

Recalibrating the governance of remedial clauses in contract law

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Abstract

Yawning gaps in bargaining powers between transacting parties have always been a source of concern in commercial relations and the legal governance of such relations. In modern times, the likely implications of gaps in bargaining powers are not only palpable as it concerns the affairs of transacting parties with weaker bargaining powers, but also on the welfare of society, at large. That is particularly so in this milieu of pervasive oligopolistic market structures, organised commercial networks, digitisation, and big data. The imperative to guard against the use of contractually agreed remedial clauses to consolidate market power and as tools for wealth extraction is the concern of this article. To this end, this article makes a case for a recalibration of the rule against penalties in contract law.

Keywords: contracts; liquidated damages; bargaining powers; wealth extraction.

Society suffers when any of the pillars weakens or strengthens overly relative to the others. Too weak the markets and society becomes unproductive, too weak a community and society tends toward crony capitalism, too weak the state and society turns fearful and apathetic. Conversely, too much market and society becomes inequitable, too much community and society becomes static, and too much state and society becomes authoritarian. A balance is essential!

Raghuram Rajan, *The Third Pillar* (William Collins 2020) xviii.

Introduction

One scholar who appears assertive in the call for judicial intervention in extortionate and oppressive bargains is Professor Stephan Waddams; who, in his recent book founded his case on equitable reasoning, chiefly on the axiom of equity that ‘no man should be a gainer by another’s loss’.¹ However, Waddams does not base his call on any discernible theoretical foundation beyond a firm reference to case law. This article seeks to carry his call further, from a different light. This paper deploys heterodox law and economics reasoning toward that end. The thesis of this article is that compensation for losses resulting from contractual wrongs should correspond to the loss suffered by a promisee, except in cases where the promisee can demonstrate legitimate interests deserving of super-compensatory protection. The thesis is pursued based on three strands, which are as follows:

1 Stephan Waddams, *Sanctity of Contracts in a Secular Age* (1st edn, Cambridge University Press 2019) 23–24, 129 and 232.

- a. the courts should have wide powers to read down remedial clauses;
- b. the imperative to reconceptualise all remedial clauses, including termination clauses, under one single category; and
- c. the postulation and discussion of considerations that should guide courts in governing remedial clauses.

The first strand is the location of judicial power to revise extortionate and oppressive bargains in the advancement of social interests. In contract law scholarship, the significant interests commonly recognised as falling within the purview of contract law are performance, reliance and restitution interests.² The consideration is that contracts seek to promote mutually beneficial bargains between parties who have voluntarily assumed them. Unfortunately, however, the interests of the society within which contractual transactions occur are rarely factored into contract law rules, except generally in those rules prohibiting illegality. The assumption is that, so long as parties have mutually bound themselves to contracts, society would gain from the exchange of economic value between such parties.³ Sadly, this is not always the case. Contracts that appear mutually beneficial to parties may yet impose or create the risk of a high cost to society.⁴

The second and third strands of this article focus on agreed remedies clauses, discussing them as species of contractual terms that are veritable candidates for judicial intervention; mainly on account of social interests. These strands advance the argument that all remedial clauses should be treated as one and should be judicially supervised or governed in uniform fashion. Through these strands, the gulf in the approaches of the UK Supreme Court and the Australian High Court towards agreed remedies as reflected in the cases of *Cavendish Square Holding BV v Talal El Makdessi*⁵ and *Andrews v ANZ Banking Group Ltd*⁶ is revisited. The thesis of this article concurs with the Australian approach as it is amenable to advancing social interests. However, despite the Australian approach being preferable to the UK approach, both share a similar flaw, and this is a concern echoed by Judge James Allsop of Australia, writing in extra-curial capacity.⁷ As he observes, 'neither court ... has taken the opportunity fully to fashion the doctrine for modern commerce in a nuanced way ... to distinguish between contractual circumstances and to make evaluative judgments as to the presence or absence of oppression and extravagance informed by the equality or inequality of bargaining power and like considerations'.⁸

This article submits that an agenda towards fashioning a viable model for the governance of agreed remedies suitable to the needs of modern commerce requires that we pay close attention to prevailing socio-economic realities. The incidence of ever-increasing and widened gaps in bargaining powers in the marketplace is the bane of the unequal distribution of cooperative gains in commercial dealings. The feared severity of the situation is the reason why some leading economists have decried a 'rigged' economic

2 See, L L Fuller and W R Perdue Jr, 'The reliance interest in contract damages: 1' (1936) 46 Yale Law Journal 52; see also, the judgment of the Australian High Court in *Clark v Macourt* [2013] HCA 56.

3 See, Robert Cooter and Thomas Ulen, *Law and Economics* (6th edn, Pearson Education 2014) 336.

4 See, Eric Talley, 'Contract renegotiation, mechanism design, and the liquidated damages rule' (1994) 46 Stanford Law Review 1195; see also, Benjamin Hermalin, Avery W Katz and Richard Craswell, 'The law and economics of contracts' (2006) Handbook of Law and Economics 33–34.

5 [2015] UKSC 67.

6 (2012) 247 CLR 205.

7 James Allsop, 'Singapore Academy of Law Distinguished Speaker Lecture 2017: The doctrine of penalties in modern contract law' (2018) 30 Singapore Academy of Law Journal 1.

8 Ibid 26.

state characterised by uneven wealth distribution, economic inequality and, arguably, reduced economic growth.⁹ In response to that position, some other economists have denied any such perilous state of affairs; arguing instead that, although there might be uneven wealth distribution, the living conditions of people across the world have improved significantly in comparison to previously prevailing states.¹⁰ Regardless of whatever position one takes in that debate, one cannot deny that wide gaps in bargaining powers can have significant implications for contractual outcomes, particularly the distribution of cooperative gains between parties to an exchange. In short, in any marketplace, the party with strong bargaining powers is king!

The truth is that uneven bargaining powers do not only result in an uneven distribution of exchange gains. They can create serious social problems, particularly an attenuation in market competition, entrepreneurship, innovation and ultimately, social welfare decimation.¹¹ The risk of these unfavourable social states arising owing to gaps in bargaining power is palpable in the modern economic setting, which is shaped by a combination of pervasive oligopolistic market structures, organised commercial networks, digitisation and big data.¹² Scholars have argued that competition/anti-trust law policies appear inadequate in addressing these new commercial realities and challenges.¹³ Thus, it is this current state of the marketplace that informs the call for judicial intervention in remedial clauses contrary to the opinion of some scholars that the market has not witnessed any change warranting such legal reformation.¹⁴

This article does not address consumer protection issues, as it focuses solely on commercial bargains; and its presentation takes the following steps. Section 1 discusses the place of agreed remedies in the scheme of contracts along with an examination of arguments against the penalty rule. Section 2, addressing the first strand of the article's thesis, examines the essence of contract law; making the submission that contract law as an institution should be recognised as one which aims at enabling private empowerment through exchanges. Also, that bargains that cross the lines of empowerment should be candidates for judicial scrutiny and review. Section 3, anchoring the second strand, advances the argument that all remedial clauses, regardless of form or label, are same in substance and, as such, should be uniformly governed. Section 4, dealing with the third strand, postulates and expounds on considerations that should govern the judicial governance of remedial clauses. In the final section, the article concludes by connecting the three strands together.

9 See, Brink Lindsey and Steven Michael Teles, *The Captured Economy: How the Powerful Enrich Themselves, Slow Down Growth, and Increase Inequality* (Oxford University Press 2017); see also, Joseph Stiglitz, *The Price of Inequality: How Today's Divided Society Endangers our Future* (1st edn, WW Norton & Co 2012); see also, Joseph Stiglitz, *People, Power, and Profits: Progressive Capitalism for an Age of Discontent* (1st edn, WW Norton & Co 2019).

10 See Jean-Philippe Delsol, Nicolas Lecaussin and Emmanuel Martin (eds), *Anti-Piketty: Capital for the 21st Century* (Cato Institute 2017).

11 See Jonathan Tepper and Denise Hearn, *The Myth of Capitalism: Monopolies and the Death of Competition* (1st edn, Wiley 2018); see also, Tim Wu, *The Curse of Bigness: Antitrust in the New Gilded Age* (1st edn, Columbia Global Reports 2018); see also, Robert Reich, *Saving Capitalism: For the Many, Not the Few* (1st edn, Vintage 2016).

12 See, Margaret Radin, 'The deformation of contract in the information society' (2017) 37 *Oxford Journal of Legal Studies* 505; see also, Robin Kar and Margaret Radin, 'Pseudo-contract and shared meaning analysis' (2019) 132 *Harvard Law Review* 1135; see also, Maurice Stucke and Allen Grunes, *Big Data and Competition Policy* (1st edn, Oxford University Press 2016).

13 See, Ariel Ezrachi and Maurice Stucke, *Virtual Competition: The Promise and Perils of the Algorithm-Driven Economy* (1st edn, Harvard University Press 2016);

14 John Carter, Wayne Courtney, Elisabeth Peden, Andrew Stewart and G J Tolhurst, 'Contractual penalties: resurrecting the equitable jurisdiction' (2013) 30 *Journal of Contract Law* 99, 113.

1 The place of agreed remedies in the scheme of contracts and the case against the penalty rule

When parties enter into contracts, they agree on terms that would govern their relations by adopting correlative rights and obligations. In some cases, they may agree on consequences that should follow upon specified events. Falling within this latter class of terms are those clauses that qualify as agreed remedies clauses. The law classifies such remedial clauses based on their form. These clauses, despite their different labels, have the same purpose(s), which is vesting the promisee with powers or rights to act in ways towards the enforcement of contracts. In other words, they are self-help remedies.¹⁵ The major problem which besets both the judicial governance and legal analysis of these clauses is the adherence to categorisation. The traditional position, for example, distinguishes the jurisdiction to reform forfeiture clauses from that to invalidate penalty clauses.¹⁶ Such bifurcation is impractical, especially as contractual drafting may make either category of provisions indistinguishable from the other. Judges have long recognised this difficulty. Lord Denning exposed the facileness of such distinction in a prominent case;¹⁷ and in another case, in which he acknowledged such legal difference, he expressed himself as willing to disregard it.¹⁸ Even in *Dunlop Pneumatic Tyre Co Ltd v New Garage Motor Co Ltd*,¹⁹ which was, until recently, recognised as providing the modern restatement on agreed remedies, Lord Dunedin described the question as to which jurisdiction governs what type of clause as being ‘probably more interesting than material’.²⁰

At this juncture, we turn to discuss the arguments against judicial reformation of remedial terms in business contexts. Here, we highlight the perceived commercial purposes of remedial terms.

1.1 ARGUMENTS IN FAVOUR OF THE STRICT ENFORCEMENT OF REMEDIAL CLAUSES

Some scholars have called for the abandonment of judicial rules that seek to govern agreed remedies. Cases of this kind abound, largely concerning liquidated damages and forfeiture clauses. Proponents of this line of reasoning have pursued their arguments mostly on the need to respect individual choice and autonomy, on the ground that such provisions are as much a contractual term as those dealing with a contract price.²¹ One such proponent is Sarah Worthington, whose argument for the abolition of the penalty rules was greeted with rejection by the UK Supreme Court in *Cavendish*.²² The crux of her argument is that rules against penalties lack proper justification beyond moral outrage

15 See Celia Taylor, ‘Self-help in contract law: an exploration and proposal’ (1988) 33 Wake Forest Law Review 839; see also, Mark Gergen, ‘A theory of self-help remedies in contract’ (2009) 89 Boston University Law Review 1397.

16 See, Neil Andrews, Malcolm Clarke, Andrew Tettenborn, Graham Virgo, *Contractual Duties: Performance, Breach, Termination and Remedies* (2nd edn, Sweet & Maxwell/Thomson Reuters 2017) 523–559.

17 *Bridge v Campbell Discount Co Ltd* [1962] 2 WLR 439, 458–560.

18 *Stockloser v Johnson* [1954] 2 WLR 439, 450.

19 [1915] AC 79

20 Ibid 87.

21 See Mindy Chen-Wishart, ‘Controlling the power to agree damages’ in Peter Birks, (ed), *Wrongs and Remedies in the Twenty-First Century* (Oxford University Press 2006) 280; see also, Sarah Worthington, ‘The death of penalties in two legal cultures?’ (2016) 7 UK Supreme Court Yearbook 129, 140.

22 Sarah Worthington, ‘Common law values: the role of party autonomy in private law’ in Andrew Robertson and Michael Tilbury (eds), *The Common Law of Obligations* (Hart 2016) 301

entrenched in case law.²³ She goes on to state that this absence of justification is the reason why judicial scrutiny of such clauses has always been pursued using crude and selective methods.²⁴ However, she shows some sympathy for the judicial intervention in forfeiture clauses; and this is simply on the basis that relief from forfeiture is only available to a promisor who can adequately address the injury of the promisee commensurably with contractual expectations.²⁵

The most systematic set of arguments against penalty rules comes from conservative scholars of law and economics. The consolidation of this brand of scholars brought about an onslaught against several legal rules and ideas, most notably competition law.²⁶ In this vein, the judicial rules for the governance of agreed damages also received criticism. Although most of these scholars in the formative years of the movement were from the USA, a few of them were from Commonwealth jurisdictions. One of the latter was Trebilcock, who argued that judicial refusal to enforce such clauses creates the sub-optimal risk of increasing the promisee's costs in seeking to ensure performance.²⁷

A line of attack popular with the scholarly movement is that remedial terms serve a signalling function between contracting parties.²⁸ They enable promisees to communicate to would-be promisors what their idiosyncratic expectations are; and the would-be promisor is also able to signal their ability to shoulder such expectations. Some scholars take the view that remedial provisions are very useful in franchising contexts; especially that they protect promisee–franchisors against the risks of 'difficult-to-verify' injuries or non-pecuniary losses such as the denting of trademark or brand value.²⁹ However, others have equally used empirical evidence to show that the usefulness or success of such clauses in franchising contexts is mixed.³⁰ Their submission is that such provisions may disrupt the relational dynamics between franchisees and franchisors.³¹

Another line of attack is that the non-enforcement of such clauses may distort the efficient allocation of commercial risks. In this connection, by relieving against such provisions, a promisor may secure a windfall for themselves after having signalled themselves as being of a particular capability to gain acceptance from the promisee who may not otherwise have offered them a bargain.³² Some other connected arguments are that the non-enforcement of such clauses would increase transaction and litigation costs,

23 Ibid 316.

24 Ibid 319

25 Ibid 321–322.

26 See Steve Teles, *The Rise of the Conservative Legal Movement: The Battle for Control of the Law* (1st edn, Princeton University Press 2008) 122–123.

27 See Michael Trebilcock, *The Limits of Freedom of Contract* (Harvard University Press 1997); see also, Michael Trebilcock, 'The doctrine of inequality of bargaining power: post-Benthamite economics in the House of Lords' (1976) 26 *University of Toronto Law Journal* 359.

28 See, David Haddock, Fred McChesney, and Menahem Spiegel, 'An ordinary economic rationale for extraordinary legal sanctions' (1990) 78 *California Law Review* 1.

29 See Albert Choi and George Triantis, 'Completing contracts in the shadow of costly verification' (2008) 37 *Journal of Legal Studies* 503; Benjamin B Reed, 'Liquidated damages provisions: strategic drafting and enforcement issues' (2018) 37 *Franchise Law Journal* 523.

30 See Adam Badawi, 'Relational governance and contract damages: evidence from franchising' (2010) 7 *Journal of Empirical Legal Studies* 743.

31 Ibid 744–745.

32 See Charles Goetz and Robert Scott, 'Liquidated damages, penalties and the just compensation principle: some notes on an enforcement model and a theory of efficient breach' (1977) 77 *Columbia Law Review* 554.

along with inefficiencies in the marketplace.³³ The upshot of this may cause essential facilities such as loans or credit facilities to be withheld from needy entities, or cause the price of such facilities to be hiked.³⁴

Finally, another basis of attack is that judicial reform of such clauses is anachronistic to modern market conditions and, therefore, should only apply in cases of procedural unconscionability such as (unilateral) mistakes and duress.³⁵ In this regard, the argument goes that the ascendancy of the compensatory principle in contract law is a by-product of historical accident and path dependency.³⁶ There are several other arguments against judicial governance of such clauses; but, for the sake of space, this article only highlights these salient ones mentioned.

The case against judicial intervention, as one can decipher, is built on respecting private ordering so long as there is a balance of fairness between contracting parties. In other words, that unconscionability is the only defensible ground for the curtailment of such clauses. The objective of this article is to show that commutative fairness in contract law would be mythical or ineffectual without a well-calibrated distribution of legal entitlements between contracting parties. In other words, commutative justice in contractual contexts is contingent upon distributive justice.

Some scholars trenchantly hold the view that contract law's domain is to enable exchanges and ensure fairness in bargains, but that issues relating to wealth distribution are not concerns of contract law.³⁷ Such a position is unsustainable, as this article argues. Judicial intervention in agreed remedies clauses is apt to serve the much-needed distributive justice goals of counterbalancing the vast chasm in bargaining powers and the use of contracts as a mechanism for rent extraction and the consolidation of market power. Judge Posner in the US Court of Appeals case of *Lake River Corp v Carborundum Co*³⁸ acknowledged that agreed remedies clauses could have social cost implications, saying:

On the other side it can be pointed out that by raising the cost of a breach of contract to the contract breaker, a penalty clause increases the risk to his other creditors; increases (what is the same thing and more, because bankruptcy imposes 'deadweight' social costs) the risk of bankruptcy; and could amplify the business cycle by increasing the number of bankruptcies in bad times, which is when contracts are most likely to be broken.³⁹

In that case, Judge Posner found the clause in issue to be an unenforceable penalty. However, being of firm conservative mould, he went on to describe the likelihood of unfavourable social outcomes resulting from remedial clauses as though they were unavoidable bad weather by saying: 'But since little effort is made to prevent businessmen

33 See Aristides N Hatzis, 'Having the cake and eating it too: efficient penalty clauses in common and civil contract law' (2002) 22 *International Review of Law and Economics* 381; see also Ugo Mattei, 'The comparative law and economics of penalty clauses in contracts' (1995) 43 *American Journal of Comparative Law* 427.

34 Deborah Zalesne, 'Enforcing the contract at all (social) costs: the boundary between private contract law and the public interest' (2005) 11 *Texas Wesleyan Law Review* 579.

35 See Larry Dimatteo, 'A theory of efficient penalty: eliminating the law of liquidated damages American' (2008) 38 *Business Law Journal* 633.

36 Robert E Scott and George G, Triantis, 'Embedded options and the case against compensation in contract law' (2004) 104 *Columbia Law Review* 1428.

37 See James Gordley and Hao Jiang, 'Contract as voluntary commutative justice' *Tulane Public Law Research Paper No 19-3* <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3324001>.

38 769 F2d 1284 (1985).

39 Ibid 1289.

from assuming risks, these reasons are no better than makeweights.⁴⁰ Statements like these represent the views of most conservative scholars. With heterodox law and economics reasoning, this article provides counterarguments against such conservative views.

2 The first strand: private empowerment as the essence of modern contract law

Towards the advancement of the thesis of this article, it is crucial to identify contract law as a mechanism for private empowerment. Before pursuing that argument, however, it is vital to deconstruct the marketplace. The objective here is to show that the market does not operate in *laissez-faire* fashion, in the ‘natural’ and self-executing sense, as some scholars are wont to argue. The market and its outcomes operate in the shadow of the law’s distribution of entitlements and the attitude of enforcing such entitlements.⁴¹

The phrase ‘freedom of contract’ is hackneyed in the writings of contract law scholars, particularly those of apparently libertarian bent. Some of such scholars have taken the view that contracts are outcomes of private orderings reflecting the choices or will of autonomous entities.⁴² Others have carried that view even further, holding that contracts should be enforced even though the enforcement of certain contracts may cause untoward outcomes to befall disfavoured parties.⁴³ Such views only reflect a romantic view of contracting, especially as the bulk of commercial contractual agreements are one-sided or boilerplate, and less likely to be an outcome of thorough negotiations.⁴⁴

These scholars also appear to take for granted the ways of the marketplace as though they were only contingent on the conditions of the ‘invisible hand’ – i.e. the outcomes of competing entities in the market characterised by different incentives, information asymmetries, varying levels of bargaining power, gradations of opportunity cost and future uncertainties.⁴⁵ The assumption is that, with the invisible hand working itself out under the forces of demand and supply, buyers and sellers (i.e. transacting parties) will exchange goods and services, enabling the re-allocation of resources to those who value them most. This view of the marketplace is blinkered. It is so because it does not take account of the system (i.e. the rules of the game) that facilitate the workings of the marketplace and its outcomes, including contracts.⁴⁶ The market takes shape against the

40 Ibid.

41 See Warren J Samuels, Marianne F Johnson, and William H Perry, *Erasing the Invisible Hand: Essays on an Elusive and Misused Concept in Economics* (1st edn, Cambridge University Press 2011); see also, Kaushik Basu, *Beyond the Invisible Hand: Groundwork for a New Economics* (1st edn, Princeton University Press 2016)

42 See, for example, Charles Fried, *Contract as Promise: A Theory of Contractual Obligation* (2nd edn, Oxford University Press 2015); see also Ernest J Weinrib, ‘Corrective justice in a nutshell’ (2002) 52 *University of Toronto Law Journal* 349; see also, Nathan Oman, *The Dignity of Commerce: Markets and the Moral Foundations of Contract Law* (1st edn, University of Chicago Press 2017).

43 See Paul Davies, ‘Bad bargains’ (2019) 72 *Current Legal Problems* 253–286; see also Jonathan Morgan, *Contract Law Minimalism A Formalist Restatement of Commercial Contract Law* (1st edn, Cambridge University Press 2013).

44 See Omri Ben-Shahar (ed), *Boilerplate: The Foundation of Market Contracts* (1st edn, Cambridge University Press 2007); see also, Russell Korobkin, ‘Bounded rationality, standard form contracts, and unconscionability’ (2003) 70 *University of Chicago Law Review* 1203; see also W David Slawson, ‘Standard form contracts and democratic control of lawmaking power’ (1971) 84 *Harvard Law Review* 529.

45 See Albert Choi and George Triantis, ‘The effect of bargaining power on contract design’ (2012) 98 *Virginia Law Review* 1665; see also Lars Stole, ‘The economics of liquidated damage clauses in contractual environments with private information’ (1992) 8 *Journal of Law, Economics and Organisation* 582.

46 See Warren Samuel, ‘The economy as a system of power and its legal bases: the legal economics of Robert Lee Hale’ (1973) 27 *University of Miami Law Review* 261; see also E J James and F W Taussig, ‘The state as an economic factor’ (1886) 7 *Science* 485.

backdrop of institutional arrangements, at the core of which are legal rules. It is these rules that allocate entitlements (i.e. who owns what). To a large extent, the law's award of entitlements shapes the directions of the invisible hand, in turn, the outcomes in the marketplace. As Robert Hale observed:

Most of our present distribution of wealth is the result of the relative power, latent or active, of various individuals and groups. The power itself is derived in part from the law's more or less blind and haphazard distribution of favors and burdens, in the shape of powers over others and obligations to others.⁴⁷

At the core of Hale's reasoning is that the bane of distributive inequalities, even in contractual transactions, is the factor of market power, which is the upshot of institutional design or laws. Other eminent legal scholars of heterodox bent such as Richard Ely⁴⁸ and John Commons⁴⁹ rationalised contract law and transactional outcomes along the same lines as Hale. However, in recent times, Eric Posner and Glen Weyl have sought to inspire a resurgence of similar heterodox reasoning, identifying increased (and undue) market power resulting from private entitlements as the bane of distributive inequalities.⁵⁰ They suggest that a radical departure from the 'traditional' conception or 'usual' workings of markets should be pursued to correct this state of affairs. This can be done, they suggest, by designing legal rules with a view to advancing 'free exchange disciplined by competition and open to all comers'.⁵¹

Libertarians argue against government intervention in the market to disrupt the (supposed) natural workings of the market. However, as Barbara Fried reported Hale to have observed, 'when the government intervened in private market relations to curb the use of certain private bargaining power, it did not inject coercion for the first time into those relations. Rather, it merely changed the relative distribution of coercive power.'⁵² Of course, one cannot deny that factors resulting from social interactions such as science, technology, innovation and novel business ideas may shape trends in the marketplace; yet, these factors rely on the forces of legal rules to have a meaningful impact on the market.⁵³ The law's recognition of rights such as trade secrets, patents, copyrights and other forms of industrial entitlements, exonerates this claim. The law's attitude towards these factors, whether proactive, neutral or negative, is usually informed by the calculations of lawmakers (i.e. legislator or judges) towards social welfare enhancement. In effect, it is institutional arrangements that chiefly determine the marketplace and its outcomes.

The rules of contract law are part of the institutional arrangements that shape outcomes in the marketplace. These rules can have implications for wealth distribution between contracting parties. An excellent example of this is the remoteness rule in the computation of expectation damages in contract law. This rule can be designed to take different forms to place an increased burden on either the promisee or promisor. For example, the principle could take the *Hadley v Baxendale*⁵⁴ form in which the promisor is

47 Robert Hale, 'Law making by unofficial minorities' (1920) 20 Columbia Law Review 451.

48 Richard Ely, *Property and Contract in their Relations to the Distribution of Wealth* vols 1 and 2 (Macmillan 1914).

49 John Commons, *Legal Foundations of Capitalism* (1st edn, Macmillan Company 1924) 65–134.

50 Eric Posner and Glen Weyl, *Radical Markets: Uprooting Capitalism and Democracy for a Just Society* (1st edn, Princeton University Press 2018)

51 Ibid xvii.

52 Barbara Fried, *The Progressive Assault on Laissez Faire* (1st edn, Harvard University Press 2001) 36.

53 See Katharina Pistor, *The Code of Capital: How the Law Creates Wealth and Inequality* (1st edn, Princeton University Press 2019) 11; see also Julie Cohen, *Between Truth and Power: The Legal Constructions of Informational Capitalism* (1st edn, Oxford University Press 2019).

54 (1854) 23 LJ Ex 179.

generally liable for foreseeable losses. The implication of this will be that promisors would have to exclude liability upfront, to avoid legal responsibility.⁵⁵ The rule could, yet, take the form propounded by Lord Hoffmann in the case of *Transfield Shipping Inc v Mercator Shipping Inc*,⁵⁶ in which mere foresight of the promisee's exposure to loss is not sufficient to allocate risk, rather the promisor's liability must be understood in terms of contractual interpretation and commercial customs. This approach too has its distributive implications. It places a burden on the promisee to secure the promisor's assumption of liability. The upshot of this can vest the promisor with bargaining powers, depending on the transactional context.

Scholars have argued against devising private law rules to achieve distributive effects. At the core of their submission is the position that private law rules are a poor avenue by which one may pursue such objectives; as doing so is apt to distort the workings of the free market.⁵⁷ They suggest reliance may be placed on taxation and other fiscal measures instead; as they are less disruptive of the marketplace. Such a position is reminiscent of the parochial *laissez-faire* view of the market, blind to the roles of institutions in commerce. The design of legal rules is always products of considerations that take priority on the minds of lawmakers, the distributive implications of which may or may not be immediately apparent. That is ineluctably the case with private law rules, including those of contract law. But then, what makes private law a poor avenue for achieving distributive ends as claimed? The answer is: nothing! Private law rules can be just as viable as other institutional regimes for advancing distributive goals.⁵⁸ The expectation is that lawmakers should duly study the situation they seek to address; select the right response in the form of legal rules; and ensure that the vital incentives of other entities needed towards productivity would not be significantly affected in negative terms.

Contract law rules can be designed or reformed with specific distributive goals in mind, as the illustration above using the remoteness rule shows. In the case of agreed remedies clauses, the distributive role played by judicial intervention is to ensure against the use of contracts as devices for wealth (or rent) extraction; instead of that, they should serve as tools for wealth creation and private empowerment. When contracts can be used by a party to extract ('unearned') wealth, an array of social costs can result.⁵⁹ Some may argue that wealth extraction through contracting should not be a problem as it is an outcome of consensual agreements which turned out to be unfavourable to one party. Another argument could be that the enrichment resulting to a contracting party from the ill-advised bargains of another does not dampen social welfare, except that it transfers wealth from one party to another. While these arguments may appear persuasive on the surface, they are undiscerning of the possible use of contracts to squeeze out earnings from an entity without corresponding 'economic sacrifice', creating risks of social costs. Inauspicious states of this kind are particularly possible with agreed damages clauses.

55 See John Barton, 'The economic basis of damages for breach of contract' (1972) 1 *Journal of Legal Studies* 277; see also, Jason Scott Johnston, 'Strategic bargaining and the economic theory of contract default rules' (1990) 100 *Yale Law Journal* 615

56 [2008] UKHL 48; [2009] AC 61.

57 See, Louis Kaplow and Steven Shavell, 'Why the legal system is less efficient than the income tax in redistributing' (1994) 23 *Journal of Legal Studies* 667; see also W N R Lucy, 'Contract as a mechanism of distributive justice' (1989) 9 *Oxford Journal of Legal Studies* 132.

58 Daphna Lewinsohn-Zamir, 'In defense of redistribution through private law' (2006) 91 *Minnesota Law Review* 326; see also Anthony T Kronman, 'Contract law and distributive justice' (1980) 89 *Yale Law Journal* 472.

59 See Barbara Fried, 'Wilt Chamberlain revisited: Nozick's "justice in transfer" and the problem of market-based distribution' (1995) 24 *Philosophy and Public Affairs* 226.

Understandably, contracting parties may be deft at negotiating bargains and able to secure for themselves price terms that qualify as extortionate. That is an issue which is not the focus of this article. It is better to leave price governance issues to administrative law, particularly the regime of competition law. However, as regards terms of contracts determining measures for enforcing contractual bargains, such provisions fall, undoubtedly, within the purview of contract law's domain. Private entities should not be able to usurp such judicial roles; particularly roles that serve to reflect society's position on the methods and extent of contractual enforcement.⁶⁰ The need for legal resistance of such private usurpation of judicial roles is most ripe in our current economic milieu, which, as explained in the introduction, is characterised by vast gulfs in bargaining powers owing to pervasive oligopolistic market structures/market concentration, organised commercial networks, digitisation and big data.

How may we reconceptualise contract law to address this concern? The answer lies in recognising contracts as arrangements for private empowerment. Therefore, to the extent that contractual terms and their execution transcend the lines of private empowerment, they call for judicial scrutiny. Where they extend beyond the lines of private empowerment, they must be justifiable on other defensible grounds parallel to empowerment.⁶¹ The obvious truth is that judges, in establishing common law rules, are not agnostic of the likely distributive implications that legal rules may have. In this regard, in the governance of contracts, the common law has not been shy in the use of default rules or standards as presumptions of the intention of parties concerning how they intend their contracts to be enforced. For example, where an express contract term entitles a promisee to terminate the contract upon a breach by the promisor, the promisee would be disentitled to lost bargain damages for terminating pursuant to such a term, except where the breach relates to a condition or its effect deprives the promisee benefits essential to the contract.⁶² Such a rule is part of contract law's institutional control of private ordering.⁶³ The obvious purpose or implication of such a rule is to discourage the inclination to terminate contractual arrangements, except where it is vital to do so or where the common law right to terminate has arisen. Even where the common law right has arisen, courts are likely to fetter the decision to terminate where it is exercised with a view to gaining an unfair economic advantage or exercised in 'bad faith'.⁶⁴ This is in line with the growing acceptance of the precept that contracting parties should be faithful to the purposes or goals of their bargain.⁶⁵

60 See Seana Shiffrin, 'Remedial clauses: the overprivatization of private law' (2016) 67 *Hastings Law Journal* 407, 419–422; see also Ian R Macneil, 'Power of contract and agreed remedies' (1962) 47 *Cornell Law Quarterly* 495; see also Selene Rowan, *Remedies for Breach of Contract: A Comparative Analysis of the Protection of Performance* (1st edn, Oxford University Press 2012) 230.

61 See, Robin Kar, 'Contract as empowerment' (2016) 83 *University of Chicago Law Review* 760.

62 See, *Rice v Great Yarmouth Borough Council* [2003] *TCLR* 1; see also *Bunge Corp v Tradax Export SA* [1981] 1 *WLR* 711; see also, *Antaios Compania SA v Salen Rederierna* [1985] *AC* 191; see also, academic articles by John Randall, 'Express termination clauses in contract law' (2014) 73 *Cambridge Law Journal* 113–141; and also, Richard Hooley, 'Express termination clauses' in Graham Virgo and Sarah Worthington (eds), *Commercial Remedies: Resolving Controversies* (1st edn, Cambridge University Press 2017) 343–365.

63 John Carter and Wayne Courtney, 'Unexpressed intention and contract construction' (2017) 37 *Oxford Journal of Legal Studies* 326, 382; see also, John Carter and Wayne Courtney, 'Breach of condition and express termination right: a distinction with a difference' (2017) 133 *Law Quarterly Review* 395.

64 Richard Hooley, 'Controlling contractual discretion' (2013) 72 *Cambridge Law Journal* 65; see also, Roger Brownsword, 'Bad faith, good reasons and termination of contracts' in J Birds, R Bradgate and C Villiers (eds), *Termination of Contracts* (Wiley Chancery 1990) 283.

65 See *Lymington Marina Ltd v MacNamara & Ors* [2007] *NPC* 27, paragraph 44; see also, *SNCB Holding v UBS AG* [2012] *EWHC* 2044 (Comm).

This article advances a case for increased judicial intervention in the enforcement of remedial terms on the rationale that doing so would help, to borrow the words of Posner and Weyl, in enabling ‘free exchange disciplined by competition and open to all comers’. This article founds its case for reconceptualising contracts as empowerment arrangements on the premise that contracts are cooperative games.⁶⁶ Such theory does not prevent the need for self-interest, nor does it seek to foist altruism on contractual parties. Instead, it advances the argument that contracts are not avenues for opportunistic enrichment.

As postulated by Mark Gergen, contract law should advance two principles, and these are *unselfish performance* and *loss alignment*.⁶⁷ By unselfish performance, contract law rules must ‘eliminate the incentive a promisor might have to perform inefficiently or that a promisee might have to induce or falsely claim breach if the promisor had to pay damages on breach that greatly exceeded the promisee’s loss on breach’.⁶⁸ However, by loss alignment, we must tailor compensation to ensure that the promisee is not left worse off than if they had not entered into the bargain in issue.⁶⁹ These two principles, although not prominently recognised in the common law of contract, are not alien to the common law of contract and are, in fact, aligned with the incorporation of the ideals of good faith into contract law. This is particularly so as courts are increasingly warming up to the reality that contracts are not adversarial or zero-sum games but relational arrangements for cooperation towards the actualisation of the ends to which bargains relate.⁷⁰ As reality shows, the transactional landscape is awash with long-term relations or, at least, repeat contractual relations. The factors of trust and confidence play significant roles in the design, revision and execution of most contracts. Hence, contractual formation or renegotiation is often ‘incomplete’ (i.e. not exhaustively providing terms that cover all likely variables and future contingencies).⁷¹ Factors often responsible for contractual incompleteness are information costs, transaction costs and bounded rationality. It is for this reason that scholars often regard incomplete contracts as relational contracts, being informed by evolving mutual understandings that go beyond documentary description.⁷²

A characteristic feature of relational contracting is the high switching costs (i.e. the cost of transferring to an alternative) it is likely to impose on contracting parties, with which comes heightened exposure to economic hold-up (or opportunism). Modern judicial attitude mirrors this by incorporating a duty to act in good-faith into contracts – an obligation which is not circumscribed to dealing honestly but extends to being

66 David Campbell, ‘The relational constitution of remedy: co-operation as the implicit second principle of remedies for breach of contract’ (2005) 11 Texas Wesleyan Law Review 455; see also, Clayton Gillette, ‘Commercial relationships and the selection of default rules for remote risks’ (1990) Journal of Legal Studies 535.

67 Mark Gergen, ‘A defense of judicial reconstruction of contracts’ (1995) 71 Indiana Law Journal 45, 46.

68 Ibid 46.

69 Ibid 46–47.

70 George Leggatt, ‘Negotiation in good faith: adapting to changing circumstances in contracts and english contract law’, Jill Poole Memorial Lecture (Aston University, 19 October 2018) <<https://www.judiciary.uk/wp-content/uploads/2018/10/leggatt-jill-poole-memorial-lecture-2018.pdf>>; see also Zhong Xing Tan, ‘Keeping faith with good faith? The evolving trajectory post-Yam Seng and Bhasin’ (2016) 5 Journal of Business Law 420; see also Wayne Courtney, ‘Good faith and termination: the English and Australian experience’ (2019) 1 Journal of Commonwealth Law 1.

71 Robert E Scott, ‘The case for formalism in relational contract’ (2000) 94 Northwestern University Law Review 847.

72 Steven Shavell, *Foundations of Economic Analysis of Law* (Harvard University Press 2009) 292–293.

cooperative.⁷³ It is understandable, however, that not all agreements accommodate good-faith expectations. Such a broad-brush imposition of a duty to act in good faith may be at variance with the essence of certain contractual contexts; typically, gambling, speculation and futures contracts.⁷⁴ One way of dealing with contractual incompleteness and uncertainty is the use of agreed remedies clauses to insure against unforeseen eventualities, and indiscriminate deprivation of effect to such clauses could frustrate such commercial engagements.

Notwithstanding the insurance value of such terms, they have potential demerits. They can be used to achieve opportunistic enrichment that has no bearing on loss arising from a contractual breach. They can be used to facilitate market concentration by serving as market entry barriers.⁷⁵ They can serve as backdoor specific performance, with the implication that they could bind promisors hand and foot, exposing them to exacting demands. Then, if contract law judges, lawyers and scholars are aware of the relational nature of contracts, why does this reality not feature in how agreed remedies clauses are perceived and enforced?

In the first instance determination of *MSC Mediterranean Shipping Company SA v Claimant Cottonex Anstalt*,⁷⁶ Leggatt J (as he then was) introduced the consideration of relational contracting into the governance of remedial provisions. However, in the English Court of Appeal, while agreeing with Leggatt J's decision, his reliance on good faith to reform the remedial provision was rejected. The Court of Appeal's consideration was that Leggatt J could have founded his decision on the basis that there was a frustration of the commercial adventure between the parties to the suit.⁷⁷

The submission of this article is that the treatment of contracts as relational cooperative games should inform the judicial attitude towards intervening in remedial provisions, and that unavoidably requires an incorporation of good faith ideals into contract law. With such an approach, not only would the interests of contracting parties be well balanced, but a proper adjustment to the interests of society would be well-factored into the enforcement of remedial terms.

3 The second strand: the specious categorisation of agreed remedies clauses

Much of the analytical confusion and intricacies surrounding agreed remedies stems from formalistic categorisation. Liquidated damages terms are considered terms that prescribe a sum or a formula for compensation of loss attributable to a specified contractual event.⁷⁸ Forfeiture clauses are clauses that entitle a promisee to deprive another or foreclose on an interest owned by another, where that other person has failed to measure

73 See, *Alan Bates and Others v Post Office Ltd* [2019] EWHC 606 (QB); see also, *Yam Seng Pte v International Trade Corp* [2013] EWHC 111.

74 See Mark Gergen, 'A defense of judicial reconstruction of contracts' (1995) 71 *Indiana Law Journal* 45, 47: 'Unexpectedness is an explicit element of the principle of loss alignment because people do enter into contracts that are zero-sum games, where one party's loss is the other's gain. That is the nature of gambling and insurance.'

75 See Philippe Aghion and Patrick Bolton, 'Contracts as a barrier to entry' (1987) 77 *American Economic Review* 388; see also Joseph Brodley and Ching-to Albert Ma, 'Contract penalties, monopolizing strategies, and antitrust policy' (1993) 45 *Stanford Law Review* 1161.

76 [2015] EWHC 283 (Comm).

77 *MSC Mediterranean Shipping Company SA v Cottonex Anstalt* [2016] EWCA Civ 789 (27 July 2016).

78 See *Phonographic Equipment (1958) Ltd v Muslu* [1961] 1 W.L.R. 1379; see also *Edgeworth Capital (Luxembourg) SARL v Aabar Investments PJS* [2018] EWHC 1627 (Comm).

up to contractual expectations.⁷⁹ It could be the deprivation of the total value or a portion of a deposit, part payment, or mortgaged interest. Termination clauses entitle a promisee to sever contractual relations with a promisor, thus ending prospective obligations.⁸⁰ Termination fees clauses are another, which may additionally be imposed upon effective communication of intention to terminate a contract. There are other recognised labels of ancillary provisions, which cannot all be enumerated here for reasons of space.

The artifice of these categorisations becomes discernible when one focuses on the consequences of these clauses rather than their form. They all share one commonality, and this is that they serve remedial purposes. Their formalistic differences are informed mainly by the factors of legal history and the technicalities of legal practice. But, as we know, life is not rivetted to history and reality betrays formality. Therefore, there should be an abandonment of their classification, and focus should be placed simply on inquiries as to whether such terms are remedial; and, if they are, whether they cross the lines of empowerment and proportionate protection essential to the promisee's interest.

Some scholars of contract law have exposed the inadequacies of such categorisations, particularly concerning the age-long distinction between forfeiture clauses and liquidated damages.⁸¹ Concerning these two forms, they seem to ask: 'What difference is there between an obligation to pay or transfer a sum or asset upon an event and a prescribed sum or asset that the promisor is expected to relinquish to the promisee?' In substance, there is no difference. Courts have recognised the emptiness of such differentiation.⁸²

The case of *Nutting v Baldwin*⁸³ highlights how a clause depriving an errant party of contractual benefits may amount to forfeiture, even where there is neither the deposit of money nor asset as security. The claimants, in this case, sought to contest a decision by the committee of an association to deprive them of the benefits of a successful court suit against certain persons, the purpose for which the said association was formed. The committee of the association had levied additional subscription fees on its members. It also reached a resolution that members who failed to pay the additional fees would be deprived of the benefits of the proposed legal suits. When the association succeeded with the lawsuits planned, it decided to deny the claimants a share in the judgment payment owing to the failure of the claimants to pay the additional levies, which were meant to fund the association's litigation costs. The court recognised that the decision of the committee amounted in substance to a forfeiture of benefits the claimants were otherwise entitled to receive, but the court did not grant relief to the claimant on the reasoning that the committee's decision was legitimate as its purpose was to avoid a derailment of the association's objectives.

As this case shows, the supposed differences between categories of remedial clauses are formalistic, as a contractual termination clause may have the same effect as forfeiture clauses. It may also have the implications of a liquidated damages provision, where a promisor seeking to avoid the deprivation of a contractual benefit or the enforcement of a termination clause might have to pay a sum or suffer a forbearance in order to avoid the promisee making a decision that might have detrimental effects for his or her business

79 *Union Eagle Ltd v Golden Achievement Ltd* [1997] AC 514, 519–523.

80 *Dalkia Utilities Services plc v Celtech International Ltd* [2006] EWHC 63 (Comm).

81 See James Edelman (ed), *McGregor on Damages* (20th edn, Sweet & Maxwell 2018) para 16-014; Hugh Beale (ed), *Chitty on Contract* vol 1 (32nd edn, Sweet & Maxwell 2017) paragraph 26-216N.

82 See *Jobson v Johnson* [1989] 1 WLR 1926.

83 [1995] 1 WLR 201.

interests. In recent times, courts have recognised how private law power derived from contracts may significantly affect the allocation of burdens and benefits between contracting parties. Such powers may be as potent in their effects as those of public authorities.⁸⁴ We can imagine the suspension of a bank from a payment card network; the shutting-out of a company from a consortium blockchain network which facilitates its business activities; or the termination of a supplies contract where a bulk buyer has minimal alternatives sources of supply to fall upon, to mention a few.⁸⁵ In similar vein, a body of case law has applied administrative law reasoning to assess the reasonableness or otherwise of discretionary decisions of parties wielding private law powers.⁸⁶ This is pertinently so in those cases where contractual terms entitle promisees to terminate contracts for breach, and the courts have interpreted such powers to be akin to discretionary powers that should be exercised in good faith.⁸⁷ But if there is an appreciation of this reality in case law, why has it not changed judicial rules concerning relief from forfeiture? We shall return to this discussion below when addressing relief from forfeiture clauses and the bias against purely contractual interests.

The unappreciated implication of practical legal decisions, like those of the Australian High Court in *Andrews* and *Pacciaco*, is the doing-away with these needless categorisations, followed by a uniform treatment of remedial terms. Halson reasons that an attempt at drawing a commonality between agreed remedies clauses, particularly stipulated sum clauses and those of forfeiture of deposits, is simplistic.⁸⁸ He posits that this is so for two reasons. One is the issue of timing. An assessment of the validity of a stipulated sum clause as being against the parties' expectations is viewed at the time of contracting; while that of forfeiture clauses is at the time of enforcement. The second relates to considerations that inform the said assessment. That the party seeking to enforce stipulated sum provisions must show that the term serves as 'proportionate protection to a legitimate interest of the promisee';⁸⁹ while those seeking to enforce a forfeiture clause only need to show that retention of the promisor's interest is reasonable. This second basis of distinction is devoid of substance. We shall return to this below when addressing the issue of legitimate interest. However, the first basis of differentiation raised by Halson (that of timing), while right on account of legal doctrine, is also destitute of substance. Thus, where there is an expurgation of the timing difference, the divergence between both clauses evaporates. Below, we shall return to the discussion on the imperative to discard the timing difference.

84 See Hon Justice Stephen Kós, 'Constraints on the exercise of contractual powers' (2011) 42 Victoria University Wellington Law Review 17; see also Robert Hale, 'Coercion and distribution in a supposedly non-coercive state' (1923) 38 Political Science Quarterly 470.

85 See, generally, Jose Gomez-Ibanez, 'Regulating infrastructure: monopoly, contracts and discretion' (1st edn, Harvard University Press 2003).

86 See Michael Bridge, 'The exercise of contractual discretion' (2019) 135 Law Quarterly Review 227; see also *Braganza v BP Shipping Ltd & Another* [2015] UKSC 17; *British Telecommunications plc v Telefónica O2 UK Ltd* [2014] UKSC 42, [2014] Bus LR 765; *Socimer International Bank Ltd v Standard Bank London Ltd* [2008] EWCA Civ 116; *Paragon Finance plc v Nash* [2001] EWCA Civ 1466, [2002] 1 WLR 685; *Abu Dhabi National Tanker Co v Product Star Shipping Ltd (The 'Product Star') (No 2)* [1993] 1 Lloyd's Rep 397.

87 *Lymington Marina Ltd v MacNamara & Others* [2007] NPC 27, paragraph 44; see also, *SNCB Holding v UBS AG* [2012] EWHC 2044 (Comm).

88 Roger Halson, *Liquidated Damages and Penalty Clauses* (1st edn, Oxford University Press 2018)156–157.

89 Ibid.

4 The third strand: considerations for recalibration

There are numerous legal variables associated with remedial terms. However, some are predominantly salient. It is these notable elements of remedial terms that this section addresses in advancing the case for recalibration. This article separates these elements into different heads for analysis. The heads addressed here are as follows:

1. the breach requirement;
2. the legitimate interest question;
3. absence or otherwise of a duty to mitigate;
4. whether a promisor has the right to elect between the enforcement of remedial clauses and falling back to common law damages
5. *ex-post* considerations; and
6. relief against forfeiture and the bias against contractual rights.

4.1 THE POINTLESSNESS OF THE BREACH REQUIREMENT

In modern contract law, the predominant position appears to be that a breach is a precondition for the rule against penalty to apply. The decisions of the UK Supreme Court in *Cavendish* and the High Court of Australia in *Andrews* (reaffirmed in *Pacciaco*) revived this question. The former court held that breach is a precondition, while the latter ruled that breach is not a precondition. There have been varying academic explorations of the gulf between these two significant courts, and, as such, this article does not engage in parsing these judgments. That primarily is because this article pursues a prescriptive case against the said breach requirement.

The said requirement rests on the rationale that the jurisdiction to intervene in a remedial clause only arises where the obligation to pay is one of a secondary nature coming into effect upon the breach of a primary one. Allied to this, however, are the rules that judicial intervention would not arise in cases where a secondary obligation to pay is not for the benefit of the party to whom the promisor owes a primary responsibility, but for a third party;⁹⁰ nor does it apply upon a specified event that has no bearing on breach⁹¹ – e.g. where an identified entity goes bankrupt, or any external occasion arises.

It is not merely that the breach requirement is problematic because distinguishing between primary and secondary obligations can be an impossible task in the face of innovative and creative contract drafting.⁹² It is that it is inherently inadequate in allaying concerns around the use of contracts to achieve an undeserved, upward distribution of wealth and wealth extraction as enabled by substantial degrees of bargaining power. What courts should be concerned about, when dealing with remedial clauses, is what the essence of the bargain between the parties to a contract is. As some judges have recognised, in determining whether a provision is of remedial value, an undue focus should not be placed on textual interpretation of contractual documents but on the

90 See *Export Credits Guarantee Department v Universal Oil Products Co* [1983] 1 WLR 399; see also *Imam-Sadeque v BlueBay Asset Management (Services) Ltd* [2012] EWHC 3511 (QB).

91 See *Euro London Appointments Ltd v Claessens International Ltd Edgeworth Capital (Luxembourg) SARL and Another v Ramblas Investments BV* [2015] EWHC 150 (Comm).

92 See David Foxton, 'How useful is Lord Diplock's distinction between primary and secondary obligations in contract?' (2019) 135 Law Quarterly Review 249; see also Justice Julie Ward, 'Penalties and the protection of freedom of contract' (Banking and Financial Services Law Association Conference, 15 August 2020) <<http://www.austlii.edu.au/au/journals/NSWJSchol/2010/18.pdf>>.

matrix of fact peculiar to the parties at the time of forming the contract. For as Lord Radcliffe expressed it in *Bridge v Campbell*:⁹³

The court's jurisdiction to relieve against penalties depends on 'a question not of words or forms of speech but of substance and of things' ... It cannot really depend on a point of construction, though it is often spoken of as so depending. A sum of money sued for in one set of circumstances, as on a hirer's breach, when alone the 'in terrorem' idea can have any application, may be a penalty in the eyes of the law, without it being necessarily anything but the price of an option in another set of circumstances or a mere guarantee in yet a third.⁹⁴

Elaborate schemes may be adopted to defeat the formulaic breach requirement.⁹⁵ For example, suppose B (a promisor) intends securing a contract with A (a promisee) in circumstances where A is sceptical about B's reliability. A requires B to obtain a letter of credit from a bank in favour of himself (A) or any of his nominees, with the instruction to the bank that where A or any of his said nominees can show that a particular task imputed to B has not been performed or if a given event occurs, then the bank should pay A or the said nominees \$X. Should B not perform, or the said event happens, and the bank pays the elected payee, B's chances of contesting the payment as a penalty would be bleak if we were to go by the breach requirement for the following reasons. One is that B's standby instruction to the bank preceded B's default. The second is that the bank's payment to A or his nominee was not made by B to A but through a third party (i.e. the bank). Thirdly, where the payment is to A's nominee with whom B has no contractual relations, B's chances are most dim; as there would be no breach of a contractual obligation owed to the payee.

The analogy is equally applicable with the same implications in cases where A and B had adopted an escrow arrangement, with A paying in advance to a third party who is instructed to pay B should there be breach or a specified event. Thus, it is patently clear that only by an understanding of the real bargain between parties that we can assess the true purpose of the said payment arrangement to determine if it serves a remedial role. In a similar vein, the Scottish Law Commission in a recently issued report on remedial clauses described the breach requirement as being too narrow on the ground that 'it would not catch the payment to be made when a party exercised an option under a contract such as terminating it early'.⁹⁶

There are fears expressed concerning the call for dispensing with the breach requirement. A common one is that it carries with it the risk of disrupting contract structuring, heightening difficulties for judges and lawyers. Another concern is that discarding the breach requirement creates room for commercial uncertainty, along with the effect of enabling contractually disadvantaged parties to be freed from ill-advised bargains.⁹⁷ Such views appear appealing on the surface; however, they only perpetuate the case for form over substance. We can allay such fears by stating the requirement for the enforceability of remedial clauses as the demonstration of a legitimate commercial interest for protection. The imposition of such a condition does not create commercial uncertainty;

93 [1962] AC 600.

94 Ibid 624; see also *Lombank Ltd v Excell* [1963] 3 WLR 700.

95 See Gerald McLaughlin, 'Standby letters of credit and penalty clauses: an unexpected synergy' (1982) 43 Ohio State Law Journal 1.

96 Scottish Law Commission, *Review of Contract Law: Discussion Paper on Penalty Clauses* (Discussion Paper No 162, 2016) 10.

97 See John Carter, Wayne Courtney, Elisabeth Peden, Andrew Stewart and G J Tolhurst, 'Contractual penalties: resurrecting the equitable jurisdiction' (2013) 30 Journal of Contract Law 99, 112–113.

it only serves to adjust the balance of legal entitlements between contracting parties. We shall return to this issue when addressing 'legitimate commercial interest' below.

What should be the criterion for identifying a clause as being of remedial implications? We can answer that question by referring to a statement of Deane J in his dissenting judgment in the Australian case of *AMEV-UDC Finance Ltd v Austin*,⁹⁸ where he said, concerning the identification of remedial clauses, that:

The general area in which they are applicable is where there exists a contractual liability ... to pay or forfeit an amount or amounts either on or in default of the occurrence of an event which can be seen, as a matter of substance, to have been treated by the parties as lying within the area of obligation of the party liable to make the payment in the sense that it is his or her responsibility to ensure that the specified event does or does not occur and where the stipulated payment contains an element of compensation for the economic loss or damage which might be sustained by the other party by reason of the particular occurrence or default.⁹⁹

Thus, the baseline of the inquiry should be whether there is an identifiable responsibility or event which the bargain of the parties requires the promisor to facilitate or avoid. Then a collateral obligation upon the promisor (whether to pay or do something) arising in response to the unwanted outcome would be of remedial implication where it serves to rectify the said undesirable outcome. Ultimately, however, whether the stipulated measure in response to the undesired outcome is remedial can only be determined by a scrutiny of the matrix of facts between the contracting parties at the time of contractual formation. Such exercise would help us ascertain what interests were at stake in the parties' agreement. By so doing, we can distinguish substantive terms (e.g. options and prices) from collateral ones that serve to remedy unwanted events. Without such a careful approach, we are bound to fall into error. For, as admonished by Lord Halsbury in *Castaneda and Others v Clydebank Engineering and Shipbuilding Co Ltd*,¹⁰⁰ 'it is impossible to lay down any abstract rule as to what it may or it may not be extravagant or unconscionable to insist upon without reference to the particular facts and circumstances which are established in the individual case'.¹⁰¹

4.2 THE LEGITIMATE INTEREST CONDITION

Ever since the decisions of *Cavendish*, *Andrews* and *Pacciacco*, the phrase 'legitimate interest' has gained prominence as the new touchstone for determining the validity of agreed remedies clauses across commonwealth jurisdictions.¹⁰² Thus, the new standard is whether the object of the clause is out of proportion with any legitimate interest which the promisee sought to protect.¹⁰³ Although the jurisprudence on the factor of legitimate interest concerning remedial clauses is still nascent, we can draw guidance on what counts as a legitimate interest from an analogous aspect of contract law in which the condition

98 (1986) 162 CLR 170

99 Ibid paragraph 5 of Deane J's dissenting judgment.

100 (1904) 12 SLT 498.

101 Ibid 500.

102 See, for example, the New Zealand Court of Appeal decision in *Honey Bees Preschool Ltd v 127 Hobson Street Ltd* [2019] NZCA 122; see also the Singaporean High Court decision in *Seraya Energy Pte Ltd v Denka Advantech Pte Ltd* [2019] SGHC 2.

103 See Lord David Hope, 'Law of penalties – a wasted opportunity?' (2016) 33 Journal of Contract Law 93.

serves as a crucial requirement.¹⁰⁴ What one may glean from discussions bordering on legitimate interests is that they are interests vital to protecting the commercial and economic objectives of the promisee following the essence of the bargain between the parties. As one scholar describes it, it must have a nexus with the promisee's performance interest.¹⁰⁵ It follows that where a promisee seeks to use the facility of a contract to enrich themselves without any bearing on the essence of the bargain between the parties, then such cannot amount to a legitimate interest.

There appears the position that being able to show a legitimate interest saves a remedial clause from invalidation.¹⁰⁶ That view may be logically valid, but it only gains validity because of assessing enforceability of a remedial provision at the time of contracting, and not at the time of the breach. The submission of this article is that being able to show a legitimate interest should not end the matter concerning enforceability. A term which might appear at the time of contracting to be legitimate may turn out disproportionate in effect at the time of breach or the eventuation of the undesirable event. For example, where the loss to the promisee is significantly lower in value than had been feared by the promisee at the time of contracting. It follows that having a legitimate interest in the use of a remedial clause should not exclude judicial review. Courts should be able to scale down a provision whose effects would be disproportionate to the legitimate interests of the promisee in the light of facts available at the time of breach or an undesired event. This issue is well addressed below under the subheading '*Ex-post* considerations'.

4.3 THE DUTY TO MITIGATE

It appears a settled rule concerning agreed damages clauses that they create a debt obligation in favour of entitled promisees. For this reason, the position is that such promisees have no bilateral duty to take measures towards the mitigation of their exposure to losses. Such an obligation to mitigate only arises, it is argued, in cases of unliquidated damages. The rationale for this rule was in modern times stated in the case of *Abrahams v Performing Rights Society Ltd*¹⁰⁷ and was recently re-echoed by Leggatt J in *MSC Mediterranean Shipping Co*, saying, among other things, that:

to allow mitigation arguments where there is a liquidated damage clause would be inconsistent and unfair because it would involve limiting the damages recoverable by a plaintiff who can show that his actual loss is greater than the stipulated sum whilst permitting a defendant who can show that it is less to take advantage of that fact. It would also expose the parties to 'the risk, expense and uncertainty of litigation the avoidance of which is to be presumed to be one of the principal reasons for their stipulating for liquidated damages'.¹⁰⁸

¹⁰⁴ Solene Rowan, 'The "legitimate interest in performance" in the law on penalties' (2019) 78 Cambridge Law Journal 148.

¹⁰⁵ Jessica Palmer, 'Implications of the new rule against penalties' (2016) 47 Victoria University of Wellington Law Review 287.

¹⁰⁶ Elizabeth Peden, 'Penalties after Paciocco – the enigma of "legitimate interests"?' (2019) Journal of Contract Law 263, 277; see also, Carmin Conte, 'The penalty rule revisited' (2016) 132 Law Quarterly Review 382 at 387: 'Once the court identifies a legitimate interest, the difficulty in conducting the comparative exercise in a principled fashion will mean that, in practice, it will always uphold the agreed remedy clause. The rule will have been abolished by the back door.'

¹⁰⁷ [1995] ICR 1028

¹⁰⁸ [2015] EWHC 283, paragraph 70.

One may try to rationalise the English Court of Appeal's decision in *Murray v Leisureplay*¹⁰⁹ on the absence of a duty to mitigate in liquidated damages cases. However, a proper understanding of that case shows that the court did not identify such a rule. Instead, the court dismissed the argument in favour of a duty to mitigate as it relates to the peculiarities of the case. The basis for that decision was that the promisee–employee (Murray) had a legitimate interest in receiving the contractually stipulated sum even though he had the opportunity to mitigate his exposure to loss of income by seeking employment elsewhere.¹¹⁰ Most importantly, the essence of the contract in issue between the parties did not give room for the recognition of such a duty to mitigate loss.

That there should be no imputation of a correlative duty of mitigation on a promisee entitled to stipulated damages payments cannot stand as a defensible rule in a milieu in which proof of an absence of legitimate interest may disentitle a promisee from receiving a contract price, as established in the case of *White and Carter (Councils) Ltd v McGregor*.¹¹¹ Suppose X is entitled, based on an executory agreement, to receive a price payment from Y on the expectation of a counter-performance by X. X may yet not be entitled to receive such amount as agreed where X is aware of Y's repudiation or lack of capability to perform but continues to keep the contract open. The rationale for rejecting X's entitlement to payment is the absence of any genuine basis for insisting upon contractual performance beyond self-enrichment that cannot fairly be reconciled with the goal of their bargain. In other words, X should not be allowed to use the agreement as an avenue for enrichment. Why then should such 'legitimate interest' requirement not apply to a promisee entitled to a liquidated sum upon breach or similar events, especially in connection with that promisee's ability to mitigate against loss? Except where a promisee can show that the context and essence of the bargain between the parties entitled the promisee to an undiscounted payment of the stipulated sum, the law should require mitigation wherever doing so is inexpensive, and there are low-risk avenues available to the promisee in achieving such mitigation. It does not mean that promisees should assume sacrificial roles, the implication of which would place onerous financial obligations on them.

It may be argued, as foreshadowed in the introduction to this article, that liquidated damages may legitimately serve to predetermine the measure of loss that may arise upon non-performance, especially in situations where losses may be difficult to quantify. It does not, however, follow that it therefore obviates the need for mitigation. This is so because, since the essence of mitigation is to uphold the policy of making compensation approximate the net loss resulting from breach or analogous events, it should be applied in reining in the enforcement of liquidated damages. Mitigation does not serve merely to prevent the promisee from accruing additional losses and transferring them to the promisor; it also serves to ensure that a promisee, in line with good-faith expectations, does not frustrate the goals of a contractual bargain.

Two significant reasons justify the recognition of such a duty to mitigate. One is that it avoids the waste of resources, thus promoting economic efficiency in circumstances where the promisee is the better cost avoider.¹¹² There is a significant risk that a promisee entitled to a liquidated sum may fail to take advantage of inexpensive and low-risk routes

109 [2005] EWCA Civ 963.

110 See *Cavendish Square Holding BV v Makdessi ParkingEye Ltd v Beavis (Consumers' Association Intervening)* [2016] AC 1172, 1269–1270.

111 [1961] UKHL 5, [1962] AC 413.

112 See, Melvin Eisenberg, 'The duty to rescue in contract law' (2002) 71 *Fordham Law Review* 647.

to reduce economic loss if a duty to mitigate is not recognised.¹¹³ This is most likely so in cases where the stipulated sum is significantly more than the promisee's net loss. However, in cases where the stipulated sum is likely to be lower than the promisee's net loss, the promisee may feel compelled to mitigate losses anyway.

Another reason is that it may enable opportunism on the part of the promisee. The fact that a compensatory sum is fixed does not eliminate the possibility of the promisee acting opportunistically. Thus, in cases where a promisee can avoid loss by taking proactive measures, the non-recognition of a duty to mitigate will vest bargaining power in the promisee where the promisor seeks to implore the former to make efforts towards mitigation. And 'double-dipping' will be implicit in cases where the promisee sues to claim the sum stipulated after they have mitigated loss.¹¹⁴ Therefore, to avoid placing the promisor at the mercy of the promisee in this regard, it is essential to entrench the legal recognition of contracts as relational cooperative arrangements. The effect of this would be to impose a duty to mitigate loss in cases of liquidated damages, where such is possible at low-cost to the promisee.

One may extend the case for the duty to mitigate to promisees seeking to enforce forfeiture clauses as well. On the authority of *Cukurova Finance International v Alfa Telecom*,¹¹⁵ a party seeking relief from a forfeiture clause may not rest their case for relief on the basis that the promisee acted in bad faith. That is so even where, for example, the promisee's actions create the risk of jeopardising the efforts of the promisor in avoiding forfeiture.¹¹⁶ Such a rule is difficult to defend. It is also difficult to reconcile with some of the well-established equitable factors that allow promisors to claim relief. Potentially, the jurisdiction to relieve a promisor from forfeiture is available in (limited) cases, mainly where the objective of the remedial provision in the contract was to facilitate the security of payment to the promisee.¹¹⁷ However, the promisor must show that, except for the non-fulfilment of the contractual obligation warranting the enforcement of the said clause, they conducted themselves properly; and that they are still able and willing to meet contractual expectations.¹¹⁸ Also, relief should also be available where there is a significant gap between the value of the interest to be lost in the enforcement of the forfeiture clause and the possible detriment likely to be suffered by the promisee.¹¹⁹ The conduct of the promisee also counts. For example, relief may be available where the 'conduct of the person seeking to secure the forfeiture has been wholly unreasonable and of a rapacious and unconscionable character'.¹²⁰

A party seeking to enforce such a clause would undoubtedly qualify as acting unreasonably, and certainly unconscionably, where they strive to frustrate the efforts of the promisor in redeeming their interest or actualising the fulfilment of contractual

113 See *Financings Ltd v Baldock* [1963] 2 WLR 359, 363–367; see also *Campbell Discount Co Ltd v Bridge* [1962] 2 WLR 439, [1962] 1 All ER 385, [1962] AC 600; see also *United Dominions Trust Ltd v Ennis* [1968] 1 QB 54. In these cases, one can glean that a duty to mitigate was implicitly recognised. The rationale being that where a promisee had terminated a contract upon the promisor's breach, losses resulting to the promisee from the decision to terminate are attributable to promisee (and not the breaching promisor).

114 See Lisa A Fortin, 'Why there should be a duty to mitigate liquidated damages clauses' (2009) 38 Hofstra Law Review 285.

115 [2013] UKPC 2

116 Ibid 16–17.

117 *Shiloh Spinners Ltd v Harding* [1973] AC 691; see also *Warnborough Ltd v Garmite Ltd* [2003] Civ 1544.

118 See *Gill v Lewis* [1956] 2 QB 1, 13–14; see also, *Inntrepreneur Pub Co (CPC) Ltd v Langton* [2000] 1 EGLR 34.

119 *Shiloh Spinners Ltd v Harding* [1973] AC 691, 725.

120 Ibid 726.

obligations.¹²¹ Such unreasonable actions may take shape in making it impossible for the promisor to obtain finance; failing to disclose vital information, or acting manifestly uncooperatively.¹²² However, we must still have regard to the nature of the transactional context between the parties.

4.4 RELIEF FROM FORFEITURE AND THE BIAS AGAINST CONTRACTUAL RIGHTS

The rule appears to be that property and personal property interests are the only recognised candidates for relief against forfeiture.¹²³ Traditionally, relief against forfeiture was considered exclusively available to interests in real property, such as leases and freehold. That was on the theory that the promisee seeking to enforce forfeiture concerning such rights would be entitled to specific performance and other corrective remedies should the promisor's action trigger the call for such a clause.¹²⁴ Then, with the advancement of time, the courts expanded the availability of the relief to interests in personal property, on the reasoning that the distinction between land and personal property is unsustainable.¹²⁵ However, as regard interests of a purely contractual nature, such as a licence in intellectual property, or any contractual right not amounting to property or personal property, relief is generally unavailable.¹²⁶ Cases in which promisors were able to secure such relief in connection to purely contractual rights have now been rationalised as dealing with interests analogous to personal property.¹²⁷

One may then ask, 'why should relief from forfeiture not be available to promisors with purely contractual interests?' The manifest bias against contractual interests in this regard is unsustainable in the prevailing knowledge-/information-/network-based economic dispensation where contractual interests are just as valuable as property interests.¹²⁸ The exercise of the power to terminate contracts or withhold a contractual benefit may significantly alter the allocation of benefits and burdens between parties to an agreement. The most relatable examples are cases of expulsion from business networks, associations or consortiums, and situations of asset-specificity – i.e. where a party has become so invested in a resource that their cost of finding an alternative can only come at an inordinate expense.¹²⁹ Relief should also be available where there is the risk of the promisee gaining an economic windfall from insisting on forfeiture in circumstances where cheaper alternative corrective measures are enough.¹³⁰ Thus, a

121 See, the statements of Justice Cardozo in the USA case of *Jacob & Youngs, Inc v Kent* 230 NY 239 (1921), 243–245.

122 See, for example, the explanations of Leggatt J in *Yam Seng Pte Ltd v International Trade Corp Ltd* [2013] EWHC 111 (QB), paragraph 142; see also Hugh Collins, 'Implied duty to give information during performance of contracts' (1992) 55 *Modern Law Review* 556.

123 See *Scandinavian Trading Tanker Co AB v Flota Petrolera Ecuatoriana* [1983] 2 AC 694.

124 See *General Motors UK Ltd v The Manchester Ship Canal Co Ltd* [2018] EWCA Civ 1100, paragraphs 40–47.

125 See *BICC plc v Burndy Corp* [1985] Ch 232, 252A–C.

126 See *SCI (Sales Curve Interactive) Ltd v Titus Sarl; Sport International Bussum BV v Inter-Footwear Ltd* [1984] 1 WLR 776; *Union Eagle Ltd v Golden Achievement Ltd* [1997] AC 514, 519F–G.

127 See *General Motors UK Ltd v. The Manchester Ship Canal Company Ltd* [2018] EWCA Civ 1100; where *On Demand Information plc v Michael Gerson (Finance) plc* [2001] 1 WLR 155 was rationalised as a case relating to personal property. Also, the Court of Appeal rejected the first instance decision on the matter before it at [2016] EWHC 2960 (Ch), which recognised the possibility of relief to contractual interests. Instead, the court rationalised the contractual licence in issue as relating to a personal interest.

128 See Kit Barker, 'Economic loss and the duty of care: a study in the exercise in the of legal justification' in Charles Rickett (ed), *Justifying Private Law Remedies* (Hart 2008) 175.

129 See Chapin Cimino, 'The relational economics of commercial contract' (2015) 3 *Texas A&M Law Review* 91, 109.

130 See *On Demand Information plc and Another v Michael Gerson (Finance) plc* (2001) 1 WLR 155, 172.

promisee should only be able to pursue forfeiture if they can show legitimate interests for enforcing it.

The bias against contractual interests in this regard cannot stand for much longer as courts now demonstrate the willingness to reverse or revise terminations that have punitive implications. An excellent example of this is the case of *Vivienne Westwood Ltd v Conduit Street Development*,¹³¹ where a landlord terminated a contractual concession which allowed the payment of a lower sum as rent, replacing it with a substitute term requiring a higher amount. The landlord did so because the tenant had technically breached the contract by paying late on a given occasion. The court found such termination to be punitive in effect in the circumstances of the case. The court reasoned, most importantly, that the financial implications of the said termination imposed disproportionate financial obligations on the tenant, especially in a situation where whatever injury likely to result to the landlord was small, and less burdensome measures to the promisor could address the promisee's injury.

One should not take this as the calling for judicial rescue from bad bargains. Contracting parties with powers to terminate or revise contracts should be able to do so in the advancement of self-interest in cases where legal limitations would render a bargain commercially obtuse. Such would be the case in situations where judicial intervention could expose the promisee to the risk of economic burdens like the loss of better deals or cost increase.¹³² Also, there should be no need for legal intervention where, for example, a higher sum is the real bargain between the parties, but there is concession allowing a lower amount; and the promisee may resume the higher amount upon breach or an undesired event.¹³³ In such cases, the high amount is the original price of the contract and, thus, not a substantive term which falls under the jurisdiction to review remedial clauses. Additionally, relief should not generally be available in cases of forfeiture of instalments already paid towards the purchase of a subject matter, where such instalments count as part of the contract price, except where the buyer can demonstrate manifest unfairness.¹³⁴

Judicial review of termination clauses and clauses with similar results should be available in cases where the promisee fails in showing a legitimate interest for insistence on such provisions, and there is a real likelihood of incommoding the promisor with heightened burdens. Such would be the case in situations where the promisee's stake does not go beyond money payments; where the object of the contract between the parties is still attainable; there is no situation of irreconcilable break down in commercial relations; and, if there is, the bargain does not require a personal relationship to execute.

4.5 EX-POST CONSIDERATIONS

An important rule concerning stipulated sums or assets, which in prevailing law sets it apart from those of forfeiture clauses, is that the time at which the promisee's legitimate interest in claiming the said sum is the time of contracting. Suppose a promisee had a specific commercial interest concerning which a stipulated amount or asset was agreed as insurance against default. Suppose, also, that the promisor's action did offend the said concern, but

¹³¹ [2017] EWHC 350 (Ch).

¹³² See *Socimer International Bank Ltd* [2008] EWCA Civ 116, 122–123.

¹³³ *Wright & Another (Liquidators of SHB Realisations Ltd) v The Prudential Assurance Company Ltd* [2018] EWHC 402 (Ch); *Thompson v Hudson* (1869) LR 4 HL 1.

¹³⁴ See *Stockloser v Johnson* [1954] 2 WLR 439; *Workers Trust & Merchant Bank Ltd v Dojap Investments Ltd* [1993] AC 573.

the magnitude and value of injury resulting are substantially insignificant as compared to the quantum of both what the promisee had feared and the stipulated sum or the asset the promisor had avowed to pay. The promisor would not by dint of the penalty rule be relieved from the obligation to pay the specified measure notwithstanding the gap in value at the time of the breach. Going by the prevailing rule, so long as the promisee had a discernible commercial fear and a proportionate legitimate interest in protecting that concern at the time of contracting, the said gap in value would not affect the promisee's entitlement to receive the specified sum or asset. As already stated above, there is no difference in substance between this rule and those governing forfeiture clauses; especially as the presentation or drafting of stipulated sums or assets clauses may take creative forms and one form of the clause may be judicially understood as being another.

There is no justifiable basis upon which one may defend such a ('time of contracting') rule. The common defence often presented is that, so long as the parties to the bargain acted freely, and are, possibly, sophisticated entities who are well-advised, the enforceability of such clauses should seldom be subject to review.¹³⁵ The weakness of such an argument is discernible. If a fear existed at the time of contracting but dissipates at the time of the breach, or the undesirable event, then it does not make any sense to allow the promisee to keep the windfall accruing on account of that gap. There can be no justification for allowing such a windfall. Such an approach relegates the gist of the contract and treats an appendage bargain (i.e. the remedial clause) as though it were the main thing the parties had in mind. There is an imperative to adjust the appendage bargain to the needs of the contract at the time of the breach. A windfall may, however, be defensible where it serves to protect the legitimate interest of the promisee and there is justification for it based on the commercial context and purpose of the bargain between the parties.

As Eisenberg explains, a piece of reality not present in the conception of the 'time of contracting' rule is that humans have defective telescopic abilities.¹³⁶ Contracting parties customarily assume that their current capabilities and calculations will sufficiently avail them towards the performance of contractual obligations. A promisor may be aware of liquidated damages clauses, but the full implications of such provisions are less likely to have been given thorough consideration by him or her. There is the likelihood that where a promisee is confident that the value of a stipulated sum will be more than that of the injury likely to result from a breach, the promisee might have an incentive to encourage such breach.¹³⁷ Thus, the promisee might feel emboldened to act uncooperatively towards the promisor, which may equally cause the promisor to spend wastefully towards avoiding a breach. It would also exceedingly tilt the balance of relations between the parties towards the promisee's favour. The case would undoubtedly be different if the incentive to act uncooperatively were removed, which could be done by the judicial adjustment of the stipulated sum towards approximation with the losses ensuing at the time of breach.

135 See, *General Trading Co (Holdings) Ltd v Richmond Corp Ltd* [2008] EWHC 1479 (Comm), paragraph 133; *Philips v Attorney General of Hong Kong* [1993] 61 BLR 41.

136 Melvin Eisenberg, 'The limits of cognition and the limits of contract' (1995) 47 *Stanford Law Review* 211, 222–228.

137 See Kenneth Clarkson, Roger Miller, and Timothy Muris, 'Liquidated damages v penalties: sense or nonsense' (1978) *Wisconsin Law Review* 351; see also, Timothy Muris, 'Opportunistic behavior and the law of contracts' (1981) 65 *Minnesota Law Review* 521.

This risk may be illustrated using a hypothetical example.¹³⁸ Suppose, a remedial clause in a joint venture contract for a software development project entitles non-defaulting parties to buy out the interests of defaulting parties at a flat discounted rate of 20 per cent. Before the launching of the software in the market, a defaulting party's interest in the arrangement is worth, say, \$100,000. Suppose, however, that within the first year of launching of the software in the market, the value of the defaulting party's share is \$600,000. If the promisee seeks to enforce the remedial clause when the value of the promisor's asset was \$100,000, the discount value would be \$20,000. Such a discount rate is one which the promisee may not have much difficulty in establishing a legitimate interest over. However, were the enforcement of the clause to be upon market entry of the software, when the promisor's share is \$600,000 in value, a discount rate of 20% would be \$120,000. Thus, it becomes clear that by not adjusting agreed remedial clauses in correspondence with hindsight information regarding the loss of the promisee, undue windfall opportunities may accrue to promisees. The call for adjustment is not that where hindsight shows that the promisee's loss is significantly less than the value of an agreed remedies clause, the court should declare it unenforceable and replace it with common law damages. Instead, the submission of this article is that the value of such provisions can be scaled down to a measure that approximates to the legitimate interest of the promisee, judging by events at the time of the breach. We address this in the next subheading.

4.6 THE ELECTION BETWEEN REMEDIAL CLAUSES AND STANDARD CONTRACT REMEDIES AT THE TIME OF ENFORCEMENT

There is the rule that where a promisee has stipulated a sum as damages, and the said sum turns out to be lower than the actual injury suffered, that party cannot then elect to fall back on standard contract law remedies. There is also the rule that where stipulated sums turn out to be punitive, they are not just unenforceable but void *ab initio*¹³⁹ and may not be judicially revised.¹⁴⁰ The implications of both rules are that promisees are restricted to either common law damages or liquidated damages; and where the latter is chosen, a scaling-down of the stipulated sum is not to be allowed where it qualifies as a penalty. This was succinctly criticised by Treitel, saying:

The common law rules for distinguishing between penalties and liquidated damages manage to get the worst of both worlds. They achieve neither the certainty of the principle of literal enforcement, since there is always some doubt as to the category into which the clause will fall, nor the flexibility of the principle of enforcement subject to reduction, since there is no judicial power of reduction. On the other hand, they place an undue premium on draftsmanship ... the chief danger is to 'home made' clauses which may be invalidated even though they are not intrinsically unfair.¹⁴¹

There should be a reformation of these rules based on the theory that agreed damages are in substance the same regardless of categorisation. If a promisee seeking to enforce a forfeiture clause realises that the value of the promisor's security is below that of the

¹³⁸ See Michael Lishman, 'Penalties and relief against forfeiture of joint venture interests' (2008) 27 Australian Resources and Energy Law Journal 219, 234.

¹³⁹ See *Cavendish Square Holding BV v Makdessi; ParkingEye Ltd v Beavis* (Consumers' Association Intervening) [2015] UKSC 67, [2016] AC 1172, 1220–1222; see also *Wall v Rederiaktiebolaget Luggude* [1915] 3 KB 66, 73; see also *Financings Ltd v Baldock* [1963] 2 QB 104, 120.

¹⁴⁰ *Dalkia Utilities Services plc v Celtech International Ltd* [2006] EWHC 63 (Comm), paragraph 128.

¹⁴¹ Guenter Treitel, *Remedies for Breach of Contract: A Comparative Account* (1st edn, Clarendon Press 1988) 233.

likely injury, the promisee may insist on the forfeiture and request for additional sums to make up for the balance of loss. Also, a forfeiture claim may be scaled down to a measure equivalent to the value of the interest lost by the promisee. Why does the law not apply similar approaches to liquidated damages as well?

The first rule above (i.e. that where the value of actual injury turns out higher than that of the sums stipulated, the promisee cannot revert to common law damages) appears to have overtaken the competing position which was that a promisee could return to common law claims where stipulated sums turned out lower than the value of a loss.¹⁴² The reason for the change in rule appears attributable to the rationale of contractual certainty and finality.¹⁴³ It is only proper that we perceive liquidated damages as foreshadowing the promisee's exposure to loss, especially as prediction may be challenging to ascertain beforehand and the promisee might have idiosyncratic expectations. In any case, the law should recognise a promisee's entitlement to choose between a stipulated sum and common law damages (as a fallback position) if the former turns out lower than the latter. Also, if a contract does not expressly stipulate an exclusion of unliquidated damages, the law should recognise them as an automatically available fallback for promisees.

The second rule above (i.e. that where a stipulated sum qualifies as a penalty it shall be void *ab initio*) is equally a product of modern innovation as the first. In the relatively recent case of *Jobson v Johnson*,¹⁴⁴ the English Court of Appeal recognised a scaling-down exercise as a proper response to clauses that overcompensate for loss.¹⁴⁵ Such scaling-down exercises would at least help the court to reach an approximation of the value of interest lost by the promisee, especially in cases where the loss is non-pecuniary nor challenging to estimate going by the compensatory principle in contract law. Thus, where remedial clauses are considered to overreach the proportionate quantum essential to protecting the promisee's legitimate interest in the light of facts available at the time of the breach, or the event it was to protect against, they should be read down to a reasonable quantum.

Conclusion

In the foregoing discussions, the thesis of this article was pursued with its pith being that courts should exercise more supervisory powers over remedial clauses. This should be done with a view to ensuring that compensation for losses resulting from contractual wrongs correspond to the loss suffered by a promisee, except in cases where the promisee can demonstrate legitimate interests deserving of super-compensatory protection. That argument was advanced based on three strands which may be recapitulated as follows:

- a. the courts should have wide powers to read down remedial clauses;
- b. the imperative to reconceptualise all remedial clauses, including termination clauses, under one single category; and
- c. the postulation and discussion of considerations that should guide courts in governing remedial clauses.

142 See *Lowe v Peers* (1768) 4 Burr 2225; *Winter v Trimmer* (1763) 1 W Bl 395; *Harrison v Wright* (1811) 13 East, 343.

143 See *Elsley v JG Collins Insurance Agencies* [1978] 2 SCR 916 (Canada).

144 [1989] 1 WLR 1026.

145 Ibid per Lord Nicholls, pages 1041–1042; see also the criticisms of the *Jobson v Johnson* decision in the UK Supreme Court in *Cavendish Square Holding BV v Talal El Makdessi* by Lords Neuberger and Sumption at paragraphs 84–87 and those of Lord Hodgson at paragraph 283.

The first strand of the recalibration agenda centres on the need to infuse the ideals of good faith and relational cooperation into contract law to accentuate private empowerment as the kernel of contract law. It is argued that the common law of contracts has always had ways of controlling contractual terms using default rules and standards, and expanding such control measures, particularly with regard to remedial clauses, is essential in our current economic milieu. Doing so will raise the bar of entitlement to agreed remedies clauses by ensuring that they do not overreach the protection of the legitimate interests of promisees. The imperative to factor society's interest in contract enforcement represents the nucleus of the first strand. The tenor of this strand is that contract law rules will serve and advance society's interest well where they do not allow remedial clauses to function as avenues for wealth extraction, upward redistribution of wealth that is undeserved, and the undue consolidation of economic power. If we adopt a libertarian attitude towards remedial clauses, even in business-to-business contexts, we will be creating room for social problems in the jejune belief of respecting freedom of contracts. That is particularly so in this age of yawning gaps in private law powers, facilitated, most notably, by the effects of commercial networks, market concentration and technology rights.

The possible counterarguments that a liberal attitude towards the revision of remedial clauses may heighten transaction costs and reduce economic certainty are weak and unsustainable. Equally weak are arguments that such a progressive approach galvanises paternalism in contract law. Adopting such an approach is not as intrusive as may be argued, even though it upsets the *status quo*. What it does is to re-allocate entitlements. Promisees may stipulate remedial clauses, but they should only be entitled to enforce such provisions if they can demonstrate a legitimate cause for doing so, particularly at the time of breach or the eventuation of an undesired event to which the provision caters. Such an approach would only reshape contract drafting, especially by making promisees identify with clarity what they consider to be legitimate interests. The legal adoption of such a standard does not amount to the removal of the promisee's right to contract for remedies; it only raises the bar of enforcement for such clauses. Also concerning paternalism, adopting the judicial attitude towards remedial provisions as canvassed for in this article is no more paternalistic than respecting the *status quo*.

The second and the third strands are complementary, and they build upon the first. The second strand drives home the argument that all remedial clauses are, in substance, same. That the categorisation of remedial clauses based on their ostensible differences is unnecessary and unhelpful and should be avoided. Instead, that all remedial clauses, including express termination clauses, should be treated as same and governed using uniform rules. The third strand postulates on considerations that should inform the legal attitude in the governance exercise. The postulated considerations are as follows:

1. an association with a breach should not be a precondition to the identification of a clause as remedial;
2. that a party seeking to enforce a remedial clause should demonstrate a legitimate commercial interest in enforcing the said clause;
3. that the demonstration of a legitimate interest in the enforcement of a remedial provision does not exempt judicial intervention where events *ex post* (i.e. at the time of enforcement) show that the commercial risks concerning which protection was sought did not turn out as grave as originally feared;
4. courts should take account of events happening at the time of breach or the contractually undesired event to adjust effects of the clause downwards or upwards.

5. recognition of a duty to mitigate against losses resulting or likely to result from a breach in cases of remedial provisions; and
6. the discrimination against purely contractual rights in the grant of relief against forfeiture is unsustainable.

