJ); *id.* [255], [284] (Lord Hodge SCJ); *id.* [293] (Lord Toulson SCJ).

⁹¹ *See id.* [216] (Lord Hodge SCJ).

⁹² *Id.* [292], [295] (Lord Toulson SCJ).

⁹³ *Id.* [299].

⁹⁴ *See id.* [312].

⁹⁵ *See supra* notes 4–5 and accompanying text.

lows for supracompensatory damages is per se invalid. Alternatively stated, a stipulated sum in a liquidated damages clause with an eye to deterring breach or punishing the breaching party, and not intended to simply compensate the nonbreaching party, is an unenforceable penalty. The tension that the penalty rule evokes is that under freedom of contract the courts should strictly enforce agreed-to terms, especially those that are bargained for; this is the essence of contract as private law. This exception to freedom of contract or freedom to contract (without judicial intervention), however, has not developed without criticism. If the penalty clause is considered a one-sided damages clause, why should it be treated any differently than any other one-sided contract term?

Yet, the penalty rule as an exception to freedom of contract is settled law. The core construct that undergirds the penalty rule is that it disenfranchises the precepts of consent and freedom in favor of unenforceability based upon public policy grounds that contract damages should be purely compensatory. As such, this rationale provides that consent and negotiation of penalties hold no sway in attacking the unenforceability of such clauses, as is often the case in large commercial transactions. As the *Cavendish-ParkingEye* Court noted, the penalty rule is “mechanical in effect and involves no exercise of discretion at all.”⁹⁶

The exceptionalism of the penalty rule was noted by Lord Roskill in *Export Credits Guarantee Department v. Universal Oil Products Co.*⁹⁷ On one hand, penalties are framed as creating a disequilibrium in the contract, as illustrated in that case by one party receiving damages larger than the actual damages incurred. But at the same time, courts enforce widely imbalanced contracts.⁹⁸ This inconsistency is rationalized as supporting different tenets of contract law. First, the fairness of contracts is not to be judged by courts. But second, penalty clauses are within the remedial area of the law, where courts are entrusted with discretion in regulating remedies.

The *Cavendish-ParkingEye* Court downplayed the clarity of the rationale behind the penalty rule. It noted Lord Eldon’s statement in 1801 that he was “much embarrassed in ascertaining the principle on

⁹⁶ *Cavendish-ParkingEye* [2015] UKSC 67 [9] (quoting *Else (1982) Ltd. v. Parkland Holdings Ltd.* [1994] 1 BCLC 130 (EWCA (Civ)) at 144 (Lord Hoffman SCJ)).

⁹⁷ [1983] 1 WLR 399 (HL) 403 (Lord Roskill) (appeal taken from Eng.) (UK) (“[I]t is not and never has been for the courts to relieve a party from the consequences of what may . . . prove to be an onerous or possibly even a commercially imprudent bargain.”).

⁹⁸ *Id.*

which [the rule was] founded.”⁹⁹ Eighty years later, Sir George Jessel observed: “The ground of that doctrine I do not know.”¹⁰⁰ Finally, the Court noted Lord Diplock’s declaration that he could “make no attempt, where so many others have failed, to rationalise this common law rule.”¹⁰¹ The Court then set its task at finding some underlying principle to be identified in support of the continuance of the rule.¹⁰² If none could be found, then except for the “clearest” cases, the rule would have to be extinguished.¹⁰³

B. Power of Precedent in the Common Law

In *Cavendish-ParkingEye*, the Court begins its analysis by stating that the UK Supreme Court and its predecessor, the House of Lords, had not discussed the principles behind the penalty rule for over a century.¹⁰⁴ However, it undertakes an intense study of the caselaw pertinent to the application of the penalty rule throughout the twentieth century.¹⁰⁵ The power of precedent is shown in the Court’s constant reference to the 1915 seminal case of *Dunlop Pneumatic Tyre Co. v. New Garage & Motor Co.*¹⁰⁶ Despite the power of the preceding caselaw and the ancient history of the penalty rule in the common law, the Court prefaces its analysis by stating that the “penalty rule in England is an ancient, haphazardly constructed edifice which has not weathered well.”¹⁰⁷ This characterization of the law of liquidated damages signals that the Court was looking to make major changes in the

⁹⁹ *Cavendish-ParkingEye* [2015] UKSC 67 [3] (quoting *Astley v. Weldon* (1801) 126 Eng. Rep. 1318, 1321; 2 Bos. & Pul. 346, 350).

¹⁰⁰ *Id.* (quoting *Wallis v. Smith* (1882) 21 Ch. D 243, 256 (Jessel MR) (Eng.)).

¹⁰¹ *Id.* (quoting *Robophone Facilities Ltd. v. Blank* [1966] 1 WLR 1428, 1446 (Lord Diplock LJ) (Eng.)).

¹⁰² *See id.* [3]–[11].

¹⁰³ *Id.* [3].

¹⁰⁴ *Id.* [1].

¹⁰⁵ *See id. passim.*

¹⁰⁶ *See id. passim* (citing *Dunlop Pneumatic Tyre Co. v. New Garage & Motor Co.* [1915] AC 79 (HL) (appeal taken from Eng.)).

¹⁰⁷ *Id.* [3]; *see also* DiMatteo, *supra* note 1, at 655–75 (arguing that the quagmire of American rules relating to the enforcement of penalties has resulted in a chaotic jurisprudence); DiMatteo, *supra* note 5, at 895 (discussing findings of empirical survey in which majority of participants did not view penalties under common law as being punitive in nature); Charles J. Goetz & Robert E. Scott, *Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach*, 77 COLUM. L. REV. 554, 557 (1977) (arguing that penalty clauses compensate for damages captured by the expectation interest, but not recognized in common law damages); Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541, 616–17 (2003) (asserting that parties should be able to bargain for penalty clauses). *But see* Shiffrin, *supra* note 7, at 410–11 (arguing for a continued presumption against liquidated damages agreements).

penalty rule but within the structure of the law of precedent. It indicates that the caselaw had become chaotic and was in need of clarification. This clarification effort is framed not as a case of overturning precedent, but instead as a way of reconstructing or ordering chaotic caselaw. American law also suffers from the same confusion and obsolescence in the area of the unenforceability of penalties.¹⁰⁸ In *Cavendish-ParkingEye*, the UK Supreme Court had available six alternative options to better clarify the law. This Section analyzes the options discussed in the Court's opinion.

First, the Court could have distinguished *Cavendish-ParkingEye* on the facts from the earlier cases. It is clear early on in the decision that this would not be the chosen path, for the Court's intent was to modernize this "ancient" rule.¹⁰⁹ Furthermore, there was nothing factually unique about the two cases—valuation of goodwill and over-staying charges in a parking garage are far from novel fact patterns.

Second, the Court could have distinguished *Cavendish-ParkingEye* on policy grounds. It partially takes this path by creating a public policy in favor of protecting proprietary rights and linking those rights to commercial interests or justifications.¹¹⁰

Third, the Court could and does highlight, somewhat disingenuously, that there are two somewhat conflicting lines of cases. This is disingenuous because the Court argues that there is a parallel line of cases (alongside the mainstream penalty rule as enunciated in *Clydebank* and *Dunlop* discussed previously) that uses the notion of "secondary obligations" to fabricate an additional standard for enforcing penalty clauses even when they fail the traditional, well-recognized tests based upon the compensation-deterrence distinction, and the requirement that the stipulated amount was a reasonable estimate of actual damages.¹¹¹ But, instead of embracing the profound change in the penalty rule that it was fostering, the Court takes the path of showing that the new approach is merely an extension of this secondary line of precedent. The first line is the mainstream view of the penalty rule and its purpose—the stipulated amount had to be a reasonable estimate of actual damages intended to deter a party from—or punish it for—breaching, or to less dramatically encourage performance, which was invariably a penalty because its purpose was beyond the mere compensatory damages allowed by contract law.

¹⁰⁸ DiMatteo, *supra* note 1, at 655–75.

¹⁰⁹ See *Cavendish-ParkingEye* [2015] UKSC 67 [3].

¹¹⁰ *Cf. id.* [17].

¹¹¹ See *id.* [241]–[242].

Fourth, the Court could have distinguished *Cavendish* and *ParkingEye* based upon the merchant-consumer distinction. It could have stated that public policy dictates the enforcement of penalties in commercial contracts but not in consumer contracts. The public policy in the former type of contract would be based upon protecting legitimate commercial interests, honoring freedom of contract, and recognizing idiosyncratic valuations of commercial parties. Public policy rationales to sustain the penalty rule in consumer contracts, on the other hand, include fairness as enunciated in the UTCCR,¹¹² consumer protection, and protection of weaker parties in order to extend the rule to small- and medium-sized enterprises in their contracts with much larger companies.¹¹³ But again, the Court does not make this distinction or use its cadre of public policy rationales. This is because the Court elects to pursue a holistic approach that could be applied to all types of contracts. In sum, commercial justifications and legitimate interests exist in both types of contracts—protection of goodwill in the sale of a business in *Cavendish*¹¹⁴ and maintaining a functional parking scheme in *ParkingEye*.¹¹⁵

Fifth, building on the discussion of the secondary line of precedent stated above, the Court could have asserted that it was simply following precedent and not actually doing anything new. Alternatively, it could have framed the two lines of precedent as conflicting, and replaced the traditional dichotomy and reasonableness tests with a broader test of serving legitimate interests. The Court was unwilling to do this, however, holding that Lord Dunedin’s 1915 criteria of “unconscionable and extravagant” remains the law of the day.¹¹⁶

Finally, the Court could and should have begun with a clean slate by abolishing the penalty rule, by either recognizing a presumption of enforceability and regulating such clauses under general policing doctrines such as misrepresentation or duress, or by recognizing a general doctrine of unconscionability. The doctrine of unconscionability could easily have been constructed from its use in equity and as a floating construct in the common law, as well as using the unfairness principle, extracted from the UTCCR.

¹¹² See generally The Unfair Terms in Consumer Contracts Regulations 1999, SI 1999/2083 (UK).

¹¹³ See generally DiMatteo, *supra* note 5.

¹¹⁴ *Infra* Section II.F.3.a.

¹¹⁵ *Infra* Section II.F.3.b.

¹¹⁶ *Cavendish-ParkingEye* [2015] UKSC 67 [20] (quoting *Clydebank Eng’g & Shipbldg. Co. v. Yzquierdo y Castaneda* [1905] AC 6 (HL) 10 (appeal taken from Scot.)).

C. Compensation-Deterrence Dichotomy

The rule against penalties dates back at least to *Peachy v. Duke of Somerset*¹¹⁷ in which Lord Macclesfield held:

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: but it is quite otherwise in the present case. These penalties or forfeitures were never intended by way of compensation, for there can be none.¹¹⁸

This remained a part of equity jurisdiction into the twentieth century.¹¹⁹ The equitable rule against penalties, as noted earlier, eventually became a part of the common law.¹²⁰

It seems that the provision in *Cavendish* can be interpreted as serving compensatory motives (loss of goodwill), but it is also fair to say that *Cavendish* had a motive to deter breach. The burden was on *Cavendish* to show with some degree of certainty whether the stipulated amount served the former and not the latter purpose. The Court assumes that it is a compensatory motive and not deterrence that was the purpose behind the clause because it serves to protect a legitimate interest and is neither unconscionable nor extravagant.¹²¹ In a convoluted way, the Court in *Cavendish-ParkingEye* confirmed the view that penalties often serve “other purposes” than that of punishing the breaching party.¹²² Therefore, in some situations, what seems to be an unenforceable penalty in a micro sense may in fact be enforceable when viewed from a macro perspective. Lord Neuberger and Lord Sumption note Lord Justice Buxton’s commentary on Lord Atkinson’s analysis in *Dunlop* that a stipulated amount can, at times, be viewed from both a deterrent perspective and commercial perspective.¹²³ It is for the courts to decide that the commercial purpose of the clause is strong enough to eliminate deterrence as its purpose.

Lord Mance in his concurrence notes that the breaching party in *Cavendish* never challenged the reasonableness of the restrictive covenant not to compete.¹²⁴ Further, the imposition of the penalty sup-

¹¹⁷ (1720) 1 Strange 447.

¹¹⁸ *Id.* at 453.

¹¹⁹ See *Cavendish-ParkingEye* [2015] UKSC 67 [5], [7].

¹²⁰ See A.W.B. Simpson, *The Penal Bond with Conditional Defeasance*, 82 LAW Q. REV. 392, 418 (1966).

¹²¹ *Cavendish-ParkingEye* [2015] UKSC 67 [278] (Lord Hodge SCJ).

¹²² See *supra* note 107.

¹²³ See *Cavendish-ParkingEye* [2015] UKSC 67 [27]–[28].

¹²⁴ *Id.* [122].

ported the finding of the importance of the value of goodwill in the sale of businesses.¹²⁵ As to *ParkingEye*, Lord Mance rightly points out that the “doctrine of penalties is commonly expressed as involving a dichotomy between compensatory and deterrent clauses.”¹²⁶ But he wisely acknowledges that a sum considered supracompensatory, especially when viewed in hindsight, does not itself mean that its purpose was to deter, punish, or have an *in terrorem* effect. He quotes Lord Radcliffe:

I do not find that that description [*in terrorem*] adds anything of substance to the idea conveyed by the word “penalty” itself, and it obscures the fact that penalties may quite readily be undertaken by parties who are not in the least terrorised by the prospect of having to pay them¹²⁷

I would underscore that commercial parties are quite comfortable in taking on the risk of nonperformance by discounting or performing a probability calculation of the likelihood of having to pay a penalty. Lord Mance emphasizes that the duality of needing to make a reasonable pre-estimate of actual damages and the difficulty of proof, especially in cases involving overall schemes of doing business, leads to chaos and poor outcomes.¹²⁸ He mobilizes the difficulty of proof criteria in supporting fee clauses tied to an overall scheme or system:

The impossibility of measuring loss from any particular breach is a reason for upholding, not for striking down, such a provision. The qualification and safeguard is that the agreed sum must not have been extravagant, unconscionable or incommensurate with any possible interest in the maintenance of the system, this being for the party in breach to show.¹²⁹

Again, Lord Mance sees the difficulty of proving actual damages and clauses that do not fit neatly into the compensatory-deterrence (penal) dichotomy as a reason for enforcing clauses (instead of not enforcing them because they fail to meet the threshold of a pre-estimate of damages) when tied to reasonable commercial interests.¹³⁰

¹²⁵ *Id.*

¹²⁶ *Id.* [131].

¹²⁷ *Id.* [140] (quoting *Bridge v. Campbell Discount Co.* [1962] AC 600 (HL) 622 (Lord Radcliffe) (appeal taken from Eng.)).

¹²⁸ *Cf. id.* [132].

¹²⁹ *Id.* [143].

¹³⁰ Lord Mance explains: “In short, commercial interests may justify the imposition upon a breach of contract of a financial burden which cannot either be related directly to loss caused by the breach or justified by reference to the impossibility of assessing such loss.” *Id.* [145].

This idea that a clause may be penal but also reasonable was the basis of my “theory of efficient penalties,” which asserts that some penalties serve functions other than deterrence or punishment and are, thereby, efficient and should be enforced.¹³¹

Mance cites Justice Colman’s opinion in *Lordsvale Finance Plc v. Bank of Zambia*¹³² as support.¹³³ That case involved a clause in a loan contract where a delinquent or delayed payment triggered an increase in the interest rate for the remainder of the contract.¹³⁴ The lack of granularity (major versus minor breach; single versus numerous delinquencies; short versus long delay) opened the clause to an attack as a penalty. In contrast, the “broader view” would have viewed the single credit default leading to an increase in the interest rate as nonpenal; it was not deterring further breach but compensating for additional risk due to the default in payment. But, under that logic, should the higher rate of interest persist even after the accrued payment is brought up to date? The broader analysis would look at the case from the perspective of the lending institution’s considerations in making a loan and the rate charged, a key factor being the lender’s assessment of the borrower’s credit risk—the higher the credit risk, the higher the rate of interest to be charged on the loan. Thus, once the borrower in *Lordsvale Finance* became delinquent on the payment, its credit rating would have become blemished, thereby justifying a higher permanent rate, especially if this would have been the result at the time of the initial loan application. And yet the court only addressed the issue of the imposition of a higher rate during the period that the payment remained delinquent.¹³⁵ Would the extension of the rate increase beyond the time the borrower became current have been penal in nature? This question was left unanswered.

Instead presuming penalties to be enforceable, Lord Mance seeks to find a solution for the breakdown of the dichotomy.¹³⁶ He goes far afield to the Federal Court of Australia in *Paciocco v Australia & New Zealand Banking Group Ltd.*¹³⁷ That Court held: “The object and purpose of the doctrine of penalties is vindicated if one considers whether

¹³¹ See generally DiMatteo, *supra* note 5.

¹³² *Lordsvale Finance Plc v. Bank of Zambia* [1996] QB 752 (Colman J) (Eng.).

¹³³ *Cavendish-ParkingEye* [2015] UKSC 67 [146] (quoting *Lordsvale Finance* [1996] QB at 763–64 (Colman J)).

¹³⁴ *Lordsvale Finance* [1996] QB at 754.

¹³⁵ See *id. passim*.

¹³⁶ See *Cavendish-ParkingEye* [2015] UKSC 67 [152] (explaining that the “dichotomy between the compensatory and the penal is not exclusive”).

¹³⁷ [2015] FCAFC 50 (Austl.); see *Cavendish-ParkingEye* [2015] UKSC 67 [151], [153].

the agreed sum is commensurate with the interest protected by the bargain.”¹³⁸ However, this “new approach” creates an incommensurability problem that the dichotomy avoided. In the determination of whether a clause is a penalty, the Court should be required to determine if the stipulated amount was reasonable in relationship to the interest being protected.

In the end, the Court retains the old distinction between penalty deterrence and liquidated damages compensation.¹³⁹ The key point is that the dichotomy remains relevant but at the same time not all penalties should be voided: “[A] dichotomy between a genuine pre-estimate of damages and a penalty does not necessarily cover all the possibilities. There are clauses which may operate on breach, but which fall into neither category, and they may be commercially perfectly justifiable.”¹⁴⁰ This change from two categories of clauses to three (liquidated damages, unenforceable penalties, enforceable penalties) arises when the Court changes its interpretive approach from a formalistic focus on the contract to a broader focus on commercial context.

This change in the penalty rule, made possible by the Court’s particular breach-general scheme distinction, holds that a penalty is not to be judged by a particular breach, but upon whether it serves a greater interest.¹⁴¹ Even though the Court chooses to retain the penalty rule, it completely upends its prior meaning, which judged whether a clause was a penalty based upon the particular or actual breach and the damages caused. The reasoning given in *Cavendish-ParkingEye* relates to the “wider interests” discussed in the earlier cases, especially Lord Atkinson’s vignette that the penal nature of a liquidated damages clause “cannot be measured by the direct loss in a monetary point of view on the particular transaction constituting the breach.”¹⁴²

D. Damages Versus Harm

The ultimate question is, what makes a liquidated damages amount penal in nature? The answer was established by Lord Dune-

¹³⁸ *Paciocco* [2015] FCAFC 50 [103].

¹³⁹ See *Cavendish-ParkingEye* [2015] UKSC 67 [42] (Lords Neuberger P & Sumption SCJ) (declining to adopt the reasoning of the Australian High Court).

¹⁴⁰ *Id.* [149] (Lord Mance SCJ) (quoting *Cine Bes Filmcilik ve Yapimcilik v. United Int’l Pictures & Ors.* [2003] EWCA (Civ) 1669 [15] (Lord Mance LJ) (Eng.)).

¹⁴¹ *Cf. id.* [276] (Lord Hodge SCJ).

¹⁴² *Id.* [22]–[24] (quoting *Dunlop Pneumatic Tyre Co. v. New Garage & Motor Co.* [1915] AC 79 (HL) 92–93 (Lord Atkinson) (appeal taken from Eng.)).

din in *Dunlop* when he stated that stipulated damages would be penal if the “sum stipulated for is extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved.”¹⁴³ This then begs the question: what is considered to be extravagant or unconscionable? The answer offered in *Cavendish* is that enforceability depends on the nature of the harm.¹⁴⁴ In cases of loss to goodwill or reputation, broader discretion should be given to enforce such clauses. The problem with this approach is Lord Dunedin’s restriction to damages “that could conceivably be proved.”¹⁴⁵

The *Cavendish* case can thus be seen as justifying a broader view of the harm being protected by liquidated damages clauses or, alternatively, loosening the rule of certainty of proving damages to include those that can be “conceivably” proved. This proposition is supported by Lord Dunedin’s other tests for determining the penal nature of a clause. A clause may not be penal in cases where it is “impossib[le] [to] precisely pre-estim[at]e the true loss,” and is likely to be penal if it stipulates the same amount for “a number of events of varying gravity.”¹⁴⁶ The Court in *Cavendish* acknowledges that Dunedin’s analysis was useful in cases involving simple liquidated damages clauses in standard form contracts, but may be insufficient in determining if a stipulated amount is extravagant or unconscionable in more complex cases.¹⁴⁷

As noted above, the Court views damages as a subset of the harm caused. Lord Atkinson followed this line of reasoning that the penal nature of a liquidated damages clause, in some cases, is not to be determined by the loss caused by the particular breach in question.¹⁴⁸ In short, the penal nature of a clause may evaporate if the judicial perspective is broadened to search for a “commercial justification” for its existence.¹⁴⁹

The broader scope of harm versus provable damages is intricately related to the Court’s prime justifications for enforcing the clauses in *Cavendish-ParkingEye*. First, the creation of the above distinction between particular breaches and general schemes replaces the harm caused by the particular breach under the old reasonable pre-estimate

¹⁴³ *Dunlop Pneumatic Tyre* [1915] AC at 87 (Lord Dunedin).

¹⁴⁴ *Cf. Cavendish-ParkingEye* [2015] UKSC 67 [75], [80].

¹⁴⁵ *Dunlop Pneumatic Tyre* [1915] AC at 87 (Lord Dunedin).

¹⁴⁶ *Cavendish-ParkingEye* [2015] UKSC 67 [21] (citing *Dunlop Pneumatic Tyre* [1914] AC at 87).

¹⁴⁷ *Id.* [22].

¹⁴⁸ *Dunlop Pneumatic Tyre* [1915] AC at 92–93 (Lord Atkinson).

¹⁴⁹ *See Cavendish-ParkingEye* [2015] UKSC 67 [25].

test, in the context of an overall scheme, and the harm caused to the integrity of that scheme. Second, the tying of the particular breach and scheme to protecting legitimate commercial interests provides further justification for enforcing clauses;¹⁵⁰ where no proportional justification exists, a similar clause would be considered an unenforceable penalty.¹⁵¹ The next Section examines the Court's major innovation in upholding the penalty clause in *ParkingEye*, and to a lesser extent, in *Cavendish*.

E. Reasonable Pre-estimate of Damages Rule

The *Cavendish-ParkingEye* Court rationalizes that *Dunlop* and subsequent cases involved “simple” penalty clauses where the penal nature was quite evident.¹⁵² For such clauses, the narrow four-test approach of Lord Dunedin was sufficient—especially the first test, which requires finding a stipulated amount greater than any possible or foreseeable estimated loss to be a penalty. But, in more recent times, more complicated clauses have led courts to investigate a broader approach. This rationale is weak, however, given that in the 100 years since *Dunlop* was decided, only recently have penalty clauses become so complex as to warrant a new approach.

The key element in the line of cases culminating with *Cavendish-ParkingEye* is that a clause that may be viewed as penal in the narrow perspective of comparing the contested clause to the “actual” damages caused in the individual case (reasonable estimate standard) may not be penal if viewed from the broader frame of valuable interests intended to be protected by the clause.¹⁵³ The broader view was noted by Lord Atkinson in *Dunlop*, who expressed: “[L]ook at their trade *in globo*”;¹⁵⁴ Lord Robertson in *Clydebank*, who argued that the greater interest in preserving price maintenance among wholesale customers needed to be protected;¹⁵⁵ and Justice Colman in *Lordsvale Finance*, who stated that the predominant purpose of the clause was not to de-

¹⁵⁰ See *id.* [97]–[99] (“[D]eterrence is not penal if there is a legitimate interest in influencing the conduct of the contracting party which is not satisfied by the mere right to recover damages for breach of contract.”).

¹⁵¹ See *id.* [100] (precluding “a sum which would be out of all proportion to [the party’s] interest”).

¹⁵² See *id.* [22], [25].

¹⁵³ See *id.* [28] (discussing a broader approach to damages clauses).

¹⁵⁴ *Id.* [23] (quoting *Dunlop Pneumatic Tyre Co. v. New Garage & Motor Co.* [1915] AC 79 (HL) 91–92 (Lord Atkinson) (appeal taken from Eng.)).

¹⁵⁵ See *id.* [20], [23] (quoting then summarizing *Clydebank Eng’g & Shipbldg. Co. v. Yzquierdo y Castaneda* [1905] AC 6 (HL) 19–20 (Lord Robertson) (appeal taken from Scot.)).

ter but to reflect change in circumstances.¹⁵⁶ It is consistent with protecting commercial justification (*ParkingEye's* parking scheme)¹⁵⁷ and protecting the value of the subject matter being transferred (*Cavendish*).¹⁵⁸

The Court asserts that the distinctions derived from *Dunlop* caused “the law relating to penalties [to] become the prisoner of artificial categorisation, itself the result of unsatisfactory distinctions: between a penalty and genuine pre-estimate of loss, and between a genuine pre-estimate of loss and a deterrent.”¹⁵⁹ The Court further asserts that these distinctions have confused, rather than clarified “such a protean concept.”¹⁶⁰ For example, “[t]he fact that the clause is not a pre-estimate of loss does not therefore, at any rate without more, mean that it is penal.”¹⁶¹ This begs the question: why are penalties qua penalties not enforceable if they serve a reasonable purpose? Instead, the Court adopts the logic that if there is a reasonable purpose, then the penalty is not a penalty.¹⁶²

The determination of the reasonableness of the estimation of damages is done at the time of contracting in English law.¹⁶³ In contrast, American law allows for two bites at the apple: was it reasonable at the time of contracting, and is it reasonable compared to the actual damages caused at the time of breach?¹⁶⁴ The new approach creates a different issue for the courts—the need to place a valuation on the protected interest. However, Lords Neuberger and Sumption avoid the issue of valuation by simply linking the stipulated sum to a scheme or a reasonable commercial interest—relying on the party’s own valuation of goodwill without considering the extent to which it was

¹⁵⁶ See *id.* [26] (citing *Lordsvale Finance Plc v. Bank of Zambia* [1996] QB 752 at 763–64 (Colman J) (Eng.)).

¹⁵⁷ See *id.* [111].

¹⁵⁸ See *id.* [75].

¹⁵⁹ *Id.* [31].

¹⁶⁰ See *id.*

¹⁶¹ *Id.*

¹⁶² See *id.* [31]–[32]. This raises an issue that, based upon the commercial justification approach, if penalties are enforceable because a party has a greater interest than just collecting damages, then why would this not hold true for granting the remedy of specific performance? See also *id.* [30], [33], [39].

¹⁶³ *Id.* [9].

¹⁶⁴ See U.C.C. § 2-718(1) (AM. LAW INST. & UNIF. LAW COMM’N 2014) (“Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach”); RESTATEMENT (SECOND) OF CONTRACTS § 356(1) (AM. LAW INST. 1981) (“Damages . . . may be liquidated . . . but only at an amount that is reasonable in the light of the anticipated or actual loss caused by the breach” (emphasis added)).

harmed in *Cavendish*,¹⁶⁵ and presuming a charge was reasonable (citing trade usage) because it could be linked to a scheme the Court presumed to be necessary while avoiding the imprimatur of a take-it-or-leave-it consumer contract in *ParkingEye*.¹⁶⁶ Lord Mance also justifies enforcement on the grounds of consent: “I consider . . . that the extent to which the parties were negotiating at arm’s length on the basis of legal advice and had every opportunity to appreciate what they were agreeing must at least be a relevant factor.”¹⁶⁷ This may be the case in *Cavendish*, but it is a weak argument in the *ParkingEye* scenario.¹⁶⁸ A consent analysis should be undertaken, but not within the confines of the penalty rule, where it previously had little overt role, but in a more general policing principle, such as unconscionability or unfairness.

F. A Broadened Approach: Serving a Legitimate Commercial Interest

The idea that “penalty” clauses may serve a wider interest is recognized by the *Cavendish-ParkingEye* Court in its reference to Lady Justice Arden’s statement in *Murray v. Leisureplay plc*,¹⁶⁹ that even if the challenging party shows that the stipulated amount was not a genuine pre-estimate of actual loss, it still must be asked if there is “some other reason which justifies the discrepancy” between the amount payable under the clause and the amount payable by way of damages in common law.¹⁷⁰ This is a disguised indictment of the compensatory nature of common law damages. It makes clear that in some instances the nonrecognition of some types of damages, as well as the gatekeeping role of the certainty principle in proving damages, results in common law damages being undercompensatory.

The *Cavendish-ParkingEye* majority picks up a point made by Lord Robertson in *Clydebank*: “The question remains, had the respondents no interest to protect by [the contested] clause, or was that interest palpably incommensurate with the sums agreed on?”¹⁷¹ It is

¹⁶⁵ See *Cavendish-ParkingEye* [2015] UKSC 67 [75].

¹⁶⁶ See *id.* [98], [100], [107]–[108].

¹⁶⁷ *Id.* [152].

¹⁶⁸ *Cf. id.* [108]. Addressing the UTCCR, the Court noted that “[t]he question is not whether Mr[.] Beavis himself would in fact have agreed to the term imposing the £85 charge in a negotiation, but whether a reasonable motorist in his position would have done so.” *Id.*

¹⁶⁹ [2005] EWCA (Civ) 963 (Eng.).

¹⁷⁰ *Cavendish-ParkingEye* [2015] UKSC 67 [27] (quoting *Murray* [2005] EWCA (Civ) 963 [54] (Lady Arden LJ)).

¹⁷¹ *Id.* [133] (quoting *Clydebank Eng’g & Shipbldg. Co. v. Yzquierdo y Castaneda* [1905] AC 6 (HL) 20 (Lord Robertson) (appeal taken from Scot.)).

the first part of the question that proves crucial to the Court's reasoning in *Cavendish-ParkingEye*: had the respondents no *interest to protect* by the clause? The Court also delegated Dunedin's "four tests" to providing guidance to "simple" clauses, but not for more complex ones, which required the Court to determine what types of consequences make a given clause unconscionable.¹⁷² This line of argument is a bit weak given the eighty-five pound charge in *ParkingEye* is simple in nature. The Court is actually saying that even a simple clause may be complex if the court looks outside of the particular provision to the complexity of the scheme or interest it is supporting. In order to accomplish this assessment, the Court needs to expand its approach from a formalistic interpretation of the clause and the particular breach to a contextual interpretation of both the clause and breach in search of an external commercial justification.

Lord Hodge, in his concurrence, focuses on whether the scope of the penalty rule has been reduced to cases where the stipulated amount is greater than any conceivable loss.¹⁷³ But there is more, as in the "majority" opinion, even though the deterrence-compensation dichotomy is deemed less than useful.¹⁷⁴ Lord Hodge notes that if the purpose of a clause is not to deter nonperformance then it shall be presumed that it is not a penalty—i.e., if the dominant purpose of the clause serves a justifiable commercial reason, then it need not meet the reasonable pre-estimate test, so long as the "dominant purpose was not to deter the borrower from breach."¹⁷⁵ The Court's analysis needs to go deeper, however, and assess whether the clause was meant to deter or punish, or to rewrite the contract price. The Court in *Lordsvale Finance* asserted that even a single default changes the credit risk to such a degree as to warrant enforcement of the rate escalation provision.¹⁷⁶ The Court in *Cavendish-ParkingEye* speaks of schemes or systems,¹⁷⁷ but justifying a rate escalation due to a single default is less than satisfactory without looking at the overall credit history of the borrower; one may be good, the other bad, but both are assessed at the same increase in interest. It is more than plausible that the singularity of the rate penalty was either an attempt either to deter breach or to profit.

¹⁷² *Id.* [22].

¹⁷³ *See id.* [219]–[221], [242], [244], [246]–[248], [253]–[255].

¹⁷⁴ *See id.* [221].

¹⁷⁵ *Id.* [222] (citing *Lordsvale Finance Plc v. Bank of Zambia* [1996] QB 752 at 763–64 (Colman J) (Eng.)).

¹⁷⁶ *Lordsvale Finance* [1996] QB at 763, 767.

¹⁷⁷ *Cavendish-ParkingEye* [2015] UKSC 67 *passim* (particularly regarding *ParkingEye*).

Penalties are often found elsewhere in loan documents. Penalties are often assessed for prepayment of loans, usually on a sliding scale—five percent of a loan if repayment is made within the first year, four percent if repaid in the second year, and so forth.¹⁷⁸ Such payments are actually called penalties in the documents despite the existence of the penalty rule.¹⁷⁹ So, are these penalties actual penalties under the penalty rule? Just as was arguably the case in *Lordsvale Finance*,¹⁸⁰ an argument could be made that the penalties were not meant to deter prepayment, but were needed to compensate the bank. But, why should commercial borrowers not be able to freely prepay loans? Possibly, the purpose is to enable the bank to recoup its “investment” in the loan—the bank incurs costs in reviewing a loan application, possibly hard costs in assessing and securing the collateral, or lost volume and opportunity profits that it amortizes over the first five years of the loan. The argument is that the “penalties” do not violate the penalty rule because the provisions’ granularity is represented by the sliding scale of the penalties.

This granularity is missing in *Cavendish-ParkingEye*—actual impact on goodwill and a single lump sum amount, whether or not the user overstays five minutes or five hours. Again, the *Cavendish-ParkingEye* Court was not wrong in deciding that the relevant provisions were enforceable, but rather, its reasoning was flawed. Lords Mance and Hodge came the closest to getting it right when they noted “that there were clauses which might operate on breach and which were commercially justifiable but which did not fall into either category of a dichotomy between a genuine pre-estimate of damages and a penalty.”¹⁸¹ This is close to what I have previously described as efficient and inefficient penalties.¹⁸² Put simply, penalties that serve other reasonable functions are efficient and should be enforced.¹⁸³ Both Lord Mance and Lord Hodge draw on Justice Colman’s distinction in *Lordsvale Finance* “between a reasonable commercial condition on the one

¹⁷⁸ See Thomas C. Homburger & Matthew K. Phillips, *What You See Is Not Always What You Get: The Enforceability of Loan Prepayment Penalties*, 23 J. MARSHALL L. REV. 65, 66 (1989).

¹⁷⁹ See, e.g., *DeKalb Cty. v. United Family Life Ins. Co.*, 219 S.E.2d 707, 709 (Ga. 1975).

¹⁸⁰ See *Lordsvale Finance* [1996] QB at 766–67.

¹⁸¹ *Cavendish-ParkingEye* [2015] UKSC 67 [223] (Lord Hodge SCJ) (citing *Cine Bes Filmcilik ve Yapimcilik v. United Int’l Pictures & Ors.* [2003] EWCA (Civ) 1669 [15] (Lord Mance LJ) (Eng.)).

¹⁸² See DiMatteo, *supra* note 5, at 900–01 (quoting Aristides N. Hatzis, *Having the Cake and Eating It Too: Efficient Penalty Clauses in Common and Civil Contract Law*, 22 INT’L REV. L. & ECON. 381, 397 (2003)). See generally DiMatteo, *supra* note 1.

¹⁸³ See DiMatteo, *supra* note 1 *passim*; DiMatteo, *supra* note 5 *passim*.

hand and a punishment on the other.”¹⁸⁴ Lord Hodge discards the traditional dichotomy by holding that the “broader approach” discussed by Justice Colman and Lord Mance “escapes the straightjacket into which the law risked being placed by an over-rigorous emphasis on a dichotomy between a genuine pre-estimate of damages on the one hand and a penalty on the other.”¹⁸⁵

1. *Contextual Interpretation*

The Court notes the importance of context in determining whether a stipulated sum is penal by noting Lord Atkinson’s attention in *Dunlop* “to the critical importance to Dunlop of the protection of their brand, reputation and goodwill, and their authorised distribution network.”¹⁸⁶ Lord Atkinson notes that a facial analysis of the clause using the stipulated versus actual damages test was not sufficient and that the court needed to look at the “underlying purpose” of the clause.¹⁸⁷ A deeper analysis may reveal the purpose of the clause is to protect a “wider interest” other than direct compensation from the individual transaction.¹⁸⁸ Lord Atkinson’s reasoning is ultimately what is found at the core of *Cavendish-ParkingEye*—a liquidated damages clause should not be judged by the monetary loss directly attachable to a particular breach.¹⁸⁹ Thus, the pivotal factor in *Dunlop* was not the penal nature of the clause when applied to a specific case or breach, but the nonpenal nature of the clause as the basis of preventing substantial harm to a manufacturer’s business from being undercut by its dealers. The logic of Lord Robertson in *Clydebank*, Lord Atkinson in *Dunlop*, and Lords Neuberger and Sumption in *Cavendish-ParkingEye* is that a clause may be penal when viewed from a narrow perspective of the specific transaction, but may be nonpenal when viewed from a broader context of the wider interests of a contracting party. But, the clause is a penalty whether viewed from the narrower or broader perspective. The better logic is that many penalties serve purposes other than punishment. Penalties often serve other “functions,” and if such functions are reasonable, then a penalty should be

¹⁸⁴ *Cavendish-ParkingEye* [2015] UKSC 67 [223] (Lord Hodge SCJ) (citing *Cine Bes Filmcilik* [2003] EWCA (Civ) 1669 [15]).

¹⁸⁵ *Id.* [225].

¹⁸⁶ *Id.* [23] (citing *Dunlop Pneumatic Tyre Co. v. New Garage & Motor Co.* [1915] AC 79 (HL) 90–91 (Lord Atkinson) (appeal taken from Eng.)).

¹⁸⁷ *See id.* (citing *Dunlop Pneumatic Tyre* [1915] AC at 92–93).

¹⁸⁸ *Id.*

¹⁸⁹ *See id.*

enforced as a penalty.¹⁹⁰ In other words, the penalty rule should be vacated and replaced by a presumption of enforceability, just like any other express term in a contract.

At first, it would seem that combining the two cases—commercial and consumer contracts—would add an additional layer of confusion, but instead, as noted earlier, it helps the court deal with the issue of penalties in a holistic way. A longstanding critique of the penalty rule was that it should not be applied in commercial contracts since the parties can protect themselves from the abuse of enforcing penalties. In response, as noted earlier, the *Cavendish-ParkingEye* Court alluded to the fact that in some commercial contracts, bargaining power asymmetry (a very contextual point) may be as great as in consumer or business-to-consumer (B2C) contracts.¹⁹¹ This is surely correct, but it is also the case that such clauses are used in contracts between sophisticated commercial entities with relatively equal bargaining power.¹⁹² So, in such cases, is it reasonable to enforce such clauses as products of private autonomy? But, that would be a contextual endeavor, which would supplant the English law's preference for formalistic rule application, freedom of contract be damned! This is quite a conundrum: the general interpretive approach requires that the text of a contract is the parties' expression of their agreement, which under freedom of contract should be strictly enforced without the need to analyze contextual evidence for an alternative reasonable meaning or the actual intended meaning. Yet, courts look to context to determine the enforceability of a penalty clause.

The prime directive of private autonomy is disregarded in the area of penalty clauses.¹⁹³ The rationale given for this deviation is that private autonomy must give way to the compensatory nature of common law damages.¹⁹⁴ And yet, distinctions between consumer contracts (as evidenced by standard terms regulations) and commercial contracts, as well as contracts between large enterprises and those between a large and a small- to medium-sized enterprise have increasingly been made in statutory law and in the common law.¹⁹⁵ Since these distinctions are being made, the strength of the penalty rule var-

¹⁹⁰ See generally DiMatteo, *supra* note 1; DiMatteo, *supra* note 5.

¹⁹¹ Cf. *Cavendish-ParkingEye* [2015] UKSC 67 [38], [257], [262].

¹⁹² See, e.g., *Lordsvale Finance Plc v. Bank of Zambia* [1996] QB 752 at 754 (Colman J) (Eng.) (reviewing a contested clause in a contract between “an international syndicate of banks” and “a bank,” both sophisticated commercial entities).

¹⁹³ See *supra* notes 17–21, 96–98 and accompanying text.

¹⁹⁴ See *supra* notes 117–20 and accompanying text.

¹⁹⁵ See *supra* notes 59–64 and accompanying text.

ies when contextual evidence of the parties' characteristics is brought into the analysis. Alternatively stated, why should companies with equal bargaining power not be able to freely negotiate penalties and have those penalties enforced in the courts?

2. *Simple-Complex Clauses and Deterrent Purpose-Effect*

The *Cavendish-ParkingEye* Court draws out the alternative universe of more complex penalty clauses, not captured by the clear mandate of the penalty rule, beginning with *Lordsvale Finance Plc v. Bank of Zambia*.¹⁹⁶ The court in *Lordsvale Finance* reasoned that the clause was not meant to deter default but to compensate for the higher risk caused by a default.¹⁹⁷ But surely an interest penalty does serve to deter default. The better argument is that despite the consequence of deterring default, the primary purpose was that of compensation.

The Court then jumps two decades from *Lordsvale Finance* to *Murray v. Leisureplay plc*, in which Lady Justice Arden places the burden of proof on the challenging party to show that the clause was *in terrorem* in nature or was not a reasonable estimate.¹⁹⁸ More importantly, she concludes that there was a commercial justification for the clause.¹⁹⁹ Lord Justice Buxton, in concurrence, harkens back to Lord Atkinson's point in *Dunlop* that "an explanation of the clause in commercial rather than deterrent terms was available."²⁰⁰ The Court in *Cavendish-ParkingEye* weaves a history in which Lord Atkinson's wider interest or justification approach is on an equal footing with the well-recognized approach of Lord Dunedin's "four-tests." If this is the case, then the so-called modern need for a wider approach espoused in *Cavendish-ParkingEye* was already a firmly embedded precedent in the common law since 1915.

Additionally, the distinction between an intent to deter and deterrent effect is never satisfactorily explained. How does one distinguish a clause, which has a commercial justification with no intent to deter, but in fact, the clause produces a deterrent effect? The *Cavendish-ParkingEye* Court questions this distinction and advances the idea that where there is a commercial justification, the fact that a clause has a deterrent effect, and, more strongly, a deterrent purpose,

¹⁹⁶ [1996] QB 752 (Colman J) (Eng.).

¹⁹⁷ *Id.* at 763.

¹⁹⁸ [2005] EWCA (Civ) 963 [68]–[70] (Eng.) (Lady Arden LJ).

¹⁹⁹ *Id.* [71], [74], [76].

²⁰⁰ *Id.* [117] (Lord Buxton LJ); see *Dunlop Pneumatic Tyre Co. v. New Garage & Motor Co.* [1915] AC 79 (HL) 92 (Lord Atkinson) (appeal taken from Eng.).

does not lead to the conclusion that it is an unenforceable penalty: “The assumption that a provision cannot have a deterrent purpose if there is a commercial justification, seems to us to be questionable.”²⁰¹ Thus, again, the rationale offered is that an interest beyond the assessment of a penalty to deter or punish may justify the enforcement of such a clause.

The simple-complex clause distinction, as well as the difficulty of proof standard, allows the court to retain some of the old rule, as well as advancing the new, broader approach. Lord Hodge states:

[T]he correct test for a penalty is whether the sum or remedy stipulated as a consequence of a breach of contract is exorbitant or unconscionable when regard is had to the innocent party’s interest in the performance of the contract. Where the test is to be applied to a clause fixing the level of damages to be paid on breach, an extravagant disproportion between the stipulated sum and the highest level of damages that could possibly arise from the breach would amount to a penalty and thus be unenforceable. In other circumstances the contractual provision that applies on breach is measured against the interest of the innocent party[,] which is protected by the contract and the court asks whether the remedy is exorbitant or unconscionable.²⁰²

In the end, Lord Hodge retains the penalty rule, albeit in a modified form, giving three reasons. “First, there remain significant imbalances in negotiating power in the commercial world. . . . Second[], abolition of the rule against penalties would go against the [trend in modern law].”²⁰³ Lord Hodge references civil law, where penalties may be modified, as favoring the continuance of the penalty rule.²⁰⁴ Arguably, however, the civil law’s rule that penalties that are deemed to be manifestly excessive may be reduced, is a rejection rather than an embrace of the common law’s penalty rule, because the standard is based upon the proposition that penalties in general are enforceable. Third, “the rule against penalties [does not] prevent[] parties from reaching sensible arrangements to fix the consequences of a breach of

²⁰¹ *Cavendish-ParkingEye* [2015] UKSC 67 [28] (appeals taken from Eng.); *see also id.* (agreeing with Lord Radcliffe’s rejection of the significance of *in terrorem* effects in which he noted: “[I]t obscures the fact that penalties may quite readily be undertaken by parties who are not in the least terrorised by the prospect of having to pay them” (quoting *Bridge v. Campbell Discount Co.* [1962] AC 600 (HL) 622 (Lord Radcliffe) (appeal taken from Eng.))).

²⁰² *Id.* [255].

²⁰³ *Id.* [262]–[263].

²⁰⁴ *Id.* [265].

contract and thus avoid expensive disputes,”²⁰⁵ such as through nonpenal liquidated damages clauses.

Lord Hodge uses the *ParkingEye* scenario to apply the new two-step approach: (1) “did ParkingEye have a legitimate interest to protect by the imposition of the parking charge,” and (2) was the charge “exorbitant or unconscionable”?²⁰⁶ Thus, supracompensatory damages clauses or penalties are enforceable if the first question is answered in the affirmative and the latter question is a negative.²⁰⁷ Also, the common law principle that a claimant has the burden of proving damages with certainty is loosened or abandoned.²⁰⁸ Alternatively stated, the inability to recover speculative damages in common law for breach of contract is relaxed in the case of penalties. Lord Hodge sidesteps this issue by arguing that the fact that ParkingEye may have suffered no loss is irrelevant given the context of the case and the fact that the deterrence effect of the provision in the case “is not the test for a penalty”!²⁰⁹

Thus, the uncertainty of damages and the intent to deter (punish), or alternatively, the prohibition against collecting supracompensatory or punitive damages, is vanquished under the legitimate interest test. Despite the Court’s machinations otherwise, the charge levied in the *ParkingEye* scheme is punitive given that a party would incur such a charge for staying one second beyond the allotted time. The Court should have gone further in determining whether a fairer scheme was available that avoided the punitive nature of the charge and still advanced the commercial interest or justification of the garage manager. For example, would a scheme giving one hour of free parking with a graduated additional rate charge, which is a common scheme, or some variation thereof, serve the manager’s purpose?

This broader perspective of analyzing various schemes before determining whether the scheme in *ParkingEye* was unnecessarily punitive is supported by a number of factors. First, two hours may not be sufficient time, especially if shopping at multiple stores. Second, the Court notes the frailty of human behavior by alluding to optimism bias and other human decisionmaking biases and suggesting that ParkingEye was taking advantage of those frailties.²¹⁰ Nonetheless, the

²⁰⁵ *Id.* [266].

²⁰⁶ *Id.* [284].

²⁰⁷ *See id.* [287].

²⁰⁸ *Cf. id.* [285].

²⁰⁹ *Id.*

²¹⁰ *See id.* [195].

Court places the burden of proof on the party making the claim to prove that the sum is exorbitant and unconscionable, while the other party has the burden of showing a legitimate interest without the need to show that the sum was a reasonable estimate or essential to that interest. The party receiving the stipulated sum need not show that its primary intent was to receive just compensation rather than to deter, punish, or take advantage of human behavior.

3. *Removing the Exceptionality of the Penalty Rule*

This Section analyzes the *Cavendish-ParkingEye* Court's unnecessary discussion of the issue of extending, rather than constricting, the penalty rule. It then detaches the Court's holistic approach of the two cases based upon the commercial justification principle and analyzes each case on its own merits.

The *Cavendish-ParkingEye* Court, after critiquing the restrictiveness of the mainstream "four-test" approach of Lord Dunedin and alluding to a line of argument that has supposedly provided a more flexible approach, goes further off track by asking: "Should the penalty rule be extended?"²¹¹ The word "extended" is an unfortunate choice; possibly, "more strictly" or "less strictly applied" would have been a better choice. It then refers to a "radical departure" from English law taken by the Australian High Court in the 2012 case of *Andrews v. Australia & New Zealand Banking Group Ltd.*²¹² (it seems like something is amiss in the common law and its penalty rule!).

The court in *Andrews* disregarded the requirement that penalties are necessarily ancillary to a breach of contract.²¹³ The case involved customers paying their bank overdraft and bounced-check fees.²¹⁴ The court found no breach of contract because the bank agreement allowed customers to overdraw their accounts subject to the payment of a fee.²¹⁵ The court, nonetheless, held that the penalty rule was applicable.²¹⁶ The *Cavendish-ParkingEye* Court disagreed, and hence, there is a split in the façade of common law purity. The Court preferred the narrow scope of the rule offered by Lord Justice Hoffman: "[T]he fact that the rule 'being an inroad upon freedom of contract which is in-

²¹¹ See *id.* [40].

²¹² See *id.* [41] (citing *Andrews v. Austl. & N.Z. Banking Grp. Ltd.* (2012) 247 CLR 205 (Austl.)).

²¹³ See *Andrews* (2012) 247 CLR at 205.

²¹⁴ *Id.* at 219.

²¹⁵ *Id.* at 238.

²¹⁶ *Id.* at 227, 238.

flexible . . . ought not to be extended.’”²¹⁷ This is all nice and good, but not very relevant to the cases at hand, which involved clauses clearly captured by the penalty rule.

a. *Cavendish v. El Makdessi*

Cavendish concerned the sale of shares in a company.²¹⁸ The Court elected to move away from a formalistic approach by discussing contextual or procedural facts: “The Agreement had been the subject of extensive negotiations over six months, and both sides were represented by highly experienced and respected commercial lawyers.”²¹⁹ Clause 11, the disputed clause, concerned the “protection of goodwill,” and prohibited the seller from engaging in activities subsequent to the entering into the sales contract that involved competing with the buyer.²²⁰ The buyer brought a claim against the seller for breach of its fiduciary duties owed to the buyer as provided in that clause. As to the Company being sold, the seller paid a \$500,000 payment for harm caused by his breach.²²¹ However, the buyer argued that its final payment on the shares should be reduced to a price provided in a defaulting shareholder option clause.²²² The Court of Appeal, following the traditional “four-test approach,” held that the provisions canceling the seller’s right to the final payment and reducing the price of the shares for his breach of noncompete obligations constituted an unenforceable penalty.²²³

The *Cavendish* Court asks whether a provision that allows the loss of full price for shares tied to the breach of a noncompete clause was captured by the penalty rule. The Court answers in the affirmative: “We are, however, prepared to assume, without deciding, that a contractual provision may in some circumstances be a penalty if it disentitles the contract-breaker from receiving a sum of money which would otherwise have been due to him.”²²⁴ But, is the clause penal in nature? A reduction in the right to receive full payment may be a penalty even though the more common scenario requires payment of

²¹⁷ *Cavendish-ParkingEye* [2015] UKSC 67 [43] (quoting *Else (1982) Ltd. v. Parkland Holdings Ltd.* [1994] 1 BCLC 130 (EWCA (Civ)) at 145 (Lord Hoffman LJ)); see Edwin Peel, *The Rule Against Penalties*, 129 LAW Q. REV. 152 (2013) (discussing the decision of the High Court of Australia in *Andrews*).

²¹⁸ *Cavendish-ParkingEye* [2015] UKSC 67 [46].

²¹⁹ *Id.* [47].

²²⁰ *Id.* [51].

²²¹ *Id.* [62].

²²² *Id.* [63].

²²³ See *id.* [64].

²²⁴ *Id.* [73].

a stipulated sum. The Court hedges, however, by asserting that not all such provisions are per se penalty clauses. For example, if framed as the giving of a security it would be considered as a primary obligation; the fact that the security might be “exorbitant” or extravagant would be immaterial because primary obligations do not come within the domain of the penalty rule. The Court states:

It is not a proper function of the penalty rule to empower the courts to review the fairness of the parties’ primary obligations, such as the consideration promised for a given standard of performance. For example, the consideration due to one party may be variable according to one or more contingencies, including the contingency of his breach of the contract. There is no reason in principle why a contract should not provide for a party to earn his remuneration, or part of it, by performing his obligations. If as a result his remuneration is reduced upon his non-performance, there is no reason to regard that outcome as penal.²²⁵

So, is the reduction in price due to the seller’s breach of Clause 11 a penalty or a price reduction clause? The Court asserts that it is the latter, a primary obligation tied to a breach, thus allowing a further cause of action in damages:

Although [the clause] has no relationship, even approximate, with the measure of loss attributable to the breach, Cavendish had a legitimate interest in the observance of the restrictive covenants which extended beyond the recovery of that loss. It had an interest in measuring the price of the business to its value. The goodwill of this business was critical to its value²²⁶

Thus, the loss of the right to the final payment and the full price of the transferred shares was held not to be a penalty. It is interesting that the characteristics of the parties—“sophisticated, successful and experienced commercial people bargaining on equal terms over a long period with expert legal advice”²²⁷—are noted, given that the penalty rule is acontextual in nature. It is also interesting considering such characteristics are factors used in American cases to apply the doctrine of unconscionability.²²⁸ Two points can be made here: First, de-

²²⁵ *Id.*

²²⁶ *Id.* [75].

²²⁷ *Id.*

²²⁸ RESTATEMENT (SECOND) OF CONTRACTS § 208 cmts. a, d (AM. LAW INST. 1981). “Relevant factors include weaknesses in the contracting process like those involved in more specific rules as to contractual capacity, fraud, and other invalidating causes” *Id.* § 208 cmt. a.

spite the “unconscionable and extravagant” standard found in English law, unconscionability there goes to the size of the stipulated sum relative to actual damages, meaning it is purely substantive in nature and is not tied to any procedural factors such as the characteristics of the parties. Second, the use of contextual factors makes for an argument that the penalty rule should be abolished and penalty clauses should be policed, like other provisions in a contract, by a general principle such as unconscionability.²²⁹

The Court frames the reduction of price (Clause 5.6) as compensation for loss of value due to the diminishment of goodwill caused by the seller’s breach of Clause 11.²³⁰ But, the question remains whether the defaulting price was a reasonable estimate of damages related to the diminishment of goodwill value. Should the nature of the breach—minor versus egregious, causing more or less harm to goodwill—not have been factored into the contract and the Court’s analysis? The Court recognizes this issue, but waives as to its importance and the difficulty of making such a determination.²³¹ Instead, it indicates that the tying of the price reduction to a legitimate interest or function is sufficient.²³²

The question remains: can such a clause still act as a penalty? In American law, generally if a liquidated damages clause’s purpose is to deter or punish nonperformance, or to encourage performance, it is likely a penalty.²³³ By contrast, a clause that is deemed to provide reasonable compensation to the nonbreaching party is enforceable.²³⁴ The *Cavendish-ParkingEye* Court makes a distinction between deterrence and punishment: “To that extent it may be described as a deterrent. But that is only objectionable if it is penal, [that is] if the object was to punish.”²³⁵ In order to deter, the stipulated sum is often set at a

Factors which may contribute to a finding of unconscionability in the bargaining process include the following: belief by the stronger party that there is no reasonable probability that the weaker party will fully perform the contract; knowledge of the stronger party that the weaker party will be unable to receive substantial benefits from the contract; knowledge of the stronger party that the weaker party is unable reasonably to protect his interests by reason of . . . ignorance, illiteracy or inability to understand the language of the agreement, or similar factors.

Id. § 208 cmt. d.

²²⁹ See *infra* Part III.

²³⁰ See *Cavendish-ParkingEye* [2015] UKSC 67 [66], [75], [79]–[82].

²³¹ See *id.* [80] (“The objection is to the formula which excludes the value of goodwill from the calculation of the price.”).

²³² *Id.* [80]–[81].

²³³ See RESTATEMENT (SECOND) OF CONTRACTS § 356 cmt. a (AM. LAW INST. 1981).

²³⁴ *Id.*

²³⁵ *Cavendish-ParkingEye* [2015] UKSC 67 [82].

supracompensatory amount.²³⁶ If so, then the distinction between deterrence and punishment becomes meaningless. However, these ordinary distinctions wither away under the legitimate functions approach.²³⁷ In the end, the two clauses were held to be subject to the penalty rule but neither was deemed to be punitive in nature.²³⁸ The Court discarded a major piece of the previous caselaw—that the amount involved needed to be a reasonable estimate, as well as a factor previously recognized in the law—the need for granularity in adjusting the stipulated amount to various levels of breach.

b. ParkingEye v. Beavis

ParkingEye involved a consumer contract relating to the assessment of fees for overstaying the allotted time in a private parking garage. Curiously, the Court opens with a matter of context rather than substance by noting the conspicuousness of the signage alerting consumers to the overstaying charge.²³⁹ The parking garage was owned by a shopping center and managed by a private company.²⁴⁰ The parking “contract” allowed users to park their cars for free for up to two hours; a user who overstayed beyond two hours was required to pay a fee of eighty-five pounds.²⁴¹ The defendant overstayed his allotted time by fifty-six minutes and was asked to pay the fee.²⁴² In defense, he asserted that the fee was an unenforceable penalty and violated the UTCCR.²⁴³ The following discussion analyzes the penalty defense.

²³⁶ See Goetz & Scott, *supra* note 107, at 561–62.

²³⁷ The Court again rationalizes that the “price formula . . . had a legitimate function which had nothing to do with punishment and everything to do with achieving Cavendish’s commercial objective in acquiring the business.” *Cavendish-ParkingEye* [2015] UKSC 67 [82].

²³⁸ *Id.* [88].

²³⁹ *Id.* [90]–[91].

²⁴⁰ *Id.* [89].

²⁴¹ *Id.* [91].

²⁴² *Id.* [92].

²⁴³ *Id.* [93]; see also *id.* [108], [206] (regarding “standard terms”). Standard terms regulations refers to the United Kingdom’s UTCCR, SI 1999/2083 (UK), which applies the European Union (“EU”) Council Directive 93/13, 1993 O.J. (L 95) 29 (EC), amended by Council Directive 2011/83, 2011 O.J. (L 304) 64 (EU). The Regulations provide that any nonnegotiated term in a consumer contract is subject to a fairness test. See UTCCR ¶¶ 4–5. This is the case in *ParkingEye*. Beyond the mandate of fairness, the Regulations provide, in an Annex, a list of suspect terms that are presumed to be unfair including at paragraph 1(e): a term “requiring any consumer who fails to fulfil his obligation to pay a disproportionately high sum in compensation.” *Id.* sched. 2 ¶ 1(e). Article 3(3) of the EU Directive references the Annex by stating: “The Annex shall contain an indicative and non-exhaustive list of the terms which may be regarded as unfair.” Council Directive 93/13, art. 3(3). The Court in *Cavendish-ParkingEye* focuses on the word “may” in the referencing sentence. *Cavendish-ParkingEye* [2015] UKSC 67 [103]. Even though a fair reading of the term “may” is that such suspect terms would bear a heavy presump-

As a starting point, the fee provision lacked any degree of granularity, as the fine was a fixed sum that did not differentiate regardless of how long the consumer overstayed the allotted two-hour limit.²⁴⁴ What if a patron overstayed by a day or two? If no additional charges are provided for in the contract, then the assessment for such a long overstay could be deemed reasonable; however, it would make charging the same amount for a fifty-six minute overstay look penal in nature. In addition, industry standards called for the granting of a

tion in favor of unenforceability, the Court focuses on the idea of whether the consumer would have agreed to the term in a negotiation or whether it was a commonplace term or a “surprising term,” the latter of which is found in the German Civil Code (BGB). *See id.* [106], [165]. The answer for the Court was in the affirmative. *Id.* [107]. It relies heavily on the European Court of Justice’s decision in Case C-415/11, *Aziz v. Caixa d’Estalvis de Catalunya, Tarragona i Manresa*, 3 C.M.L.R. 5 (2013). *Cavendish-ParkingEye* [2015] UKSC 67 [105]. In sum, a term that creates a substantial imbalance in the contract can, nonetheless, be considered fair if there is “an objective reason for the term” and the consumer benefits in some way. *Id.* [106] (quoting *Aziz*, 3 C.M.L.R. 5 ¶ AG75). In *ParkingEye*, the reasoning would be that the eighty-five pound penalty makes it possible to provide the consumer with two hours of free parking—that somehow “the efficient management of the car park” based upon the manager’s “business model” justified the assessment of penalties. *See id.* [107]. The *Cavendish-ParkingEye* Court admits that there may be fairer schemes, *cf. id.* [111], but that fact does not make the scheme adopted by *ParkingEye* an unfair one: “*ParkingEye*’s business model could have had a graduated charge for overstayers based on how long they overstayed, but the fact that it did not do so does not render it unfair.” *Id.* Furthermore, the Court sidesteps the industry’s code of practice that a grace period should be provided before a penalty is assessed since any such issues could be dealt with through the appeals process provided by *ParkingEye*, which was to make a claim in court. *Id.* This seems somewhat ludicrous. The lack of a grace period, in addition to adding the additional costs of a court proceeding, makes the charge look even more penal in nature when these other elements in the overall scheme are factored into the analysis.

Amusingly, the *Cavendish-ParkingEye* Court accepts the reasoning in the *Aziz* case that a defaulting sum in excess of actual damages may be justified “if it serves to encourage compliance with the borrower’s obligations.” *Id.* [106] (citing *Aziz*, 3 C.M.L.R. 5 ¶ AG87). This is antithetical to the rationale behind the penalty rule that liquidated damages must be compensatory in nature and a reasonable pre-estimate of actual damages. The Court cites *Aziz* for the point that the stipulated sum may be supracompensatory in order to “encourage” performance as long as it is not “much higher than is necessary to achieve that aim.” *Id.* Finally, the Court implies that what is normal is fair and not a penalty, and even though given on a take-it-or-leave-it basis, that is less important than the conspicuousness of the signage or notice. *Id.* [108]–[109]. Arguably, however, large companies in the same industry often place similar terms in their standard contracts and that the “commonness” of the terms in no way makes them more or less unfair or penal in nature. And, conspicuousness as the surrogate of pseudo-consent belies the nature of the consumer’s position in asymmetrical, take-it-or-leave-it standard form contracting. Surely, these are the reasons for the Directive and Regulations to begin with, and they emphasize scrutiny for non-individually-negotiated terms—which justifies a presumption of unfairness for the listed terms. *See* Council Directive 93/13, art. 3(3); UTCCR ¶ 5.

²⁴⁴ *Cavendish-ParkingEye* [2015] UKSC 67 [110]–[111] (noting that the fee “was payable by a motorist who overstayed *even by a minute*” (emphasis added)).

reasonable “grace period” beyond the allotted time.²⁴⁵ The British Parking Association’s Code of Practice also adopted the common law penalty rule by stating that the late charge “must be based on the genuine pre-estimate of loss” and “cannot be punitive or unreasonable.”²⁴⁶

The Court, however, looks to local government regulations for public parking, by analogy, which establish penalties ranging from 50£ to 130£.²⁴⁷ But, this begs the question of whether practice or trade usage survives the penalty rule analysis. If trade usage (akin to the government authority charging scheme) accepts a punitive charge, would it not violate the penalty rule despite it being a trade usage? For example, per diem penalties are often found in construction contracts,²⁴⁸ but that commonality does not make some of them less penal in nature. Should custom or trade usage lead to what seems like a conclusive presumption of enforceability? Is it not the job of the court to determine whether a trade usage adopts a charge that violates the penalty rule? If not, the penalty rule can easily be avoided through collusion within a trade or industry to accept a penalty as trade usage.

Justice Toulson, in his dissent, rejects the analogy of penalties assessed in public parking schemes as inappropriate, noting that they were statutory and not contractual in nature and that not all the costs for the scheme were borne by the collecting of penalties (as was the case in ParkingEye’s scheme); in fact, “a large amount of the cost is raised from all users by hourly charges.”²⁴⁹ Therefore, the costs of the public parking scheme were spread among the breaching parties (stay-overs) and the nonbreaching parties (non-stay-overs).²⁵⁰

Also, liquidated damages clauses qua penalties are ubiquitous in common law contracts. Do the parties incorporating such clauses have a true expectation of enforcement, or are they examples of unenforceable clauses that are used for strategic advantage, such as to terrorize the other party into performing or anchor dispute resolution negotiations?²⁵¹ It is almost certainly the case that unenforceable clauses are

²⁴⁵ See *id.* [96] (citing BRITISH PARKING ASS’N, BPA APPROVED OPERATOR SCHEME CODE OF PRACTICE ¶ 13.4 (version 2, Mar. 2013)).

²⁴⁶ *Id.* (quoting BRITISH PARKING ASS’N, *supra* note 245, ¶¶ 19.5–19.6).

²⁴⁷ *Id.*

²⁴⁸ See Ann Morales Olazábal, *Formal and Operative Rules in Overliquidation Per Se Cases*, 41 AM. BUS. L.J. 503, 515 (2004).

²⁴⁹ *Cavendish-ParkingEye* [2015] UKSC 67 [312] (Lord Toulson SCJ).

²⁵⁰ See *id.*

²⁵¹ See Harlan M. Blake, *Employee Agreements Not to Compete*, 73 HARV. L. REV. 625, 627–28 (1960); Bailey Kuklin, *On the Knowing Inclusion of Unenforceable Contract and Lease*

used for strategic advantage given practicing lawyers' awareness of the penalty rule. The reference to the existence of charges assessed under statutory law, as well as practices recognized by the British Parking Association, allows the Court to avoid the traditional penalty analysis.²⁵² Custom, however, cannot justify the enforceability of what is actually a penalty clause unless, of course, the penalty rule is expunged from the common law.

The Court accepts the purpose of the fee as necessary to deter overstaying parking garage users without questioning its punitive nature, stating that the objectives for such deterrence were to

manage the efficient use of parking space in the interests of the retail outlets, and of the users of those outlets who wish to find spaces in which to park their cars. This was to be achieved by deterring commuters or other long-stay motorists from occupying parking spaces for long periods or engaging in other inconsiderate parking practices, thereby reducing the space available to other members of the public, in particular the customers of the retail outlets. The other purpose was to provide an income stream to enable ParkingEye to meet the costs of operating the scheme and make a profit from its services, without which those services [free parking] would not be available.²⁵³

The Court reasons that even if the eighty-five pound charge could be deemed a penalty in a given case, because the actual harm to the parking manager was far below the charge assessed against the plaintiff, it was not invalidated by the penalty rule because it was part of a parking scheme that was reasonable and was a result of business necessity.²⁵⁴ In sum, even if the parking manager suffered no actual loss, the fee was reasonable because it supported the legitimate interest of paying for management of the garage and providing users two hours of free parking.²⁵⁵ The Court states: “[D]eterrence is not penal if there is a legitimate interest in influencing the conduct of the contracting party which is not satisfied by the mere right to recover damages for breach of contract.”²⁵⁶ The Court refers to the traditional approach:

Terms, 56 U. CIN. L. REV. 845, 900, 904 (1988); Kurt E. Olafsen, Note, *Preventing the Use of Unenforceable Provisions in Residential Leases*, 64 CORNELL L. REV. 522, 523–24 (1979).

²⁵² See *Cavendish-ParkingEye* [2015] UKSC 67 [311] (noting that the British Parking Association Code of Practice is not a contractual document).

²⁵³ *Id.* [98] (Lords Neuberger P & Sumption SCJ).

²⁵⁴ See *id.* [97]–[98].

²⁵⁵ See *id.*

²⁵⁶ *Id.* [99].

the determination of a penalty is to be judged within the four corners of the contract, by evaluating party intent and taking into account an ex post determination of damages.²⁵⁷ But, in fact, the Court is doing just the opposite by looking outside of the contract to the scheme of which the user is unaware.

Furthermore, the Court rejects the first mover argument, which requires an analysis from the perspective of the garage owner rather than that of the manager.²⁵⁸ If the owner has other options, such as running the garage itself or making a deal with another company involving a different, less punitive scheme, then should the *ParkingEye* scheme not be compared to other such schemes that would be less penal in nature?

Alternatively, the Court should have questioned whether there were other schemes that *ParkingEye*, in conjunction with the garage owner, could have employed that would have furthered their interests without applying a fixed fee to all users staying just a few minutes over the allotted time. Without such a comparative analysis of schemes, the fact that the late charge supported the given parking scheme is not a sufficient rationale for avoiding the penal nature of the late charge; a more granulated parking scheme could have served the legitimate interests of the parties and avoided the penal nature of the fixed fee.²⁵⁹

A more granulated scheme would be fairer in cases where a user exceeds the allotted time by a just a few minutes—the additional payment could simply be the payment of the fee for the next hour of usage rather than a draconian penalty. It seems queer that the *ParkingEye* scheme worked to further the interests of the garage owner to the detriment of the users. The interests of shopping centers and retail owners are advanced when customers spend more rather than less time shopping, because the longer the stay, the greater the chance is that additional purchases will be made. Also, from a psychological impact perspective, it would seem that a busy shopping center is preferred over a barren one for the purpose of attracting additional shoppers. If so, did the parking garage owner agree to a scheme that worked against its own interests?

²⁵⁷ See *id.* (“[W]hether a contractual provision is a penalty turns on the construction of the contract, which cannot normally turn on facts not recorded in the contract unless they are known, or could reasonably be known, to both parties.”).

²⁵⁸ See *id.*

²⁵⁹ See *id.* [312]–[314] (Lord Toulson SCJ).

III. A SUMMARY OF JUDICIAL REASONING

This Part briefly summarizes the analysis above and what can be learned about common law legal reasoning—the good, the bad, the ugly, and the beautiful. The *Cavendish-ParkingEye* Court offered the most recent challenge to the absoluteness of the penalty rule. But, instead of overturning an archaic rule, the Court continued the common law's tradition of incremental change that allows for the characterization of the common law as supporting the certainty and predictability of law. The Court clearly sees the irrationality of the prohibition of contractual penalties as a *per se* rule.²⁶⁰ Thus, incrementalism in this case proves to be counterproductive as it makes the common law less certain and predictable. We are left with arguably the right outcome, but a muddled approach that rests on the continued recognition of the penalty rule. The new, broader approach of looking beyond the contracting parties, especially in the *ParkingEye* case, to a legitimate purpose, interest, or function provides the avenue for the contraction of the rule, but is more a case of posturing over the meaning of a penalty: when is a penalty not really a penalty?

The Court signals the need for a fundamental change to the law of liquidated damages by characterizing the current law as “haphazardly constructed.”²⁶¹ The elements of common law reasoning provided the court with numerous options—distinguishing the cases on their facts from previously decided cases; distinguishing the cases on public policy grounds, such as the merchant-consumer distinction (more readily enforceable in commercial contracts, but not enforceable in consumer contracts in order to align the rule with the public policy of consumer protection); abolishing the penalty rule by recognizing a presumption of enforceability and regulating such clauses under general policing doctrines; and “finding” a parallel line of precedents to support its broader approach. The Court chose the last course of action. Under this option, the Court could have framed the two lines of precedent as conflicting and replaced the traditional deterrence-compensation dichotomy and reasonable estimate test with a broader test of serving legitimate interests. But the Court was unwilling to do this expressly. Instead, the Court somewhat disingenuously uses this “secondary line” to fabricate an additional standard for enforcing penalty clauses even when such clauses fail the traditional, well-recognized tests.²⁶²

²⁶⁰ See *id.* [162]–[170] (Lord Mance SCJ).

²⁶¹ See *id.* [3] (Lords Neuberger P & Sumption SCJ).

²⁶² See *supra* Section II.B.

The Court's new measure of commercial justification leaves the law uncertain as to just how extenuated that justification may be used to legitimize a penalty, especially in consumer contracts. The Court makes no true distinction between justification in commercial versus consumer contracts, and ignores a comprehensive analysis of *ParkingEye* under the fairness test found in the UTCCR, which is particularly relevant given that remedial clauses are presumed to be unfair under the Regulations.²⁶³ This absence is odd given the wealth of EU consumer protection law, subsequently adopted into UK law, which is premised upon the merchant-consumer distinction. Was this disregard due to the Court's goal of making a "holistic" change in the penalty rule at the expense of public policy considerations?

The other flaw in the judicial reasoning is its failure to provide any real guidance as to how to weigh the value of the commercial justification against the penalty assessed. It rightly diminishes or removes the necessity of reasonable estimation of damages and the deterrence-compensatory distinction, but by retaining the penalty rule, the Court short-circuits the analysis of the vital question of how future courts should balance or measure the penalty against the value it is intended to protect. Instead, the Court presumes that the party's reduction of price provision (as discussed in *Cavendish*) is an appropriate value of goodwill, and in *ParkingEye*, the Court uses overstaying provisions in public parking regulations as trade usage to justify the penalty assessed.²⁶⁴ Lord Toulson rightly takes issue with this analogy as it applies to the lower threshold of unfairness established in the Consumer Contract Regulation.²⁶⁵ The Court did not perform the in-depth analysis needed to support the analogy to justify the penalty given that the contract involved a consumer contract, despite the higher evidentiary threshold for proving a penalty.

Assuming that the clarity of the facts in both cases did not require more from the Court, is it not too much to ask for it to have provided more guidance to future courts in obiter dicta given the profound change made to the penalty rule? For example, the Court alludes to the importance of granularity, but seemingly disregards the Lord Dunedin's test in favor of emphasizing the explanatory power of the commercial justification approach. Should future courts still look warily upon penalty clauses that treat all types of circumstances and breaches the same despite the fact that they may produce a range of

²⁶³ See *supra* Section I.D.

²⁶⁴ See *Cavendish-ParkingEye* [2015] UKSC 67 [82], [95], [100].

²⁶⁵ *Id.* [306]–[312] (Lord Toulson SCJ).

actual damages? Instead of merely tying a clause to a commercial interest or justification, shouldn't the party claiming the penalty have to show, at least in a consumer contract, that the clause was constructed to be flexible or adjustable to the actual consequences of the range of breaches anticipated? This does not necessarily mean that the stipulated "sum" needs to be a reasonable estimate, but rather that such granulated clauses recognize that not all breaches create the same amount of damages.

Finally, the Court uses a variety of rationales often not associated with one another. The penalty rule has always been fashioned as a substantive fairness or justice principle employed in the remedial phase of contract law. Put simply, consent to penalties should not be an avenue to enforcement. Yet, the Court (especially Lord Mance) on numerous occasions focuses on consent factors as additional support for enforcing the clauses.²⁶⁶ Even though consent is traditionally irrelevant, the genuineness of consent in the *ParkingEye* case is highly questionable given the cases and scholarship on standard form consumer contracts, as well as the existence of standard terms regulation of consumer contracts. The signage in the *ParkingEye* case was no more than a contract of adhesion—nonnegotiable terms, given on a take-it-or-leave-it basis, with no viable options for those wishing to shop at the retail center. It may be that the late parking charge is enforceable under the commercial justification approach, but the use of consent factors is an odd addition to the analysis. By bringing consent factors into play, the Court may be unintentionally aligning itself with the principle of unconscionability, which focuses on substantive unconscionability (such as a penalty) and procedural unconscionability (consent factors).²⁶⁷ Essentially, the end result of the decision is to align the English penalty rule with the American doctrine of unconscionability.

A better approach would be to expressly recognize gross substantive imbalances and consent factors already existing in the notion of unconscionability as a free-floating concept of English law, and to review penalty and other grossly one-sided clauses under a principle of unconscionability.²⁶⁸ This approach would certainly simplify the law and is discussed in greater detail in Part IV. There would be no need for the Court's differentiation between simple and complex clauses, particular breaches and general schemes, as well as the pre-estimate of

²⁶⁶ See, e.g., *id.* [152] (Lord Mance SCJ).

²⁶⁷ See *supra* Section I.C (discussing the American doctrine).

²⁶⁸ See *supra* Section II.B.

damages test and the deterrence-compensation dichotomy. Simply put, penalties qua penalties would be enforceable as a general matter.

An added benefit of abolishing the penalty rule and replacing it with a principle of unconscionability would be a requirement that the courts openly employ a contextual analysis, which the *Cavendish-ParkingEye* Court clearly does. Contextualism allows the Court to step away from the formalistic application of the rules of liquidated damages, which have been a hallmark of the formalism embedded in common law judicial reasoning.²⁶⁹ Contextualism allowed the *Cavendish-ParkingEye* Court to look outside the four corners of the contract to find a commercial justification, as well as to employ consent factors to support its decision. The use of contextualism in *Cavendish-ParkingEye* creates a feedback loop that will transform the penalty rule—a penalty is enforceable if there is commercial justification for its existence.²⁷⁰ Going forward, future courts will need to embrace a contextual analysis in order to apply the broader approach enunciated in *Cavendish-ParkingEye*. Courts will now need to search for or admit evidence of a commercial purpose or justification, as well as determine whether—despite the finding of a commercial justification for the clause—the clause is “unconscionable or extravagant.” But what will be considered an extravagant or unconscionable penalty?²⁷¹ Unfortunately, the *Cavendish-ParkingEye* Court failed to provide any guidance on how to answer this question.

The Court’s summary conclusion that a finding of commercial justification is the beginning and the end of the penalty inquiry raises an assortment of questions because the new approach upends the prior meaning of the penalty rule. The prior meaning judged whether a clause was a penalty based upon the particular or actual breach and the provable damages caused. In making that determination, how far beyond provable common law damages can courts go in defining the harm caused by a breach? Does the *Cavendish-ParkingEye* approach allow for a presumption of enforceability, or is it simply loosening the rule of certainty in proving damages to include harm that is conceiva-

²⁶⁹ See DiMatteo, *supra* note 40, at 332–33.

²⁷⁰ See *Cavendish-ParkingEye* [2015] UKSC 67 [152] (Lord Mance SCJ) (“There may be interests beyond the compensatory which justify the imposition on a party in breach of an additional financial burden. . . . What is necessary in each case is to consider, first, whether any (and if so what) legitimate business interest is served and protected by the clause . . .”).

²⁷¹ See *id.* (“In judging what is extravagant, exorbitant or unconscionable, I consider . . . that the extent to which the parties were negotiating at arm’s length on the basis of legal advice and had every opportunity to appreciate what they were agreeing must at least be a relevant factor.”).

ble, but not provable? Is the Court really saying that the law of liquidated damages can be divided into three categories of clauses: enforceable pre-estimates of damages, enforceable penalties, and unenforceable penalties?

Other questions are left unanswered. Why should companies with equal bargaining power not be able to freely negotiate penalties and have those penalties enforced in the courts, even when they are considered to be extravagant? Can the legitimacy of the commercial justification be questioned based upon the distinction between clauses that have commercial justifications with no intent to deter but that in fact produce a deterrent effect? Is the Court essentially placing the burden of proof on the party making the claim to prove that the sum is exorbitant and unconscionable, in contrast to the other party's burden of showing a legitimate interest without the need to show that the sum was a reasonable estimate or causally essential to that interest? The Court looks to local government regulations as trade usage, but this begs the question of whether the practice or trade usage survives the penalty rule analysis. If trade usage accepts a punitive-like charge, would it not violate the penalty rule despite it being a trade usage? Is the factor of granularity emaciated under the new approach? If the garage owner in *ParkingEye* had other options that involved less punitive schemes, then should the *ParkingEye* scheme not be compared to other such schemes in determining its penal nature?

Although the reasoning of the Court is stunted by its unwillingness to completely void precedent and reach the more rational conclusion of abolishing the penalty rule, the enforcement of the alleged penalties in these two cases and the loosening of the penalty rule to allow their enforcement, especially the former, is a move in the right direction, but it seems to be delaying the inevitable.

IV. THE WAY FORWARD

The revamping of the penalty rule in *Cavendish-ParkingEye* is a partial reconstruction. On one end, the Court adopts a broader approach but still retains the rationale of pre-estimation of damages to be applied in “some” cases, finding: “The focus on the disproportion between the specified sum and damage capable of pre-estimation makes sense in the context of a damages clause but is an artificial concept if applied to clauses which have another commercial justification.”²⁷² This seems to be a Janus-type of approach—damages provi-

²⁷² *Id.* [247] (Lord Hodge SCJ).

sions need to be a pre-estimate of likely damages, unless there is a commercial justification.

The Court does not adequately address whether clauses that serve a commercial interest can be punitive in nature. If the clause has a commercial justification is it inherently nonpunitive? That would be a difficult proposition to support given cases where a party uses a commercial justification to fabricate an extravagant damages provision. The Court is unclear on this point because it sought solace in procedural unconscionability (consent) and difficulty of proof factors to justify enforcement, rather than in a determination of whether the clauses were punitive or not. In the end, we are left with the Court's self-expressed loosening of the standards by which the penalty rule is to be applied, but no real guidance as to what the loosening means for future cases. Arguably, the loosening comes close to abrogating the rule and that abrogation would end most of the existing confusion and provide proper guidance for future cases.

In general, the Court signals a sea shift in the penalty rule, but at the same time bases its decision on conceptual, mostly semantic differences, such as that the "parties are allowed a generous margin,"²⁷³ and whether there was a "breach of an obligation to perform some act" or a "wilful breach of a prohibition."²⁷⁴ Also, the Court hones in on procedural unconscionability factors throughout its opinion.²⁷⁵ The decision leads to the plausible question of whether the penalty rule is a substantive fairness doctrine or a consent doctrine. The Court provides a hint in asserting that the penalty rule should not be applied strictly because penalty clauses are products of consent.²⁷⁶

The flaw of the *Cavendish-ParkingEye* decision is that the Court did not go far enough. The dichotomy that should have been discarded is the distinction between liquidated damages and penalty clauses. The ending of this overall categorization of clauses would lead to the elimination of the penalty rule,²⁷⁷ which in the end is what I

²⁷³ *Id.* [248] (quoting *Murray v. Leisureplay plc* [2005] EWCA (Civ) 963 [43] (Lady Arden LJ) (Eng.)).

²⁷⁴ *Id.* [249] (referencing Scottish law).

²⁷⁵ *See id.* [274] (noting the parties "had access to expert legal advice and negotiated the contract over several months"); *see also id.* [189] (Lord Mance SCJ) (noting the importance placed upon the signage in *ParkingEye*).

²⁷⁶ *See id.* [248] ("[T]he 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." (quoting *Philips H.K. Ltd. v. A-G of H.K.* [1993] UKPC 3a at 11 (appeal taken from H.K.)).

²⁷⁷ In fact, the *Cavendish-ParkingEye* Court expands the penalty rule into the area of non-refundable deposits, which were not traditionally considered within the penalty rule in English and Scottish law. *See id.* [237]–[238].

believe *Cavendish-ParkingEye* will be viewed as doing in hindsight. Lord Hodge was correct in rejecting the longstanding “genuine pre-estimate of loss” test in favor of the broader commercial justification approach.²⁷⁸ In place of the penalty rule, a general policing doctrine should regulate penalty clauses, including deposits and stipulated sums not related to breach. In the United States, the doctrine of unconscionability is enshrined in the law²⁷⁹ and would effectively serve that purpose. While not formerly recognized as a standalone doctrine in English common law, as with the penalty rule, the unconscionability construct is used in the application of the formal rules of contract and in the interpretation of contracts.²⁸⁰ The recognition of unconscionability as an independent doctrine of the common law can be constructed from its scattered existence within English common law. The Court comes close to such recognition by referencing the manifestly excessive standard in the civil law in Lord Hodge’s statement that “at its heart was the idea of exorbitance or gross excessiveness.”²⁸¹

The *Cavendish-ParkingEye* Court posed the following question: Should the penalty rule be abrogated? The Court acknowledged the rationality of the argument, but passed on making such a decision by relying on the straw man of the incremental change of common law development:

We rather doubt that the courts would have invented the rule today if their predecessors had not done so three centuries ago. But this is not the way in which English law develops, and we do not consider that judicial abolition would be a proper course for this court to take.²⁸²

The Court relied on the sterile argument that the longevity of the rule is reason alone for its preservation. It also disingenuously appealed to the universality of the rule in referencing provisions of civil law, the Council of Europe,²⁸³ and international law instruments.²⁸⁴ But the common recognition of liquidated or penalty clauses in these

²⁷⁸ See *id.* [236].

²⁷⁹ See U.C.C. § 2-302 (AM. LAW INST. & UNIF. LAW COMM’N 2014); RESTATEMENT (SECOND) OF CONTRACTS § 208 (AM. LAW INST. 1981).

²⁸⁰ Cf. A.H. Angelo & E.P. Ellinger, *Unconscionable Contracts: A Comparative Study of the Approaches in England, France, Germany, and the United States*, 14 LOY. L.A. INT’L & COMP. L. REV. 455, 470 (1992).

²⁸¹ *Cavendish-ParkingEye* [2015] UKSC 67 [244].

²⁸² *Id.* [36] (Lords Neuberger P & Sumption SCJ).

²⁸³ *Id.* [37] (quoting COMM. OF MINISTERS, COUNCIL OF EUR., *Resolution (78)3, Relating to Penal Clauses in Civil Law*, app. art. 7 (1978)).

²⁸⁴ *Id.*

laws and instruments ignore a major divergence. In most legal systems, the courts have the power to adjust the stipulated amount. In the civil law systems, under Resolution 78(3) of the Council of Europe, and in international legal instruments in which the sum is deemed to be “manifestly excessive,” the courts have the ability to reduce the stipulated sum.²⁸⁵ However, these laws’ starting point is that penalties are generally enforceable, while in the common law they are per se illegal. The Court’s reference to the civil law concept of “manifestly excessive” also provides an opportunity to recognize reformation as a way to reconcile the law of liquidated damages with freedom of contract. Adjusting the penalty amount provides courts with the ability to reinstate the basis of the bargain. This could be achieved by allowing courts to reform unreasonable clauses. Instead of voiding penalty clauses, courts should be allowed to reduce or increase the stipulated amount of the clause to reach the threshold of reasonableness, allowed under the principles of unconscionability or “manifestly excessive.” If reformation were made an option, the parties would be able to provide evidence to assist the court in its determination of a reasonable stipulated sum. Lord Hodge notes that the English penalty rule is similar to the rule in Scottish law, with the exception that under Scottish law the courts have the power to reform the penalty amount.²⁸⁶

In sum, the Court may have reached the right outcome, but through improper, or—to put it more politely—unnecessary legal reasoning. This reasoning was due to *doctrinal capture*, in which the Court’s reasoning was intended to stay within the confines of an existing doctrine that had far passed its usefulness. The decision sustains the penalty rule as a part of the common law while eviscerating the underpinning structure upon which it remained afloat.²⁸⁷ The parking fee in *ParkingEye* was a penalty in relation to the discrete transaction, but was not a penalty when viewed from *ParkingEye*’s perspective because it served the interest of advancing the scheme that allowed *ParkingEye* to manage the garage for a profit and, at the same time, provide the user with the benefit of free parking.²⁸⁸ But, the profitability of the scheme depended on enticing users by offering free parking

285 See, e.g., COMM. OF MINISTERS, COUNCIL OF EUR., *supra* note 283, app. art. 7.

286 See *Cavendish-ParkingEye* [2015] UKSC 67 [216] (Lord Hodge SCJ) (“Scottish courts have in certain circumstances a power to abate the penalty which the English courts do not.”).

287 See *supra* Part III.

288 See *Cavendish-ParkingEye* [2015] UKSC 67 [98] (Lords Neuberger P & Sumption SCJ).

in the hope of being able to levy a penal amount if they stayed even a bit longer than the time allotted.²⁸⁹

The outcome in *Cavendish-ParkingEye* may be the correct one not because the penalties were not penalties, but because they were enforceable penalties. But, in order to take such an approach, the Court would have had to overturn centuries of precedent holding that penalties are unenforceable.²⁹⁰ Again, the better approach would have been to admit that the civil law has had it right all along that penalties should be enforced, especially when they are products of contractual intent, unless a given penalty is deemed to be manifestly excessive. Thus, the “unconscionable and extravagant” criteria should be retained, not as a method of rendering all supracompensatory clauses unenforceable, but as a substitute for the civil law’s manifestly excessive standard. The common law should move from a *per se* rule of unenforceability to a presumption of enforceability. Instead of the litmus test of supracompensation, the law should recognize that penalties often serve functions other than to punish, that deterring or punishing nonperformance is not always a bad thing when the “punishment” is a product of mutual assent between commercial parties of relative symmetrical bargaining power, and given that common law damages are rarely fully compensatory.²⁹¹

If a penalty is unconscionable, then why not use the unconscionability doctrine to police liquidated damages and other contract terms—as the author has previously argued?

The current law of liquidated damages is premised on the belief that penalty clauses are *per se* unfair. If it can be shown that some penalty clauses are indeed fair, then the rationale for the current law is severely flawed. . . . Any [reform] should entail eliminating the specialized law of liquidated damages and returning it to the main body of contract doctrine. . . . Recognizing the *nature of the transaction* and the *relationship of the parties* suggests the use of unconscionability as the primary mechanism for policing liquidated damages clauses [and allows for] . . . *partial relief* . . . [by] granting the courts the option to reform excessive liquidated damages [penalty] clauses.²⁹²

²⁸⁹ *Id.*

²⁹⁰ *See supra* Section I.A.

²⁹¹ *See supra* Section I.B.

²⁹² DiMatteo, *supra* note 1, at 706–07.

Of course, this requires a change in thought that not all penalties are unconscionable. This is, in essence, what the *Cavendish-ParkingEye* Court did, but only indirectly, by magically transforming a penalty in a consumer contract into a nonpenalty. The penalty within the consumer contract is eradicated by going outside of the contract to find justification in a scheme developed between the garage owner and the garage manager.

Another important point is that by focusing on procedural factors such as the ample signage²⁹³ and what is common practice,²⁹⁴ the Court moves the penalty rule from a principle of substantive fairness to one, at least partially, of consent.²⁹⁵ This is a dubious move since consent in a contract between a merchant and consumer using standard-form contracting, on a take-it-or-leave-it basis, has always been tenuous at best. The lack of true consent, along with the citadel of compensatory damages or just compensation, has buttressed the penalty rule against attacks of being contrary to freedom of contract.²⁹⁶

Despite the *Cavendish-ParkingEye* Court's choice of a second-best option, it has made English common law's penalty rule more progressive than its American counterpart. Its major contribution has been to show that liquidated damages as penalties may serve functions other than to compensate, deter, or punish. The idea of "other functions" was encased in the Court's idea of legitimate party interests or commercial justification.²⁹⁷ This broad umbrella allows other courts

²⁹³ The Court notes that "[t]he charge is prominently displayed in large letters at the entrance to the car park and at frequent intervals within it." *Cavendish-ParkingEye* [2015] UKSC 67 [100].

²⁹⁴ The Court states that the fact that the "actual level of charge for overstaying (£85) [is] common in the UK provides support for the proposition that the charge in question is not a penalty." *Id.*

²⁹⁵ See generally DiMatteo & Rich, *supra* note 53.

²⁹⁶ Professor Shiffrin has made a recent attempt to bolster the rationale for keeping the penalty rule. She asserts stipulated damages clauses that assess penalties (as well as arbitration clauses), or what she refers to as "remedial clauses," are different from other contract terms because they replace the courts' public function of crafting fair remedies. Shiffrin concludes that the enforcement of penalties or a loosening of the penalty rule "eviscerates the important role of the judiciary in vindicating the public interest in addressing legal wrongs fairly, impartially, and independently. In this case, the traditional [penalty] rule got it right. The judiciary's special role in crafting and meting out remedies should not be outsourced." Shiffrin, *supra* note 7, at 442. Thus Shiffrin bases her support of the penalty rule on the public function served by courts in determining appropriate remedies: (1) "the public's interest in reserving remedial decisionmaking to impartial adjudicators who are positioned to tailor remedies with sensitivity to the details of the circumstances and significance of a breach"; and (2) "remedial clauses displace the public's role in determining the content of an important area of law and objectionably displace the judiciary's role in providing fair and impartial judgments." *Id.* at 411.

²⁹⁷ See *supra* Section I.D.

discretion to conceive of a host of rationales and reasons to justify the enforcement of such clauses, which is what the Court might have intended while paying homage to precedent. The idea that the legitimate business interests standard existed within the existing jurisprudence, along with the reasonable estimate test, compensation-deterrence dichotomy, and the factor of the granularity of disputed clauses, is implausible at best.²⁹⁸ If that were the case, the legitimate business interest test was at most tangential and existed at the far fringes of the penalty rule's rationale to invalidate supracompensatory liquidated damages clauses.

Unfortunately, the new "broad approach" espoused in *Cavendish-ParkingEye* may have unintended consequences. First, future schemes may narrowly define legitimate interests in the context of parties' valuations of components of contracts, such as goodwill, and general or systemic schemes. There are numerous other functions that penalties serve, which should be recognized by their enforceability and, therefore, future courts should be open to extending the breadth of the "broader approach."²⁹⁹

Second, despite the pairing of commercial and consumer contracts in the two appeals, and despite the Court's many references to procedural factors,³⁰⁰ the Court fails to properly and fully recognize the business-consumer contract distinction. It correctly points out that many business-to-business contracts suffer from the same bargaining disparities, as do most consumer contracts.³⁰¹ However, the fact remains that consumer contracts have long been recognized as being beset with procedural unconscionability issues—standard terms, take-it-or-leave-it basis, no reasonable alternatives, fine print, no legal representation, bargaining power asymmetry, informational asymmetry (education, sophistication, social economic class), and so forth.³⁰² The Court recognized the positive procedural factors (conspicuousness of the signage) to buttress its decision, but avoided any analysis of negative procedural factors such as those noted above.

²⁹⁸ See *supra* Sections I.A, I.B.

²⁹⁹ "Other more efficient policing doctrines exist in the law of contracts to protect against manifestly excessive penalties or those obtained through overreaching[.] . . . such as unconscionability, duress, and misrepresentation . . ." DiMatteo, *supra* note 5, at 916 (footnotes omitted) (citing M.P. Ellinghaus & E.W. Wright, *The Common Law of Contracts: Are Broad Principles Better than Detailed Rules? An Empirical Investigation*, 11 TEX. WESLEYAN L. REV. 399, 420 (2005) (arguing that general principles are more efficient than detailed rules)).

³⁰⁰ See, e.g., *Cavendish-ParkingEye* [2015] UKSC 67 [169] (appeals taken from Eng.) (Lord Mance SCJ).

³⁰¹ See *id.* [38] (Lords Neuberger P & Sumption SCJ).

³⁰² See generally DiMatteo & Rich, *supra* note 53.

CONCLUSION

Cavendish and *ParkingEye* represent the beginning of the common law's rejection of the penalty rule. The rationales presented by the justices provide a basis for rejecting the rule, but in the gradual, incremental way of common law change, the justices expressly elected not to overturn the penalty rule. Instead, their decision seeds its future destruction. Whether the Court intended this gradual withering away of a longstanding common law rule, the fact remains that what would have formerly been considered unenforceable penalties were upheld. In the end, the idea of other purposes or functions served by penalties provides an avenue for lawyers to argue for their enforceability in future cases. Hopefully, future cases will erode the rationales supporting the need for such a rule, resulting in its rightful extinction.