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AGREED DAMAGES, THE PENALTY RULE AND UNFAIR TERMS: AN ANGLO-AUSTRALIAN AND CHINESE COMPARISON

Abstract:

Focussing on two recent decisions handed down by the highest authority in the United Kingdom and Australia, this article attempts to critically review the common law rule dealing with contractual penalties through a comparison with its 'functional equivalent' under Chinese law. In the above two decisions the UK and Australian courts effectively tightened the test for a penalty clause by making it harder for a contracting party to escape from the provision of the contract. However, the decision to retain the penalty jurisdiction remains a controversial one and the historical and comparative analysis offered by the UK Supreme Court to justify the retention is particularly tenuous. In this regard a comparison with Chinese law, which bears diametrical differences from the common law in both systematic design and under-structure, helps to bring out the incoherency between rule and rationale under the common law. By tracing the different historical origins and paths of evolution of both the common law and Chinese rules, the article offers a full-fledged comparison that penetrates the surface of legal texts and challenges the long-held assumption that the penalty jurisdiction exercises a fairness control by reference to the time when the contract is made. It concludes that the true rationale of allowing judicial intervention in agreed damages clauses lies in the existence of a discretionary power to achieve remedial justice and that the common law penalty rule should be abolished given its inability to adapt to this rationale.

Keywords:

Contractual penalty, agreed/liquidated damages, Cavendish Square v Makdessi; Parking Eye v Beavis, Chinese Contract Law article 114, Paciocco v Australia and New Zealand Banking Group

I. INTRODUCTION

Are two legal systems with diametrical differences in their political and cultural underpinnings and/or stages of development 'comparable'?[1] What benefits can be gained by comparing, for example, a legal system with such maturity and international influence as the common law of England and Australia, with a legal system that has to date, by and large, been

[1] See generally, M Siems, *Comparative Law* (CUP 2014) 27-28 and materials cited.

at the receiving end of 'legal transplantation' and is still in transition, such as the law of the People's Republic of China (henceforth 'Chinese law')? In particular, might any valuable lesson be learned by the more 'advanced' comparator (in this case, Anglo-Australian law) from its supposedly humbler counterpart (in this case, Chinese law)? Existing literature has only lightly touched upon this matter, and few comparative studies have been conducted to elicit such an inverted reflection. It is said that even a comparison between a capitalist system and a socialist system, once considered impossible, may not only be feasible in that the two systems 'have to solve similar problems', but also valuable if carried out by way of 'a careful comparative analysis' that 'digs deep enough into the reality of legal facts'.[2] Thus, 'judicial responses' to similar 'real life situations' can be compared in the context of their 'functional relation to society' and on the basis of their shared 'deeper universal values'.[3] Central to this approach is the identification of common factual problems, from which one may proceed to 'package' foreign materials into alternative solutions capable of informing the formulation of the appropriate local judicial response.[4] Of course, one should not assume that 'universal' values, such as certainty of law and freedom of contract, found amongst western legal systems, must of necessity be shared in oriental legal systems, at least not with the same vigour. Likewise, when common law courts broaden their scope of reference to a 'world elsewhere'[5] that extends beyond continental European laws, no presumption of similarity in legal solutions should be made. Differences in underlying values and legal solutions, even of a fundamental nature, do not have to stultify the comparison; instead, they can facilitate deeper critical reflections over much that is taken for granted. A wider political variance, for instance, while a barrier to legal transplantation,[6] may stimulate a sharper rethinking of a comparator's inner logic.

This article attempts to offer a unique critical review of the common law rule governing whether a contract term is to be invalidated as a 'penalty', through a comparative study with its 'functional equivalent' under Chinese law. The comparative study proceeds from a recent decision of the Supreme Court of the United Kingdom in *Cavendish Square Holding BV v Makdessi; Parking Eye Ltd v Beavis (Consumers' Association Intervening)* (hereafter '*Cavendish*').[7] By comparing how legal problems arising from the facts of *Cavendish* are resolved or likely to be resolved in the comparator systems, the article attempts to identify the strongest justification for judicial intervention into contractually agreed damages for breach of contract and to ascertain whether that justification could be adopted to

[2] K Zweigert, 'Methodological Problems in Comparative Law' (1972) 7(4) *Israel LR* 465, 470-71. Also, R Sacco, 'Legal Formats: A Dynamic Approach to Comparative Law (Installment I of II)' (1991) 39 *Am J Com L* 1, 7; R Michaels, 'The Functional Method of Comparative Law' in M Reimann and R Zimmermann (eds), *The Oxford Handbook of Comparative Law* (OUP 2006) 342, 357-58. See also, U Drobnig, 'The Comparability of Socialist and Non-Socialist Systems of Law', (1977) 3 *Tel-Aviv University Studies in Law* 45, 53-55, 56.

[3] Michaels ibid 344-345, 360.

[4] Sir Basil Markesinis and J Fedtke, *Engaging with Foreign Law* (Hart 2009), particularly Ch 2. Also, G Samuel, *An Introduction to Comparative Law Theory and Method* (Hart 2014) Ch 4 (Functional Method), particularly III (Functionalism and Case Studies) 71-75.

[5] TH Bingham, '"There is a World Elsewhere": The Changing Perspectives of English Law' (1992) 41 ICLQ 513, 514-5, cf 527.

[6] O Kahn-Freund, 'On Uses and Misuses of Comparative Law', (1974) 37(1) MLR 1, 11.

[7] [2015] UKSC 67, [2015] 3 WLR 1373.

rationalise Anglo-Australian law. The following section will first take a close look at the common problem that the relevant Anglo-Australian and Chinese rules seek to address. The main body of the article consists of a historical survey of how both rules evolved to take their present shape and a detailed assessment of the relationship between rule and rationale in each of the two systems. Based on this comparative analysis, we conclude the article by offering a new perspective for conceiving the future development of Anglo-Australian law.

II. THE CAVENDISH CASE AND COMPARATIVE LAW

A. The Cavendish Case and the Common Problem

At the outset it is necessary to establish a consistent and neutral terminology. A clause in a contract which provides for a sum of money to be paid upon the payor's breach of contract will be described by the non-predictive term, 'an agreed damages clause'. Under the common law, strictly, only when such a clause is unenforceable is it termed a penalty and, only when it is enforceable, is it called a liquidated damages clause. This has given rise to the semantic trap identified by Ian Macneil: 'the built-in determination of invalidity or validity implied by the words penalty and liquidated damages'.[8] The terminology adopted avoids this trap and finds consonance with the Chinese notion of contractual (as opposed to statutory) '*weiyue jin*' (违约金, which literally translates into 'money payable upon breach of contract').

The breadth of the socio-economic problem to be investigated in this article is apparent from the very different facts of the two conjoined appeals in *Cavendish*, where the Supreme Court, for the first time in over a century, took the opportunity to re-examine the law relating to liquidated damages and penalties. Prior to this litigation the issue raised in the conjoined appeals, the principles underlying the relevant law, had not been considered by the UK's highest appellate court since the House of Lord's 1915 decision in *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd* ('*Dunlop*').[9] The first appeal *Cavendish Square Holding BV v Makdessi* ('*Makdessi*') concerned two clauses in a substantial commercial contract which if enforceable would reduce the consideration payable by more than $44M, whilst the second appeal *Parking Eye Ltd v Beavis* ('*Beavis*') involved the enforceability of an £85 charge for 'overstaying' at a car park under a low value consumer contract. The two appeals truly 'lie at opposite ends of a financial spectrum'.[10]

In *Makdessi*, following protracted negotiations with both sides being advised throughout by very experienced commercial lawyers, Mr Makdessi (the appellant), the co-founder and co-owner of the largest advertising and marketing communications company in the Middle

[8] IR MacNeil, 'Power of Contract and Agreed Remedies' 47 Cornell Law Quarterly 495 (1962), 499 fn 16.
[9] [1915] AC 79.
[10] *Cavendish* (n 7) [116] (Lord Mance).

East, agreed to sell to Cavendish Square Holding BV (the respondent) approximately 47% of the shares in the company he founded with the price payable in stages. Clause 11.2 of the sale contract subjected Mr Makdessi to an obliogation not to engage in competitive activities and in clauses 5.1 and 5.6 the contract provided that if he did he would lose the right to future interim and final payments and further that he would be required to transfer to Cavendish the rest of his shares at a lower price that took no account of the company's goodwill. It was accepted that Mr Makdessi was in breach of clause 11.2 and so argument centred upon the legal effects of clauses 5.1 and 5.6. The Judge at first instance rejected Mr Makdessi's submission that the two clauses were penal and enforced clauses 5.1 and 5.6. The Court of Appeal allowed Mr Makdessi's appeal finding that the two clauses were not genuine pre-estimates of loss and so were unenforceable as penalties. Cavendish then appealed to the Supreme Court on the basis that the clauses were not penal and further contending that the common law rule on penalties should be abolished or at least restricted to the extent that it should not apply to commercial transactions between parties with equal bargaining power acting on legal advice.

In *Beavis* Mr Beavis had 'overstayed' in a car park for 56 minutes longer than the permitted 2 hour 'free' period and thereby, under the terms displayed at the entrance and inside the car park, became liable to pay a charge of £85 (reducible to £50 if paid within 14 days). When Mr Beavis sought to resist a claim to enforce the charge against him both the trial Judge and the Court of Appeal rejected his argument that the charge was unenforceable at common law as a penalty or was 'unfair' under Regulation 5(1)of the Unfair Terms in Consumer Contracts Regulations 1999 (the '1999 Regulations').[11]

The Supreme Court upheld the contract clauses in both appeals, reversing the decision of the Court of Appeal in *Makdessi* and affirming the decision of the same court in *Beavis*. The UK Supreme Court unanimously declined the invitation to abolish altogether the 'penalty rule', which distinguished an invalid penalty from a valid liquidated damages clause. The decision on the 'penalty' question was unanimous but Lord Toulson JSC dissented on the unfair term point in *Beavis*.[12] The conjoined appeals, the result of a century's reflection and

[11] Interestingly given the amount in dispute Mr Beavis was represented by experienced senior counsel who were acting *pro bono* with the other costs of the litigation paid for by 'crowdfunding': Law Society Gazette, 23rd July 2015.

[12] Lord Toulson held that in his view the other Justices had applied the wrong test to determine whether there had been a significant imbalance in the parties' rights and obligations as required by Regulation 5(1) of the 1999 Regulations:

> A contractual term which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract , to the detriment of the consumer

Lord Toulson said (at [315]) that the other Justices in answering the question in the negative had merely asked whether the clause was reasonable or not, whereas the proper test derived from the Court of Justice of the European Union in *Aziz v Caixad'Estalvis de Catalunya, Taragona I Manresa (Catalunyacaixa)* (Case C-415/11) [2013] All ER (EC) 770 was to ask whether the supplier could (hypothetically) reasonably have assumed that the customer would have agreed to the term. On the facts of *Beavis* Lord Toulson held that no such assumption was justifiable and so the clause was not valid.

seven voices[13] produced the longest Supreme Court judgment of the year running to 316 paragraphs.

Coincidentally, less than 9 months from the date of judgment in *Cavendish*, the High Court of Australia in *Lucio Robert Paciocco v Australia and New Zealand Banking Group* ('*Paciocco*')[14] undertook an even lengthier (376 paragraphs) examination of the 'penalty rule' and associated statutory provisions. *Paciocco* concerned whether a 'Late Payment Fee' charged by the ANZ bank to its customers where the latter failed to pay a minimum figure by the date shown on their bank statements was invalid as a 'penalty'. It was held that the Fee did not constitute a 'penalty'.[15] Like the UK Supreme Court, the High Court adopted a new, apparently narrower, test for a penalty, thereby making it harder to escape from an agreed damages clause than before. The facts of *Paciocco* bear some resemblance to those of prior litigation in the UK on charges levied for unauthorized overdrafts.[16] However a crucial difference in the prior litigation is that, though charges levied for unauthorized overdrafts were 'akin to default charges which are triggered by a breach of contract',[17] the banks had so structured their contract with their customers that these charges could not be struck down as unenforceable penalties at common law. The overdraft was unauthorized in the sense of not having been approved in advance, but the implied 'request' (usually a simple act of 'spending' money beyond the agreed limits) for such an overdraft though not pre-approved did *not* constitute a breach of contract.[18] The challenge on the charges thus failed by virtue of the currently prevailing law in the UK that, if there is no breach of contract by the customer, there is no 'trigger' for the penalty jurisdiction.[19] By contrast, in Australia the penalty rule was controversially extended to contract clauses requiring a payment to be made (or other detriment incurred) upon events other than the payor's breach of contract.[20] In *Paciocco* the

[13] Since its establishment in 2009 the Supreme Court has generally followed the practice of the body it replaced, the appellate committee of the House of Lords, and sat with five judges. When cases involve more wide-ranging issues such as *Cavendish* the Court might sat with seven Justices or even en banc. In 2015 the Court delivered judgments in 79 cases. 65 (or 85%) were heard by 5 justices, only 13 were heard by 7 and 1 case, dealing with costs, was heard by a bench of 3.

[14] [2016] HCA 28, (2016) 333 ALR 569, 90 ALJR 835.

[15] The High Court thus upheld the decision in *Paciocco v Australia and New Zealand Banking Group Ltd* (2015) FCAFC 50, (2015) 321 ALR 584, which reversed the primary judge's finding in *Paciocco v Australia and New Zealand Banking Group Ltd* [2014] FCA 35, (2014) 309 ALR 249. It was also affirmed that the Late Payment Fee did not contravene the statutory prohibitions of unconscionable conduct or unfair or unjust terms in consumer contracts.

[16] *Office of Fair Trading v Abbey National plc* [2009] UKSC 6, [2010] 1 AC 696 ('*the Abbey case*').

[17] *Office of Fair Trading v Abbey National plc* [2009] EWCA Civ 116, [107].

[18] In the Supreme Court, the banks succeeded on the ground that the fees levied in respect of unauthorized borrowing should properly be regarded as part of the consideration paid by customers for the package of banking services they were entitled to receive. This meant that, so long as these, though perhaps not all other, charges were expressed in plain intelligible language, the fairness of the terms under which they were raised was excluded by reg 6(2) from challenge under the regulations. The 1999 Regulations have now been revoked and re-enacted in a slightly different form in Part 2 of the Consumer Rights Act 2015.

[19] *Export Credits Guarantee Department v Universal Oil Products Co* [1983] 2 All ER 205, [1983] 1 WLR 399.

[20] *Andrews v Australia and New Zealand Banking Group Ltd* [2012] HCA 30, (2012) 247 CLR 205 ('*Andrews*').

issue did not arise since it was accepted that the obligation to pay the Late Payment Fee was consequent upon ('enlivened by') a breach of contract on the part of the customer.[21]

The paradigmatic scenario arising from *Cavendish* and *Paciocco* is that contracting parties agree upon *a sum of money* to be payable in the event of *a breach of contract by one of them*. The problem common to both English and Chinese laws is how a court should respond to a claim to have such a clause/agreement enforced. This problem in turn raises two general theoretical questions. First and above all, there is a fundamental issue as to the identification of a raison d'être for judicial intervention or non-intervention into an autonomous agreement of the parties. In particular, do the legal and policy grounds for judicial intervention correspond to those that justify judicial reviews of all or other specific contract terms, such as fairness and/or inequality of bargaining power? The second question concerns the mode of intervention to be fashioned where intervention is considered necessary. The penalty rule applied in *Cavendish* is characterised by a test centring upon the validity or enforceability of the clause concerned. Yet this is but one of the possible modes of intervention and it carries national 'conceptual context' and 'doctrinal overtones' that must be put to one side in formulating both the common problem and its solutions.[22] From this platform one may then further inquire whether *a sum of money* might be substituted by a non-monetary detriment to the party in breach and whether the pre-requisite for intervention might be extended from *a breach of contract* to non-breach events ranging from those closely allied to breach to those entirely unrelated to breach.

B. The Use and Significance of Agreed Damages Clauses

How significant is the above problem in practice? Agreed damages clauses have great commercial importance. In England, such clauses are found in many standard form contracts in the construction[23] and other industries[24] and are a common incident of voyage charters

[21] *Paciocco* (n 14) [6] (French CJ). Cf the penalty rule was held not engaged in respect of other fees (including honour, dishonour and over-limit fees) charged by the bank given that all those fees were payable only if the bank voluntarily granted an extra facility to the customer at the latter's request and hence did not rest upon a breach of contract by the customer or a failure of a primary contract stipulation in favour of the bank: *Paciocco* [2014] FCA 35, [202], [249], [261]-[262], [272].

[22] K Zweigert & H Kötz, T Weir (tran), *An Introduction to Comparative Law* (3rd edn, OUP 1998) 35, 44. Also, each comparator must be investigated in a 'maximally internal' manner, namely from the perspective of the actors in the system: C Valcke, 'Reflections on comparative law methodology – getting inside contract law', Ch 2 in M Adams and J Bomhoff (eds), *Practice and Theory in Comparative Law* (CUP 2012) 22-48, 29.

[23] N Dennys and R Clay, *Hudson's Building and Engineering Contracts* (13th edn, Thomson Reuters 2015), 6-022 – 6-047 and R ter Har and C ter Haar, *Remedies in Construction Law* (Informa 2010), 14.15-14.11. For a discussion of the use of agreed damages clauses in the United States from a civil engineering perspective see LG Crowley, WC Zech, C Bailey and P Gujar, 'Liquidated Damages: Review of Current State of the Practice' 134(4) J Prof Issues Eng Educ Pract 383 (2008).

[24] Eg the oil and gas industry where analogous forfeiture clauses '…which are invariably governed by English law…' are a feature of 'many of the extant…UK JOA's [Joint Operating Agreements]', see G Hewitt, 'Default on the UKCS and the Law on Penalties – Has Anything Changed?' (2016) International Energy Law Review 5, 5.

where they are known as 'demurrage' clauses.[25] Contracting practice in China is not much different. Chinese parties appear to make routine use of a *weiyue jin* clause in contracts such as real estate or construction contracts.[26] The frequency of the use of clauses which seek to fix or liquidate in advance the compensation that is payable on breach of contract is confirmed by many reviews of this area of law.[27] Surprisingly, most of the observations made are not supported by any source or reference; they are clearly just empirical 'hunches'.[28] The closest attempt (and in the international sphere) to furnish some evidence in this regard might be the

[25] Voyage charters invariably provide a time period called 'laytime' within which the loading/ unloading operation must be completed. If this laytime is exceeded the charterer will become liable under the terms of the charter to pay 'demurrage' for the extra period. In some old cases this extra period was been referred to as 'lay days that have to be paid for' (*Lilly v Stevenson* (1895) 22 R 278, 286 (Lord Trayner)). However in the modern cases it has been stated authoritatively that demurrage is liquidated damages, ie a sum payable on breach of contract (*President of India v Lips Maritime Co* [1988] AC 395, 422 (Lord Brandon): 'a liability in damages to which a charterer becomes subject because, by detaining the chartered ship beyond the stipulated lay days, he is in breach of contract'). See generally, B Eder, H Bennett, S Berry, D Foxton and C Smith, *Scrutton on Charterparties* (23rd edn, Thomson Reuters 2015) Chapter 15 especially 15-001 – 15-0014 and the more specialist works: J Schofield, *Laytime and Demurrage,* (6th edn, informa 2011) and H Tiberg, *The Law of Demurrage* (5th edn, Thomson Reeuters 2013)

[26] In a recent survey of 165 cases concerning *weiyue jin* clauses in contracts of sales decided by an Intermediate People's Court ('IPC') from 1 January 2013 to 1 July 2014, all published on the official 'China Judgments Online' website (<http://wenshu.court.gov.cn>), it was found that 110 (67%) of them were directly associated with the sale of real estate or construction materials; a further 40 cases (24%) were for the sale of iron or machinery: 李旭[LI Xu], '实证调查：违约金调整的类型化研究[Categorisation of Court Adjustment of Weiyue Jin: An Empirical Survey]', available in Chinese at <http://lixunlvshi.66law.cn/wenji_270645.aspx> (last visited 15 March 2017). Agreed damages clauses are also commonly found in model international commercial contracts used by Chinese enterprises such as Ministry of Foreign Economic Relations and Trade Model Chinese Joint Venture Contract, art 54; Model Terms of Contract for Sale of Goods for Sales between German and Chinese Firms and Corporations, arts 16.2-16.4.

[27] The Law Commission of England and Wales, *Penalty Clauses and Forfeiture of Moneys Paid ('Penalty Working Paper')*, Law Com No 61 (1975) para 10 ('[t]he use of penalty clauses is extensive') and the Scottish Law Commission *Report on Penalty Clauses* No 171 (1999) para 1.2 (contracts 'often' provide for payment of a stated sum in the event of breach) 2. For academic assertions, see H Collins, *The Law of Contract* (4thed CUP 2003) 365: most written contracts pay 'considerable attention' to remedial provision to the extent that the remedy for breach is usually found in the contract terms and L Gullifer, 'Agreed Remedies', chap 16 in A Burrows and E Peel (eds), *Commercial Remedies* (OUP 2003): the use of such clauses 'is a widespread practice'. . American authors seem to be more conservative: see the first sentence of 'Section E Penalty Clauses' in TJ Muris, 'Opportunistic Behavior and the Law of Contracts' 65 Minnesota Law Review (1981) 521, 581: contracting parties only 'occasionally' stipulate the dollar amount that the breaching party must pay the non-breacher; cf the second sentence of L DiMatteo, 'A Theory of Efficient Penalty: Eliminating the Law of Liquidated Damages" 38 American Business Law Journal 633 (2001): '[f]rom a practical perspective, such liquidated damages clauses are commonly found in many types of contract…'. A more general assertion is made by Hachem examining 'agreed sums payable upon breach of an obligation' across common law and continental civil law jurisdictions who states boldly that such clauses '… are a standard feature of commercial contracts in all areas of industry': P Hachem, *Agreed Sums Payable upon Breach of an Obligation: Rethinking Penalty and Liquidated Damages Clauses* (Eleven Int'l Pub 2014) 20. In China, the 'extremely wide use' of *weiyue jin* clauses in practice, 'whether ancient or modern, China or abroad', was noted: 韩世远[HAN Shiyuan], '违约金的理论问题[Theoretical Issues Concerning Weiyue Jin]', 法学研究[The Chinese Journal of Law], 2003, vol 4, 15.

[28] The situation is the same in more focussed studies E McKendrick, 'Liquidated Damages and related Clauses in Claims involving Chattels" chap 38 in N Palmer and E McKendrick (eds), *Interests in Goods* (2nd edn 1998) at 955 refers to the 'common practice' of parties to contracts of hire or hire purchase to include liquidated damages clauses that are 'triggered' by the hirer's failure to pay hire promptly and B Eggleston, *Liquidated Damages and Extensions of Time in Construction Contracts* (3rd edn, Wiley-Blackwell 2009) at p 3 states that 'most' standard forms contain such clauses.

UNCITRAL *Report of the Secretary-General: Liquidated Damages and Penalty Clauses*[29] where '[i]n order to determine the nature and extent of the use of liquidated damages and penalty clauses in international trade contracts', a representative selection of general conditions and contracts was analysed. Of the 167 general conditions and contracts analysed 79 contained liquidated damages or penalty clauses and 88 did not.[30]

However, even if reliable statistics were available, the economic and social significance of this area of law could not be ascertained by simply counting the number of agreed damages clauses that are used or by totalling the value of transactions in which they figure. This is because such clauses feature so regularly in consumer contracts that they raise wider questions as to contract fairness, consumer protection and judicial intervention into contractual autonomy. For example, the litigations in *the Abbey case* discussed above have impacted upon most UK households.[31] Some idea of the commercial significance of *the Abbey case* can be gleaned from a quick look at the 'all-star' cast and compendious judgment. At first instance,[32] Andrew Smith J was assisted by 11 Queen's Counsel and *all* the 'magic circle' firms of city solicitors, before producing a judgment that ran to no less than 450 paragraphs examining the standard contractual terms offered to personal customers by all the leading UK banks.[33] The Clydesdale Bank, which had the smallest share of the market, had over 2.4 million personal customers in the UK. Another point illustrated by *the Abbey case* is that, the greatest impact of the penalty rule upon commercial practice may be the steps which are taken to avoid its application. In the case the banks drafted the contracts in a way that avoided the application of the penalty jurisdiction at all by making the challenged charges not contingent on a customer's breach of contract.

C. Comparative Law in the Cavendish Case

The judgments in *Cavendish* relied upon a detailed historical, and briefer comparative, analysis to justify the conclusion that the penalty rule should be retained. However, it may be doubted whether this conclusion is necessitated by any comparison, whether in terms of history or otherwise, with alternative legal models. Particularly, it is suggested that the differences between the common law and civil law systems that were cursorily reviewed in *Cavendish* are more significant than were acknowledged.

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[29] *Yearbook of the United Nations Commission on International Trade Law*, 1979 Vol X, A/CN.9/161, section VI, [30]. Hereafter '*UNCITRAL Report*'.

[30] Such clauses were mostly contained in contracts of international sale of goods where delays in either delivery of goods or payment of price constituted the most common types of breach for which liquidated damages or penalties were payable: ibid, [31]-[32].

[31] The point being made about the relevance of the common law penalty jurisdiction is not jurisdiction specific. A recent survey in the US reported that '[t]he mandatory rules against penalties ... appear as vibrant today as ever': G Klass, 'Contracting for Co-operation in Recovery' (2007) 117 Yale Law Journal 2, 35. Similar challenges to bank fees have been litigated in Australia: see *Andrews* (n 20) [2012] HCA 30, (2012) 247 CLR 205 and *Paciocco* (n 14).

[32] *Office of Fair Trading v Abbey National plc* [2008] EWHC 875 (Comm).

[33] Abbey National plc, Barclays, Clydesdale, HBOS, HSBC, Lloyds TSB, Royal Bank of Scotland, and Nationwide, a mutual building society.

In *Cavendish* it appears that, at the court's request, Cavendish was asked to submit an appendix to its case which was described as 'a valuable examination of the law of, and relevant academic commentary from, other common law countries'.[34] This document is not appended to the report of the case but is assumed to be the basis for the comparative reflections in the leading joint judgment of Lords Neuberger and Sumption concluding that '…the penalty rule… is common to almost all the major systems of law, at any rate in the western world'. This over-general conclusion is supported by a single paragraph of discussion which notes that 'a corresponding rule… is to be found in the Civil Codes' and 'is included in influential attempts to codify the law of contracts internationally'.[35] So compressed an account will inevitably involve distortion and that is surely the case here.[36] The different juridical starting point and distinct historical contexts of the civil and common law systems are not emphasised in this brief analysis. The civilian commitment to the literal enforcement of penalties derives from the respect for the intention or will of the parties.[37] It was a rule of classical Roman law that an aggrieved party was entitled to recover an agreed sum without restriction.[38] This was received into the Napoleonic Code in Article 1152 which formed the basis for the laws of neighbouring countries: Belgium, Italy, Portugal and Spain. However there was a progressive retreat from this extreme position[39] with most European countries giving to a Judge the power to moderate an agreed sum[40] which was adjudged as grossly excessive. There is however some irregularity in discrete legal systems.[41] Particularly, under German law, the power to reduce the agreed sum is exercisable only where the clause in question is intended to pressurise a party to perform a legal obligation (rather than to fix in

[34] Only referred to by Lord Mance at *Cavendish* (n 7) [166].

[35] *Cavendish* ibid [37]. Similarly, see the brief, unannotated reference to BGB s 343 in *Paciocco* (n 14) [55] (Kiefel J, French CJ agreeing).

[36] For extensive and dispassionate overviews of civil and common law approaches see U Mattei, 'The Comparative Law and Economics of Penalty Clauses in Contracts' (1995) 43 Am Journal of Comparative Law 427 and Hachem (n 27).

[37] E Nordin, 'The Penalty Clause Bias' (2014) 21 Maastricht Journal of European and Comparative Law 162, 166. For a similarly spirited promotion of the civil over the common law approach to penalty clauses, see AN Hatzis, 'Having the Cake and Eating It Too: Efficient Penalty Clauses in Common and Civil Contract Law' (2003) 22 International Review of Law and Economics 381. The suggested 'superiority' of civil law is at a general level contradicted by various surveys analysing the jurisdictional preferences of parties engaged in international contracting including the annual World Bank *Doing Business* survey which ranks countries in terms of the ease of doing business across 11 key metrics and whose top 10 places are always dominated by common law, as opposed to civil law, jurisdictions. In the latest 2017 survey 5 of the top 8 jurisdictions ranked overall for the ease of doing business are common law based (New Zealand, Singapore, Hong Kong SAR, the United Kingdom and the United States). See generally, R Halson and D Campbell, 'Harmonisation and Its Discontents: A Transaction Costs Critique of A European Contract Law', chap 6 in J Devenney and M Kenny (eds), *The Transformation of European Private Law* (CUP 2013) 114-5.

[38] Paulus (D.44, 7, 44, 6).

[39] IM Garcia, 'Enforcement of Penalty Clauses in Civil and Common Law: A Puzzle to be Solved by the Contracting Parties' (2012) 5(1) Eur J Legal Stud 95, 100 fn 19 and accompanying text.

[40] For an overview see J Smits, *Contract Law: A Comparative Introduction* (2nd edn, Edward Elgar 2017) 225-6.

[41] Eg Spanish law will only permit the moderation of the clause if the undertaking has been partly performed (Spanish Civil Code Art 1154); French law empowers the judge to increase the agreed penalty (Code Civil Art 1231-5, formerly Art 1152). For further discussions of Spanish and French Law on penalties see, respectively, J Turner, 'Spain: Contracts – Penalty Clauses' (case comment) (2002) 13(4) International Company and Commercial Law Review 34 and L Miller, 'Penalty Clauses in England and France: a Comparative Study' (2004) 53(1) ICLQ 79. An attempt to impose uniformity on Belgium, Netherlands and Luxemburg through the Benelux Convention on Penalty Clauses (1973) failed.

advance the amount of damages)[42] and where that party is not a merchant (BGB 343 and 348).[43]

The reference by Lords Neuberger and Sumption's to the inclusion of a penalty prohibition '…in influential attempts to codify the law of contracts internationally'[44] was probably directed to the *UNIDROIT Principles of International Commercial Contracts*.[45] However, the failure of the international community to reach an agreement on the subject in the United Nations Convention on Contracts for the International Sale of Goods ('CISG'), the most successful international convention for the unification of commercial law, '[b]ecause of the wide gulf between common law systems and other legal systems',[46] was not referred to. Such a failure is only explicable by the differences between common law and civil law on the subject which the *UNCITRAL Report* described as 'sharp' and recognised as constituting '[t]he most serious impediments to unification'.[47] It has even been said that '[n]owhere in the law of contracts has the clash of common law and civil law seemed as irreconcilable as in the treatment of penalty clauses.'[48] Even if these differences are sometimes exaggerated, significant points of distinction remain which are not sufficiently emphasised by Lords Neuberger and Sumption who gave an impression of a more consistent treatment between the two great families of legal systems.[49]

The survey of different common law systems which was also relied upon in *Cavendish* is similarly abbreviated and suggests a greater homogeneity than is justified. With the exception of Australia where the High Court's removal in *Andrews*[50] of the 'breach' requirement was noted and criticised, an impression of a basic similarity is conveyed. In Canada it has been accepted judicially that the proper basis of the rule against penalties is unconscionability[51] and further that the jurisdiction should more explicitly reflect that '… the

[42] Such a clause is a 'dependent' penalty clause. The legal obligation imposed under it may be contractual or non-contractual (such as tortious). Where a clause sets out to secure the performance of a particular act the party is not bound to do, it is 'independent' and not subject to the power to reduce. See further, F Faust, 'Contractual Penalties in German Law' (2015) 23(3) European Review of Private Law 285, 288, 289-90.

[43] If a merchant, the party may resort only to legal grounds invalidating the clause. As an exception, in 'extreme cases' the agreed sum may be reduced, albeit by a smaller margin, where the agreed sum is considered to contradict the principle of good faith: Faust, ibid, 294.

[44] *Cavendish* (n 7) [37].

[45] (2010) art 7.1.13. Also, 'Uniform Rules on Contract Clauses for an Agreed Sum Due upon Failure of Performance' (A/38/17, annex I) (A/CN.9/243, annex I), art 6 (the Rules were issued by the UNCITRAL in 1983 but never came into effect).

[46] EA Farnsworth, *Contracts* (4th edn, Aspen 2004) 812 fn 5; JS Solorzano, 'An Uncertain Penalty; A Look at the International Community's Inability to Harmonize the Law of Liquidated damages and Penalty Clauses' (2009) 15 Law & Bus Rev Am 779, 813; Garcia (n 39) 116, fn 86. Similarly,.

[47] Above n 29.

[48] JM Perillo, 'Unidroit Principles of International Commercial Contracts: the Black letter Text and a Review' (1994) 5(1) Fordham Law Rev 281.

[49] The comparative law comments of Lords Mance and Hodge followed a similar pattern though the latter looked extensively at the development of Scottish law. See *Cavendish* (n 7) [164]-[166] (Lord Mance); [263]-[265] (Lord Hodge).

[50] Above n 20.

[51] *HF Clarke Ltd v Thermidaire Corp* [1976] 1 SCR 319 ('… and judicial interference with the enforcement of what the Courts regard as penalty clauses is simply a manifestation of a concern for fairness and reasonableness, rising above contractual stipulation, whenever the parties seek to remove from the Courts their ordinary authority to determine not only whether there has been a breach but what damages may be recovered as a result thereof').

power to strike down a penalty clause … is designed for the sole purpose of providing relief against oppression'.[52] The law in the United States is distinct from that in the UK in several regards.[53] The UK approach places emphasis upon *ex ante* reasonableness; in contrast the US approach requires either *ex ante* or *ex post* reasonableness. There is therefore a considerable difference between the common law approaches considered above. One major common law jurisdiction even adopts an approach to agreed damages clauses that is closer to that of the unmodified Code Napoleon! India has a partly codified law of contract and the India Contract Act 1872 rejects the distinction between valid liquidated damages clauses and invalid penalties and Section 74 states that the victim of the breach is entitled to 'reasonable compensation not exceeding the amount so named or… the penalty stipulated for'.[54]

It is suggested thatthe comparative analysis in *Cavendish* is not sufficiently extensive, nor conducted in a way that can yield a coherent justification for the retention of the penalty rule in the case. To claim support from civil law systems for such a course of action is particularly problematic. In this article we attempt a nuanced and detailed comparative study of the penalty rule with the markedly different Chinese law, one legal system that assumes global importance but was left out in the comparative analysis in *Cavendish*. Based essentially on the civilian (particularly German and French) model(s), but also shaped by the joint influences of the Chinese tradition and socialist ideology, the pertinent area of Chinese law provides a dramatic whilst enlightening comparator to the penalty rule. By placing emphasis upon the relationship between the legal rule and its rationale, this study is useful in gaining a greater understanding of the *law in action* in China including its longstanding tie with policy.[55] But above all, comparison with such a diametrically different system leads us to evaluate Anglo-Australian law from a rare perspective, to question the very use of 'penalty' as a means to either describe or solve the problem confronted and to explore the hidden link between modern courts' strict stance against excessive agreed damages and their power elsewhere to review unfair contract terms. Since the differences between the comparators are

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For academic support for this view: S Waddams, The Law of Contracts (5th edn, Canada Law Book Inc 2005) 323 [453]; M Chen-Wishart, 'Controlling the Power to Agree Damages' and T Downes, 'Rethinking Penalty Clauses' in Birks (ed), *Wrongs and Remedies in the Twenty-First Century* (Clarendon 1996) 271 and 249 respectively.

[52] *Elsley v JG Collins Insurance Agencies* [1978] 2 SCR 916, [1978] 83 DLR 1 (SCC) 15 (Dickson J). Similarly, *AMEV-UDC Finance Ltd v Austin* (1986) 162 CLR 170, 193-94 (Mason and Wilson JJ). This approach was rejected in the UK before *Cavendish*: see Arden LJ in *Murray v Leisureplay plc* [2005] EWCA Civ 963, [2005] IRLR 946, [49] who rejected the approach when she expressed her clear view that she did '… not consider that oppression … is of itself a criterion in determining whether a contractual sum is a penalty'. See also, *Jeancharm Limited (T/A Beaver International) v Barnet Football Club Limited* [2003] EWCA Civ 58, [2003] All ER (D) 69 (Jan) at [10] (Jacob LJ).

[53] In *Banta v Stamford Motor Co* 92 A 665 (Conn 1914) 667-8, the test for a valid liquidated damages clause was said to have three elements: (1) the damages to be anticipated as resulting from the breach must be uncertain in amount or difficult to prove; (2) there must have been an intent on the part of the parties to liquidate them in advance; and (3) the amount stipulated must be a reasonable one, that is to say, not greatly disproportionate to the presumable loss or injury. In time the second requirement was dropped and the third requirement was relaxed so that it could be satisfied if the amount was reasonable either in relation to the loss anticipated at the time of contracting or the loss that actually transpired: Restatement (Second) of Contracts, art 356.

[54] The Cyprus Law of Contract (1930) is modelled on the Indian Act.

[55] SB Lubman, *Bird in a Cage: Legal Reform in China after Mao* (Stanford University Press 2000) Ch 2 'Eye at the Telescope or Face in the Mirror? Approaching Chinese Law', 35-36. Also, SB Lubman, 'Studying Contemporary Chinese Law: Limits, Possibilities and Strategy', 39 Am J Comp L 293, 330-331 1991.

partially attributable to how each system evolved historically, our first port of call is naturally the diverging historical paths that shape the current laws in England/Australia and China.[56]

III. TWO PATHS OF LAW

A. Historical Evolution of the English Penalty Rule[57]

Examination of the history of the penalty rule in England reveals that it is '…an ancient, haphazardly constructed edifice which has not weathered well…'.[58] As acknowledged by Lords Neuberger and Sumption in *Cavendish*, ascertaining the test for distinguishing penal from other clauses has for some time been a challenge for the most able of judges.[59] The reason for these difficulties lies in the fact that although agreed damages clauses can boast a simple beginning they experienced a complex subsequent history.[60] Such clauses first appeared in a variety of contracts and conveyances in the 13th century; then for two centuries English judges, at least before 1348 when penal bonds were invented, routinely enforced such clauses uninhibited by objections based on usury or the size of the agreed sum.[61] It seems likely that the regulation of penalty clauses and forfeiture have a common origin[62] in the relief offered by courts of equity. The penalty jurisdiction grew from the practice in equity of offering relief from penal bonds. A penal bond consisted of a promise to pay a stated sum, subject to a condition that if the main obligation was fulfilled by a particular time the promise

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[56] Zweigert & Kötz (n 22) 8 ('if the comparatist is to make sense of the rules and the problems they are intended to solve he must often investigate their history').

[57] For a more extensive account see R Halson, *Liquidated Damages and Penalty Clauses* (Oxford University Press 2018) Chapter 1 where the history of the 'penalty' rule is traced to its earliest origins.

[58] *Cavendish* (n 7), [3] (Lords Neuberger and Sumption, Lord Carnwath agreeing).

[59] ibid [3] (Lords Neuberger and Sumption), citing *Astley v Weldon* (1801) 2 Bos & P 346, 350, 126 ER 1318, 1321 (Lord Eldon CJ); *Wallis v Smith* (1882) 21 ChD 243, 256 (Lord Jessel MR); *Robophone Facilities v Blank* [1966] 1 WLR 1428, 1446 (Diplock LJ). Similar frustration has been experienced in the United States: *Sanders & Ables v Carter* 91 Ga 450, 451, 17 SE 345, 345-46 (1893) ('What construction should be placed on contracts [containing agreed damages clauses] is a question that has long vexed and perplexed the courts in this country and of England'); *Giesecke v Cullerton* 280 Ill. 510, 513, 117 NE 777, 778 (1917) ('[N]o branch of the law is involved in more obscurity by contradictory decisions than whether a sum specified… will be treated as liquidated damages or a penalty'); generally, JB Coopersmith, 'Refocussing Liquidated Damages Law for Real Estate Contracts: Returning to the Historical Roots of the Penalty Doctrine' (1990) 39 Emory LJ 267.

[60] AWB Simpson, *A History of the Common Law of Contract* (1975), at 118; D Ibbetson, *A Historical Introduction to the Law of Obligations* (CUP, 1999) 150-1 and 213-4; *McGregor on Damages*, paras [15-003]-[15-007]; and the more expansive account in J Heydon, M Leeming and P Turner, *Meagher, Gummow and Lehane's Equity: Doctrines and Remedies* (5th edn, LexisNexis 2014) Pt 4 s 7; AWB Simpson, 'The Penal Bond with Conditional Defeasance' (1966) 82 LQR 392; EG Henderson, 'Relief from Bonds in the English Chancery' (1974) 18 Am J Leg Hist 298; E Lanyon, 'Equity and the Doctrine of Penalties' (1996) 9 JCL 234; GA Muir 'Stipulations for the Payment of Agreed Sums' (1983-5) 10 Sydney L Rev 503, 503-10. For other, mainly brief, judicial discussions, see *Wall v Rederiaktiebolaget Luggude* [1915] 3 KB 66, 72–73 (Bailache J, hereafter '*Wall's* case'); *Bridge v Campbell Discount Co* [1962] AC 600, 630-631 (Lord Denning); *Jobson v Johnson* [1989] 1 All ER 621, 631-632 (Nicholls LJ); *Lancore Services Ltd v Barclays Bank plc* [2008] EWHC 1264 (Ch), [2008] 1 CLC 1039, [97].

[61] J Biancalana, 'Contractual Penalties in the King's Court 1260-1360' (2005) 64(1) CLJ 212, 231, 241-242.

[62] *Jobson v Johnson* (n 60) 631 (Nicholls LJ).

to pay the stated sum would be void. In *Wyllie v Wilkes*[63] Lord Mansfield observed that at the time of Henry VIII, Sir Thomas More:

> … summoned [the common law judges] … to a conference concerning the granting relief at law, after the forfeiture of bonds, upon payment of principal, interest, and costs; and when they said they could not relieve against the penalty, he swore by the body of God, he would grant an injunction.[64]

The common law followed this lead in statutes of 1696 and 1705[65] and, for a considerable period in history, the action of debt under the penal bond gained prominence in formal agreements.[66]

Thereafter the penal bond metamorphosed into a closer approximation to the modern form when it appeared as an agreement to pay a sum on breach of contract. This turned around the old penal bond; now the 'penalty' was stated as the subsidiary obligation. By 1801 it was established that the claimant had a technical election: he could bring an action in debt to recover the 'penalty', which recovery would be limited by the statute to the damage sustained, or he could sue in assumpsit for his actual losses.[67] Therefore in either case the result was the same, recovery for actual loss only.[68] The action to enforce the penal bond met its demise when the common law courts started in the 17th century to routinely grant relief against the penalty on the ground that the debtor had rendered or would render performance of the condition subsequent in a substantial way[69] and so the action to enforce the 'penalty' has now been largely forgotten.[70] But it was not until at the start of the 19th century that notions of unconscionability in departing from actual loss or even substantive unfairness started to infiltrate and dominate the relief.[71] The rather late development of the relief came at an age when the will theory of contract grew in influence and courts consciously refrained from

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[63] (1780) 2 Doug 519, 99 ER 331.
[64] ibid 523, 333.
[65] 8 & 9 Will 111 c 11, s 8 and 4 & 5 Anne c 3 ss 12 and 13 repealed respectively by SI 1957/1178, reg 7 under powers conferred by the Supreme Court of Judicature Act 1925, s 99(1)(f), (g) and Sch 1 and the Statute Law Revision Act 1948, s 1 and Sch 1.
[66] Ibbetson (n 60) 222-223.
[67] *Lowe v Peers* (1768) 4 Burr 2225, 98 ER 160.
[68] *Astley v Weldon* (n 59).
[69] Ibbetson (n 60) 214. This was consolidated by a 1697 statute which effectively made the action one for damages in substance, and the debt in the bond subsidiary to the performance of the condition as security (see 150-151).
[70] '… today … a penalty clause in a contract is, in practice, a dead letter': *Jobson v Johnson* [1989] 1 All ER 621, 632 (Nicholl LJ). Cf the discussion in *AMEV-UDC* (n 52) 162 CLR 170, 192-193, 201-203.
[71] For example, two of Lord Dunedin's rules (money obligation and variety of breach, respectively 4(b) and 4(c) at 87-88) can be traced back to *Astley v Weldon* (n 59). See, Ibbetson (n 60) 255-256 (where the modern approach focussed on genuine pre-estimate started to take shape in cases like *Clydebank Engineering and Shipbuilding Co v Don Jose Ramos Yzquierdo y Castenada* [1905] AC 6 ('*Clydebank*') and finally *Dunlop* (n 9) with inspirations from Scots law and South African law, which had been heavily influenced by continental civilian traditions).

rewriting the contract,[72] opting instead to declare a non-conforming clause invalid or unenforceable.

It would thus appear that the initial equitable origin of the penalty jurisdiction was superseded by a common law regime which provided relief in the form of a declaration of invalidity. A modern court would not see the clause as potentially voidable in equity, in the sense that it would be upheld unless and until effectively rescinded by the innocent party. Nor would it be likely that the clause be enforced to the extent of the actual loss that the innocent party could prove.[73] But the rationale of the penalty rule was never convincingly articulated. Consequently in *Andrews*,[74] the High Court of Australia reached the opposite result on very similar facts to those of the *Abbey case*,[75] holding that the penalty jurisdiction was applicable to charges levied for so called 'unauthorised borrowing'. The Court built upon a subtly different historical account which asserts that there exists a distinct and subsisting equitable jurisdiction to relieve against penalties which is wider than, as opposed to co-extensive with, the common law jurisdiction and so extends to relief from 'collateral' or accessory obligations to pay money contingent upon events involving mere 'failure of a primary stipulation' that does not generate a contractual obligation.[76] The Court's 'entirely historical' reasoning[77] is, however, criticised as flawed in that it places undue reliance on earlier English law, including penal bond cases which no longer have contemporary relevance.[78] In *Cavendish* the approach of the High Court of Australia was disapproved of as a matter of authority and of principle. As to authority Lords Neuberger and Sumption point out the asserted broad equitable jurisdiction to relieve 'appears to have left no trace in the authorities since the fusion of law and equity in 1873'.[79] The only recent authority[80] would appear to be a case in the Court of Appeal[81] that may have been wrongly decided.[82] *Andrews* was defended as an authority by

[72] PS Atiyah, *The Rise and Fall of the Freedom of Contract* (Clarendon 1979) 426. Common law is traditionally adverse to such a paternalistic intrusion into individual preferences in the absence of cognitive incapacity or deflected will: MJ Trebilcock, *The Limits of Freedom of Contract* (Harvard University Press 1993) 163.

[73] Cf *Jobson v Johnson* (n 60): a substantial share in a football club was sold for a consideration payable in instalments with a provision that if the purchaser defaults on payment he must retransfer the shares at undervalue. When the purchaser defaulted on payment he was not able to claim relief under the usual relief from forfeiture principles because he had failed to comply with disclosure requirements. The Court of Appeal accepted the purchaser's argument that the retransfer clause was penal. The usual consequence would be that the clause was not enforced but as was pointed out in *Cavendish* (n 7) [84] this might have resulted in the purchaser being advantaged by his failure to disclose. Perhaps to avoid this consequence the Court of Appeal applied forfeiture principles to the relief from a penalty and held effectively that the penalty clause was enforceable to the extent of any loss caused by the breach and the seller was therefore offered a choice of remedies to effect this. The reasoning was disapproved of in *Cavendish* (n 7) [87].

[74] Above n 20.

[75] Above n 16.

[76] *Andrews* (n 20) [10].

[77] *Cavendish* (n 7) [41], [42] (Lords Neuberger and Sumption, Lord Carnwath agreeing). The importance of a historical perspective was emphasised by the High Court when they stated in *Andrews* (n 20) [14]: '…an understanding of the penalty doctrine requires more than a brief backward glance'.

[78] JW Carter, W Courtney, E Peden, A Stewart and GJ Tolhurst, 'Contractual Penalties: Resurrecting the Equitable Jurisdiction' (2013) 30 JCL 99. Modern cases such as *AMEV-UDC* (n 52) 184 (Mason and Wilson JJ) were ignored in *Andrews* (n 20).

[79] *Cavendish* (n 7) [42].

[80] ibid (where two other older comments are explained on a different basis by Lords Neuberger and Sumption).

[81] *Jobson v Johnson* (n 60).

[82] *Cavendish* (n 7) [84]-[87] (Lords Neuberger and Sumption).

some members of the High Court in *Paciocco* on the basis that the common law of Australia had developed differently from the common law of England.[83] However, history seems to support the proposition that the transformation of the penalty jurisdiction from equity to law is substantive rather than (as the High Court suggested) merely procedural. It also appears that a separate equitable doctrine does not furnish a new or stronger justification for the penalty jurisdiction.[84]

In *Cavendish* the Supreme Court emphatically rejected all arguments of principle to expand the penalty jurisdiction to review clauses which require sums to be payable (or foregone or other acts performed) contingent upon events other than the payer or transferor's breach of contract. The issue had been dealt with by the Law Commission in its working paper on penalty clauses[85] who referred to the 'absurd paradox' noted by Lord Denning in *Bridge v Campbell Discount Co Ltd*[86] and correctly identified the problem as how to define the scope of this power of review in a way that does not subject to review every contractual term requiring the payment of money.[87] Without resolving this quandary or suggesting a plausible rationale for the penalty rule,[88] their conclusion[89] was that 'the rules as to penalties should be applied wherever the object of the disputed contractual obligation is to secure the act or result which is the true purpose of the contract'.[90] In *Cavendish* the Law Commission's Penalty Working Paper is referred to separately by Lords Neuberger and Sumption,[91] Lord Mance[92] and Lord Hodge[93] in exactly the same way. The fact that the Law Commission had

[83] *Paciocco* (n 14) [7] et seq (French CJ); [121] (Gageler J). The same issue did not arise on the facts of *Paciocco* where it was accepted that the so-called late payment fee was incontrovertibly 'enlivened' ie triggered by a breach of contract.

[84] The equitable doctrine was applied in earlier proceedings of *Paciocco*: [2014] FCA 35, (2014) 309 ALR 249, [114], [115]; (2015) FCAFC 50, (2015) 321 ALR 584, [89] (Allsop CJ, Besanko and Middleton JJ agreeing), where it was held to enshrine the same test of extravagance and unconscionability as at common law: FCA, [15] (5), (6); FCAFC, [22]. The equitable doctrine was not applied by the High Court: see particularly [74], [115], [124] (Gageler J, citing Deane J in *AMEV-UDC* (n 52) 195): it was 'ordinarily of but academic or historical interest' and applicable only in 'those comparative rare cases' where the party asserting unenforceability sought 'purely equitable' positive relief such as an order for re-conveyance. Also, *AMEV-UDC* (n 52) 191 (Mason and Wilson JJ).

[85] *Penalty Working Paper* (n).

[86] (n 60) 629 ('the court will grant relief to a man who breaks his contract but will penalise a man who [exercises] a contractual option').

[87] *Penalty Working Paper* (n) para 22. Following *Jobson v Johnson* (n 60), the task is even more difficult as it must encompass clauses stipulating for the transfer of property as well.

[88] Eg, M Baer, Note, 1 Can Bus LJ 399 1975-1976, 399, 400, 402-403.

[89] The Law Commission rejected the approach embodied in the South African Conventional Penalties Act 1962 which extends the power to review penalties to provisions which state that a party is to remain liable to the performance of some obligation upon withdrawal from the agreement. This formulation would appear to cover 'minimum payment' clauses like that in *Bridge v Campbell* (n 60). See B Hepple (1961) 78 SALJ 445 and FE Myburgh and R Zimmermann, 'JC de Wet and the Conventional Penalties Act 15 of 1962' chap 11 in J Du Plessis and G Lubbe, *A Man of Principle: The Life and Legacy of J C de Wet* (Claremont, South Africa, 2013).

[90] *Penalty Working Paper* (n) para 26 giving the following example: 'If … a building contract were to provide for completion of the building by a certain date unless delayed by bad weather there would be no breach of contract if completion were delayed by bad weather. If the contract were also to provide that the builder should pay £50 for every day's delay caused by bad weather, the recoverability of the specified sum would depend on its being a genuine pre-estimate of the loss caused by the delay.' See also, para 22 ('provisional view … that the court should have the power to deal with such clauses in the same way whether or not they come into operation by breach').

[91] *Cavendish* (n 7) [38].

[92] ibid [163].

proposed expanding the ambit of the penalty jurisdiction was used to rebut an argument that it should be abolished or limited. Unfortunately none of the Justices engage with the matter of substance raised by the Law Commission. Notwithstanding this it is submitted that the position endorsed in *Cavendish* is preferable for three reasons. The first argument arises from the prior and assumed commitment to 'freedom of contract' that guarantees to the parties the maximal rights of contractual self-determination.[94] An expansion of the scope of the penalty rule tends to restrict the parties' freedom to an unacceptable degree. The second argument arises from the difficulty of stating the limits of a wider power of review. The inevitable corollary of this boundary determination is of course the potential created for drafting and structuring contractual obligations in a way that avoids the penalty jurisdiction as exemplified by *the Abbey case*.[95] The third argument is based on the 'fundamental distinction' drawn by Lords Neuberger and Sumption between the courts' jurisdiction to review the fairness of a primary obligation and their jurisdiction to regulate the remedy for a breach of that obligation.[96] This distinction, albeit not always an easy one to draw, dictates that the invocation of the penalty rule should be premised upon a breach of contract.

From the above discussion we can see that a historical analysis of the penalty rule in England does not support the existence of an equitable jurisdiction in modern times, but it does show how the law gets to where it is now. In particular, history seems to shape the mode of intervention that affects agreed damages clauses. The transition from earlier actions in debt and equitable relief to the modern action for breach of contract was accompanied by the rise of freedom of contract which led to English courts' adoption of an all-or-nothing test of enforceability at common law. However, not only English law, but also Australian law which embraces a separate equitable doctrine, struggle in yielding a clear, sufficient justification for the penalty rule. Next we will turn to an alternative model developed in China.

B. Tradition and Transplantation in Chinese Law

Earlier Chinese history is characterised by a punitive view of agreed damages. Clauses sanctioning the payment of money or transfer of properties in the event of a breach appeared in civil or commercial agreements dated back to the Han Dynasty (206 BC – 220 AD).[97] A

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[93] ibid [263].

[94] ibid [33] (Lords Neuberger and Sumption): 'The penalty rule is an interference with freedom of contract. It undermines the certainty which parties are entitled to expect of the law' and [43] quoting Hoffmann LJ in *Else (1982) Ltd v Parkland Holdings Ltd* [1994] 1 BCLC 130, 145 that '… being an inroad upon freedom of contract which is inflexible …[it]… ought not to be extended'; ibid [257] (Lord Hodge): 'The rule against penalties is an exception to the general approach of the common law that parties are free to contract as they please…'.

[95] ibid [14] (Lords Neuberger and Sumption): 'in some cases the application of the penalty rule may depend on how the relevant legislation is framed in the instrument' and [43]: 'We would accept that the application of the penalty rule can still turn on questions of drafting even where a realistic approach is taken to the substance of the transaction and not just its form'; [130] (Lord Mance); [258] (Lord Hodge). See *the Abbey case* (n 16).

[96] ibid [13].

[97] An example is a contract of sale which stated that the buyer would be liable to pay interests at a fixed daily rate should he fail to meet the date by which the contract price fell due: 胡留元[HU Liuyuan], '第三章汉代民事法律制度[Chapter 3 Civil Law Institutions in the Han Dynasty]' in 孔庆明[KONG Qingming], 胡留元[HU

clause of this type was seen as a form of security against breach of contract. As security it deterred a party from non-performance by prescribing a consequence unrelated to, and almost invariably much severer than, likely losses. This practice continued into the Wei-Jin and Southern-Northern Dynasties[98] and became widespread in the Tang Dynasty (618 AD – 907 AD). Documents unearthed from Dunhuang (Touen-Houang) show that it was common for parties at the time to agree that resiling from the agreement would carry with it a 'penalty' of giving up a large quantity of money or goods (such as wheat, cloth or cattle) either to the innocent party or to the government.[99] Some agreements in the Qing Dynasty (1644 AD – 1912 AD) stipulated that a sum amounting to half of the contract price be payable to the government in the event of a breach.[100]

Notwithstanding their aversion to litigation and punishment and preference for moral education as a response to wrongdoing, Confucian officialdom who sat in imperial courts as judges did not resist the enforcement of such outright penalties. From the earliest days when Confucianism rose as the dominant school of ideology in ancient China, private agreements were enforced to uphold the value of *hsin* (or xin, trustworthiness and creditability) or *shouyüeh* (or shouyue, contract-keeping) so as to prevent dishonest persons from obtaining 'ill-gotten' gains.[101] Therefore punishment was accepted as a pragmatic, albeit temporal, measure to discourage any violation of law[102] and to achieve the end of *li* (ritual propriety or normality). Indeed, to encourage actual performance of such agreements, a breach of contract (including a default on a debt) was regarded in penal codes in various Chinese dynasties as a criminal act endangering public order and warranting physical punishment such as flagellation and imprisonment.[103] However, such statutory sanctions were rarely sought or granted[104] and were often overshadowed by the morally more appealing, less harsh contractual penalties.[105] Given that contractual penalties were not prohibited or heavily regulated by penal codes,[106]

Liuyuan] & 孙季平[SUN Jiping] (eds), *中国民法史[A History of Chinese Civil Law]* (Jilin People's Press 1996) 167.

[98] Examples can be found in *吐鲁番出土文献[Unearthed Documents from Turpan]* (Cultural Relics Press, Beijing, 1987) vol. 1, 191.

[99] Jacques Gernet, 'La vente en Chine d'après les contrats de Touen-houang (IXe-Xe siècles)', *T'oung Pao*, Second Series, Vol. 45, Livr. 4/5 (1957), 295-391.

[100] 张晋藩[ZHANG Jinfan], *清代民法综论[A General Study on the Qing Civil Law]* (Chinese University of Politics and Law Press, Beijing, 1998) 134-135.

[101] H Scogin, 'Between Heaven and Man: Contract and the State in Han Dynasty China', (1990) 63(5) Southern California LR 1325, 1375-1376, 1378, 1404.

[102] 瞿同祖[QU Tongzu], *Law and Society in Traditional China* (Paris: Mouton, 1961) 363 et seq.

[103] Eg, 唐律[Tang Code] (Miscellaneous) art 398: W Johnson (tran), *The T'Ang Code: Volume II Specific Articles* (Princeton University Press 1997) 464.

[104] This type of criminal sanction was 'an ever-present threat but rarely an actual resort' and did not create any enforceable right or obligation in contracting parties: PCC Huang, *Code, Custom, and Legal Practice in China: The Qing and the Republic Compared* (Stanford University Press, California 2001) 121.

[105] As a study of commercial sales agreements in the late 19th century Taiwan shows, 'self-executing' or 'self-enforcement' measures such as deposits were widely used and regularly enforced in substitution of criminal sanctions in statutes: RH Brockman, 'Commercial Contract Law in Late Nineteenth-Century Taiwan' in JA Cohen, RR Edwards and Fu-mei Chang Chen (eds), *Essays on China's Legal Tradition* (Princeton University Press, 1980) Ch. IV 76-136, 124, 129.

[106] Two notable prohibitions are (1) contractual penalties amounting to usury: eg, 唐开元杂令 [Miscellaneous Ordinances in the Kaiyuan Era] arts 37-39; ZHANG (n 100) 157, citing Qing Code, vol. 14, art 149 (interests for a loan are limited to the value of the loan in amount and to 3% in monthly rate. Generally, PCC Huang, *Chinese*

their continual use in a wide range of agreements was assured, showing that they were normally enforced or recognised as enforceable.

Nevertheless, where contractual penalties were enforced, the reason for their enforcement was not so much the judges' respect for the parties' will or consent as their belief that it was a morally and pragmatically desirable response to a breach of contract. While the judges saw no difficulty in enforcing a contractual penalty when to do so was right and fit in their eyes, they were not recognising the 'binding' force of the agreement and felt no constraint in departing from it when this was considered appropriate. Thus, the judges might disregard a contractual penalty entirely, but they would more likely make it work by adjusting its amount. After all, black-letter laws in the penal codes formed only part of the juridical arsenal available to the judges. As noted by some scholars, in a process called the 'Confucianisation of law' commencing since the Han Dynasty, the judges were given 'considerable freedom in interpreting and applying the law' and were hence increasingly accustomed to going beyond the articles of the code to forge from Confucian learnings a harmonious solution to the dispute.[107]

From the beginning of the 20th century great changes were brought upon the Chinese society and a modern legal system started to emerge through transplantation from the west. The draft Qing Civil Code, the first of the kind in China's history, was heavily influenced by the Japanese Code, whilst the later enacted 1929 Republican Civil Code, the archetype of today's Taiwanese Civil Code, switched to a model based on the German and Swiss Codes. Both the Qing and Republican Codes contained a provision for *weiyue jin*, which largely followed the French Code Civil in viewing it as a consensual compensation for loss not susceptible to judicial adjustment.[108] But such a provision was no more than an imitation of foreign law without adapting it to local circumstances.[109] The tie with the civilian legal tradition endured in the People's Republic of China who has since her establishment in 1949

Civil Justice: Past and Present (Rowman & Littlefield Publishers, 2010) 168-171; PCC Huang, 'Chapter Six: Codified Law and Magisterial Adjudication in the Qing' in K Bernhardt and PCC Huang (eds.), *Civil Law in Qing and Republican China* (Stanford University Press, 1994) 152, 155-156; (2) contractual penalties that allow a lender to, without resort to the authority, break into the borrower's house and seize the latter's personal properties in satisfaction of the loan in the event of a default. Examples can be seen from: 中国社科院历史研究所[The Institute of History Research of the Chinese Academy of Social Science], *敦煌文献[Dunhuang Materials]*, vol. 1, 353; *Unearthed Documents from Turpan* (n 98) vol. 6, 422. Examples of the statutory prohibition are Tang Code (Miscellaneous) art 399, see 长孙无忌[ZHANGSUN Wuji], *唐律疏议[Tanglv Shuyi]* (Zhonghua Book Co, Beijing, 1983), vol 26 (Za Lv) 485-486; Johnson (n 103) 464.

[107] QU (n 102) 375.

[108] In the draft Qing Civil Code, *weiyue jin* was presumed to be damages for loss incurred (art 394), identical to the Japanese Civil Code art 420(3), see 杨立新[YANG Lixin] (ed), *大清民律草案-民国民律草案[Draft Qing and Republican Civil Codes]* (Jilin University Press, 2002). Similarly, 1928 Republican Civil Code arts 250-253; 张启泰[ZHANG Qitai], '约定违约金之比较研究[A Comparative Study of Agreed Weiyue Jin]', in 何勤华[HE Qinhua] & 李秀清[LI Xiuqing] (eds), *民国法学论文精萃[Selected Law Essays in the Republics]* (Law Press Beijing 2004) vol 3 (civil and commercial law), 287-290, 293-294 (criticising the French model for insufficient protection of the weak).

[109] S Zhang, 'From an Integration of Western and Chinese Legal Norms to Comparative Legislation: Codification of the Civil Law of the Republic of China', (2013) 1 China Legal Science 128, 137-38.

opted to adopt the Civil Code of the RSFSR[110] as a blueprint for civil law. Even today, the authoritarian and paternalistic mentality of the Soviet law can find its traces in the Chinese law on *weiyue jin*.[111]

In the 1980's, when China reopened herself to western legal institutions and thoughts in building a socialist market economy, the *weiyue jin* regime started to develop its unique characteristics. Critically, *weiyue jin* ceased to be seen as a means of securing contract performance in the way deposits were, and started to be conceived of as a form of civil liability responsive to culpable wrongdoing.[112] As a corollary, it became recoverable jointly with a deposit, provided that their combined value did not exceed a certain cap set up by courts.[113] The conception of *weiyue jin* as a form of civil liability made two further transformations possible. The first transformation was that a previous exclusively punitive view of *weiyue jin* gave way to a characterisation of it as 'primarily compensatory and secondarily punitive' in nature. In the earlier stages of the PRC, *weiyue jin* was mostly statutory rather than contractual, being imposed upon a party as an administrative or even criminal sanction in response to its failure to implement state economic plans.[114] But its

[110] RSFSR refers to Russian Socialist Federated Soviet Republic or, after 1936, Russian Soviet Federated Socialist Republic). Initially, the blueprint used was the 1922 Civil Code (adopted by the All-Russian Central Executive Committee on October 31, 1922, effective on January 1, 1923), *SU RSFSR*, No. 71, item 904 (1922). After the Cultural Revolution, it was the 1964 Civil Code (adopted on 11 June 1964, effective as of 1 Oct 1964) that wielded influence on civil lawmaking in China: for an English translation see W Gray and R Stults (trans), *Civil Code of the Russian Soviet Federated Socialist Republic* (University of Michigan Law School Scholarship Repository 1965) Ch 17, 48-50, 54. Generally, 何勤华[HE Qinhua] & 殷啸虎[YIN Xiaohu] (eds), *中华人民共和国民法史[A History of the Civil Law of the PRC]* (Fudan University Press Shanghai 1999) 19.

[111] For such features of the Soviet law apparently carried into Chinese law, see HJ Berman, 'Soviet Perspectives on Chinese Law', ch 12 in JA Cohen (ed) 1 Contemporary Chinese Law Research Problems and Perspectives 313, 1970, at 316-17. For current similarities shared by Russian law, see M Yefremova, S Yakovleva and J Henderson, *Contract Law in Russia* (Hart Publishing 2014) 243-251.

[112] An explicit statement of the security view can be found in the third draft of Civil Code in the 1950's, produced on 5 Feb. 1957, art 34(1), see 何勤华[HE Qinhua], 李秀清[LI Xiuqing] & 陈颐[CHEN Yi] (eds), *新中国民法典草案总览[A Full Collection of Draft Civil Codes of the PRC]* (Law Press, Beijing, 2003), vol I, 239. For the liability view, see 中华人民共和国民法通则 [General Principles Of Civil Law of The People's Republic Of China, 'GPCL'], adopted at the 6th National People's Congress ('NPC'), amended at the 11th NPC Standing Committee ('NPCSC') on Aug. 27, 2009, arts 112(2), 134; 中华人民共和国经济合同法[Economic Contract Law of the PRC, 'ECL'], adopted by the 4th Meeting of the 5th NPC on 13 Dec 1981, effective as of 1 July 1982, amended by the 3rd Meeting of the 8th NPCSC on 2 Sept 1993, art 35 (art 31 after the 1993 amendment). Also, Editorial Office of the *Chinese Journal of Law* (ed), *中国民法学研究综述[Summarisation of Civil Law Research in the PRC]* (China Social Science Press, Beijing, 1990) 479-480; 王家福[WANG Jiafu] (ed), *民法债权[Chinese Civil Law: Obligations]* (Law Press, Beijing, 1991) 249. Similarly, under the Soviet law: VP Mozolin, 'Part I' in EA Farnsworth & VP Mozolin, *Contract Law in the USSR and the United States: History and General Concept* (International Law Institute 1987) 145-46, cf 147-48.

[113] Eg the total contract price: Supreme People's Court of the PRC ('SPC'), Replies on Certain Issues Concerning the Concrete Application of the Economic Contract Law in Adjudication of Economic Contract Disputes (hereafter 'ECL Replies'), Fa (Jing) Fa (1987) No. 20, issued and effective as of 21 July 1987, section 8(4). The ECL Replies became ineffective on 13 July 2000 following the enactment of 中华人民共和国合同法 [Contract Law of the People's Republic of China (hereafter 'CCL')], adopted at the 9th NPC on 15 March 1999, effective as of 1 Oct 1999.

[114] All the three drafts of Civil Code in the 1950's required a contract between socialist economic organizations to contain a *weiyue jin* clause: see HE et al (n 112). Also, 彭冰[PENG Bing], '中国 50 年代的国家与契约[State and Contracts in the 50's China]', Peking University Law Review (1998), vol 1, No 1, 143, 154, 155. Cf H Kroll, 'Breach of Contract in the Soviet Economy', Journal of Legal Studies, vol XVI, Jan 1987, 119, 143-44 (agreed penalties infrequently invoked and insufficient as incentive for contract performance). For the practical

punitive character started to fade in the 1980's. At first, the name '*weiyue jin*' was preferred to 'penalty' by lawmakers.[115] This change reflected contracting practice.[116] Then, the enactment of the three Contract Laws evidenced a change in the characterisation in chronological sequence. The 1981 ECL apparently adopted the punitive view, confining *weiyue jin* mostly to money due as a result of a delay in performing one's obligations under the contract whilst distinguishing it from both damages and interests on loans.[117] By contrast, the 1985 Foreign-related Economic Contract Law expressly declared that contractual *weiyue jin* was a type of 'damages for breach of contract'.[118] More ambivalent was the 1987 Technology Contract Law, which regarded *weiyue jin* as an alternative remedy to damages,[119] whereas its Implementation Regulations deemed it damages.[120] The characterisation was important in that punitive *weiyue jin* could be recovered jointly with actual performance and/or damages whilst compensatory *weiyue jin* could not.[121] Eventually, both the CCL and the SPC discarded the view that the parties' intention was presumed to pre-fix compensation unless shown otherwise,[122] and accepted that the characterisation should hinge on a comparison between the amount of *weiyue jin* and the amount of actual loss occasioned by the breach: *weiyue jin* was compensatory where, and to the extent that, its amount did not exceed that of the loss occasioned, but, any portion of *weiyue jin* in excess of that loss would be considered punitive.[123]

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importance of penalties in Eastern Germany during the same period, see B Grossfeld, 'Money Sanctions for Breach of Contract in a Communist Economy', 72 Yale LJ 1326 1962-1963, at 1331-2, 1340-1.

[115] Three of the four drafts of Civil Code in the 1980's as well as legislation promulgated during the period opted for *weiyue jin*: HE et al (n 112), vol II, 389-390, 455-456, 514-515, 581-582.

[116] A transfer of goods had long existed in traditional contracting practice as a form of penalty. However, in the era of the PRC it seems that only contract clauses stipulating the payment of a sum of money can be found; according to a recorded file by the Research Office of NPCSC on 3 Sept 1956, a major state department store in Beijing testified that *weiyue jin* clauses were common in processing, ordering and contracted sales contracts and were always calculated in monetary terms and never in goods: HE et al (n 112) 197-198.

[117] ECL (n 112) arts 32-40.

[118] 中华人民共和国涉外经济合同法[Foreign-related Economic Contract Law of the People's Republic of China, 'FECL'], adopted at the 10th Meeting of the 6th NPCSC on 21 Mar. 1985, effective 1 July 1985, art 20(2). Also, Reply of the SPC Concerning Certain Issues Concerning the Application of the FECL, 19 Oct 1987, Fa (Jing) Fa (1987) No 27, section 6(2) (*weiyue jin* is 'pre-fixed damages').

[119] 中华人民共和国技术合同法[Technology Contract Law of the People's Republic of China], adopted at the 21st Meeting of the 6th NPCSC on 23 June 1987, effective as of 1 Nov 1987, arts 17, 40.

[120] The Implementation Regulations of the Technology Contract Law of the People's Republic of China, issued and effective as of 15 Mar 1989, State Technology Commission Order No 4, approved by the State Council on 15 Feb 1989, art 22(1).

[121] *Summarisation of Civil Law Research* (n 112) 479; HE et al (n 112) 230; 崔建远[CUI Jianyuan], '关于违约金责任的探讨[Exploring the Liability to Pay Weiyue Jin]', 法学研究[The Chinese Journal of Law], 1991, No 2, 59-65.

[122] *Summarisation of Civil Law Research*, ibid 486.

[123] ibid 479-480. Also, the three 1950s drafts (version 1, art 18(1); ver 2(1), art 59; ver 2(2), art 41(1); ver 3, art 35) and the fourth draft on 1 May 1982, art 160: *weiyue jin* and damages cannot both be claimed to the extent that they make good the same loss. Cf Implementation Regulations TCL, art 22(1): payment of *weiyue jin* precludes a claim for damages, except that the contract 'specifically' allows a claim for loss in excess of *weiyue jin*. For Soviet influence, see Mozolin (n 112) 157-58 (claim for damages in addition to a forfeit and exceptions), 159 (rare availability of a forfeit in addition to full damages). However, Chinese law never like 1964 Soviet Code, art 189(2) gives contracting parties the scope to agree that either both agreed damages and normal damages or only one of them are available in the event of a breach.

The other important pre-1999 transformation was a reorientation and restructuring of state control over agreed *weiyue jin*. This period saw the diminishing role of legislators in regulating such clauses; meanwhile, the power of people's courts to adjust the agreed sum achieved gradual recognition and institutionalisation. In the 1950's it was commonly understood by regulators and contracting parties (state-owned economic organisations) alike that the agreed sum should not normally exceed a small percentage of the contract value.[124] More sophisticated and onerous restrictions were developed in the 1980's, principally through various forms of statutory *weiyue jin*. As noted by the SPC,[125] many administrative regulations and ministerial rules imposed a mandatory cap or range which the parties had to abide by when fixing *weiyue jin*.[126] An important controlling measure was to subject *weiyue jin* additionally to the umbrella principle that it 'shall not be manifestly unfair'.[127] With the enactment of the CCL in 1999, most of these restrictions were annulled.[128] A parallel pre-1999 development was the re-assumption by Chinese courts of their traditional role of

[124] In the 1950's drafts of Civil Code the agreed sum was often capped by 15% of the total value of the obligation or of the value of the unperformed obligation (version 1, art 16(2); version 2(2), art 40(2)). But according to the figures provided by the Beijing department store (n 116), in practice, mostly, a daily rate of 0.1% of the total value of the contract was charged; where the total amount of penalty exceeded 15% of the contract value, a request could be made to the authority to handle the matter: HE et al (n 112) 197-198.

[125] ECL Replies (n 113) section 9.

[126] Eg, 加工承揽合同条例[Regulations on Contracts for Processing and Work], issued by State Council on 20 Dec 1984, arts 21(5), 22(2), 22(5); 工矿产品购销合同条例[Regulations on the Sale and Purchase of Industrial and Mineral Products], issued by the State Council on and effective as of 23 Jan 1984, arts 35(1), (5), 36(1)(3)(4). Even though legislators granted some freedom to the parties (eg, Regulations on Contracts for Processing and Work, art 21(4); 仓储保管合同实施细则[Implementation Regulations on Contracts for Warehousing and Storage], issued by Ministry of Commerce, Ministry of Foreign Economic and Trade and State Bureau of Material Reserve on 15 Oct 1985, approved by State Coucil on 25 Sept 1985, effective as of 1 Jan 1986, art 25(1); 建筑安装工程承包合同条例[Regulations on Contracts for Construction and Installation Projects], issued by the State Council on and effective as of 8 Aug 1983, art 13(1)(2), (2)(4)), a general cap might apply: ECL Replies (n 113) section 9 ('the total price of the unperformed part of the contract'); Implementation Reg TCL (n 120) art 22(3) ('the total amount of contract price, remuneration or fees').

[127] Implementation Reg TCL, ibid, art 22(3).

[128] One notable exception is the calculation of interests payable for delayed contract payment, which are still subject to semi-statutory regulation. Where the parties have not agreed upon it, people's courts must apply the relevant rate issued by the People's Bank of China ('PBC') for delayed payment of loans between financial institutions: eg, 最高人民法院关于逾期付款违约金应当按照何种标准计算问题的批复[SPC Reply on the Issue of Criterion to be Followed in Calculating Weiyue Jin for Delayed Payment], Fa Shi [1999] No. 8, approved by SPCJC No. 1042 Meeting on 29 Jan 1999, effective as of 16 Feb 1999, as amended by Fa Shi [2000] No. 34, approved by SPCJC No. 1137 Meeting on 13 Nov 2000, effective as of 21 Nov 2000; 最高人民法院关于审理涉及金融资产管理公司收购、管理、处置国有银行不良贷款形成的资产的案件适用法律若干问题的规定[SPC Provisions on Certain Issues Concerning the Application of Law in the Adjudication of Cases Involving the Purchase, Management or Disposition by Financial Asset Management Companies of Assets Acquired Through Bad Loans by State Banks], Fa Shi (2001) No. 12, approved by SPCJC No. 1167 Meeting on 3 April 2001, effective as of 23 April 2001, art 7; 最高人民法院关于审理建设工程施工合同纠纷案件适用法律问题的解释[SPC Interpretation on the Application of Law in the Adjudication of Cases Involving Disputes under Contracts for Construction Projects], Fa Shi [2004] No. 14, approved by SPCJC No. 1327 Meeting on 29 Sept 2004, effective as of 25 Oct 2004, art 17. However, in relation to loan contracts between non-state parties, agreed interests (including any *weiyue jin*) for delayed payment are capped by 24% per annum; any interests over and above that cap but up to 36% are deemed 'natural debts' and courts will not support their recovery whether paid or not; any interests above 36% are invalid and, if already paid, may be claimed back: 最高人民法院关于审理民间借贷案件适用法律若干问题的规定[SPC Provisions on Certain Issues Concerning the Application of Law in the Adjudication of Cases Involving Loans Between Non-State Parties], Fa Shi [2015] No. 18, approved by the SPCJC No. 1655 Meeting on 23 June 2015, effective as of 1 Sept 2015, arts 29, 30.

rewriting *weiyue jin* clauses adjudicated to be 'unfair' based on highly fact-sensitive, contextual standards.[129] Acknowledging that contractual *weiyue jin* served useful purposes where there was no commonly available market price to measure damages, a strengthened judiciary embraced and developed an equity-like approach which very often derogated from the letter of the law and the terms of the contract and which placed great emphasis on achieving a 'harmonious' compromise between the parties.[130] Against this background the Foreign-related Economic Contract Law took the significant step by openly countenancing a general judicial power to adjust agreed *weiyue jin*.[131] After 1999 this power consolidated and filled the lacuna left by the annulment of the previous statutory restrictions.

It was the model under the Foreign-related Economic Contract Law that, by and large, found its way into the CCL. However, the CCL still borrowed only the 'form' of European codes. It had to, and did, go through a process of, as Roscoe Pound called for, nurturing a unique technique of interpretation and application according to the local circumstances.[132] The SPC has played a major role in doing this work, with a high degree of interventionism and reminiscent of the traditional punitive view, which, while largely buried, still ruled from the grave. What is most distinctive of the history of *weiyue jin* is the emergence of an equity-like approach under which Chinese courts are, unlike their common law or even continental European counterparts, more likely and freely to rewrite a valid and enforceable contract by adjusting agreed damages.

IV. JUDICIAL REVIEW OF AGREED DAMAGES CLAUSES

A. The Anglo-Australian Penalty Rule

1. The 'straightjacket' of the old law

[129] PL Chang, 'Deciding Disputes: Factors that Guide Chinese Courts in the Adjudication of Rural Responsibility Contract Disputes', (1989) 52 Law and Contemporary Problems 101, 132. The development was evident in late 1970's and 1980's. Little trace of it could be found in statutes, cases or contracts in the 1950's. Cf in all but one drafts of Civil Code in the 1950's a court was allowed to reduce *weiyue jin* agreed upon by the parties 'extenuatorily' in light of the performance of the contract where the amount is excessively high: HE et al (n 112), version 1, art 18(2); version 2(1), art 60; version 2(2), art 41(2). This power was criticised by some as incompatible with the statutory cap: HE et al (n 112) 220 (revised version 2(2)). Both the reduction power and the statutory cap was abandoned version 3, see HE et al (n 112) 232 et seq, 239. Contra, the 1964 USSR Civil Code (n 121) art 190.

[130] Cf the so-called 'reciprocity norm': R Macneil, 'Contract in China: Law, Practice, and Dispute Resolution', 38 Stanford Law Review 303, 341-42, 360-61, 375-79 (1986). Further, Chinese judges were said to 'feel significantly less bound by the precise terms of the contract and freer to soften and compromise the impact of failure to perform on the breaching party': L Cheng and A Rosett, 'Contract with a Chinese Face: Socially Embedded Factors in the Transformation from Hierarchy to Market, 1978-1989', Journal of Chinese Law, 5 (1991): 143, 225, additionally 221-22, 230.

[131] FECL (n 118) art 20(2).

[132] R Pound, 'Comparative Law and History as Bases for Chinese Law', 61(5) Harvard L R 749, 1948, at 759 (highlighting the use of comparative law in this endeavour).

Before investigating how the common law rationalises judicial intervention into agreed damages clauses, we must examine the test for a penalty and its reformation. The English definition of a penalty can be traced back to *Dunlop*, in which Lord Dunedin classically stated that

> The essence of a penalty is a payment of money stipulated as in terrorem of the offending party; the essence of liquidated damages is a genuine covenanted pre-estimate of damage.[133]

This statement contains two definitions: a penalty and a liquidated damages clause and each in turn derive from a different source.[134] However this definition of a penalty provided is not sufficient to allow a penalty to be identified. The Latin phrase 'in terrorem' appears to import a sort of *mens rea* requirement on the part of the person for whose benefit the clause is designed to operate. Although the Latin term was later abandoned and substituted with 'intended to deter',[135] the cases applying the definition were never decided upon the questionwhether the beneficiary of the clause intended it to operate in a coercive way. In contrast the focus was always upon the definition of a liquidated damages clause and a penalty was simply treated as its negative counterpart, ie a clause that provides for something in excess of a 'genuine … pre-estimate of loss'.[136] In this way , 'a payment of money stipulated in terrorem of the offending party' describes a conclusion of law arrived at by the application of the 'genuine pre-estimate' of loss test, to which it adds nothing.[137] In *Cavendish* Lords Neuberger and Sumption as well as Lord Mance[138] endorsed an important, but neglected[139] statement by Lord Radcliffe about the redundancy of the *in terrorem* requirement.[140]

The simple dichotomy described above was the focus of the greatest criticism in *Cavendish*. Lords Neuberger and Sumption complained that the law had '… become the

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[133] *Dunlop* (n 9) 86, referring to *Clydebank* (n 71). See also his earlier judgment in *Public Works Commissioner v Hills* [1906] AC 368, 375–376.

[134] Penalty – *Elphinstone v Monkland Iron & Coal Co* (1886) 11 App Cas 332, 348 (Lord Halsbury), repeated in *Clydebank* (n 71) 10. Liquidated damages – *Wallis v Smith* (n 59) 267 (Cotton LJ).

[135] In *Cavendish* the Court of Appeal suggested a more modern translation of 'intended to deter': *El Makdessi v Cavendish Square Holdings BV* [2013] EWCA Civ 1539, [58]. Similarly, in *Paciocco* (n 14) the High Court of Australia stressed that subjective or actual intention was immaterial and a penalty need not be 'in terrorem of' the offending party: [17], [31]-[32] (Kiefel J, French CJ agreeing); [243], cf [257]-[259] (Keane J).

[136] *Murray v Leisureplay* (n 52) [111] (Buxton LJ, with whom Clarke LJ agreed): it was '... important to note that the two alternatives, a deterrent penalty; or a genuine pre-estimate of loss; are indeed alternatives, with no middle ground between them'. Their approach was rejected by Arden LJ at [15].

[137] *Lordsvale Finance plc v Bank of Zambia* [1996] QB 752, 762G (Colman J), approved in *Cine Bes Filmcilik VE Yapimcilik v United International Pictures* (*Cine*) [2003] EWCA Civ 1669, [2003] All ER (D) 312 (Nov); *Murray v Leisureplay* (n 52) [106], [109] (Clarke and Buxton LJJ); *Euro London Appointments Ltd v Claessens International Ltd* [2006] EWCA Civ 385, [2006] 2 Lloyd's Rep 436, [2006] All ER (D) 79 (Apr), [30]–[31].

[138] *Cavendish* (n 7) [28] and [140] respectively and to similar effect at [248] (Lord Hodge).

[139] Eg it is not mentioned in H McGregor, *McGregor on Damages* (19th edn Sweet & Maxwell 2014) or E Peel, *Treitel on The Law of Contract* (14th edn Sweet & Maxwell 2015). Cf R Halson, *Contract Law* (2nd edn Pearson 2013) 507.

[140] *Bridge v Campbell* (n 60) 622 ('I do not myself think that it helps to identify a penalty, to describe it as in the nature of a threat "to be enforced *in terrorem* …". I do not find that that description 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 them and yet are, as I understand it, entitled to claim the protection of the court when they are called upon to make good their promises.').

prisoner of artificial categorisation' and that a 'penal' provision and a 'genuine pre-estimate of loss … are not natural opposites or mutually exclusive categories.'[141] Similarly Lord Hodge referred to 'the straightjacket into which the law risked being placed by an over-rigorous emphasis on' the above dichotomy.[142] The discussion in *Cavendish* of the previous law acknowledged the attempts that the courts had made to escape this 'straightjacket' and expand the categorisation of stipulated damages clauses. These attempts took two forms. First, many cases contained a concurrent, but contradictory, emphasis such as that of Lord Woolf in *Phillips Hong Kong Ltd v Attorney General of Hong Kong (1993)*:[143]

> '... the court has to be careful not to set too high a standard and bear in mind that what the parties have agreed should normally be upheld. Any other approach will lead to undesirable uncertainty especially in commercial contracts.'

This approach was put more succinctly in *Murray v Leisureplay plc*[144] where Arden and Buxton LJJ described the 'generous margin' accorded to parties before a provision is considered penal. However, no readily applicable rule is deducible from this statement.

Second, in some cases it was simply suggested that there existed a third category of case which is not a genuine pre-estimate of loss but which is nonetheless enforceable. In *Murray v Leisureplay plc*[145] Arden LJ said that she 'found valuable' an earlier suggestion by Colman J in *Lordsvale Finance plc v Bank of Zambia*[146] that the dichotomy 'does not cover all the possibilities'. This shows that the entire notion of identifying a genuine pre-estimate of loss at the time of contract was under severe stress. Thus in *Paciocco*, where the bank by its own admission fixed a 'Late Payment Fee' from time to time without reference to any loss that a failure to make due payment might cause, it was held that 'a genuine pre-estimate of loss' ought to be recognised as 'a descriptive phrase' of an extravagant and unconscionable clause and hence 'the reflex of a penalty'.[147] According to this approach, a genuine pre-estimate of loss is unhelpful as it is defined by what is not a penalty, which is in turn to be determined by some other test.

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[141] *Cavendish* (n 7) [31] (Lord Carnwath agreeing).
[142] ibid [225].
[143] (1993) 61 BLR 41, 59. Also, *Robophone Facilities v Blank* (n 59) 1477 (Diplock LJ).
[144] Above n 52, [43], [114], relied upon in *Cadogan Petroleum Holdings Ltd v Global Process Systems* [2013] EWHC 214 (Comm), [36].
[145] ibid [15]; cf [111] (Buxton LJ, with whom Clarke LJ agreed): there is 'no middle ground between' the two alternatives.
[146] Above n 137. The judgment of Coleman J in the *Lordsvale* case was the most lauded previous judgment in *Cavendish* (n 7) [27]-[28] (Lords Neuberger and Sumption, Lord Carnwath agreeing); [145] *et seq* (Lord Mance); [225] (Lord Hodge). Also, *United International Pictures* (n 137) [15] (Mance LJ, as he then was); *Lancore Services Ltd v Barclays Bank Plc* [2008] EWHS 1264 at [100] Hodge J QC said that the condition in question 'falls outside the traditional dichotomy between a genuine pre-estimate of damages and a penalty, and that the applicable test is that of commercial justifiability'
[147] Above n 84, FCFCA, [100] (Allsop CJ, with whom Besanko and Middleton JJ agreed). See also, FCA, [25]. The High Court affirmed the Full Court's decision that the bank's failure to refer to loss was no conclusive evidence of a penalty: *Cavendish* (n 7) [30] (Kiefel J, French CJ agreeing): the dichotomy drawn by Lord Dunedin 'should not be understood as a limiting rule'; [283] (Keane J).

2. The new test in the Cavendish case

The perceived unsatisfactory state of the old law led the Supreme Court in *Cavendish* to feed the above considerations back into the formulation of a new test which now places emphasis upon the justifying interest of the party seeking to enforce the clause. Consequently, the definition of a penalty stated by Lord Dunedin in *Dunlop* as a clause that provided for the payment of a sum that was greater than 'a genuine pre-estimate of loss' will no longer apply generally.[148] The new test was stated by their Lordships in slightly differing formulations.[149] In short, it is a test of extravagance and unconscionability which comprises two essential elements.[150] The real change consists in the adoption of 'a legitimate interest' as the new yardstick for identifying the relevant loss(es) to be compared with the value of agreed damages, whereas the requirement for a high degree of disproportionality between the two is maintained.[151] Thus, the Supreme Court substituted the new yardstick for Lord Dunedin's formula 'the greatest loss that could conceivably be proved to have followed from the breach' .[152] In doing so the Court placed reliance upon and reinvigorated Lord Atkinson's test in *Dunlop* that the agreed damages should be shown to be incommensurate with the 'probable or possible interest in the due performance of the contract'.[153] The relevant interest has been described as an interest in 'performance or in some appropriate alternative to performance'[154] of the 'principal'[155] or more accurately 'primary'[156] obligation, or simply as an 'interest

[148] *Cavendish* ibid [25], [35] (Lords Neuberger and Sumption, Lords Carnwath agreeing): suggesting that it may continue to apply in 'straightforward' cases; [145] (Lord Mance, Lord Toulson agreeing at [292]); [225] (Lord Hodge).

[149] ibid [35] (Lords Neuberger and Sumption, Lords Carnwath and Clarke agreeing): 'whether the impugned provision is a secondary obligation which imposes a detriment on the contract-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation'; [152] (Lord Mance): '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, and, second, whether, assuming such an interest to exist, the provision made for the interest is nevertheless in the circumstances extravagant, exorbitant or unconscionable'; [255] (Lord Hodge, Lord Toulson agreeing at [293]): '…the 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'.

[150] Perhaps only Lord Mance expressly acknowledges the two distinct elements at ibid [152].

[151] In respect of the latter element strong words such as 'extravagant', 'exorbitant', 'unconscionable' and 'out of all proportion' are used to denote the 'high hurdle' that must be overcome in concluding that the clause is of a 'plainly excessive nature', which is satisfied only in the 'exceptional' case of 'egregious contractual provisions', see particularly *Paciocco* (n 14) [29], [34], [53]-[54] (Kiefel J, French CJ agreeing); [156] (Gaegler J); [250]-[251] (Keane J); [318] (Nettle J). Also, *Ringrow Pty Ltd v BP Australia Pty Ltd* [2005] HCA 71, (2005) 224 CLR 656, [32].

[152] *Dunlop* (n 9) 87 (4(a)).

[153] ibid 96; also, 92.

[154] *Cavendish* (n 7) [35] (Lords Neuberger and Sumption).

[155] *Yzquierdo y Castaneda v Clydebank Engineering and Shipbuilding Co Ltd* (1903) 5 F 1016, 1022 (Lord Kyllachy), aff'd *Clydebank* (n 71) 19 (Lord Robertson), cited with approval in *Cavendish* (n 7) [246] (Lord Hodge, Lord Toulson agreeing); *Paciocco* (n 14) [135], [137] (Gageler J).

[156] *Cavendish* (n 7) [35] (Lords Neuberger and Sumption).

protected by the bargain'.[157] Such an interest is not necessarily commercial but may be 'social' or otherwise non-commercial in nature.[158]

The critical distinction is that the requisite legitimate interest extends beyond a mere interest in compensation for loss caused by the breach of contract.[159] Such an interest is not that easy to derive from the judgments but would appear to be: in *Makdessi* Cavendish had a 'very substantial and legitimate interest in protecting the value of the company's goodwill' and in ensuring that the seller remained loyal;[160] in *Beavis* Parking Eye 'had a legitimate interest …[in imposing] the parking charge in order to encourage the prompt turnover of car parking spaces and also to fund its own business activities and make a profit'.[161] Likewise, a belligerent in a war would have an interest in avoiding the use of naval and military specialists in order to assess damages for the late delivery of motor torpedo boats,[162] a supplier (Dunlop) seeking to enforce £5 payable for every tyre sold below a minimum price had 'an obvious interest'[163] in avoiding their prices being undercut and 'in the maintenance of a system of trade which only functions if all the trading partners adhere to it'[164] and the lender of a syndicated loan has a legitimate interest in charging a higher rate upon default in that the debtor's default affects the credit risk and also possibly the cost of administering the loan.[165] Such interests appear to be real and substantial, although it may be difficult to place a precise figure on their value.

However, in none of the cases above were the outer limits of the legitimate interest clearly marked out. In *Paciocco*, while it was unanimously acknowledged that *as a matter of principle* the 'interest protected by the bargain' should not be confined to 'direct costs associated with the recovery of the minimum payment outstanding', including 'the sums outstanding, enforcement costs and interest',[166] a majority (French CJ, Kiefel, Gegaler and Keane JJ, Nettle J dissenting) extended it to three particular heads of loss: 'operational costs',[167] 'provisioning costs'[168] and 'regulatory capital costs'.[169] Not all 'operational costs'

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[157] *Clydebank* (n 71) 20 (Lord Robertson); *Paciocco* (n 14) [28] (Kiefel J), aff'g above n 84, FCFCA, [103], which was approved in *Cavendish* (n 7) [152]-[153] (Lord Mance).
[158] *Cavendish* (n 7) [29] (Lords Neuberger and Sumption); [249] (Lord Hodge). Cf [152] (Lord Mance): 'legitimate business interest'.
[159] ibid [32] (Lords Neuberger and Sumption); [152] (Lord Mance); *Paciocco* (n 14) [26], [41] (Kiefel J).
[160] ibid [274] (Lord Hodge). Also, [75] (Lords Neuberger and Sumption). Lord Mance added that the clauses were fairly designed to protect against competition that was difficult to detect: [172].
[161] ibid [286] (Lord Hodge). Also, [99] (Lords Sumption and Neuberger); [193] (Lord Mance).
[162] These were the facts of *Clydebank* (n 1) 20 (Lord Roberson).
[163] *Dunlop* (n 9) 91-92 (Lord Atkinson), paraphrased in *Cavendish* (n 7) [23] (Lords Neuberger and Sumption) as 'Lord Atkinson pointed… to the critical importance to Dunlop of the protection of their brand, reputation and goodwill, and their authorised distribution network.'
[164] *Cavendish* ibid [152] (Lord Mance), also [137], citing *Dunlop* (n 9) 91-93 (Lord Atkinson).
[165] *Lordsvale Finance plc v Bank of Zambia* (n 137). See *Cavendish* ibid [148], [152] (Lord Mance).
[166] *Paciocco* (n 14) [13]-[14], [65] (Kiefel J); [323] (Nettle J): 'repayment of the facility with interest at the agreed rate plus adequate recoupment of any costs imposed on the lender as a result of the customer's failure to adhere to the terms of the facility'.
[167] ibid [59]: such as 'costs incurred by the use of staff contacting Mr Paciocco and other administration costs', including 'overhead' costs. Also, [101] (Gageler J).
[168] ibid [60]: a debit on the ANZ's financial accounts reflecting the possibility of non-recovery of its loan to Mr Paciocco. Also, [99] (Gageler J).

and neither 'provisioning costs' nor 'regulatory capital costs' are 'real' losses in the sense that they are, viewed from the date of judgment, both actually incurred and causally linked to Mr Paciocco's breach of contract.[170] The majority nonetheless agreed with Allsop CJ in holding that by excluding those costs from consideration the primary judge had 'failed to address the question of extravagance and exorbitance prospectively, that is *ex ante*'.[171] However, to extend the protected interest to hypothetical losses and to disregard entirely later transpired facts seems to introduce an element of artificiality and to sanction speculation when knowledge is available.[172]

3. The persisting abnormality

In *Cavendish*, the Supreme Court declined the invitation to abolish the penalty rule, choosing instead to restate it.[173] The adoption of a broader 'legitimate interest' was intended to salvage, not abolish, the *ex ante* assessment embodied in Lord Dunedin's tests in *Dunlop*.[174] In this regard, Lords Neuberger and Sumption suggest that:[175]

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[169] ibid [63]: an increase of the ANZ's regulatory capital to cover unexpected losses, including those resulting from actual non-recovery of loans to some customers. Also, [100] (Gageler J).

[170] ibid [326] (Nettle J): no extra interest could be identified as representing costs 'in fact incurred' or 'which the parties could reasonably have conceived' at the time of contract. Thus, 'overhead costs' bore no relation to the breach, see above n 84, FCA, [161]-[164], cf FCFCA, [176]; 'provisioning costs': FCA, [150] ('merely an accounting entry' and 'no more than a probability' of non-payment which did not materialise in Mr Paciocco's case), cf *Paciocco* (n 14) [172] (Gageler J: 'directly affected recorded profit') and FCFCA, [167] (a 'present impairment of value and worth' reflecting a future risk of an economic loss); 'regulatory capital costs': FCA, [155] ('part of the costs of running a bank' and not 'directly or indirectly related to any of the late payments by Mr Paciocco'), cf *Paciocco*, [172] (Gageler J: 'a real outgoing') and FCFCA, [167] (the increase of the ANZ's regulatory capital was derived from funds withdrawn from its circulating capital). Contra, *Paciocco*, [68] (Kiefel J, French CJ agreeing: the costs were 'real because they had to be taken into account by the ANZ'); [277]-[278] (Keane J: ANZ had an interest in 'reward for … the risk assumed by the bank in making the facility available to the customer' and in 'freedom … to pursue more profitably its business of lending to its customers'), cf [327]-[330] (Nettle J).

[171] Above n 84, FCFCA, [26]-[28].

[172] On this view the majority's decision would be better explained on the ground that the party in breach (Mr Paciocco) failed to adduce adequate evidence to show that the fee was out of all proportion to the ANZ's protected interest, be it confined to the direct costs or not: *Paciocco* (n 14) [69] (Kiefel J), also [44]-[45] citing *Dunlop* (n 9) 92 (Lord Atkinson) and *Clydebank* (n 71) 20 (Lord Roberson).

[173] *Cavendish* (n 7) [36]-[39] (Lords Neuberger and Sumption, Lord Carnwath agreeing); [162]-[170] (Lord Mance); [292] (Lord Toulson).

[174] In *Cavendish*, *Dunlop* was criticised for being over-rigid 'immutable rules of general application'[174] and 'a straightjacket': ibid [225] (Lord Hodge), but clearly, it was not formally overruled. Also, *Paciocco* (n 14) [32] (Kiefel J): Lord Dunedin's tests are 'intended as guidance only'. While *Dunlop* was held to contain the 'governing principles' of the penalty rule ([115] (Gageler J); also, [5] (French CJ)), the intended meaning of Lord Dunedin's 'the greatest loss' was held to comprise the wider interest ([139], [143], [145] (Gageler J), citing *Commissioner of Public Works v Hills* [1906] AC 368 (PC) 375-76 (Lord Dunedin), which endorsed Lord Kyllachy's formulation in *Clydebank* (n 71), see n 155 above, and *Dunlop* (n 9) 86 (Lord Dunedin), which described the relevant loss as 'damage' rather than 'damages'.

[175] *Cavendish* (n 7) [22], cited with approval in *Paciocco* (n 14) [321] (Nettle J).

> [Lord Dunedin's] four tests are a useful tool for deciding whether these expressions can properly be applied to simple damages clauses in standard contracts. But they are not easily applied to more complex cases.

The suggestion appears to be that perhaps reference should still be made to the basic test in *Dunlop* for simple cases and to the extended test of *Cavendish* for more complex ones. In other words in the so-called simple cases it will continue to be sufficient to compare the amount stipulated with pre-fixed damages whereas only in more complex cases will it be necessary to identify whether the party enforcing the clause had a legitimate interest sufficient to justify the stipulation of a sum in excess of pre-fixed damages.

This approach is problematic for a number of reason. First the asserted empirical basis is not established. Lords Neuberger and Sumption state that the 'great majority of cases decided in England since *Dunlop* have concerned more or less standard damages charges in consumer contracts' in respect of which Lord Dunedin's tests 'have proved perfectly adequate'.[176] This assertion is contradictedby the prevalent types of standard forms which contain such clauses, such as construction contracts,[177] demurrage clauses in voyage charters[178] and what has become known as 'container demurrage'.[179] Secondthe co-existence of these two tests to determine the enforceability of any agreed damages provisio will inevitably raise boundary disputes as to what is a simple, and what a complex case. It was held in *Cavendish* that in a contract between 'properly advised parties of comparable bargaining power' there should operate a 'strong initial presumption' of enforceability.[180] However to make the division on this basis is unpromising, since the application of the penalty rule 'does not depend on any disparity of power of the contracting parties'.[181] A workable criterion to distinguish simple from complex cases is thus absent.[182]

Critically, in neither *Cavendish* nor *Paciocco* was a convincing rationale furnished for the penalty rule, to justify the exceptional but necessary intrusion into freedom of contract. *Cavendish* does however repeat the previously articulated advantages of agreed damages clauses as Lord Hodge asserted forcefully:

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[176] ibid [25].
[177] B Eggleston, *Liquidated Damages and Extensions of Time in Construction Contracts* (3rd edn, Wiley-Blackwell 2009).
[178] *President of India v Lips Maritime Corp* [1988] AC 395.
[179] *MSC Mediterranean Shipping Company SA v Cottonex Anstalt* [2016] EWCA Civ 789.
[180] *Cavendish* (n 7) [35]. Cf D Hope, 'The Law on Penalties – A Wasted Opportunity?', (2016) 33 JCL 93 (suggesting that the penalty rule should not apply to contracts between commercial parties of equal bargaining power). However, the author of this article takes the view that arguments founded on freedom of contract do not of themselves rule out interference based on other considerations and that it is critical to understand what those considerations are and whether they are strong enough to trump freedom of contract.
[181] ibid [257] (Lord Hodge), citing *Imperial Tobacco Co (of Great Britain and Ireland) Ltd v Parslay* [1936] 2 All ER 515 (CA) 523 (Lord Wright MR); cf [262].
[182] Eg, *Paciocco* (n 14) [323]-[324], [346] (Nettle J): while adopting the division, his Honour merely suggested that the new test was applicable as an exception when there was 'evidence or other indication of any interest' apart from the direct costs resulting from the delayed payment or when likely damage was 'not capable of precise pre-assessment'.

> There is without doubt real benefit in parties being able to agree the consequences of a breach of contract, particularly where there would be difficulty in ascertaining the sum in damages… Parties save on transaction costs...[183]

Some of these advantages are simply overstated in that they do not sufficiently factor in indeterminacy in legal rules and the cost of negotiating the clause and any 'counter measures'.[184] At any rate, such advantages do not obviate the need for a safety valve to filter out excessive damages. The principal justification traditionally suggested for the penalty rule is one rested upon public policy.[185] Thus the penalty rule is said to be a rule of construction based on a public policy that 'the courts will not enforce a stipulation for punishment for breach of contract'.[186] In *Paciocco* Kiefel J (as she then was, French CJ agreeing) stated:[187]

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[183] *Cavendish* (n 7) [259]. The articulated advantages include: *Philips Hong Kong v A-G of Hong Kong* (1993) 61 BLR 41, 54-55 (Lord Woolf): such clauses quantify in advance the amount of damages a promisor would have to pay in the event of his breach, thus enabling him to convince a promisee of his reliability, and make the promisee aware of his likely recovery; *Diestal v Stevenson* [1906] 2 KB 345, 350 (Kennedy J): after a breach has occurred it has been said that these clauses save legal costs because the court will not be required to assess as unliquidated damages the losses of the promisee; *Wise v United States* 52 Ct. Cl. 400, 1917 U.S. Ct. Cl. LEXIS 95, 249 US 647 (1918) 649 (Clarke J): such clauses avoid 'difficulty, uncertainty, delay and expense'.

[184] Eg, a promisor confronted with a liquidated damages clause may respond by proposing a *force majeure* clause for his own protection.

[185] Attempts (mostly in the US literature) to justify the penalty rule from an economics perspective are far from conclusive. For example, resort has been had to the notion of 'efficient breach', viz a breach of contract which enables the contract breaker to 'redirect' his contractual performance to a third party who is prepared to pay more for it than the original contractor; this relocation is said to be efficient because it places the resource in the hands of the person who values it most highly: see generally P Newman (ed), *The New Palgrave Dictionary of Economnics and the Law,* (Palgrave Macmillan, 2002), Vol 1, 174-5. Enforcing a penalty was said to prevent an 'efficient breach' from occurring: JP Fenton, 'Liquidated Damages as Prima Facie Evidence' (1975) 51 Indiana LJ 189; RL Birmingham, 'Breach of Contract, Damage Measures, and Economic Efficiency' (1970) 24 Rutgers LR 273. However, 'efficient breach' may occur by private bargaining: CJ Goetz and RE Scott, 'Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach' (1977) 77 Col LR 554, 568 (applying the famous Coase theorem that in the absence of transaction costs the imposition of legal liability is irrelevant to the attainment of efficiency, see R Coase, 'The Problem of Social Cost' (1960) 3 Journal of Law and Econ 1); A Burrows, *Remedies for Torts and Breach of Contract* (3rd edn, OUP 2004) 450-51. Further explanations proffered include: a rule such as the present one which denies enforceability to penalties is necessary to deter contractors from trying to obtain the stipulated sum by inducing their contractual partner to breach the contract. Such 'breach inducement' is wasteful in itself and might cause the other party to waste further resources in his attempt to avoid it: KW Clarkson, RL Miller and TJ Muris, 'Liquidated Damages v Penalties: Sense or Nonsense' (1978) Wisconsin LR 351; both liquidated damages clauses and penalties should be enforced either on the basis that such clauses allow the promisee to effectively insure against otherwise uncompensable idiosyncratic loss: Goetz and Scott, ibid; or because to do otherwise would be to deprive the recipient of a benefit he has in fact paid for: SA Rea, 'Efficiency Implications of Penalties and Liquidated Damages' (1984) 13 J Legal Stud 147; M Pressman, 'The Two Contract Approach to Liquidated Damages: A New Framework for Exploring the Penalty Clause Debate' (2013) 7 Virg Law & Bus Rev 651. Also inconclusive are justifications based on behavioural decision theory: MA Eisenberg 'The Limits of Cognition and the Limits of Contract' (1995) 47 Stan Law Rev 211, esp 225-236; RA Hillman, 'The Limits of Behavioural Decision Theory in Legal Analysis: The Case of Liquidated Damages' (2000) 85 Cornell Law Rev 717, 738.

[186] *Cavendish* (n 7) [243] (Lord Hodge, Lord Toulson agreeing). Also, [7], [9] (Lords Neuberger and Sumption, with whom Lord Carnwath agreed); [131] (Lord Mance).

[187] *Paciocco* (n 14) [32] (emphasis added). Also, [155] (Gageler J), citing with approval Diplock LJ's statement of 'the rule of public policy' against 'a penalty or punishment imposed upon the contract-breaker' in *Robophone Facilities v Blank* (n 59) 1446 and Frankfurter J's 'basic reason' for the doctrine 'that the infliction of punishment through courts is a function of society and should not inure to the benefit of individuals' in *Priebe & Sons Inc v United States* 332 US 407, 417-18 (1947).

> the basal purpose of the larger principle, or policy, of the law … has not changed over time. It is that a sum may not be stipulated for payment on default if it is stipulated as a *threat* over the person obliged to perform; it may not be stipulated where the purpose and effect of requiring payment is to *punish* the defaulting party.

Notwithstanding the loose reference to 'threat', or deterrence, this justification in effect treats a penalty as an invalid or unenforceable contract term which is 'contrary to public policy' and hence illegal at common law. However, the nature and content of the public policy that necessitates the penalty rule is never adequately articulated. This inadequacy has created a few taxonomical inconsistencies.

First, in *Cavendish* the Supreme Court rejected the extension of the penalty rule to an event other than the promisor's breach of contract and reaffirmed the traditional boundary of the 'penalty jurisdiction' that the agreed damages must be triggered by such a breach.[188] Thus, the penalty rule does not apply where the agreed sum is payable upon the payor's breach of a contractual obligation owed by the payor to a third party[189] or where a retention of instalments paid is triggered by a lawful termination of the contract.[190] However, if as Kiefel J asserts the underlying policy of the penalty rule is simply one against punishment, then it is difficult to see why a payment premised on a non-breach event cannot punish the payor. Conversely, if the English approach that confines the scope of judicial review to agreed sums premised on a breach of contract is to be preferred,[191] then it is reasonable to expect that a breach of contract constitutes an essential, even though hidden, ingredient to the underlying policy of that approach.

Secondly, it seems to be assumed that the relevant public policy is one that comes into play at the time when the contract is made and that it dictates an *ex ante* assessment as to the validity or enforceability of the clause in question. In *Paciocco* the primary judge's decision was thus overturned on the ground that she had taken into consideration facts that transpired subsequent to the time of contract.[192] However, consistently with Kiefel J's rationalisation above it can be questioned whether post-contractual evidence should be excluded, given that it could be said that it is not the parties' intention to punish, but the punitive 'purpose and

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[188] *Cavendish* (n 7) [43] (Lords Neuberger and Sumption, Lords Carnwath and Clarke at [291] agreeing); [130] (Lord Mance), [258] (Lord Hodge), with Lord Toulson agreeing with both at [292]. See discussions above (text to and after n 74) of *Andrews* (n 20).

[189] *Export Credits v Universal Oil* (n 19). See also *Edgeworth Capital (Luxenbourg) Sarl v Ramblas Investments BV* [2015] EWHC 150 (Comm) [68] and *In re B (Children) (Removal from Jurisdiction: Enforcement of Contract Order* [2015] EWCA Civ 1302, [2016] 1 WLR 2326 [65].

[190] *Cadogan Petroleum Holdings Ltd v Global Process Systems* [2013] EWHC 214 (Comm).. For recent further illustrations see *Lehman Brothers Soecial Financing Inc v Carlton Communications Ltd* [2011] EWHC 718 (Ch); *Berg v Blackburn Rovers Football Club & Athletic plc* [2013] EWHC 1070 (Ch), [2013] IRLR 537: *Hayfin Opal Luxco 3 SARL v Windermere VII CMBS Plc* [2016] EWHC 782 (Ch), *Brown's Bay Resort Ltd v Pozzoni* [2016] UKPC 10 and *Richards v IP Solutions Ltd* [2016] EWHC 1835. Generally, R Halson, chap 8 in M Furmston (ed), *The Law of Contract* (5th edn 2013) paras 8.112-3.

[191] See text accompanying nn 95-97 above.

[192] Text to n 171 above.

effect' of the clause that constitutes the recognised object of the assessment.[193] Further, in *Cavendish* Lords Neuberger and Sumption stated that the penalty jurisdiction was fundamentally distinguishable from a review of the fairness of primary contractual obligations in that it regulated the fashioning of a remedy for a breach of contract.[194] If this were right, then there is something to be said for viewing the underlying policy as one regulating remedy awarding rather than contract making, with the consequence that the relevant clause be assessed by reference to the time when the remedy is awarded.

Thirdly, the obscurity in policy of the penalty rule can be seen from its uneasy relationship with the statutory regime that regulates unfair contract terms in the UK and Australia. The basic logic of the statutory regime is that contracts made by consumers, who are generally in a weaker bargaining position vis-à-vis corporate parties, are likely to disadvantage consumers unfairly and should be subjected to close scrutiny. It is thus informed by a policy against unscrupulous advantage taking in contract negotiation. In *Cavendish* the Supreme Court rejected an argument that the penalty rule be abolished by reason of the existence of the statutory regime, stating that the statutory regime was limited in scope, not covering 'non-consumer contracts' including those involving 'professionals and small businesses'.[195] However, unless the penalty rule can be shown to rest upon a distinct policy from that of the statutory regime, the claim that it remains useful in a commercial context seems misplaced. Additionally, the Supreme Court's implicit concession that the penalty rule is superfluous in a consumer context, which suggests that its underlying policy aligns with that of the statutory regime and addresses unscrupulous advantage taking,[196] seems intuitive and unproved.

The standard expression of the policy against punishment may be questioned when one realises that regulation over agreed damages is inextricably associated with remedial justice or appropriateness. In *Cavendish* Lords Neuberger and Sumption stated the legal issue as one concerning the 'availability of remedies for a breach of duty' and described one of the 'broader social and economic considerations' to be taken into account as that 'the law will not generally make a remedy available to a party, the adverse impact of which on the defaulter significantly exceeds any legitimate interest of the innocent party'.[197] Professor Burrows also points out that the 'strongest support' for the penalty rule lies in the 'unavailability of punitive

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[193] Emphasis addded. The assessment is sometimes said to be of the reasonableness of the agreed sum: E McKendrick & Q Liu, *Contract Law Australian Edition* (Palgrave Macmillan 2015) 474-75.

[194] Text and citation to n 96 above.

[195] *Cavendish* (n 7) [38], [167] (Lord Mance); [260], [262] (Lord Hodge).

[196] A penalty was included in the indicative list of unfair contract terms under the 1999 Regulations: Schedule 2, para 1(e). See now the Consumer Rights Act 2015 Schedule 2 Part A para 6. It is also of relevance to note that in both *Beavis* and *Paciocco* the penalty rule, applied as a rule of contract enforceability, and the statutory regime led to the same outcome: *Cavendish* ibid [115] (Lords Neuberger and Sumption, Lord Carnwath agreeing); [199], [213] (Lord Mance); [288], [289] (Lord Hodge); [291] (Lord Clarke); cf [295], [315], [316] (Lord Toulson dissenting, pointing out that the penalty rule and the 1999 Regulations employ different tests, including different placements of onus of proof, see further n 12 above); *Paciocco* (n 14) [303]-[304] (Keane J, French CJ and Kiefel J agreeing) ; [201] (Gageler J).

[197] *Cavendish* ibid [29]. Their Lordships drew an analogy with the notion of 'legitimate interest' in *White & Carter (Councils) Ltd v McGregor* [1962] AC 413. With respect, however, the issue in *White & Carter* is not the availability of remedies, see further Q Liu, 'The White & Carter Principle: A Restatement' (2011) 74(2) MLR 171, 178-180, 184-186.

damages for breach of contract under common law',[198] which support is weakened by English courts' recent approach which allows in some cases recovery of damages greater than one's loss.[199] If the relevant policy is that excessive damages should not be awarded for a breach of contract,[200] even in the face of the parties' agreement upon a hefty sum, then the issue should be framed as one of remedy determination at the time of judgment which lies ultimately in judicial not private hands.[201] So formulated a policy is informed by a general notion of fairness but it features a distinction between agreed damages clauses and other contract terms to sustain a discretely targeted review. To fully appreciate the implications of adopting such a rationale one must see it at work, and this can be achieved through the lens of Chinese law.

B. The Chinese Weiyue Jin Rule

1. Article 114 of the Chinese Contract Law

The key legal rules concerning *weiyue jin* are contained in article 114 of the 1999 Chinese Contract Law, or 'CCL'.[202] Article 114(1) allows contracting parties to agree upon the amount of *weiyue jin* or the method of calculating it. Such an agreement is legally enforceable unless otherwise invalidated by law or qualified by the contract.[203] There are two prerequisites for a claim for *weiyue jin* to arise under article 114. First, the claim hinges on the accrual of a

[198] Burrows (n 185) 451; also, 445 ('the validity of parties' own agreed remedies will to some extent be assessed in line with the judicial remedies available. The further the parties stray from what the courts would themselves award, the more likely it is that the agreed remedy will be regarded as penal or otherwise invalid'). Equivalently, compensation is said to be the sole legitimate aim of an award of damages for breach of contract: MacNeil (n 8); R Halson, 'Neglected Insights into Agreed Remedies' ch 5 in D Campbell, L Mulcahy and S Wheeler (eds), *Changing Concepts of Contract* (Palgrave Macmillan 2013).

[199] Eg *Attorney-General v Blake* [2001] 1 AC 268. Cf Downes (n 51) 265-66.

[200] Not the award of an agreed price, cf Burrows (n 185) 440.

[201] See Frankfurter J's above cited statement in *Priebe v United States* (n 187); Mattei (n 36) 431: the suspicion with which civilian but especially common law jurisdictions view agreed damages clauses is difficult to justify in economic terms but is consistent with a general judicial hostility to attempts to curb the court's remedial discretion. In this respect arguments founded on freedom of contract, particularly that secondary terms form part of the whole bargain – see Chen-Wishart (n 51) 275-76, should act as relevant factors in remedy determination, rather than debar the judicial power to review agreed damages altogether.

[202] Such clauses are also subjected to generally applicable validity controls including 'genuineness of consent', 'fairness' and 'legality' (CCL arts 52, 54) as well as regulations tailored for such specific contracts as labour or personal employment contracts: 中华人民共和国劳动合同法[Labour Contract Law of the People's Republic of China], as amended by the 28th Meeting of the 10th NPCSC on 29 June 2007 and by the 30th Meeting of the 11th NPCSC on 28 Dec 2012, art 22 (agreed *weiyue jin* up to training costs where the employee breaches the agreed period of employment); 23 (agreed *weiyue jin* for a breach of restraint of trade clauses); art 25. Also, Implementation Regulations of Labour Contract Law, issued by State Council and effective as of 18 Sept 2008, art 26 (agreed *weiyue jin* for termination due to employee's fault).

[203] The parties may define the circumstances of breach that will trigger a claim for the agreed *weiyue jin*: CCL art 124(1). Thus a strained interpretation on such circumstances may result in a *weiyue jin* clause being sidestepped: *香港锦程投资有限公司与山西省心血管疾病医院等中外合资经营企业合同纠纷案[Hong Kong Jincheng Investment Co Ltd v Shanxi Cardiovascular Disease Hospital]*, SPC, 17 Aug 2010, (2010) Min Si Zhong Zi No 3 Civil Judgment (the agreed *weiyue jin* for 'delayed investment' was held not to apply to a total failure to invest).

liability for a breach of contract.[204] Thus article 124 has no application where the contract is either void *ab initio* or rescinded, but is applicable upon a termination of the contract.[205] Second, a claim for *weiyue jin* must by definition seek the payment of a sum of money, and cannot comprise any other form of detriment to the party in breach such as withholding payments or transfer of properties.[206] Hence, should *Makdessi* be decided by a Chinese court, it would most likely hold, like some members of the UK Supreme Court did for an entirely different reason,[207] that neither clause 5.1 nor 5.6 engage the relevant rule. Thus, *weiyue jin* bears a high degree of resemblance to normal damages, but this also makes it open to circumvention by clever drafting.

Once a claim for *weiyue jin* arises, it is subjected to the control mechanism under article 114(2), which states:

> Where the agreed *weiyue jin* are less than the loss occasioned, a party may request a people's court or arbitral tribunal to increase the damages; where the agreed *weiyue jin* are excessively more than the loss occasioned, a party may request a people's court or arbitral tribunal to reduce the damages appropriately.

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[204] This does not require proof of fault or loss: CCL, art 107. Also, 韩世远[HAN Shiyuan], 合同法总论[The Law of Contract], (3rd edn, Law Press, 2011 Beijing) 659-660.

[205] A *weiyue jin* clause is treated as a settlement and liquidation clause under CCL, art 98 which governs a legal act 'independent of contract performance' and thus survives contract termination: 最高人民法院关于当前形势下审理民商事合同纠纷案件若干问题的指导意见[SPC Guiding Opinion on Certain Issues Concerning the Adjudication of Civil and Commercial Contract Disputes Under Current Conditions] (hereafter 'SPC Guiding Opinion'), Fa Fa [2009] No 4, 7 July 2009, art 8; 最高人民法院关于审理买卖合同纠纷案件适用法律问题的解释[SPC Interpretation on Issues Concerning the Application of Law in the Adjudication of Sales Contract Dispute Cases) (hereafter 'SPC Sales Interpretation'), approved by the SPC Adjudication Committee No 1545 Meeting on 31 March 2012, effective as of 1 July 2012, art 26; 沈德咏[SHEN Deyong], 奚晓明[XI Xiaoming] and SPC Research Office (eds), *最高人民法院关于合同法司法解释(二)理解与适用[Understanding and Applying the SPC Interpretation II on Contract Law]* (The People's Court Press, 2009), 206. In most cases *weiyue jin* was awarded under a terminated contract: eg, *重庆索特盐化股份有限公司与重庆新万基房地产开发有限公司土地使用权转让合同纠纷案[Chongqing Suote Yanhua Stocks Co Ltd v Chongqing Xinwanji Real Estate Development Co Ltd]*, SPC, 24 Dec 2014, (2010) Min Kang Zi No. 67 Civil Judgment; cf *广西桂冠电力股份有限公司与广西泳臣房地产开发有限公司房屋买卖合同纠纷案[Guangxi Guiguan Electricity Stocks Co Ltd v Guangxi Yongchen Property Development Co Ltd]*, SPC, (2009) Min Yi Zhong Zi No 23, 15 Dec 2009, *Gazette of the Supreme People's Court of the People's Republic of China (hereafter 'SPC Gazette')*, vol 163 (2010 vol 5) 18-25: CCL art 97 (post-termination remedial measures) referred only to restitution and damages but not to a claim for agreed *weiyue jin*. For a critique, see 王成[WANG Cheng], '合同解除与违约金[Contract Termination and Weiyue Jin]', 政治与法律[Politics and Law], 2014, vol 7, 8.

[206] Contrast, *Cavendish* (n 7) [15] (Lords Neuberger and Sumption, Lords Carnwath and Clarke agreeing at [291]): the law will always look to the substance and not the 'form' or 'label' of any contract clause; [35]: the penalty rule would continue to apply to obligations to confer or forego non-monetary benefits, such as transfer of assets at undervalue, as much as to clauses requiring a payment to be made; [157], [170], [183] (Lord Mance, Lord Toulson agreeing at [292]): '…absurd to draw a rigid distinction between a requirement to pay money and transfer property…'; [221], [226], [230] (Lord Hodge).

[207] *Cavendish* (n 7) [74], [83] (Lords Neuberger and Sumption, Lord Carnwath agreeing): the clauses provide for primary instead of secondary obligations and hence do not engage the penalty rule. Also, [183] (Lord Mance). Cf [270], [280] (Lord Hodge, Lords Clarke and Toulson agreeing).

A request must be made before the conclusion of court debates during the first instance trial, and may not be made during an appeal unless supported by new evidence.[208] However, it may be made in various forms such as by way of a defence or counter-claim[209] and by all interested parties including those not privy to the contract.[210] The request is essential in the sense that a court shall not intervene without it,[211] but, once the request is made, a power to adjust the agreed sum is vested in the court in spite of any agreement to the contrary.[212] That judicial interference with agreed damages is justifiable and necessary is explained by the SPC in the following terms:

> CCL article 114 and so on already confirm the principal function of the law on *weiyue jin* is the compensation of the innocent party's loss, rather than harsh punishment of the party in breach; since *weiyue jin* presents itself mostly as a form of civil liability in our contract law, it shall not be left entirely to the parties' agreement, and this is so particularly in so far as clauses fixing an excessive amount of *weiyue jin* are concerned. If the parties are free to agree upon excessive *weiyue jin* and courts support such an agreement on the ground of party autonomy, then, in some cases, this is tantamount to providing an incentive for a party to profiteer unduly, and, in order to obtain a hefty *weiyue jin*, the party may be driven to deliberately induce the other party to breach the contract. In view of this, people's courts are empowered to adjust the amount of *weiyue jin* adjudged to be unreasonable, so as to safeguard the civil law principles of fairness and good faith, and to relieve the party in breach from the shackle of an excessively heavy, unreasonable liability to pay *weiyue jin*.[213]

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[208] Shanghai High People's Court ('HPC'), 上海市高院关于商事审判中规范违约金调整问题的意见 [Opinion on Issues Concerning the Regulation of Adjustment of Weiyue Jin in Commercial Adjudication] (hereafter 'SHHPC Opinion'), Hu Gao Fa Min Er [2009] No 13, 9 Dec 2009, art 4.

[209] 最高人民法院关于适用(中华人民共和国合同法)若干问题的解释(二)[SPC Interpretation on Certain Issues Concerning the Application of Contract Law of the PRC II] (hereafter 'SPC Interpretation II'), Fa Shi [2009] No 5, approved by SPC Judicial Committee No 1462 Meeting, 9 Feb 2009, effective as of 13 May 2009, art 27.

[210] Such as a surety or even an eligible people's procuratorate who initiates a contestation procedure against the court decision: *Chongqing Suote* (n 205). For procuratorial contestation, see 中华人民共和国民事诉讼法[Civil Procedure Law of the PRC], adopted by the NPC on 9 April 1991, latest revision by NPCSC on 31 August 2012, art 208.

[211] Even where the agreed sum is evidently excessive: : *武汉建工第三建筑有限公司与武汉天恒置业有限责任公司建筑安装工程施工合同纠纷上诉案[Wuhan Jiangong the Third Construction Co Ltd v Wuhan Tianheng Estate Co Ltd]*, SPC, (2004) Min Yi Zhong Zi No 112, 16 Aug 2005, noted by 杨永清[YANG Yongqing] in 黄松有[HUANG Songyou] & SPC Civil Trial 1st Tribunal (eds), *民事审判指导与参考[Civil Trial Guidance and References]* (Law Press Beijing), vol 30 (2007 vol 2), 175, 205; *山西嘉和泰房地产开发有限公司与太原重型机械(集团)有限公司土地使用权转让合同纠纷案[Shanxi Jiahetai Real Estate Development Co Ltd v Taiyuan Heavy Machinery (Group) Co Ltd]*, SPC, (2007) Min Yi Zhong Zi No 62 Civil Judgment, 21 Dec 2007, *SPC Gazette*, vol 137 (2008 vol 3) 27-39. Generally, SHHPC Opinion (n 208) arts 1-3; SHEN & XI (n 205) 214-15. However, the court '*ke yi*' [may] (SPC Guiding Opinion, n 205, art 8) or '*ying dang*' [shall] (SPC Sales Interpretation, n 205, art 27; *Wuhan Jiangong*, above) explain to the parties the existing liability to pay *weiyue jin* and its jurisdiction to adjust the amount of *weiyue jin* under article 114.

[212] SHEN & XI (n 205) 209.

[213] *青岛市光明总公司与青岛啤酒股份有限公司啤酒买卖合同纠纷案[Qingdao Guangming Co v Tsingdao Beer Co Ltd]*, SPC, Min Er Zhong Zi No 125 Civil Judgment, 21 Nov 2005 (my translation). Also, *韶关市汇丰*

2. *Reduction of weiyue jin by Chinese courts*

Article 29 of the SPC's Interpretation II on the Contract Law lays down the approach to the reduction of agreed *weiyue jin* under article 124(2):

> a court shall decide on the basis of actual loss, taking into account factors including the extent of contract performance, relative degrees of parties' fault, and the expected interest, and in accordance with the principles of fairness and good faith. Where the parties agree upon a sum of *weiyue jin* more than 30% higher than the amount of the loss occasioned, that sum is generally regarded as 'excessively more than the loss occasioned' under article 114(2) of the Contract Law.

'Actual loss' refers to 'the loss occasioned' by the breach and recoverable at law,[214] including the loss of the expected performance.[215] A practical dilemma for ascertaining such loss is that the party who requests a reduction is not the party who sustains the loss, whereas the party who sustains the loss is not the party who should be burdened to make out a case for reducing the agreed sum. A suggested solution is to require the party in breach to adduce some evidence sufficient to raise suspicion in a court over the excessiveness of the agreed sum, and to shift to the innocent party the onus of proof once the party in breach does so.[216] However, it is doubtful how well this solution might work given the fact that the initial onus of proof placed upon the party in breach remains unclear, except for the near certainty of failure for one who produces no evidence at all.[217] Further, the subsequent onus of proof shifted to the innocent party appears prohibitively substantial.[218] Nevertheless, where both parties adduce

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华南创展企业有限公司与广东省环境工程装备总公司广东省环境保护工程研究设计院合同纠纷案 [Huifeng Huanan Chuangzhan Enterprise Co Ltd of Shaoguan City v Environmental Engineering Equipment Co Ltd of Guangdong Province et al], SPC, (2011) Min Zai Shen Zhi No 84 Civil Judgment, 30 May 2011, *SPC Gazette*, vol 179 (2011 vol 9) 39-41. Further, SHEN & XI (n 205) 209-210.

[214] *新疆亚坤商贸有限公司与新疆精河县康瑞棉花加工有限公司买卖合同纠纷案 [Xinjiang Yakun Commerce & Trading Ltd v Xinjiang Jinghe Kangrui Cotton Processing Ltd]*, SPC, (2006) Min Er Zhong Zi No. 111 Civil Judgment, 12 Sept 2006 (in the context of increasing agreed *weiyue jin* that was less than the loss ascertained). Therefore legal restrictions on the recovery of normal damages (such as foreseeability, causation and mitigation) apply: HAN (n 204) 665-666, cf 661.

[215] *Wuhan Jiangong* (n 211) 205; *Chongqing Suote* (n 205): where the contract is terminated for the breach. Contra, *上海避风塘公司茶楼有限公司诉唐扣平等解除特许经营合同案[Shanghai Bifengtang Tea House Co Ltd v Tang Kouping]*, Shanghai No 2 Intermediate People's Court ('IPC'), (2004) Hu Er Zhong Min San (Shang) Zhong Zi No 394 Civil Judgment, 8 Feb 2005, in 人民法院案例选[Selected Cases of People's Court, or 'SCPC'] (People's Court Press), vol 60 (2007 vol 2), Case No 38, 312, 316.

[216] SPC Guiding Opinion (n 205) art 8; SHHPC Opinion (n 208) arts 6, 7. Also, SHEN & XI (n 205) 210-211.

[217] Particularly where the innocent party shows that the loss occasioned is not greatly lower than the agreed sum: *合肥市明利房地产开发有限公司与甘永生等房屋买卖合同纠纷再审案[Hefei Mingli Property Development Co Ltd v GAN Yongsheng et al]*, SPC, (2013) Min Shen Zi No 1714 Civil Ruling; or where the party in breach is suspected to have acted maliciously in delaying or refusing performance: *史文培与甘肃皇台酿造(集团)有限责任公司等互易合同纠纷案 [Shi Wenpei v Gansu Huangtai Brewery (Group) Co Ltd et al]*, SPC, (2007) Min Er Zhong Zi No 139 Civil Judgment, 24 April 2008, in SPC Gazette, vol 141 (2008 vol 7), 26-35.

[218] The innocent party has been required to adduce evidence such as a contract with a third party under which the innocent party is liable to pay a deposit or *weiyue jin* as a consequence of the breach or, in the case of late

some evidence but neither succeeds in proving the actual loss, the court may step in and reduce the agreed sum to a reasonable amount,[219] especially when an objective benchmark is available to measure the loss.[220]

Chinese courts apply a multi-factorial discretionary test to determine whether, and if so to what extent, the agreed sum is to be reduced. The SPC has deliberately opted for a discretionary as opposed to absolutist approach to ensure flexibility and latitude to achieve remedial justice[221] and the discretion so created is a wide one.[222] In addition to the innocent party's actual loss, the SPC adopts a list of relevant factors including the extent of contract performance, relative degrees of parties' fault, the expected interest and, additionally,[223] the parties' bargaining power and the use of a standard-form contract.[224] However, this list should not be regarded as exhaustive. For example, profits made out of a breach of contract may be used to offset any reduction that would otherwise be made to the agreed *weiyue jin*.[225] Further, the 30% margin above the loss occasioned should also be treated as a convenient guide to be considered in conjunction with other factors, rather than a 'one size fit all' figure or 'an

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delivery of properties, authoritative market surveys demonstrating rents expected from comparable properties in neighboring areas: *Wuhan Jiangong* (n 211), noted by YANG at 180.

[219] Often invoking the principles of fairness and good faith: *冯晓军等与陕西中实投资集团有限公司撤销权纠纷案[Feng Xiaojun et al v Shaanxi International Industry & Commerce (Group) Co Ltd]*, SPC, (2010) Min Er Zhong Zi No 54-1 Civil Judgment, 6 Dec 2010 (first instance ruling to half the agreed sum upheld given that neither party adduced any contrary evidence); *香港国际服装有限公司与常州威迈帝服饰有限公司等买卖合同纠纷上诉案[I.C.S. HK Co Ltd v Changzhou Weimaidi Clothing Ltd]*, Zhejiang HPC, (2011) Zhe Shang Wai Zhong Zi No 25 Civil Judgment, 22 Aug 2011 (agreed damages reduced by around two thirds even though the innocent party failed to show its actual loss).

[220] Eg in a case where the innocent party is deprived of the use of money, the losses sustained are deemed to be interests calculated by reference to the comparable loan interest rate issued by the PBC, see discussions above at n 128; SPC Sales Interpretation (n 205) art 24; *北沙坡村村委会诉西安市高新技术产业开发区东区管委会等拖欠征地款纠纷案[Beishapo Village Commission v Xi'an High-Tech Industries Development Zone Eastern District Administrative Committee]*, SPC, (2003) Min Yi Zhong Zi No 40 Civil Judgment, 2 Sept 2003, SPC Gazette, vol 99 (2005 vol 1) 23-29.

[221] Eg, the SPC considered but rejected a proposal to bar any reduction where the breach was malicious or deliberate, and instead made it one of the factors to be taken into account: SHEN & XI (n 205) 212-214. Also, *Shi Wenpei* (n 217); SHHPC Opinion (n 208) art 9.

[222] SPC Guiding Opinion (n 205) art 6: the discretion is capable of being further extended in turbulent economic conditions, where there are rampant incidences of contract breach and a large number of enterprises running into difficulties, so as to prevent the enforcement of 'an agreement upon excessively high *weiyue jin* in the name of party autonomy'.

[223] The two additional factors are stipulated in SPC Guiding Opinion (n 205) art 7.

[224] Three more factors are contained in SHHPC Opinion (n 208) art 8: whether the innocent party already agreed to reduce the agreed sum, the base figure for the calculation of *weiyue jin* and other factors that ought to be taken into account in the circumstances of the case.

[225] *武汉小屏房地产开发有限公司与武汉华氏实业集团发展有限公司等项目权益转让合同纠纷案[Wuhan Xiaoping Real Estate Development Co Ltd v Wuhan Huashi Industrial Group Development Co Ltd et al]*, SPC, (2015) Min Yi Zhong Zi No 7 Civil Judgment, 19 Oct 2015, affirming Hubei HPC, (2012) E Min Yi Chu Zi No 3 Civil Judgment: an agreed interest rate several times that of the PBC was adopted on the ground that both parties were in the highly lucrative real estate development business and the party in breach wrongfully detained the innocent party's money to earn substantial profits; *农工商超市（集团）有限公司诉上海伊塔纳旅游用品有限公司房屋租赁合同纠纷案[Nong Gong Shang Supermarket (Group) Co Ltd v Shanghai Yitana Travel Accessories Ltd]*, Shanghai No 1 IPC, [2005] Hu Yi Zhong Min Er (Min) Zhong Zi No 2194 Civil Judgment, 16 Nov 2005.

invariable fixed criterion'.[226] Thus, an agreed sum more than 30% higher than the loss occasioned may not be 'excessive' if, for instance, the party liable to pay the *weiyue jin* commits the breach maliciously without substantially performing its part of the contract.[227] The 30% margin is to be used as a possible 'trigger' of the court's power to reduce agreed damages,[228] rather than a compulsory standard regarding the extent of the reduction.[229] How might *Beavis* be decided by a Chinese court? Unlike in *Cavendish*, 'the expected interest' in the SPC's list should not extend beyond legally recoverable 'actual loss'.[230] The fact that Parking Eye has not proved any actual loss thus militates in favour of a reduction of the agreed sum in accordance with article 114, so as to bring that sum within an acceptable range of the loss sustained and recoverable by Parking Eye.

Various justifications have been suggested for Chinese courts' discretionary power to reduce a sum agreed upon by the contracting parties. On one view, the conferral of such a power aims to protect the weaker party (particularly a consumer) from exploitation and profiteering. A similar argument in the context of German law is that the party in breach deserves special protection in that it may 'weigh inadequately the advantages and disadvantages' of an agreed damages clause when it commits to it in the belief that the clause would never be invoked and it would encounter no difficulty in performing the contract.[231] However, such concerns about unequal bargaining are squarely addressed by rules of fraud, duress, unconscionability and material misapprehension[232] rather than the *weiyue jin* rule. On another view, the *weiyue jin* rule is a specific application of the doctrine of 'manifest

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[226] Such were the warnings issued by the SPC in SPC Guiding Opinion (n 205) art 7; *Huifeng Huanan* (n 213). For this reason, the SPC when drafting article 29 of the Interpretation II (n 209) departed from an earlier approach which mechanically applied the 30% criterion: 最高人民法院关于审理商品房买卖合同纠纷案件适用法律若干问题的解释[SPC Interpretation on Certain Issues Concerning the Application of Law in the Adjudication of Disputes Arising from Contracts for the Sale of Commodity Properties], Fa Shi [2003] No 7, approved by the SPCAC on 24 Mar 2003, effective as of 1 June 2003, art 16. Also, SHEN & XI (n 205) 213.

[227] *浙江东方集团浩业贸易有限公司与卡姆丹克太阳能(江苏)有限公司买卖合同纠纷案[Zhejiang Orient Group Haoye Trading Co Ltd v Comtec Solar (Jiangsu) Co Ltd]*, Jiangsu HPC, (2014) Su Shang Zhong Zi No 28 Civil Judgment, 23 April 2014.

[228] By showing the excessiveness of any surplus that the agreed sum has over the loss occasioned: *Shi Wenpei* (n 217). Therefore the mere existence of a surplus does not suffice to trigger the power to reduce.

[229] *Huifeng Huanan* (n 213). Therefore the court is not bound to arrive at a figure precisely 1.3 times the loss occasioned, *Qingdao Guangming* (n 213): reducing the amount of agreed damages to roughly 2 times the loss occasioned. However, it is not uncommon in practice for lower courts to make reduction to reach an award 1.3 times the loss occasioned. Nor is it required to apply unbendingly a statutory measure, such as that concerning interests for delayed payment, without taking into account other relevant factors *Beishapo Village* (n 220). Where the statute sets up a fixed cap, the court may nevertheless decide to award a lower sum: eg *新疆六道湾实业有限责任公司清算组与乌鲁木齐市博元汽车修理有限公司合同纠纷案 [Xinjiang Liudaowan Industrial Co Ltd v Urumqi Boyuan Motor Repairs Co Ltd]*, SPC, (2013) Min Ti Zi No 145 Civil Judgment, 12 Dec 2013, or award the maximum amount where the defaulting borrower repeatedly failed to repay despite the lender's extensions of the deadline for repayment: *刘莉等与王志和合同纠纷上诉[Liu Li and others v Wang Zhihe]*, SPC, (2013) Min Yi Zhong Zi No 84 Civil Judgment, 19 Aug 2013.

[230] It has been suggested that Chinese law should follow BGB art 343(2), which requires a court to take into account 'every legitimate interest of the creditor, whether pecuniary or not': 韩强[HAN Qiang], '违约金担保功能的异化与回归[The Distortion and Restoration of the Security Function of Weiyue Jin]', 法学研究[Chinese Journal of Law], 2015 vol 3, 47, 60.

[231] Faust (n 42) 296.

[232] CCL, art 54.

unfairness' that has application to all contract terms.[233] Yet, this overlooks important distinctions between the two. The presence of manifest unfairness requires not only substantive imbalance between the parties' interests, but also unscrupulous taking advantage of such circumstances as the other party's distress or impaired decision-making ability.[234] Further, such unfairness is determined by reference to the time of contract and more recently its legal effect tends to be confined to rendering a contract (or a term of it) voidable as opposed to adaptable.[235] By contrast, under the *weiyue jin* rule a court is empowered to rewrite 'remedial' contract terms to the extent that they are substantively unfair. This power stems from the court's authority to fashion the most appropriate remedy for an established wrong. Accordingly, what the court is effectively doing is comparing, at the time of judgment, the agreed remedy (*weiyue jin*) with the legal remedy (normal damages), using its discretion to bring all relevant circumstances to bear on the casting of the award.[236]

3. Increase of weiyue jin by Chinese courts

To the eyes of a common lawyer, the most startling feature of the *weiyue jin* rule is perhaps that the court is empowered to increase agreed *weiyue jin* at the request of an interested party. This makes a stark contrast to the position at common law that a contract clause which 'liquidates' damages instead of imposing penalties binds the parties.[237]

The power to increase agreed *weiyue jin* is exercisable where the court is satisfied that that amount is lower than legally recoverable losses,[238] which the innocent party has the onus

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[233] ibid, which is in turn founded on the general principle of fairness governing the parties' determination of their rights and obligations, see CCL, art 5.

[234] 中华人民共和国民法总则[General Provisions of Civil Law of the People's Republic of China], adopted at the 5th Session of the 12th NPC on 15 March 2017, to be effective as of 1 Oct 2017, art 151; 最高人民法院关于贯彻执行民法通则若干问题的意见[Opinions on Certain Issues Concerning the Implementation of the General Principles of Civil Law], SPC, approved 26 Jan 1988, revised 5 Dec 1990, partly repealed 24 Dec 2008, arts 72-73. For academic support, see eg 冉克平[RAN Keping], '显失公平与乘人之危的现实困境与制度重构[Practical Dilemma and Institutional Reconstruction of Manifest Unfairness and Taking Advantage of Distress]', 比较法研究[Journal of Comparative Law], 2015, vol 5, 30, 36; generally, Bing Ling, *Contract Law in China*, Sweet & Maxwell Asia, 2002, 191 [4.079]. For judicial support, see eg *家园公司诉森得瑞公司合同纠纷案[Jiayuan Co v Sandery Co]*, SPC Gazette, vol 124 (2007 vol 2); 张豪[ZHANG Hao], '合同显失公平的认定[Ascertaining Manifest Unfairness in Contract]', 人民司法案例[People's Judicature - Cases], 2009 vol 12, 23, 26: commenting on a case decided by the author as the presiding judge in *张春成诉青岛大昌房地产开发有限公司买卖房屋合同纠纷案[Zhang Chuncheng v Qingdao Dachang Real Estate Development Co Ltd]*, Shandong HPC, (2006) Lu Min Yi Zhong Zhi No 320 Civil Judgment.

[235] General Provisions of Civil Law, ibid. Cf CCL art 54: a request may be made to adapt or rescind a contract where the contract is shown to be manifestly unfair and that a contract shall not be rescinded where a request for adaptation is made.

[236] See the SPC statement in *Qingdao Guangming* (n 213) quoted above.

[237] *Diestal v Stevenson* (n 183); *Elsley v Collins* (n 52) 83 DLR 1, 14-15.

[238] *雷彦杰与鞠自全、鞠炳辉股权转让纠纷案[Lei Yanjie v Ju Ziquan and Ju Binghui]*, SPC, (2009) Min Ti Zi No 45 Civil Judgment, 30 Oct 2009; SPC Second Civil Tribunal (ed), 商事审判指导 [Guidance on Commercial Adjudication] (People's Court Press, 2010), vol 21 (2010 vol 1), 122-139: losses resulting from non-delivery of

to prove.[239] In such a case, the court is not bound to grant an increase or, if it sees fit to do so, to award the full difference between *weiyue jin* and proved losses. Although any increase is capped by proved losses, the court may, as in the case of reducing the agreed sum, take into account a wide range of factors in determining whether and if so to what extent an increase is to be made.[240]

Is this power to increase agreed damages justifiable? In the context of common law a liquidated damages clause is binding and it is also suggested that the innocent party is not allowed to recover a loss greater in amount than the liquidated damages by claiming that the clause constitutes a penalty.[241] This seems to assume that a valid agreed damages clause has the effect of not only pre-fixing damages, but also restricting the extent of liability as a limitation clause does. Yet, does an agreed damages clause, which admittedly saves one from the expense and trouble of proving losses, necessarily preclude one from doing so in pursuit of a larger award? The answer must depend on the parties' intention but there is often little evidence that the parties intend one way or the other. Where there is no clear common intention that agreed damages limit the extent of liability, it seems plausible to disregard the pre-fixed sum and grant a full recovery of loss in order to avoid under-compensation. This approach is consistent with the Chinese rule that the innocent party is free to claim agreed *weiyue jin* or normal damages or both, provided only that there is no double recovery of the same loss.[242] Even where both parties intend the agreed sum to act as a cap on the liability of the party in breach, giving effect to this intention may be seen as resulting from an exercise of discretion under CCL article 114(2) which gives primacy to the parties' will having taken account of countervailing factors.[243]

V. CONCLUSION

The penalty rule has long been perturbed by a justifiability crisis. As a judge in the Court of Appeal Lord Diplock said that he would 'make no attempt where so may others have failed, to

company shares comprise not only expected dividends but also profits from rising market price and all such losses must be foreseeable at the time of contract under CCL art 113(1).

[239] *乌审旗华宇工贸有限公司与西安雅荷房地产开发有限公司商品房买卖合同纠纷案[Uxin Banner Huayu Industrial & Trading Co Ltd v Xi'an Yahe Real Estate Development Co Ltd]*, Shaanxi HPC, (2011) Shan Min Er Zhong Zi No 5 Civil Judgment, 23 Sept 2011; Case No 19, SCPC, vol 77 (2011 vol 4) 124, 129-30: request to increase agreed *weiyue jin* for property developer's late delivery rejected since the purchaser failed to prove 'the amount of its actual loss' by adducing any evidence to the effect that it had to enter into a cover lease of like properties in the same area or would have earned rents from the properties had they been delivered on time.

[240] Perhaps by reason of the uncertainty brought about by this discretion, the increase mechanism under art 114(2) has proved unattractive to the innocent party and has been rarely invoked in publicised cases.

[241] Burrows (n 185) 447-48.

[242] *Lei Yanjie* (n 238). However, once an increase of *weiyue jin* is granted, this will foreclose any further claim for damages, see SPC Interpretation II (n 209) art 28.

[243] Of course, as a limitation clause it is further subjected to special regulation of a standard exemption clause under CCL arts 40 and 53 but this is as explained above regulation based on an entirely different rationale. For the need to make a distinction between a liquidated damages clause and a limitation clause under English law, see *Cellulose Acetate Silk Co v Widnes Foundry Ltd* [1933] AC 20 and discussions in Burrows (n 185) 448-49.

rationalise [the penalty rule]'[244] and as a prominent academic (now Judge) Richard Posner despairingly described it as 'a major unexplained puzzle in the economic theory of the common law'. [245] The Supreme Court's decision in *Cavendish* certainly clarified the applicable legal principles and their limits of application in the United Kingdom. However, the above *lacunae* has not been filled by the historical and comparative analyses undertaken by the Court. That no sound justification exists is hinted at by Lords Neuberger and Sumption when, in almost a despairing aside, they 'rather doubt that the courts would have invented the rule today if their predecessors had not done so three centuries ago'.[246]

In this article we have sought to demonstrate the systematic incoherency of the Anglo-Australian penalty rule through a historical and comparative analysis and to suggest the best way for its removal. The historical evolution of that rule appears to consist of a series of uncoordinated efforts to promote predominantly clarity rather than coherency. In England, an equitable jurisdiction providing relief against penal bonds transformed into a common law test revolving around a wholesale declaration of enforceability or unenforceability for an agreed damages clause. The adoption of such an all-or-nothing approach and its perceived certainty comes at the expense of rationality. The requirement of a breach of contract as a 'trigger' for the application of the penalty jurisdiction and the *ex ante* assessment by reference to the time of contracting are not consistent with any clearly articulated rationale for the power to review agreed damages clauses. Instead, the most promising justification for such judicial intervention may rest upon a public policy which promotes remedial justice thereby acknowledging that an agreed damages clause is a contractual arrangement of a secondary, as opposed to primary, obligation. This rationale is not advanced by the equitable doctrine dubiously promoted by Australian courts; on the contrary, their departure from the 'breach' requirement denies its legitimacy. The incoherency between rule and rationale under English and Australian laws is made all the more conspicuous by insights from Chinese law, which countenances a much greater measure of judicial interventionism against a narrower conception of freedom of contract due to both cultural and political factors in its historical development. By giving courts considerable discretion in making *ex post* adjustments of agreed damages the *weiyue jin* rule reflects faithfully the policy against remedial injustice. Thus, while the *weiyue jin* rule itself suffers from serious limitations such as in leaving a case like *Makdessi* out and in allocating too heavy a burden on the innocent party to prove loss and therefore cannot be an example to follow wholesale, the alignment between rule and rationale provides important lessons for Anglo-Australian law. One such lesson is that, given that common law courts are unlikely to be empowered to engage in a substantial scale of contract rewriting as Chinese courts do, the better course for the Supreme Court to take in *Cavendish* might have been to abolish the penalty rule altogether, instead of retaining it on the basis of an inadequate comparative survey and so allowing it to linger in a social and legal setting hostile

[244] As Diplock LJ in *Robophone Facilities v Blank* (n 59) 1477.
[245] R Posner, 'Some Uses and Abuses of Economics in Law' (1979) 46 U Chi LR 281, 290. Similarly, in a lecture delivered at University College London in 2013 Professor Victor Goldberg commented that he was 'surprised and disappointed in learning that the English treatment of penalty clauses is no better than the American': VP Goldberg, 'The Archilleas: Foresaking Foreseeability' (2013) 66(1) Current Legal Problems 107, 120 fn 50.
[246] *Cavendish* (n 7) [36].

to the development of remedial justice and flexibility as a dominant policy. Another lesson is that, should common law courts seek to justify the penalty rule on the weaker ground of substantive fairness, they should seriously consider the possibility of recognising a general test of fairness for all contract terms comparable to that sitting alongside the *weiyue jin* rule under Chinese law, as the solitary penalty rule carries real difficulties in justifying a distinction between agreed damages clauses and other contract clauses. This may predicably be an unpopular proposal given that the orthodox stance of common law (particularly English law) is to give primacy to legal certainty. Ironically in *Cavendish* the Supreme Court has endorsed an elusive 'legitimate interest' test which reintroduces uncertainty into the law. This is unfortunate as it may transpire that the 'cure' proves worse than 'disease' and that continuing ignorance of the root incoherency between rule and rationale that our comparative study so glaringly reveals will be to the detriment of common law development.