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IN THE SUPREME COURT OF NEW ZEALAND
I TE KŌTI MANA NUI

SC 40/2019
[2019] NZSC Trans 27

BETWEEN **127 HOBSON STREET LIMITED**
First Appellant

SUNIL GOVIND PARBHU
(AKA DENNIS PARBHU)
Second Appellant

AND **HONEY BEES PRESCHOOL LIMITED**
First Respondent

JASON JAMES
Second Respondent

Hearing: 10 October 2019

Coram: Winkelmann CJ
O'Regan J
Ellen France J
Williams J
Arnold J

Appearances: R M Dillon for the Appellants
N S Gedye QC and C M Fisher for the Respondents

CIVIL APPEAL

MR DILLON:

Dillon appearing for the appellants.

WINKELMANN CJ:

Tēnā koe Mr Dillon.

MR GEDYE QC:

May it please Your Honours. Gedye appearing with Ms Fisher for the respondents.

WINKELMANN CJ:

Tēnā korua. Mr Dillon?

MR DILLON:

Thank you. I have handed up this morning a brief outline of the oral submissions, it should be in front of you. It confirms with the three page limit described by the rules, which does make it a matter of bullet points rather than something that can easily be read, but hopefully we should be able to work out way through it. It would be probably helpful to point out what the abbreviations are as we work through that particular document. If it's a capital "A" it means it's a reference to the full written submissions of the appellants. An "AA" is a reference to the appellants' authorities, the bundle of authorities.

The first heading is from intent to interpretation. This is basically a contract dispute. The key clause is alleged by the appellants to be a penalty clause but the assessment of a penalty clause does require first, an appreciation of the effects that may flow from that clause and the effects that may flow, a question of interpretation, in two particular degrees. One is the term for which the indemnity might last for, and the second is, the extent that the indemnity attaches to. Now the appellants' position –

WINKELMANN CJ:

Sorry, the extent the indemnity attaches to what?

MR DILLON:

Well, the lower courts both held that the indemnity only attaches to the payments. The payment of rent, the payment of outgoings. The appellants' position is that the deed in clause 2 is quite specific, very clear, simply English and clearly extends beyond just those two points.

WINKELMANN CJ:

So that is a large focus of your submission, is that the indemnity, which is the secondary obligation, applies to the full, to the lease through its extensions, renewals, but also that it covers every kind of obligation or that the lessee may have come upon it, but what say, your submissions don't really grapple with the alternative scenario as found by the Court of Appeal, and we're going to ask you to engage with that so you should also address submissions to us which proceed upon the basis that the clause is to be interpreted as the Court of Appeal interpreted it.

MR DILLON:

That is the intent and I believe that is set out reasonably fulsomely in the full written submissions as to the reasons why truncating the clear words really is an offence to the intent of the parties.

WINKELMANN CJ:

No, no, Mr Dillon, I'm saying – so that's one argument, and we'll hear you on that, but there is a second argument you do need to join, which is say you lose on that interpretation argument, so your argument on penalty has to be advanced on the basis that the clause is to be interpreted as the Court of Appeal did, so as to be interpreted to have this –

MR DILLON:

Restrictive effect.

WINKELMANN CJ:

Yes, restricted, so only until the end of the first term and only payment of rent and outgoings.

MR DILLON:

Yes, I understand that, yes. So the question of the intent, it's respectfully submitted, is reasonably clear and the key clause in the written submissions is paragraph 37 of the appellants' written submissions, which set out the statements Mr James made when giving his instructions to his solicitors. This was read into the evidence, it was in his briefs of evidence and he confirmed that in his oral evidence.

WINKELMANN CJ:

Can I just ask you just before you embark on the details, can you give us a short overview of your argument because there are a couple of aspects of it I found a little bit difficult to follow.

MR DILLON:

Very well. The first section is setting the context for the interpretation of the clause because there is a question of proportionality between the effects of the clause on the one hand, and the effects in terms of the legitimate interests of the, in this case the tenant, in having the particular clause, the primary obligation performed, and the proportion really is a comparison between the effects of the secondary obligation and the legitimate interests in performance, the primary obligation. So this first stage is setting the stage to set out the context because that is one of the two things that must be compared and considered to determine whether the effects are out of all proportion to the legitimate interest of, in this case, the tenant.

The way into this analysis is to consider what the phrase "legitimate interests" encompass, and the appellants' fundamental contention is that the legitimate interest is a shorthand way of describing the types of awards and damages that a plaintiff can obtain for breach of the particular primary obligation. That is, it is respectfully submitted, the very core of the appellants' position and so in determining what are the legitimate interests, it is not a question of a plaintiff to come before the Court, perhaps two years, three years after the breach, and advance speculatively all the possible things that could have gone wrong. It's for the plaintiff to say, well, we have a legitimate interest.

If this had of gone wrong and this clause did not exist, these are the types of damages that would flow. So imagine that there was no penalty clause and they were seeking damages simpliciter. How would they be assessed? And when one looks at the law of damages there is no lacunae, there is no gap, there is nothing that is legitimate that cannot be recovered, and you'll see in the written submissions there's a reference made to the United Kingdom's case of *Morris-Garner v One Step (Support)* [2018] 2 WLR 1353; [2018] UKSC 20, the negotiating damages cases. That is particularly relevant because in the negotiation damages assessment the Court is putting itself in the place of somebody, a party, negotiating a penalty clause, or a liquidate the damages clause probably.

O'REGAN J:
Yes, exactly.

MR DILLON:
And setting out the principal basis on which one can come up with a damages award that represents a pre-breach assessment of the plaintiff's loss, and it is respectfully submitted that this is really important to mesh the concept of penalty with the general rules of damages. These things, in the appellants' submission, are fully consistent and that is why the phrase "legitimate interest" is a shorthand for saying how the general rules of damages would have applied if this particular clause was not in place. That is the scope for legitimate interest. Then we look at the other key part of –

ARNOLD J:
Can I just understand what you're saying. I thought the point of a lot of the cases was that it's going to be very difficult to, in some situations, to figure out what the damages would be, either in advance or afterwards, and I suppose the *Dunlop* case, the early case, is a good example because that was a way of doing business and if that, and as I understand it the Courts do accept that as a legitimate interest so it doesn't, doesn't that undermine your point that there is a sort of close inter-relationship between them? Isn't the idea of

legitimate interest broader than something that you can necessarily express in damages?

MR DILLON:

With respect, if we use the thought experiment of what would happen if there was no liquidated damages/penalty clause, so if this clause did not exist. Does the Court not award damages because it's too hard to assess? With respect, there is clear law on that. The Court will award damages and do an assessment of the legitimate interests to come to a conclusion. Some things can never result in an award of damages. There's no causation, for instance is the obvious example, or it's too remote.

ARNOLD J:

Well are you saying then that the reasoning in *Cavendish* should not be followed because the Judges there certainly did say that there were legitimate interests that were not easily reflected, were not compensatory, or compensatible, in the usual way.

MR DILLON:

Well it's the qualification Sir that brings everything back into balance. There are things that are very difficult to assess. That has never stopped the Court assessing them.

WINKELMANN CJ:

Yes, but when you're looking before breach it's legitimate for the parties to say, this is going to be difficult to assess, and therefore we're going to provide our own framework for it, and that's what *Cavendish* has said.

MR DILLON:

Yes, and it's –

WINKELMANN CJ:

That's the argument you have to meet?

MR DILLON:

And there is not an argument against *Cavendish Square Holding BV v Makdessi* [2015] UKSC 67, rather it is a matter of focusing in on what *Cavendish* actually means when those particular elements of the key question, the essential question as it's referred to in *Wilaci Pty Limited v Torchlight Fund* [2017] NZCA 152, is teased apart. What does it mean to be out of all proportion. That indicates there is a proportion. Well if there is a proportion to be within, it's a mathematical calculation, isn't it. We have the proportion. All proportions, everything within the closed set. Once we are out of that proportion we're into a penalty and outside a legitimate interest.

WINKELMANN CJ:

Okay, so you're saying that even though there might be legitimate interests which cannot be protected in damages, the Court still has to do a damages calculation, does its absolute best to do it for outside that proportion, and that's the only measure. Or is that not what you're saying?

MR DILLON:

I believe the *Cavendish* formula allows for the fact that we're not dealing with judicial precision, we're dealing with lay parties doing their best to establish before breach what their losses can be. So there is an accepted wriggle room in relation to that, and that's why it's out of all proportion. The all proportion is the proportion which would be a full judicial assessment and an award of damages without a clause. All proportion might be the amount of wriggle room given the lay parties. The other formulation is it's grossly disproportionate as opposed to out of all proportion.

WINKELMANN CJ:

Yes, but Mr Dillon I thought I had understood you so can I just ask you to answer the question. Because you're taking us to those cases, the *One Step* cases, I had understood your argument to be that although it may be, as the Court says in *Cavendish*, that there are legitimate interest that may be protected through a penalty clause, when you're looking prospectively, when it comes to the situation when the penalty clause is enforced, in order to do that

out of all proportion calculation the Court has to do this notional calculation of damages, however difficult it is to assess whether there is the required proportionality. Is that your argument or is it something else?

MR DILLON:

No, that's what it comes to in effect. One must look at whether it's liquidated damages, and how would you do that unless you had a way of establishing what liquidated damages would look like in terms of a judicial assessment, and *One Step* really does answer that question because *One Step*, the *One Step* process is the Court's doing a liquidated damages assessment, they're assessing the effects of the breach before the breach, and coming up with a damages award which reflects that, and it's respectfully submitted that that is what makes it legitimate. It's something that the Courts will award by way of damages. Anything that is beyond what the Courts would award by way of damages, becomes illegitimate –

O'REGAN J:

But that's just completely contrary to what *Cavendish* says.

MR DILLON:

With respect Sir, I don't believe it is, because *Cavendish* uses the concepts of proportionality and uses the concept of legitimacy, and those words must mean something.

O'REGAN J:

Yes, but it doesn't say legitimacy is measured by calculating liquidated damages, or where does it say that. I didn't see that anywhere.

MR DILLON:

The question of the dichotomy between liquidated damages and penalty is something that is referred to in *Cavendish*. I've got that actually in the oral argument if I can just find it. Lord Mance in *Cavendish* at paragraphs 149 to 153 surveys the position in relation to the binary effect, the it's got to be either a penalty clause or it's got to be liquidated damages.

WILLIAMS J:

Give me the page number again please?

MR DILLON:

It's not a page number, it's a paragraph number. Paragraph 149 is where his assessment starts.

ELLEN FRANCE J:

149 Mr Dillon?

MR DILLON:

Yes, 149 is where his assessment of this issue of the dichotomy starts. He's referring to the –

WINKELMANN CJ:

Is that where he says, "In *Cine Bes* case…"?

MR DILLON:

Yes indeed.

WINKELMANN CJ:

Which is the part you wanted to draw our attention to?

MR DILLON:

Paragraph 152 is probably the key paragraph. He surveys the cases that deal with this issue and finds that the authorities are sound. "It is most easily explained on the basis that the dichotomy between the compensatory and the penal is not exclusive." So his view is that it's not absolute dichotomy, there must be something in the middle, although conceptually it's very hard to see how that could be the case.

WINKELMANN CJ:

Well, no, not in the middle. Not necessarily in the middle. It's not a complete list so there's no, there is more than compensatory interests which can be pursued through the clause in question.

MR DILLON:

Yes, and that's exactly the next sentence. "There may be interests beyond the compensatory which justify the imposition on a party in breach of an additional financial burden." Then he refers to the maintenance of the system of trade in *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd* [1915] AC 79 could be reviewed in that light, and –

WINKELMANN CJ:

But what do you take from that?

MR DILLON:

With respect –

WINKELMANN CJ:

We don't need to say this with respect.

MR DILLON:

Well with respect to Lord Mance –

WINKELMANN CJ:

We assume you respect both us and also Lord Mance.

MR DILLON:

Thank you Ma'am. The point really is this, that it really does have to be one or the other. It does have to be liquidated damages. Liquidated damages is the parties agreeing on the damages.

WINKELMANN CJ:

So how can you take us to Lord Mance and say he supports your argument when you're saying exactly the opposite?

MR DILLON:

He appears to accept that there is an issue as to whether it's a dichotomy or not –

WINKELMANN CJ:

And says it isn't.

MR DILLON:

And his view is that it isn't, having reviewed those authorities. But with respect conceptually it has to be one thing or the other –

WINKELMANN CJ:

So you are actually disagreeing with *Cavendish*?

MR DILLON:

I am actually disagreeing with him. It has to be either liquidated damages defined as the parties agreeing on something that is not out of all proportion and does respect the legitimate interests of the promisee, or it's a penalty.

WILLIAMS J:

And so these can only be compensatory, you say?

MR DILLON:

It is –

WILLIAMS J:

To be proportionate it must be compensatory?

MR DILLON:

It must be compensatory. The issue here is what will the Courts compensate for. The *Cavendish*, Lord Mance in effect says the Court will compensate for something that might not traditionally be regarded as compensatory because it justifies an additional financial burden. Now once we get to the point of is this extra burden justified, we're going back into the general law of damages to see whether it's a type of damages that the Court would allow, and if we cross that bar we have got a legitimate interest.

WINKELMANN CJ:

So the question is what will the Court compensate for and Lord Mance is saying at 152 that the Court will compensate for something other than…

MR DILLON:

Will allow compensation for something that represents and additional financial burden.

WINKELMANN CJ:

Additional to what?

MR DILLON:

Well that is –

WILLIAMS J:

To compensatory, isn't that what he's saying?

MR DILLON:

That seems to be what he's saying but that doesn't make sense in the sense that it's something the Court will allow to be awarded and therefore legitimate, and therefore is a damages award –

WINKELMANN CJ:

Or it might be he's not saying they'll allow compensation but rather that they'll allow that it's a legitimate interest to be protected by the clause and therefore it does make sense.

MR DILLON:

Well that brings us back to what is proportion and what is legitimate interest and it's respectfully submitted that the answer to that has got to be what the Courts will allow to be granted in terms of the general law of damages.

WINKELMANN CJ:

So your argument is it's just compensatory. That's the only legitimate interest. It's something that can be compensated for through a damages award.

MR DILLON:

Indeed and I've put out –

WILLIAMS J:

Can I just ask you. I just wonder how real this distinction is because on your analysis it's the Court establishing a form of damage to a wider legitimate interest that's being protected by the clause, and isn't that what happened in *Dunlop*?

MR DILLON:

In *Dunlop* –

WILLIAMS J:

The standard damages measure in *Dunlop* would have been the difference between what the tyres were sold for, and what the list price was, and it sure wasn't £5, but the Court said, £5 is fine. Now assuming that you support *Dunlop*, how does that fit your analysis?

MR DILLON:

Dunlop was a contract that was designed to protect something that is now unlawful, but was designed to protect a retail price maintenance arrangement.

WILLIAMS J:

Sure.

MR DILLON:

And the parties accepted that was the whole purpose of the contract. It wasn't simply a, here's some tyres for you to sell. It came with this particular tag that we didn't want our whole marketing, or the whole country undermined by somebody selling cut price –

WILLIAMS J:

Yes, I understand that.

MR DILLON:

So the Court accepted that that was a legitimate interest and the purpose behind the particular contract. So the contract wasn't simply about selling tyres. The contract was about a nationwide price maintenance arrangement, and this particular dealer entered into that contract and then breached it, and the Court said in those circumstances, given those wider interests, this is appropriate.

WILLIAMS J:

Right, but the Court did not say all you're entitled to is to rebuild value back to a level which would maintain the price maintenance standards. In fact it said there will be a super premium on top of that, that is quite significant. How does that fit with your proportionality assessment?

MR DILLON:

Because the parties were looking at how is this to be protected. If it's breached how are those losses to be assessed, and the parties agreed that £5 would be an appropriate proportionate –

WILLIAMS J:

Of course they did, just as the parties appear to agree here. My question is how does that fit with your mathematical approach to compensation in that case, not this case, that case.

MR DILLON:

In the *Dunlop* case one would have to consider what that interest is and how a breach would be valued, and using the *One Step* analysis we could come to a figure that, with respect, is likely to be actually considerably greater than the £5 figure if the entire system nationwide is undermined as a result of the actions of a rogue, or a couple of rogue dealers, and in advance of the breach, not knowing exactly how it's going to play out, again, this is *One Step* approaches it, what compensation would be proportionate within the general rules in advance of that breach, what would that look like, and then compare it

to the £5 and with respect, not being able to put myself back into the economy of those times, it still seems that £5 would be well within that sort of range.

WILLIAMS J:

So the assessment then is what notional damage is done at the time of entering it the collateral deed here, to Honey Bees business, if within however many months it was I can't remember, there isn't a second lift.

MR DILLON:

Yes, if there's not a second lift within, I think it was 31 months' time.

WILLIAMS J:

But you agree that is a very broad assessment? You must do otherwise you'd be disagreeing with *Dunlop*.

MR DILLON:

It's a broad assessment but it's an assessment that is still fixed on the compensatory principle. If we look at *Dunlop* there is a nationwide retail price maintenance. If we look at the instant case, there is a premise on the fifth floor of a building. It has three ways of access. It has two sets of stairs and one lift. It also has a lift well.

WINKELMANN CJ:

Okay, so before we just go further I was just keen to get you to state clearly what your position is in relation to *Cavendish*, and it seems to me you really are saying that *Cavendish* is not to be understood as taking things beyond really, it is a genuine dichotomy in the sense that it has, the clause to be relevant has to be a genuine pre-estimate of damages.

MR DILLON:

It's submitted that once the penalty doctrine does not apply it has to be regarded as a liquidated damages clause. It has to –

WINKELMANN CJ:

But the question is whether it is a penalty clause. What test are you saying it is to decide whether it's a penalty clause or not?

MR DILLON:

The appellant isn't taking any issue with the formulation which is whether the penalty imposes a detriment on a promisor out of all proportion to any legitimate interest of the promise of the enforcement of the primary obligation.

WINKELMANN CJ:

Yes, so are you saying the legitimate interest saying is in effectively a genuine pre-estimate of damage?

MR DILLON:

To understand the proportionality, which is one element of it –

WINKELMANN CJ:

Well can you just answer yes or no before you go on to say…

MR DILLON:

Well both of them, both parts talk to each other. The proportionality and the legitimate interest are inter-related concepts and both of them reflect the general law of damages, particularly in the light of how *One Step* approaches a pre-estimate of damages. Pre-estimate in that it's an estimate before the breach.

WINKELMANN CJ:

I don't think my question is hard. I mean if it's not, when you're deciding whether or not it's protecting a legitimate interest, what are you measuring it with? Are you measuring it with what the damages would be or are you measuring it with something else?

MR DILLON:

When you're measuring the legitimate interest you're looking at the *One Step* analysis.

WINKELMANN CJ:

Yes, so that's a calculation of damages.

MR DILLON:

Its' a calculation of damages. It's based on the compensatory principle but it brings into play all the types of damages that can be assessed.

WINKELMANN CJ:

Okay, so if we back to my question some time ago, I think your answer to me was really, yes, which is that you really take the *One Step*, when you're trying to work out whether it's out of proportion you try to work out whether you do a measure of damages, and it's the kind of *One Step* measure of damages.

MR DILLON:

And that gives you a judicially precise figure.

WINKELMANN CJ:

Yes, and that's your proportionality.

MR DILLON:

From which you allow some wriggle room for the fact that we've got lay assessment, but that determines whether it's out of that degree of proportionality.

WINKELMANN CJ:

So you're really saying, the simple question is, when you're deciding whether it's out of proportion it really is a mathematical thing done by reference to the calculation of damages, however hard it is for the Court to do that calculation?

MR DILLON:

The only objection I have to that formulation, Your Honour, is the fact that it's a mathematical. Yes, it's based on a mathematical –

WINKELMANN CJ:

Well that's your words.

MR DILLON:

It's based on a series of principles that are fairly well outlined, yes, and the, well the idea of the said being proportion, and being outside of all proportion is certainly a mathematical concept, but these are principles, they're not actually mathematical formula.

O'REGAN J:

So you must be asking us not to follow *Cavendish*, mustn't you? This is just completely antithetical to what *Cavendish* says.

MR DILLON:

With respect it's not Sir because it really underlines what the words used in *Cavendish* actually mean.

O'REGAN J:

Well you took us to one part of *Cavendish* which said the precise opposite of what you said it would say. Is there anything else in *Cavendish* which backs up what you've just put to us as being the law?

MR DILLON:

The extract from *Cavendish* sets out that there is something in Lord Mance's view that is more than compensation and less than a penalty. That's the effect of 152, that's what he appears to say, having reviewed those authorities.

O'REGAN J:

Where does he say, in order to determine a legitimate interest you do a mathematical calculation of damages?

MR DILLON:

He doesn't use those –

O'REGAN J:

He doesn't say that.

MR DILLON:

No he doesn't say that.

O'REGAN J:

And neither does anybody else in *Cavendish*.

MR DILLON:

No Sir.

O'REGAN J:

So why are you putting it to us and telling us it's consistent with *Cavendish*?

MR DILLON:

What I'm putting to you, Sir, is that the words used in *Cavendish* must be, must have a meaning, and the question really is, what that meaning is, and it's a question of teasing out that meaning. The appellants' position –

O'REGAN J:

Well why don't we just take the meaning the Judges in *Cavendish* gave it and look at what the respective tests were. They're very clearly expressed. Why do we need to second-guess them?

MR DILLON:

We're not second-guessing them Sir. We're understanding what the principle means in practice. The appellants' position is that if a party is drafting a

liquidated damages clause they need a degree of guidance, and the appellants' position is that *One Step* gives them good guidance.

O'REGAN J:
But they're not drafting a liquidated damages clause.

MR DILLON:
The effect of this case, of this decision will be to establish a precedent as to how parties are to view the issue of the penalty doctrine.

WINKELMANN CJ:
Okay, so I think we've got, we may have struggled to see how you can reconcile what you're saying with *Cavendish*, but I think we've got your overview. Then the other issues, so you want to tell us what you say the legal test is, you want to tell us how the clause should be interpreted, then you want to apply that interpretation to the test you've done and also meet the respondent's position if your interpretation is wrong.

MR DILLON:
Yes.

WINKELMANN CJ:
So do you want to move on to facts and come back to the law or do you want to finish on the law?

MR DILLON:
The outline of the oral submission starts with the facts and the fact starts with the intent of the parties, and again right at the outset I suggested we need to do that just to get the context within which we can assess the effects to look at the questions of legitimate interests and whether it's proportionate.

WINKELMANN CJ:
So shall we go to that now then?

MR DILLON:

If we go to that, that will be helpful. Paragraph 37 of the oral submissions set out the extracts from Mr James' evidence about what his intent was when this deed came to be drafted. His evidence was that he instructed his solicitors that the deed be drafted, "In terms that would ensure that the lift got installed." That shows his intent behind clause 2 and he said in his brief that he wanted the clause to be, "As watertight as possible, to make sure it happened". And that it would give him, "Certainty that it was actually going to happen."

So his intent was to have a second lift installed and anything that would achieve that purpose was approved effectively by him. As the time for performance approached he told Mr Parbhu that, "The purpose of the collateral deed was to ensure the lift was installed." In cross-examination he variously stated, "The agreement was something that I could put in place that I could ensure Mr Parbhu would do what he said he's going to do…I thought this would compel him to put it in… I needed something that was going to be sufficient that would, you know, he would actually do what he said he's going to do…I relied on the lawyers to put something that was going to be strong enough…" in place. It's respectfully submitted that Mr James' intent was to have a deed that was so strong that it would impel Mr Parbhu to have the second lift installed by the agreed date and it's the –

ARNOLD J:

What extent is evidence of his actual intention relevant because Lord Neuberger and Lord Sumption in *Cavendish* said that normal rule, you do need to understand commercial background, you do need to understand the purpose of the clause, but that will generally be an inference from its effect, but they then go on to say the answer cannot be in evidence of actual intention. So what do you want us to take from this?

MR DILLON:

Sir, we use those expressions of Mr James to then look at what the deed provided, what the clause provided, and that leads us into these two issues.

O'REGAN J:

Well let me put this to you. If he had used language which seemed very punitive in its nature, but if you looked at the background circumstances in terms of trying to assess the purpose of the clause, and there was a legitimate reason for it, would the fact that he had expressed it in the way that he had mean the Court would be obliged to view the clause through the lens of his description?

MR DILLON:

The submission isn't that if Mr James was to say, this is a penalty clause, then that's determinative. The issue here is what do the words in the deed when they refer to "the lease" mean. What is the term of the deed. And when it refers to the obligations, or specifically all obligations under the lease, what do those words mean given that there are at least two competing views as to what those views mean. Now in that context the intent of one of the parties, particular the party who gave the instructions to draft it, is illustrative of what was intended, at least by that party, for those words to mean, and given that those expressions of intent, when the deed refers to the lease being a document dated such and such, then as long as that document is in effect, the indemnity applies, that's the appellant's position.

WINKELMANN CJ:

Can I just ask, it's not your submission then – well, this might be a complicated question. Is it also your submission that the fact Mr James said he wanted to make sure that the second lift was installed and that's what he included this clause, are you submitting that wasn't a legitimate interest for him to pursue, that including the clause to make sure the lift was installed is not a legitimate interest. Is that your submission?

MR DILLON:

It doesn't necessarily go quite that far.

WINKELMANN CJ:

Well yes or no first.

MR DILLON:

Very well, no, because it doesn't quite go that far. The intent of the party expressed here isn't in relation to a statement as to what the terms of the deed were to be. It's a bizarre factor of this case that we're arguing about something that only the lawyers drafted and the parties seem to have had very little involvement in.

WINKELMANN CJ:

Okay so can you just stop. So you do not submit that it was illegitimate to include a clause to ensure the lift was installed?

MR DILLON:

No, rather the submission is that the penalty intent, if it reflects a penalty in fact, is an illegitimate interest so if the intent is to penalise, that is an illegitimate interest, and these expressions of intent do indicate an intent to penalise the –

WINKELMANN CJ:

Okay, so you're saying an intent to compel performance is an intent to penalise?

MR DILLON:

An intent – no I'm saying the intent to penalise is an illegitimate interest which the Court won't countenance.

O'REGAN J:

But there's nothing in this that talks about penalty, in your 37, it's all about incentive, isn't it? Are you saying incentive and penalty are synonymous?

MR DILLON:

I'm saying that when we're dealing with compulsion, with the intent of compulsion, that that's penalising someone.

WINKELMANN CJ:

So your answer to my question at the beginning was actually yes then. You're saying that it is illegitimate for you to include a clause to compel someone to perform?

MR DILLON:

That's not the question that I answered. My answer was that if the intent is to penalise that is an illegitimate interest which the Court won't countenance.

WILLIAMS J:

Your argument is that it was such a big issue for Mr James that he imposed an impossible burden, and you do that via the circular, to be fair, reasoning of saying that must mean that the words in the clause meant the whole duration of the lease, and related to all obligations, and that's what makes it disproportionate.

MR DILLON:

I have to pull that question apart a little bit Your Honour. The first statement was, this was such a big issue to Mr James, that's not accepted.

WILLIAMS J:

Well you were saying that he was, what he wanted was a clause that was so strong it would impel him to do it.

MR DILLON:

Yes.

WILLIAMS J:

Right.

MR DILLON:

But that doesn't meant that it was important to Mr James.

WILLIAMS J:

But then you went on – well, yes, I know you're going to argue about that, but then you went on to say, and bearing that in mind you should read the clause relating to lease term and obligations punitively because of his bad intent –

MR DILLON:

No.

WILLIAMS J:

– and therefore it's disproportionate.

MR DILLON:

Yes, that might be putting the cart before the horse. The issue –

WILLIAMS J:

Well that's the way you argued it.

MR DILLON:

Certainly, if we have an issue as to interpretation, and there are two options. Is it the first term of the lease or is the reference to "the lease" which mean as long as the lease exists the indemnity exists. Then we look at the intent of the party that was drafting it, particularly because the other party's intent isn't evidenced, he just received it, read it and signed it. Then that intent, the intent to compel, the intent to punish, gives an insight into how long this deed was meant to last. If we've got the choice, and we have to determine between those two, we look at that intent to determine what the intent of the party was, what he intended, in relation to the words used in the document.

WILLIAMS J:

Well –

WINKELMANN CJ:

That's great, okay, so next I think –

ELLEN FRANCE J:

Sorry, could I just check, just following up on Justice Arnold's point, you do seem to be relying then on actual intention, so saying there should be a different approach here to interpretation than would normally apply.

MR DILLON:

With respect it is the normal approach where we have some issue as to whether it is one thing or the other, we look at the parties' intent. I understood that was the classical means of interpreting the contract. There's no difference. We just have these statements of intent. They don't go to the actual words. We don't have an exchange of email or anything else that suggests changes and variations to these words at all.

WINKELMANN CJ:

I don't think you'll find that is the classical interpretation approach. But in any case you are relying upon their statements of intent?

MR DILLON:

Indeed, in terms of assisting the Court in interpreting what the reference to the lease in the deed means.

WINKELMANN CJ:

Okay, and so what is it in that evidence which tells us what the reference to the lease in the deed means?

MR DILLON:

That is the point. There is no evidence before the deed is signed which directly addresses this particular issue. It is only post-contract when there is some exchange of email that we have some indication of what the parties thought there were agreeing, and I have to say that the Court of Appeal said that those post-event exchanges don't assist but perhaps cynically that's because it didn't help to get to the decision that the Court of Appeal got to.

WINKELMANN CJ:

Pause there, thank you Mr Dillon. So you're saying that this is helpful because it tells us that they didn't really turn their minds to the meaning of – or what, because you're saying there's no evidence which tells us what they mean when they refer to the lease?

MR DILLON:

No evidence prior to –

WINKELMANN CJ:

Yes.

MR DILLON:

– entering into the deed, but there is this exchange after entering into the deed, which indicates that the appellant was looking at a 22-year indemnity which the respondent replied to was that the position is clear, he didn't deny that it wasn't 22 years, you'll see that's, the evidence is referred to in paragraph 38 of the written submissions.

In addition there is a pleading point that arose in this proceeding because the statement of defence very specifically referred to the fact that this indemnity was to last for 22 years. You'll find that in volume 1, page 10 of the case at point M. Now there was a reply filed in accordance with the Rules and the reply is at page 13 of the case, and the reply does not address the 22-year issue, and the reply isn't a general reply, it's a very particularised reply.

WINKELMANN CJ:

So you're relying on exchanges that occurred after the clause was brought into effect because the lift hadn't been installed by due date?

MR DILLON:

There is the post-contract exchange between the parties but there is also a pleading point that means that the matter came before the Court on a particular basis and the matter came before the Court on the basis that it was

a 22-year term for the indemnity, which I have to say that in their opening address, before the High Court, the respondents resiled from and said, no, that's the defendant's mistake, there's no such admission, because of course failure to address it in the reply would be an admission of that point.

WINKELMANN CJ:
I think we've got your written submissions on this point. So is the next thing you move on to the terms of the indemnity itself?

MR DILLON:
Yes, if we then look at the clause 2, which is set out again in the full written submissions it's set out in full, paragraph 35, "… that in the event that the second lift is not fully operational on or before 31 July 2016 then 127 Hobson *(First Appellant)* and the Guarantor *(Second Appellant)* jointly and severally hereby indemnify Honey Bees (*First Respondent*) and Jason (*Second Respondent*) jointly and severally for all obligations they may incur to 127 Hobson or any other landlord under the Lease including the payment of rent, operating expenses and other payments as provided under the Lease to the expiry of the Lease. *(italics added)*."

Now in that regard the lease itself is defined in the deed. So we have, again we have these two separate documents. One is signed before the other, the deed is signed first. The deed refers to the lease as a deed of lease dated on or about the date of this deed, quote, "the lease" end quote. Accordingly in clause 2 when we're looking at the terms of the indemnity, the appellants' point is that when it refers to the lease, it refers to a document of a certain date, and as long as the document of a certain date is in play, then the indemnity applies. It's submitted that there's no basis to read down those straightforward and clear words to just the first term of the lease. The first term of the lease only arises in issue when one looks at the lease itself where there is one clause in that lease and it's the only clause where there is any distinction between the first term of the lease and the lease which has a final expiry date 22 years in advance of the breach.

Now with respect to the two lower courts, they both said well that's commercially not sensible. The parties could not have intended that. At that point Mr James' comments in paragraph 37 are in answer. If the Court is looking to the intent of the parties we have Mr James' intent specified and that is the only intent specified. And if that is Mr James' intent there is no reason to suggest that something that would compel Mr Parbhu –

WINKELMANN CJ:

I didn't really want to raise this, but when you're looking at interpreting contracts you look at the intentions of the parties objectively assessed, so their evidence of their statements of intent are not admissible as to the meaning of the contract. So it's objectively assessed.

MR DILLON:

Yes, it can be objectively assessed –

WINKELMANN CJ:

In the factual matrix.

MR DILLON:

In the factual matrix, but in light of what they actually said they intended.

O'REGAN J:

No, that isn't the law.

WINKELMANN CJ:

No, it's not the law Mr Dillon.

MR DILLON:

Very well.

WINKELMANN CJ:

Anyway we've had your submissions on the point.

MR DILLON:

Yes, and in that case if we're looking at objective intent without looking at what the parties actually said, we have the words, and the words are quite clear, they're in plain English, and they don't bear a meaning but reads down the document dated such and such to the first term.

WINKELMANN CJ:

Do you want to take us to the lease?

MR DILLON:

I don't have to take you to the lease, Your Honour, just to the deed.

WINKELMANN CJ:

I know but don't you also want to meet the argument that's made in reliance on the lease?

MR DILLON:

The argument in reliance on the lease is in relation to one clause only of the lease, which is clause, from memory, 32, and it's only in that clause that there is any distinction at all between the terms of the lease. The lease itself provides for a final expiry date, which I think is 24 years in total.

WINKELMANN CJ:

Yes.

MR DILLON:

And if we just read then the deed in relation to the final expiry date, we have 24 years. It's only when we read the deed in relation to only clause 32 of the lease –

ARNOLD J:

But how do you explain the term, the first term, six years?

MR DILLON:

That only arises in clause 32 Sir.

ARNOLD J:

No it doesn't. If you look at the first schedule at 154: 1, premises; 2, carparks; 3, terms; 6, years; 4, commencement date; 5, rights of renewal and 7, final expiry date. Now you've got to look at all of that in combination. You can't just take the entry that favours your position and ignore the rest of it. You've got to come up with some explanation that covers it all. So what is the third entry term six years, how do you explain it?

MR DILLON:

This is a process that gives a particular right to the tenant to keep extending it up to the final expiry date.

ARNOLD J:

That's right.

MR DILLON:

And as long as the tenant does keep extending it the lease, and I'll use that in quotation "the lease" continues in effect. It's respectfully submitted that if the lease continues in effect so does the indemnity, because that's how the deed refers to the lease.

ARNOLD J:

Doesn't the six year entry indicate that when there's a renewal there is a new lease, albeit it on the same terms as the old one?

MR DILLON:

If one looks at the lease itself it says on renewal all of this document continues in effect. It's not as if the parties have to enter into a completely new document. They might document the renewal but the lease continues until it's final expiry date, if it's renewed.

ARNOLD J:

Its terms continue. The new lease has the same terms as the old one.

MR DILLON:

Indeed, which means that the lease continues, as it's defined in the deed.

ARNOLD J:

Okay, I understand your point, thanks.

MR DILLON:

In addition to the question of whether it's just for the expiry of the first time or until it's the expiry of the lease, being the further 22 years, there is the question of what the scope of the indemnity is where we have the expression all obligations under the lease, including the payment of rent, outgoings and other payments as provided under the lease. Both of the lower courts read down those words, both the reference to "all obligations" and the words "including rent, operating expenses and other payments," just to "rent and operating expenses" and it's respectfully submitted that that can't be a proper interpretation of the extent of the indemnity because again on its clear words it refers to all obligations and it includes rent, operating expenses and other payments. So at the very least there must be and other payments if the word "including" is somehow transformed into meaning only the payment of rent and operating expenses. It must also only be the other expenses, the other payments, the cash sums that might be paid from the landlord, from the tenant to the landlord. Those two issues, the term and the extent then weigh into the question of proportionality between the detriment arising from the clause and the legitimate interest of the promisee in the primary obligation. It is the appellants' contention that once we have a phrase that's used including rent, outgoings and other payments, it must at least be something more than just rent and outgoings, and it's respectfully submitted in the appellants' view that it is actually all obligations that arise under the lease and if it is all obligations the effect of the clause is to alienate form the landlord every interest in the property that's being leased, save the reversion at the conclusion of the lease which is a rather extraordinary proposition in terms of a liquidated damages claim, which then leads into the question of is it liquidated damages or is it penalty.

The second stage of the oral submissions is headed “Penalty or Liquidated Damages.” We have already explored that this morning and it is the appellants’ submission that if it’s not a penalty then it must be regarded as liquidated damages in the sense that it’s something that the Court will allow recovery for.

WINKELMANN CJ:
So where are we in your written submissions Mr Dillon?

MR DILLON:
If we look at the full written submissions we would probably now be starting at item D, paragraph 51, but if you look at the oral submissions it’s probably better to start there under the second heading, “B. Penalty or Liquidated Damages” on page 1.

WINKELMANN CJ:
So now you’re taking us to your submissions that are actually the effects of a failure by Mr Parbhu to do this by the date are slight.

MR DILLON:
Indeed, in terms of the factual assessment when we’re looking at the legitimate interests that are being protected. But in terms of the legal analysis it probably is helpful to start dealing with that in some detail.

WINKELMANN CJ:
So when do you say you assess the proportionality?

MR DILLON:
The proportionality has to be assessed in relation to the legitimate interests of the, in this case the tenant, and it’s assessed as at the date that the deed is executed. So we are assessing what, effectively what could go wrong. What damages could flow but in advance of any breach. In this case the only breach we’re looking at is the failure to install a second lift by a specified date, and to give that a context it is an interesting experiment to regard it as a

construction contract. Imagine it was a third party contracting with Mr James to install a second lift for the use of those premises by a fixed date. What damages would flow if that wasn't done by that date. What would the Court compensate for. That gives a different flavour to the respondents' submission which is, no, these4 things are absolutely tied up with the lease, but with respect they're not. It is really a contract to install a particular means of access.

WINKELMANN CJ:

So you're saying that's more than a thought experiment, you're saying that actually is what it is. It's effectively a contract to install a lift and you have to separate it from the lease?

MR DILLON:

With respect, no, it is only a thought experiment because the actual facts before the Court show that this is a collateral deed, so it does have a relationship to the lease, but in terms of considering what the legitimate interests are, it gives a very different gloss to the question if one uses the thought experiment, and that helps determine what the legitimate interests really are. Let's look at the second lift, just as a matter of fact. We had a floor plan in the premises. It's in the case. You'll see there's two stairwells and two lift wells, only one of which actually has a lift in it. The lift well itself is in place. What is needed is to put the actual mechanism in there and have that installed by a date 31 months in advance. What is the relevance to the tenant of that? Effectively is it the appellants' position that the relevance was only a matter of convenience, and why is that? Because the second lift is the fourth means of access to the premises. The fourth means of exit from the premises, except if there's an emergency, because in an emergency that second lift is completely irrelevant. Now that is –

O'REGAN J:

So are you suggesting that parents would walk up five flights of stairs with their two and three year olds?

MR DILLON:

Sir, I'm suggesting that it can happen but if there is an emergency they have to leave that way. They have to leave by walking down the stairs.

O'REGAN J:

I know that. I'm just saying, you said there were basically three different ways of getting in, two stairwells and a lift. That suggests that the childcare facility would say to parents, walk up the stairs with your children, or carry your babies in prams up the stairs.

MR DILLON:

And one only has to state it to see how inconvenient that would be.

O'REGAN J:

So there was really realistically only one way of getting there, which was the lift.

MR DILLON:

There was one convenient way of getting there, but that convenient way of getting there is not available for the purposes of emergency exit and the reason that that factor is important is because there's this whole regulatory regime that applies, both in relation to fire and in relation to the Ministry of Education licencing of this childcare on the 5th floor of this building, and for the purposes of those regulatory concerns, the second lift was irrelevant because their concerns were about safety, and in terms of safety emergencies, the second lift would not be utilised. It's against the fire regulations to utilise them.

WINKELMANN CJ:

Okay so you're saying that it's just inconvenient, it's no more, and it could have been looked ahead at that point in time and said to be inconvenient and no more?

MR DILLON:

Indeed and the reason for that is because the regulatory compliance was a required pre-condition to even entering into the lease. So that hurdle had been crossed. Further, if subsequently there was a problem, there is a provision in the lease that specifically addresses that problem, clause 50.1, again referred to in the written submissions, which says in the event of these regulatory problems, or any regulatory problems arising, then the tenant has the ability to either terminate, which with respect is a highly unlikely event given the evidence that the tenant gave about the investments that the tenant had made in the premises, or to renegotiate the lease. So we have the parties agreeing that if there's a regulatory problem they will stand back and look at this issue again to find something that meets their mutual interests. Those factors remove the second lift issue from being a matter of great moment or substance, as far as the tenant is concerned, and the tenant actually evidences this lack of concern in his own approaches to this issue.

WINKELMANN CJ:

Just before you move on to that, what about the importance to a business of having good operating lift access when it's a childcare facility on the 5th floor of an inner city building where there is problematic parking?

MR DILLON:

There is no indication that there is problematic parking. There is parking –

WINKELMANN CJ:

Drop off zones?

MR DILLON:

Yes, and there's five of those that can be used, and because they're drop off zones they can only be used by each person dropping for a limited period of time, that means there is a constant turnover of them.

WINKELMANN CJ:

Yes, but that's the point. If it's a place where there are 50 children, parents are dropping off within a narrow timeframe on their way to work, if it takes them 15 minutes waiting for a lift for five minutes each way, so it's a 15 minute exchange, then those carparks aren't turning around, people are getting late to the work, which is the point that's made against you?

MR DILLON:

Yes and it's absolutely admitted that that does represent a level of inconvenience, but that's what it represents, a level of inconvenience, and the effect of that is –

WINKELMANN CJ:

Yes, but that's not the point that I've just made. The point that's made against you is not that it's inconvenient, that it's actually a fundamental problem for the business model.

MR DILLON:

The way that this is structured is to anticipate that there are going to be traffic movements, and it's designed to encourage those traffic movement, which is why those parks are only pick up and drop off.

WINKELMANN CJ:

Yes, but can't you see the inherent flaw in your argument Mr Dillon, for there to be traffic movements people have to be able to move quickly in and out of the building, which is why a person who's running this business would be concerned to ensure that the lift access to the 5th floor, which they must be dependent on when they're bringing small children in and out, is moving quickly.

MR DILLON:

I understand that, Your Honour, but let's look at what the alternatives are for these premises. No parking at all provided with them, or five permanent spaces provided, or five pick up and drop off.

WINKELMANN CJ:

Right, so that's your answer? Okay.

MR DILLON:

The answer is that the pick up and drop off was designed to facilitate the movement which assisted in the fact that there was only the one convenient means of access to the premises.

WILLIAMS J:

From the business' point of view, looking at it before start up presumably, the lift represents a potential bottleneck. That's a fairly plausible proposition, isn't it? In a high end, high needs clientele.

MR DILLON:

The respondents' position is that this was extremely important to Mr James.

WILLIAMS J:

Do you agree that it's a potential bottleneck?

MR DILLON:

I agree, Sir, that it is a potential bottleneck, but I don't agree that Mr James regarded it as such to the extent that the respondent now submits that he does, and the reason for that is set out at paragraph 21 of the written submissions where the opportunities for Mr James to raise this issue well before the eve of executing the formal lease, passed by without comment.

WILLIAMS J:

So his reply to that is well we had a discussion about it and there was an oral representation to the effect that one would be put in, but over the course of the building of the relationship it became clear that it had to be recorded in writing. That's why it was silent at the start and a big issue at the end. What do you say to that?

MR DILLON:

The difficulty with that, Sir, is that the chronology does not match that representation, and that is why paragraph 21 is important. You have to look at the opportunities to raise it, and in particular there's a further agreement in August of 2013. Now Mr James' evidence was that Mr Parbhu said the lift would be installed within 12 months, and that this representation was made prior to the initial agreement to lease. Now if that was so then by the time of this further agreement in August 2013, time was already up, and the second lift obviously wasn't in place, and yet no mention is made of it at all, and that is so contrary to Mr James' established pattern of conduct right at the outset –

WINKELMANN CJ:

So your submission is that he really wanted Mr Parbhu to comply with this clause, but it really didn't matter to him. Is that your submission?

MR DILLON:

The submission is that it wasn't so essential to him. It was a nice to have and he wanted it. It's like, exactly the same as a new car is nice to have, and I want one, and in fact in this particular case Mr James criticises Mr Parbhu for making exactly that analogy when he signs the collateral deed. Mr James says words to the effect that Mr Parbhu said it's like a new car to me because Mr Parbhu actually lived on the top two floors of the building, and having a new lift would be convenient to Mr Parbhu as well. Mr James criticises Mr Parbhu for making that strange and flippant comment, but is the same analogy in relation to Mr James when one looks at Mr James' actions over what was a long period prior to the formation of the deed and the lease.

WINKELMANN CJ:

All right, I think we've got your submission on that point. Thanks Mr Dillon. Now was there anything else you wanted to say about the effects of the breach, because you've set that all out very helpfully in your written submissions. That it's inconvenient.

MR DILLON:

The submission is that properly assessed –

WINKELMANN CJ:

Which you sum up at 63, don't you.

MR DILLON:

Yes, yes. The submission is that when one looks at Mr James' own actions at the time, including leading up to the breach and even subsequent to the breach, it would indicate that this was all about the convenience. When Mr Parbhu after the date for performance has passed is still trying to install the second lift, the installers are receiving interference, effectively, a running interference from the tenants in the building.

WINKELMANN CJ:

Yes, but that's only, it's not Mr James, is it?

MR DILLON:

Mr James and his staff were involved to some degree. There was another tenant that seems to be involved to a greater degree.

O'REGAN J:

So it's irrelevant to us, isn't it?

MR DILLON:

To the extent that it –

O'REGAN J:

Well how does it affect the interpretation of the deed and the determination of the issue that's before us, what happened five years later.

WINKELMANN CJ:

And if that was the case, Mr Dillon, your argument, you should have made an argument that they had actually procured the breach themselves, but you didn't make that argument, so that's an irrelevance.

MR DILLON:

It's not an argument of procuring the breach indeed but it's an argument that refers to how the party regarded the importance to that party of this particular obligation, and the appellants' contention is that it's a much lower level. It's still significant, we're not saying that it wasn't significant.

O'REGAN J:

We don't even know if the other tenants were aware of the deed, so why does it tell us anything? The people who were frustrated, it had nothing to do with the deed, they probably didn't even know it existed.

MR DILLON:

The people that, the other tenant was involved to the extent that it was the other tenant who particularly wanted the lift extended down to the basement.

O'REGAN J:

Yes, but that's not Mr James' problem or Honey Bees' problem.

MR DILLON:

Perhaps not, no.

O'REGAN J:

So why are we even talking about it?

MR DILLON:

To the extent that Mr James and/or his staff were involved in steps that slowed down the process.

O'REGAN J:

After the breach had occurred, so it's irrelevant. Let's just move on.

MR DILLON:

Very well Sir.

ARNOLD J:

Could I just, if you're looking at the factual matrix, one part of it, of course, looking at it objectively and at the time of entry into the contract of the deed, is to know what was happening on the other floors. So as I understand it in the floors up to level 4 there was this hotel being operated, is that correct?

MR DILLON:

I believe so, yes Sir.

ARNOLD J:

And that had 90 rooms, is that right?

MR DILLON:

I can't recall the exact number of rooms Sir. It was an apartment hotel so it wasn't operating in the same way one would imagine one that was servicing, for instance, cruise ships where you have huge numbers of people coming through at particular times. But these were more longer-stay type –

ARNOLD J:

So I think it did have 90 rooms, but correct me if I'm wrong, you can check, and people would tend to check out around about nine, before or after, and to check in later in the day is the common – now those are the sorts of times that parents will be turning up to pick up their children or drop them off. So there is going to be quite a competition, isn't there, for the single lift, particularly –

MR DILLON:

There was very limited evidence of any competition between them. The checkout time of –

ARNOLD J:

No, no, I'm trying to understand the context of this arrangement that was made at the time it was made, and if you looked at that building what you would see was a nine storey building with apartments on the top four floors I think, the day-care centre going to be operating from the fifth, and a hotel

operating on the remaining floors. Now just describing it in that way, I must say for myself the need for a second lift seems obvious. Not convenient, nice to have, like a new car. Really important.

MR DILLON:

Sir, if it was so important then, again, one comes back to the chronology. This wasn't something where there was an agreement to lease followed a couple of months later by the formal document. The agreement to lease pre-dated the formal document by over a year, something like 18 months, so there was plenty of time to assess all those issues while there was fit-out, while there was arguments over the regulatory regime and getting the licences granted and so forth, and yet if one looks at Mr James' actions over that period of time, the second lift does not occur as a factor that he raises until the eve of signing the deed of lease, and that is, with respect, out of –

ARNOLD J:

Well then he raised it and your client accepted it.

MR DILLON:

Yes.

ARNOLD J:

He had every opportunity to take legal advice, to do whatever he liked, but he didn't, he accepted it. There was, I think a very lengthy time was allowed for the installation and in fact an elevator was brought within reasonable time. So what you seem to be saying is that, yes, there was an interested that Mr James had, a legitimate interest to protect, but it wasn't a particularly significant one. Is that ultimately what it comes down to?

MR DILLON:

That's what it comes down to Sir. It wasn't as significant as it is now being portrayed and one can establish that by looking at Mr James' actions leading up to signing the deed.

ARNOLD J:

Now doesn't the Court take the view that by and large parties, freedom to contract, is going to be highly significant, given great weight, particularly where you have people who are legally advised, or in Mr Parbhu's case, a highly experienced property manager, making contracts. So the starting point really is the freedom of contract and the certainty of contract, do you agree with that?

MR DILLON:

Yes Sir, that is the starting point.

ARNOLD J:

Right, and so if you can identify a legitimate interest, and you've accepted that Mr James had one, or Honey Bees had one, it's going to be a relatively exceptional case where you say that the consequence of the operation of the particular clause is so disproportionate that it must be regarded as a penalty. That will be a very unusual outcome where you have a freely negotiated contract such as exists here, won't it?

MR DILLON:

And that is the normal course. It is an unusual outcome to find the penalty doctrine successfully invoked.

ARNOLD J:

So are you really going to be able to show that this is one of those highly unusual cases in circumstances where you accept there is a legitimate interest, but you quibble about how strong it is, how significant it is.

MR DILLON:

The issue is always the extent of the legitimate interest and then how that is proportionate. How the clause if proportionate in its response to that legitimate interest. It is always a matter of weighing and balancing, and that is why the appellants' submissions are about unravelling what the proportion means, how it's assessed, and what the legitimate interest is, and what it

means, and how it's assessed, and the appellants' position is that those two parts of the test of the penalty doctrine, harmonise with the general law of damages. The Courts will compensate –

ARNOLD J:
Well I'm not sure, with respect, if that's right. I mean the Courts have accepted, and *Cavendish* is an example, that a particular outcome maybe a harsh one. It may be a very hard outcome but that does not mean that the clause is a penalty.

MR DILLON:
Well if we look at the *ParkingEye* element of *Cavendish*, which *Cavendish* involved these two sets of facts, the *ParkingEye* was that the charge for staying over the time period, and in order to assess the proportionality of that clause, one of the things the Court looked at is the statutory regime that allowed for a certain amount to be levied where there was a similar default, and it did a comparison of, well here is an existing statutory regime, here is the contractual amount, these two things are comparable, they're not the same but at least they're comparable, and that assisted in establishing the proportionality of the outcome. If one looks at *Dunlop*, that's more difficult because you have this retail price maintenance regime and it is a difficulty and it's so difficult that it's since been banned as a means of conducting business. It's not something that would ever occur again.

If we look at some of the other cases, the comparison is what would happen if this clause was not in effect and the general law of damages applied and that established the proportionality. One of the cases, and I can't remember which one it is, but I believe it's the Australian one, *Paciocco v Australia New Zealand Banking Group* [2016] HCA 28, looked at if this clause wasn't in effect the damages on the classical assessment would be greater than what the clause provided, and therefore it can't be a penalty because it was proportionate to the legitimate interests. Now that does seem that the Court, by default, is always going back and saying what interests will we protect, because that determines what the legitimate interests are, and then what does

this clause provide, and is it proportionate or is it out of all proportion to that assessment.

ARNOLD J:
Okay, well I understand, thank you.

MR DILLON:
So when one reads the actual results of the leading cases now, in relation to this precise test one finds the Court actually invoking the dichotomy as a way of checking that it's coming to a correct conclusion and that there is a proportion in relation to the legitimate interest, and that then harmonises the penalty doctrine with the general law of damages. If it's something that the Court in the normal course would actually award, no matter how hard it is to assess, then it's going to fit within the terms proportionate and legitimate interest.

WINKELMANN CJ:
We'll take the morning adjournment now thanks Mr Dillon.

COURT ADJOURNS: 11.28 AM

COURT RESUMES: 11.44 AM

WINKELMANN CJ:
So Mr Dillon, we're just talking about timing, and it seems to me that you should aim to finish by 12.15.

MR DILLON:
I think I can do that, yes, Your Honour.

WINKELMANN CJ:
Excellent.

MR DILLON:
Having reviewed my notes I think I'm up to page 2 of the outline.

WINKELMANN CJ:

And page 14 of your submissions?

MR DILLON:

Yes, although I think I'll be following page 2 of the orals because I think we get through the essential points rather more quickly because we're looking really at the legal issue of how in the appellants' submission the penalty doctrine harmonises with the general law of damages, and conceptually that is exactly how we would like to see things, so that anybody that is trying to draft a liquidated damages clause has a very clear guide as to where the dividing lines are. What these concepts of proportionality and legitimate interests actually mean in practice, and a completely new set of facts.

It's the appellants' submission that the *One Step* case gives a very good outline of the principles that should be applied in those sort of circumstances. I've referred in the oral summary to paragraph 95 of the *One Step* decision which can be round in the appellants' authorities, probably at page 64 which is starting at 95, subparagraph (6), setting out those general principles. The first is that, "Common law damages for breach of contract are intended to compensate the claimant for loss or damage resulting from the non-performance of the obligation in question. They are therefore normally based on the difference between the effect of performance and non-performance upon the claimant's situation."

Then at (7), "Where damages are sought at common law for breach of contract, it is for the claimant to establish that a loss has been incurred, in the sense that he is in a less favourable situation, either economically or in some other respect, than he would have been in if the contract had been performed."

And point (8), "Where the breach of a contractual obligation has caused the claimant to suffer economic loss, that loss should be measured or estimated as accurately and reliably as the nature of the case permits. The law is tolerant of imprecision where the loss is incapable of precise measurement,

and there are also a variety of legal principles which can assist the claimant in cases where there is a paucity of evidence."

It's respectfully submitted that those probably are the key ones that are relevant to any general application. The other statements of principle are more designed to deal with the particular fact situations where you have a claimant who hasn't lost anything and yet their rights have been impugned.

It's submitted that the concept of proportionality requires comparison and that means the relationship of one thing to another by reference to number amount, level of one thing when compared to another, and the issue then is what is being compared. It's submitted that obviously it is the detriment as against the failure to perform the primary obligation. In other words, the effect of this particular clause against the failure to install the second lift by the due date 32 months after the lease had commenced.

It is respectfully submitted that fundamentally this is a damages assessment and therefore those general rules of damages apply in order to assess the effect on the promisee of the failure to perform the primary obligation. Those general rules of damages limit what can be considered as a proper or legitimate loss. For instance, and I start with the *Paper Reclaim Ltd v Aotearoa International Ltd* [2006] 3 NZLR 188 case, exemplary damages in contract are prohibited. The reference in the oral submissions sets out a number of paragraphs in the *Paper Reclaim* case but it's probably paragraph 182 of that case which can be found in the appellants' authorities at page 442, that is probably the most useful paragraph for the purposes of the present case. The Court in that case was just looking at whether exemplary damages are claimable but goes on to refer to the types of damages that can be awarded. At paragraph 182 the Court says, "There is certainly no need for exemplary damages to fill any hole in the range of compensatory damages in the contract field. Contractual remedies now available in appropriate cases include expectation damages, reliance damages, and damages for non-pecuniary loss, mental distress, disappointment and loss of amenity. It has even been suggested that a Court could order an account of profits as a

contractual remedy. In addition, in appropriate cases indemnity costs may be available for improper conduct in the course of litigation. And, of course, also within the Court's armoury are the non-monetary remedies of injunction and specific performance. There is no reason in principle to add yet another remedy to the above list that would give a contracting party a windfall profit over and above that which it had bargained for," and it's probably the first two sentences and that last sentence that are particularly relevant when we are looking at legitimate interests and proportionality. There is a fundamental principle in damages that windfall profits are not something that are compensated for, so any super-compensatory effects are something that should not be countenanced, and when those principles are brought forward into the penalty doctrine it is submitted that they condition what the phrase "out of all proportion" in respect to the legitimate interests actually means.

Now leading on from that summary of remedies available in contract just been referred to, we have the restraint of trade provisions which protect goodwill, and *Cavendish* itself is a good example of that type of clause. Now restraint of trade clauses have generally been regarded as unenforceable unless proved to be reasonable, and authority for that is in this recent case which I've handed up, and Your Honours should have that as a free-floating set of about five pages.

WINKELMANN CJ:
Is that *Mad Butcher*?

MR DILLON:
The *Mad Butcher Holdings v Standard 730 Limited* [2019] NZHC 589 case, yes. The statement of principle appears at paragraph 18, "The legal principles applicable to restraint of trade clauses are well established and not in dispute. It is common ground that restraints of trade are prima facie invalid but will be enforced where they are no wider than is reasonably necessary to protect the legitimate interests the restraint was intended to protect," and then there is the reference to the case of *Brown v Brown* [1980] 1 NZLR 484 (CA) at 491 which established that principle. That really does resonate as a sentence in relation

to the penalty doctrine, because it's using the same concepts in relation to the assessment of a restraint clause which prima facie is regarded as unenforceable. That also is significant because we have a type of clause in a contract which the Courts will not enforce unless a particular hurdle is jumped. The hurdle looked very much the same as the one that the party seeking to have a penalty clause set aside has to jump, it's the, if you like, the inverse, the inverse issue, but the same principles are being applied.

The Court goes on, "Reasonableness in the relevant sense relates to the legitimate interest of the parties to the covenant and to wider public interest." The reference to the "wider public interest" is the reason that restraint clause are prima facie invalid, that is a matter of public policy. "Reasonableness is assessed at the time of the contract," again, that looks like the penalty clause, so it's the time the contract is entered into that the assessment is made, and the onus in these clauses, "Is on the party seeking to enforce."

Then one looks at this particular example, we find the application of those principles at paragraphs 25 to 27 of the case, where – this was an injunction application so it's a relatively low level of factual inquiry, but the Court was reviewing the arguments that were being advanced. "There may be some force in the defendants' alternative argument that the restraint could be unreasonable, at least if the franchisor had no intention of competing or continuing business in the region," this was a restraint in a franchise contract, the question was whether it was enforceable against the franchisee. "However, the restraint is to be scrutinised as at the date of the agreement, not according to subsequent events," exactly the same as a penalty in that analysis, and there was in this case no suggestion that the company had no intention of continuing in the Whangarei area if the franchise agreement came to an end. "I consider," the franchisor, "also has a strong argument that it has a legitimate interest in protecting the investment and goodwill in the business model by prohibiting franchisees from exploiting it for their own advantage and in competition with the franchisor and other franchisees as referred to in a number of the franchise cases." Paragraph 26 then resonates with the *Dunlop* issue of the retail price management-type analysis, it's a much wider

issue, that's accepted in the restraint of trade clauses as a legitimate interest to be protected.

And then at 27, "It is against this legitimate interest that the reasonableness of the restraint, particularly its duration and geographic scope, is to be assessed," and that wasn't contested at the interim stage. So we have another area of contract law where the same sorts of principles are being applied as the penalty doctrine, but it's almost the obvious position where this type of clause, for public policy reasons, is regarded as invalid unless it can be proved to be reasonable. In penalty clauses we've got the primacy of contract, meaning that the parties agreed, and therefore it's assumed to be valid liquidator damages, unless the other party can prove that it is out of all proportion to legitimate interests. But it's the same sort of legitimate interests principles that are being applied.

It's accordingly submitted that those interests are governed by the general laws of damages, and the last paragraph on page 2 of the oral submissions sets out some of those principles. Fundamentally it's compensation for expectation losses, as per *Stirling v Poulgrain* [1980] 2 NZLR 402 (CA), causation links the wrong to the loss, and remoteness limits the extent of the liability. Now, as a matter of policy non-pecuniary loss is not recoverable unless that was the purpose of the contract, even if the loss was of the type that was contemplated, as per *Bloxham v Robinson* [1996] 2 NZLR 664 (CA). Difficulty in assessment is no bar to an award, that's something that has come up a number of times in the penalty cases themselves, but in New Zealand we have *Walsh v Kerr* [1989] 1 NZLR 490 (CA). Loss of a chance can result in an award. So we're getting into some speculative areas where the Courts will, nonetheless, award damages. Damages for wrongful use without loss are recognised in New Zealand, so we're not just relying on *One Step*. We have the *Roberts v Rodney District Council* [2001] 2 NZLR 402 case as an example in New Zealand of exactly the same sort of approach. But there is also a betterment principle, which will be applied to avoid any windfall profits and ensure a party is not over-compensated. There's a reference to *I T Walker Holdings v Tuf Shoes Ltd* [1981] 2 NZLR 391 (CA). Now that is

important as a matter of underlying principle because that is the reason that penalty clauses are not enforceable, because they're going beyond a compensation of a legitimate interest, and windfall profits and over-compensation are something that are to be avoided.

Then we have dealings with interests in land, and of course this particular case is an interest in land. Damages can be assessed either on the basis of the cost to reinstate on the basis of a loss of value where the cost of reinstatement is disproportionate to the loss in value. So *Ruxley Electronics Ltd v Forsyth* [1996] AC 344 is the classic statement, I think that was about the depth of the swimming pool, it wasn't quite to the stipulated depth, the cost of reinstatement was enormous, so the Court assessed the loss on the basis of the difference in value, which was relatively modest and, in the Court's view, much more proportionate to the breach.

So it is respectfully submitted that underlying the general rule of damages we have this sense of proportion between the performance expectation, in this case that a second life will be installed 32 months after the lease commence –

WINKELMANN CJ:
Well, this is a point the Judges make in *Cavendish*, isn't it?

MR DILLON:
Indeed. But the cases up to and including *Cavendish* seem conceptually to have in their mind that there is a gap between what the Courts will award and what, appropriate award, and what the parties might agree to, which is always the case, because that's exactly where the penalty doctrine arises because the parties agree to something that is completely outside what the Court would award. So that sense of proportion is always a reference back to these general rules of damages. But the point is that under the general rules of damages there is already a wide appreciation of what can constitute legitimate interests, and this recent *Mad Butcher* case in the franchising is a perfect example of that, and it is so similar to the *Dunlop* type of situation that it really does speak to this issue in this Court.

Now damages properly assessed by the Court do take into account all the legitimate interests because those legitimate interests can be compensated for. But if we have a super-compensatory outcome, if we have a windfall profit that is out of proportion to that analysis, then it is a penalty clause and should be struck down, that is the heart of the appellants' submission, really that the general law and the penalty doctrine aren't coming from competing angles, they're actually speaking to each other through that particular phrase articulated in *Cavendish*, "out of all proportion to the legitimate interests," it's a matter of what those two words or two parts of the phrase mean, and when one looks at them one comes back to the general rules, what can be compensated for, and once one oversteps that one is into the penalty doctrine. So it harmonises penalty and the general rule.

In this present case we have the second lift and, as already submitted, that's the fourth way of access. It is a much more convenient way of access than taking your toddlers up five flights of stairs, but it has still only some limited relevance to the respondent. It's not a question of the appellants coming here and saying, "This is just icing on the cake," the appellants accept it's part of the cake, that having a second lift is certainly of benefit to the tenant. But that benefit and the legitimate interests of the tenant can best be considered when one applies the thought experiment. Imagine that it's a third party contract to install a second lift 32 months into the lease term. It's not done, what are the losses? Well, in this case the losses are assessed as a loss of all interest in the premises until the expiry of either the first term or 22 years, and it doesn't actually matter which of those two are assessed, and the comes back to answering the Court's question right at the outset: let's imagine it is only the first term, well, even on the first term it's something like $550,000. The actual cost, the complete cost, of installing the second lift was something like $220,000, so it's more than double the cost of actually installing the second lift. So let's imagine that it's a construction contract, complete failure of performance by the contractor, the tenant gets somebody else in to do it, they do it, it's going to cost them $220,000, what's his claim? Well, it's going to $220,000 plus perhaps some business losses. But it is respectfully submitted

there is no basis at all for coming to a conclusion that it's $550,000-odd, which is the value of just the rent and outgoing, let alone any other payments, for the first term. If it's a 22 years it's truly bizarre in its outcome, but even restricted in the way that both the High Court and the Court of Appeal have restricted the words, it is respectfully submitted as out of all proportion to the legitimate interest of the tenant. In the oral outline another thought experiment is suggested and that is, let's imagine that the landlord did actually get the second lift installed, but on or the day before the due date for performance the second lift was rendered inoperable for an indeterminate period. Now that's a breach of the terms and the full consequences of the penalty clause then arise, right at that point, $550,000. Now it could be that the lift is operable again two days later, it doesn't matter to the penalty clause at all. The tenant has got its indemnity for the balance of the term, whether it's six or –

ARNOLD J:
Sorry, I'm not following this. Just explain the example again?

MR DILLON:
Yes, we have the existing clause.

ARNOLD J:
Yes.

MR DILLON:
The landlord gets it installed in time.

ARNOLD J:
Yes.

MR DILLON:
So it's there, but before the due date for performance, for some reason it's inoperable, it just ceases to operate and can't be operated on the due date.

ARNOLD J:

I don't see how that follows but anyway.

MR DILLON:

Well, I suppose the point really is coming back to what was submitted before the Court of Appeal. If one looks at the, of performance by the due date, and then compares that with performance a day late, this clause has no proportion in terms of the consequences and the legitimate interests of the tenant. Imagine that it's installed a week, a month, a year, or never, if it's never installed we have arguably an indemnity for only the first term, or do we have an indemnity for the full term of the lease, assuming that the tenant elects to renew. The point is that this clause actually operates is a disincentive to performance. If the date is approaching and it can't be done why would you incur $220,000 to do it if you know it's going to be late and all the consequences of the penalty clause come down upon your head. So it doesn't fulfil the objective of protecting the legitimate interest of the tenant, and the reason it doesn't do that is because it was intended to be penal. It was intended to make the consequences so bad that Mr Parbhu would have to have it installed by the due date, and that takes us back to the clause 37 statements of what Mr James was intending to achieve through this deed. So that is entirely consistent with how this has played out. In fact the second lift has been installed. It was certainly installed late. There's no question of breach, that's not being argued about, but it is the proportionality assessed at the date of the deed in terms of looking forward and deciding, here's the date, 32 months, but what if it's just a bit late as opposed to never being installed. There's no incentive to do it once the date has passed.

The other thing with the 32 months is that it bears no relationship to the other arrangements around the lease proper. The lease proper has this discount built into it that reflects the fact that the tenant is not going to be fully funded from the outset, he's only got a licence for a limited number of children, but everybody understands that that licence will increase as the tenant proves its ability to the regulatory authority, and as already submitted, clause 50.1 of the lease has an out for the parties to work their way through that if there is a

problem. But the timing of the rent reductions in the lease has nothing to do with the 32 month concession in the deed. If it was a fundamental issue of the business case one would have expected those things to have been harmonised. One would have expected, as the number of children increase, it becomes more and more pressing to have the second lift installed and therefore if the rent concessions reflect, as they do, this slow increase, this slow build up, certainly by the time that the rent concessions have finished, that's when the lift should be installed. But those things were never harmonised, not even from the outset. The date was extended but even the shorter date didn't harmonise with those provisions, and that is because fundamentally this clause is out of all proposition to the legitimate interests of the tenant in the performance of that primary obligation. To that extent it really does represent a windfall profit. It has not relationship even to the cost of the tenant going in and installing a second lift if that was ever a realistic prospect. I mean setting aside property law issues as to interference with somebody else's building, and that's why the thought experiment of the third party contractor is actually quite useful to look at how those legitimate interests would play out. The fact that the lease is there is a complicating factor but not really. It doesn't really change that assessment because that assessment establishes what the legitimate interests really are and in that context things like business losses for late payment would always be proportionate. How late is it. That's a legitimate interest if we can show it's only one week late it probably isn't worth worrying about. If it's never installed, that's a different issue. Those losses can be assessed but that type of assessment wasn't part of the thinking behind this clause, and it's certainly not part of its effects.

O'REGAN J:

So what was the point of the deed then?

MR DILLON:

The point of the deed gets back to Mr James' statements about why he wanted it, and why he wanted it drafted that way.

O'REGAN J:

Well what was Mr Parbhu doing? He was just signing onto something which he knew meant nothing. He would never suffer any loss if he just ignored it?

MR DILLON:

Not at all. Mr Parbhu's view was this was always a nice to have. Mr Parbhu's evidence was, when he initially discussed this with Mr James, before any of the documentation was signed up, even the agreement to lease, he said, "My intent is to put a second lift in there. The lift well's in – "

O'REGAN J:

But it I don't it doesn't matter. There will be no consequence.

MR DILLON:

My intent is to do it when I can afford to do it and the evidence was that the other tenant in the building understood that that was Mr Parbhu's view. Now he wasn't party to the negotiations, but to the extent that Mr Parbhu's evidence was, I told this tenant this thing, Mr James said, no you told me a different thing, there is a third party that was told the same thing by Mr Parbhu.

O'REGAN J:

I know all that but what you're saying is he signed a solemn deed that set out something set out what the consequences would be, but in fact it was meaningless because they weren't the consequences at all?

MR DILLON:

Sir, it's very harsh to say it's meaningless. This man spent $220,000 installing the second lift and it was late.

O'REGAN J:

20 months late. I mean…

MR DILLON:

Sir, why did he spend the money at all. Once he's late he's up for –

O'REGAN J:

Because he lives in the building and he wants to use the lift.

MR DILLON:

But he's up for –

O'REGAN J:

He's not stupid. He's got a hotel in there.

MR DILLON:

He's up for a $550,000 loss.

O'REGAN J:

And he's got people who can renew a lease after six years, or walk away.

MR DILLON:

He's effectively spent $770,000 –

O'REGAN J:

Are you suggesting he spent $220,000 because of this deed?

MR DILLON:

He had an obligation to perform and he was performing it.

O'REGAN J:

He didn't perform it.

MR DILLON:

He performed it late.

O'REGAN J:

He breached it.

MR DILLON:

With respect he performed it late. The issue is not about whether he failed completely. He failed to do it in time.

O'REGAN J:

By about 50, 60, 70%.

MR DILLON:

Yes.

O'REGAN J:

Longer than the time he was given?

MR DILLON:

Yes Sir.

O'REGAN J:

It's hardly pushing yourself, is it?

MR DILLON:

Does the deed respond to the time, and the answer is not at all. Why did he do it at all once he was late. Once he was late he was up for $550,000 of losses.

O'REGAN J:

Because he owns a building which needs two lifts. That's why. I mean why wouldn't he do it. He's got a lift shaft. He's got the elevator already delivered. You'd have to be pretty stupid not to install it.

MR DILLON:

As I say Sir in relation to this deed, the obligations under this deed –

O'REGAN J:

Yes, but Honey Bees isn't the only tenant in the building.

MR DILLON:

No it isn't. In fact Mr Parbhu is one himself, as Your Honour has observed.

O'REGAN J:

Exactly and he's on the top floor so he needs the lift more than anyone.

MR DILLON:

Well he certainly said right from the outset he'd like to have it, and he was prepared to get it as soon as he could afford it. He took all necessary steps to get it installed until the decision was made to extend it into the basement.

O'REGAN J:

It was his decision.

MR DILLON:

Well it was his decision and it was a request of one of the other tenants.

WINKELMANN CJ:

So your submission is that if you placed this clause within the overall lease, there is, and what, and the interest that Mr James said he had, which was to make this business work, the failure for, the lack of any calibration of the consequence to the impact of a business, so it doesn't say, this, past this many months it's this much, et cetera, it's just a one-off payment. The lack of any linking to a number of children in the premises is, shows that it's out of all proportion to the legitimate interest?

MR DILLON:

That is indeed the case but particularly when you say, when you look at how other interests were proportionately dealt with, this one is rather extraordinary in the way that it operates, and it certainly doesn't operate as an incentive to perform, but rather as a disincentive once the date has passed. Now as a matter of fact that isn't what happened because steps were taken to implement it both before and through to completion albeit it could hardly be

regarded as timeous completion. But there's no proportionality at all in relation to the response of the deed to that –

WINKELMANN CJ:
I think we have that, thanks. So are those your submissions Mr Dillon?

MR DILLON:
They are. Thank you.

WINKELMANN CJ:
Thank you very much.

MR GEDYE QC:
If Your Honours please, I propose to cover three issues in my submissions. Firstly, what should the test for penalty be in New Zealand law. Secondly, what is a correct interpretation of clause 2 of the collateral deed, both as to scope and duration, and thirdly, whether clause 2 is, in fact, unenforceable as a penalty.

Dealing with the question of what the law of penalty in New Zealand should be, it's useful to consider the weight of authorities which have been recently issued by appellate courts. The Court has an unusually rich resource available to assist it. In 2015 the United Kingdom Supreme Court issued the *Cavendish* decision, which was an exhaustive review of the law. In 2016 the High Court of Australia issued the *Paciocco* decision, which was equally a comprehensive review. In 2017 the New Zealand Court of Appeal issued the *Wilaci* decision, which we rely on as a concise and clear review of the UK and Australian authorities. This Court, of course, declined leave to appeal from that decision, albeit primarily because New South Wales law was applicable. Then there's the Court of Appeal decision in this case which also conducted a review of the essentials.

Now there's one additional case I'd like to place before Your Honours, which is a Canadian decision, *Capital Steel Inc v Chandos Construction Ltd* 2019

ABCA 32, a decision of the Alberta Court of Appeal. When preparing the written submissions I had proceeded on the assumption that Canadian law would be similar to UK law, Lord Mance, at paragraph 166 of *Cavendish* recorded that, but this is a recent case from the Alberta Court of Appeal. I can indicate that the Canadian Supreme Court has granted leave to appeal and that the appeal is due to be heard provisionally on the 20th of January 2010. It's an unusual case and I will just explain briefly why I think it is worth putting before the Court. It concerned two issues. There was a construction contract and a subcontractor had a contract in which a term provided for forfeiture of 10% of the contract fee in the event of insolvency. The case concerned two issues. Firstly, the law of penalty and secondly, the anti-deprivation rule in insolvency, common law rule. Now I say the case is unusual because the majority in the Court of Appeal decided the case on the anti-deprivation point and did not address penalty. But in a long and wide-ranging dissenting judgment Mr Justice Wakeling conducted an exhaustive review of the law of penalty, and it's that judgment I want to refer to in a couple of respects. In fact he advocates strongly for the abolition of the rule, which is not part of the respondent's case. But it did seem appropriate to place before you the current state of the law of Canada, which clearly appears to be unsettled, and the Justice Wakeling decision does contain an interesting discussion highlighting some of the anomalies of the penalty rule. It's particularly insightful on the freedom of contract issue, on the inappropriateness of using a comparison with damages as the test, and I will refer to it briefly as I go through.

There's one other resource I will mention. In the Court of Appeal decision at footnote 36 Justice Kós the President referred to an article by Professor Halson in 2018 and I don't have a paper copy of that but will make a copy of the article available to you electronically in the event that that is found useful.

WINKELMANN CJ:

How do you spell that surname?

MR GEDYE QC:
H-A-L-S-O-N Your Honour.

WINKELMANN CJ:
It's mentioned at paragraph 30 of the case under appeal and it's footnote 36. It doesn't add anything which I consider to be fresh or which would move the issues either way but it is a very good and clear review of the state of the law following *Cavendish*, *Paciocco* and to some extent *Wilaci*.

So while this Court, with respect, is not constrained by any of these materials, they do provide substantial assistance. The consistent line of the law arising out of all of these decisions is to adopt the commercial justification test, or the disproportionality test. That is the test set out in *Cavendish* based on the legitimate interest of the promisee.

In my submission the law of penalty is not an area of law susceptible to national differences or to any underlying policies which are likely to be different in New Zealand, compared to other countries. It is desirable to have comity between jurisdictions, particularly with Australia.

O'REGAN J:
That's a bit of a problem here, though, isn't it, because there is a difference between Australia and the UK in some respects.

MR GEDYE QC:
Well, yes Your Honour, the key difference is that in Australia following the *Andrews v Australia and New Zealand Banking Group Ltd* [2012] HCA 249 decision, it appears that the law does not require breach of contract, whereas *Cavendish* was very clear that that was a misconceived approach. But that issue doesn't arise in this case because there is clearly a breach of contract, and that's an issue, the difference between the two jurisdictions is one which should be left for another day when it might be relevant. As the Court of Appeal covered in the *Wilaci* case, on everything else of any materiality *Paciocco* is on all fours with the *Cavendish* approach.

I'd like to turn to three points of substance about the test. The first is whether the test should be based on, or give primacy to, a comparison with damages. Now in my respect submission however my friend has expressed his submissions, in reality and in substance her is advocating for a comparison with damages test. In so doing he is arguing against *Cavendish*, *Paciocco* and the Court of Appeal in *Wilaci* and I'd just like to take you to a couple of paragraphs in *Wilaci* as the most clear expositions of what was decided about the damages test. It's in tab 3 of our paper materials. In my submission it is explicitly and unequivocally clear that *Cavendish* has done away with the comparison with damages and that there's no room to argue against that. Paragraph 76 of *Wilaci* the Court of Appeal said, "The principal difficulty created by *Dunlop* is in Lord Dunedin's first test, which is that a sum "will be held to be a penalty if the sum stipulated for is extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have flowed from the breach." President Kós referred to, "… countless attempts by parties alleging penalty to contrast the payment required on default with the alternative remedy of damages for breach…"

Paragraph 78, "As must be obvious from these passages," and he's referring there to *Dunlop* and *Clydebank Engineering and Shipbuilding Co Ltd v Yzquierdo E Castaneda* (1903) 3 F 1016, "… the question of whether the stipulation was a penalty was not to be resolved by a simplistic contrast between the collateral obligation now due and the maximum amount that might instead be recovered by way of damages for breach."

Paragraph 80, "First, as Lord Mance particularly observed, the dichotomy which Lord Dunedin concerned himself with between penalty and legitimate liquidated damages is a false one – or at least not exclusive. Rather, 'there may be interests beyond the compensatory which justify the imposition on a party in breach of an additional financial burden'."

Paragraph 87, in the bottom part of the paragraph, “It follows that the test for a penalty cannot simply involve a narrow comparison between contractually stipulated and alternative court-imposed damages.”

Finally paragraph 96, “First, the relevant inquiry is not what damages *Wilaci* might have received had it sued on the primary obligation alone. That is the false dichotomy that developed through an over-rigid application of Lord Dunedin's first test.”

There are equally clear statements in *Cavendish* and *Paciocco* as well, and so I submit that there’s no reading of those cases which leaves any room to use the damages comparison test, that if this Court were to entertain that as a test it would be a retrograde step. It was the primary deficiency addressed by *Cavendish*. There are two fundamental problems with using a damages comparison. The first is that it fails to recognise that contracting parties will frequently have a broader range of interests than just damages or the direct financial consequences of the breach. As such the rule, or the test is too narrow and it’s too limited. It simply doesn’t meet commercial reality.

The second fundamental problem is that it does not assist in cases where it’s impossible or difficult to ascertain damages.

ELLEN FRANCE J:
Could I just check. Do you accept Lord Neuberger seems to suggest that, well does say, “We therefore expect Lord Dunedin’s four tests would usually be perfectly adequate,” this is at paragraph 32, that’s in the context of noting, “In the case of a straightforward damages clause, that interest will rarely extend beyond compensation for the breach.” So I suppose what I’m trying to understand is the extent to which it would be necessary to go beyond Lord Dunedin’s test. Thinking about your notion of commercial reality.

MR GEDYE QC:
Just trying to recall the reference. The reference that I recall said that in the case of a straightforward consumer contract a comparison with damages may

suffice. I didn't read any of the judgments in *Cavendish* as suggesting that that should be the only test and that there is a category of contract where you would exclude looking at the legitimate interests as well. A comparison with damages, I don't argue that it has no role, but in my submission if you utilise the legitimate interest proportionality test it accommodates a case where the only legitimate interest is to be paid a sum of money on a date, or where the only legitimate interest is to receive damages, and that will normally be a simple contract involving a payment of money and indeed Lord Sumption and Neuberger in their judgment I think referred to a consumer contract.

O'REGAN J:
It says, "In the case of a straightforward damages clause," that's what Lord Neuberger says at paragraph 32.

MR GEDYE QC:
Yes I will find the reference to a consumer contract, it's elsewhere, but as I understood my friend he was contending for a primary test or a sole test of damages comparison and although the appellate judgments are long and involve many judgments, the essential ratio, in my submission, is that a comparison with damages is too simple, too narrow and too inflexible. In *Cavendish* paragraph 8 it traced the genuine pre-estimate of loss test back to at least *Astley v Weldon* (1801) 2 Box & Pul 346 in 1801. So the test is at least 220 years old and it must have arisen at a time when transactions were quite simple and indeed the real origins of the penalty rule arose in an extremely simple contract which was a bond, namely payment of a sum of money on a date.

Your Honours have referred to *Dunlop*. I'd like to make the point that Lord Dunedin's four tests are only part of *Dunlop*. The judgments of Lord Atkinson and Parmoor in particular in substance advocate for the legitimate interest test. None of the other Lords in *Dunlop* specifically adopted the four tests of Lord Dunedin and in fact preceding *Dunlop* the *Clydebank* case also effectively propounded the legitimate interest test.

Wilaci at 70 and 71 is perhaps the most convenient place to note this. The Court of Appeal reviewed *Dunlop* and *Clydebank* and particularly referred to the Lord Ordinaries' judgment below in *Clydebank* saying, and this is in paragraph 71 at the end of the quote, ".. the amount stipulated might be such as to make it plain that it was merely stipulated *in terrorem*, and could not possibly have formed a genuine pre-estimate of probably or possible damage, or, to speak perhaps more correctly, a genuine pre-estimate of the creditor's probable or possible interest in the due performance of the principal obligation."

So that, of course, back in I think 1905 and it's interesting to note, it can be said that *Cavendish* really just captures that test.

WINKELMANN CJ:
Sorry, what paragraph was that?

MR GEDYE QC:
It's in the *Wilaci* judgment, Your Honour, paragraph 71, and it's quoting from the *Clydebank* decision. I hope the Court has appreciated that we enclosed the wrong decision in tab 4 and the right one has been supplied.

WINKELMANN CJ:
Yes, we got that.

MR GEDYE QC:
So as the Court in *Cavendish* and particularly in *Wilaci* have explained, the contest is not really between *Dunlop* and the present because *Dunlop* and *Clydebank* before it also took account of the legitimate interest or commercial justification test. So what the respondents' contend for is not new and nor is it, in my submission, at all adventurous.

My friend has urged on the Court the need to harmonise with the law of damages, but in my submission there is on such need and it can't be found in *Cavendish*, *Paciocco* or *Wilaci*.

WINKELMANN CJ:

Well, although the analysis does, in fact, go through the general approach in the law of damages to say that it's concerned to compensate in a way which responds to legitimate interest, doesn't it, so it does link that in.

MR GEDYE QC:

Well the submission I'd made, Your Honour, is that damages is a different concept serving a different purpose. Can I refer you to the Canadian decision, paragraph 173.

WINKELMANN CJ:

They also linked it to specific performance, too, didn't they?

MR GEDYE QC:

In *Cavendish* Your Honour?

WINKELMANN CJ:

Yes, I believe so. I think they did do quite a, I think it was in the judgment of Lord Neuberger and Sumption, they did a schematic analysis. Anyway.

MR GEDYE QC:

Yes, I don't recall that off the top of my head. The point I make, as encapsulated by Justice Wakeling at paragraph 173 on page 46 of this long judgment, he said, "It is not obvious why a promisor's commitment in a commercial agreement to pay a sum for breach of another term of the agreement that may be no relationship to damages that a court would award for non-performance is contrary to public policy." He uses this term, Your Honours, a stipulated consequence on breach term in a commercial contract and the common law damages principles serve completely different purposes. The former is adopted to avoid the need to utilise common law damages protocol to resolve the consequences of non-performance of the contract promise. The latter, being damages, is resorted to because the parties have been unable to resolve the obligations of the promisor to the promisee on the breach. The proposition that it is –

WINKELMANN CJ:

Sorry, I missed the paragraph number.

MR GEDYE QC:

It's 173 Your Honour. My friend has also made a submission based on the evils of over-compensating but in my submission it is important to delineate at the outset that the law of penalty does not need to align with or be harmonised with the law of damages because they are concerned with quite different things. I accept that the damages a court might award is something that a court might look at in a particular case, perhaps more so in a simple or consumer contract, but to take the matter to the point where they must serve the same purpose, or one is an analogue for the other is, in my submission, a misconception because they do serve different purposes. To put it another way, there's no reason why parties who bargain and reach an agreed position in a contract need to reach a position which will correspond with damages. I'll come back to that in freedom of contract.

The question of cases where damages are not available or cannot be calculated is an important one. My friend has talked about the difficulty of calculating damages not necessarily being a bar to recovery but that is, well in my submission, that's not a helpful way of looking at it. There are many categories of case. It may even be the majority in penalty cases where it is simply not possible to arrive at a damages figure which would represent the interest. The examples are *Clydebank* where the manufacturer of the four torpedo boats didn't deliver on time. Spain's war effort against America was said to be hampered. There was just no way to put a damages figure on that sort of harm, or consequence. *Dunlop*, being well traversed, the harm of upsetting a trading system by discounting. *ParkingEye*, the consequences to the carpark operator of overstaying the two hour limit were not calculable in damages. *Cavendish*, another example, the breach of the agreement for sale and the loyalty obligations and *Paciocco*, another one, a banking customer makes a late payment of the amount owed to the bank. The costs and consequences to the banking business in that case were stated to be not all recoverable as damages. And this case is another example, Honey Bees…

WINKELMANN CJ:

That one's quite hard to see, isn't it, the Latin one?

MR GEDYE QC:

Paciocco.

WINKELMANN CJ:

Yes.

MR GEDYE QC:

Well, the Court there did have quite a lot of evidence from bankers and financial people about the direct financial costs, and there were some, costs of administration and setting out bounced cheque notices and computer systems and so on, but there was a much wider consequence to banking business generally of frequent late payments, really coming down to the general discipline of having to comply with the bank rules rather than just doing what you want, and if customers could pay whenever they wanted to the whole banking business would suffer, and that's very difficult to calculate in a way producing a dollar sum.

But those are only examples. Justice Wakeling's decision traverses many others, and there's no doubt that it's an important category, possibly the most important category of case, involving a penalty argument. It's probably ironical that *Dunlop*, which gave rise to an application involving the damages test was a classic example of a case where damages could not be calculated and no one attempted to. A rigorous approach to the ratio of *Dunlop* I think should proceed from the fact that it was found that you couldn't calculate damages. Same with *Clydebank.*

WILLIAMS J:

Isn't it a lot like *Paciocco* though, at least at Mr Dillon suggested? In fact the damages figure would be a lot higher than five pound per tyre, potentially.

MR GEDYE QC:

Well, as I see it, Your Honour –

WILLIAMS J:

For the same reason, you know, the whole the system falls apart if people can charge whatever they want.

MR GEDYE QC:

Well, a systemic, a threat to a system is only one form of incalculable damages. Another is a circumstance like *ParkingEye* or *Wilaci* or here, where at the time of the contract it is simply not possible to estimate or calculate what the harm will be.

WILLIAMS J:

But is it correct to say these losses are incalculable?

MR GEDYE QC:

In this case, Sir.

WILLIAMS J:

Well, not in this case, but in the cases that you've identified as examples of incalculable losses. Because isn't *Dunlop* very much like the *Paciocco* case in terms of unpicking the underpinning rules of a system?

MR GEDYE QC:

Yes, undermining a system. Well, yes, that's true, Sir, and if the system actually collapsed then you could calculate damages no doubt. I don't rest it on impossibility of calculation, I just put into the category of very difficult.

WILLIAMS J:

Difficult.

MR GEDYE QC:

Or unrealistic. And certainly in *Dunlop* they did not even attempt to try and calculate the effect on *Dunlop* of having people discounting. They talked about competitors moving in and –

WILLIAMS J:

To which Mr Dillon I think cites *Pater Reclaim's* reference to "a wide margin of tolerance" –

MR GEDYE QC:

Yes.

WILLIAMS J:

– in assessing the appropriate number.

MR GEDYE QC:

Well, in my submission there's many cases that go beyond mere difficulty or a wide margin or tolerance. Some cases do not – either they cannot be calculated or they simply won't produce a financial result. And so, for example, in this case you have a childcare centre on the fifty floor of a city building, the lack of a second lift could be extraordinarily inconvenient, it could have people pulling their hair out for years, but I don't think it can be resounding in damages. Perhaps some general damages for inconvenience, but there's inconvenience of the clients and the customers and…

WINKELMANN CJ:

Well, isn't it the impact on his business is how you calculate it?

MR GEDYE QC:

Yes, but then he would have to show a causation of a direct financial loss, which he may or may not be able to show.

WINKELMANN CJ:
It's not that unusual, I have to say, because when I was counsel I used to try and prove losses to businesses caused by a defect in a component part being supplied, which feeds into the whole thing, and yet you still did go out and try and prove it.

ARNOLD J:
Your difficulty in this case is that they got to 50 really quickly.

MR GEDYE QC:
Yes, well.

WINKELMANN CJ:
Well, not really, because it's prospective, isn't it?

MR GEDYE QC:
Yes, it's prospective, and I don't accept that's a difficulty, Sir, but I'll come back to that.

But one of the key points made about the evils of the damages comparison is even if you can put together a damages case it's extremely expensive and difficult and it causes delay and litigation and the proposition is that parties should be able by freely entering into a negotiated position to pre-empt the risk of litigation and all of the cost and delay and uncertainty.

WINKELMANN CJ:
So that's your submission, that there's no reason why parties who bargain for a position need to reach the position, which would be the same as if the matter was reflected through a damages assessment. Freedom of contract allows them to look ahead and say, "Well, if this happens we think this should be the outcome."

MR GEDYE QC:
Yes.

WINKELMANN CJ:

I'm just interested in how that does fit with the paragraph in *Cavendish,* Lord Neuberger, which does sit there, doesn't it?

MR GEDYE QC:

Yes, well, of course *Cavendish* has to be read as a whole. Paragraph 249 of *Cavendish,* Lords Hodge, referred to the benefit of fixing in advance the remedy and avoiding, "The necessity of an expensive trial." He's quoting there from, I think, Lady Justice Arden in the *Murray v Leisureplay plc* [2005] IRLR 946, this is in paragraph 249 of *Cavendish.*

WINKELMANN CJ:

But again, accepting, "The innocent party's interests are normally fully served by the payment of the stipulated sum," et cetera.

MR GEDYE QC:

Yes. "More complex questions arise where there is an obligation to perform by a certain date, such as the construction of the torpedo boats," and this is an obligation in this case to perform by a certain date. And, "The assessment of the loss suffered by the innocent party may often be difficult and parties may have an interest in fixing the level of compensation in advance to avoid the necessity of an expensive trial."

WILLIAMS J:

What paragraph are you at?

MR GEDYE QC:

249 of *Cavendish*, Your Honour. It's quoting from *Murray v Leisureplay* case. I'll come in the third issue as to why I submit damages would not reflect Honey Bees' interests in this case.

WINKELMANN CJ:

Well, you would say in relation to paragraph 32, I suppose, of the judgment of Lords Neuberger and Sumption that they're really saying if you conceptualise

a very simply straightforward case, for instance, if you agreed to buy a couch, or something extremely straightforward, and it was defective, you could not really have any legitimate interest beyond the value of what that couch should have been, which is something easily compensable in damages?

MR GEDYE QC:

Yes, I'd accept that example. The other simple or supposedly simple case is a lending agreement where if the borrower doesn't pay the principal sum on the due the lender will then encounter lending, costs of capital costs, overhead costs, and you can calculate the loss to a lender of not receiving back a principal sum on a certain date quite readily. But *Wilaci* was such a case and the Court concluded very firmly that a comparison to damages was not appropriate there.

WINKELMANN CJ:

If you look at Lord Hodge's conclusion at paragraph 255, do you read that as saying there are two slightly different tests, or at least the test might be applied differently in different circumstances?

MR GEDYE QC:

Your Honour, I still see, even in 255, the primary test being the legitimate interest, and as I read 255 His Lordship is saying if the legitimate interest can be limited to payment of the sum of money on a date, or something as simple as that, then in a comparison of the damages maybe an appropriate way of viewing it.

The problem with the question of tests is they have all expressed it slightly differently in Halson at page 52. The author has listed three tests. The first by Lords Sumption and Neuberger, the second Lord Mance and the third is Lord Hodge, with Lord Toulson agreeing. In my submission it's not profitable to analyse and pass these test with a fine toothcomb because they are all saying that the legitimate interest and the proportionality of that is the primary approach. I don't read Lord Hodge as differing from the other Judges in that respect. "There is a prospect of injustice if one limits a test to damages

comparison. The law of penalty produces a binary outcome. It's either enforceable in full or it's invalid in full, there is no discretion, and while the primacy you can still claim in damages in case where that is not realistic or won't be effective then the contract breaker would succeed and the innocent party has no effective remedy. The legitimate interest test guards against that possibility."

I'd like to turn to the test which, I submit, is the appropriate one, or the criterion to apply, which is "out of all proportion". In this case in the Court of Appeal at paragraph 32 the President said, "The bar, which is out of all proportion, is a particularly high one. Lord Mance, in *Cavendish*, posited a similar test of whether the provision made to protect the promisee's legitimate interest is in all the circumstances, 'Extravagant, exorbitant or unconscionable.' These are tests not easily satisfied. The casual or opportunistic complaint of disadvantage is swiftly spurned by them."

In my submission there is a real benefit in limiting the expressions used to state the test. The benefit of using the expression "out of all proportion" is that it's flexible, not limiting, and it's simple. I have no objection to using the term "extravagant", I note that –

ARNOLD J:
The difficulty with it, I guess, is it introduces a notion of proportionality and you're weighing up on the one hand the legitimate interest and assessing the effect of the clause. So the proportionality, because you're not – I mean, the beauty of a monetising approach is that it does give you a simple thing on each side, doesn't it, of the balance? But this one doesn't.

MR GEDYE QC:
I would submit frequently over-simple, Your Honour. I understand the word "proportionality" does create that problem, but one way or another the Court will have to do a balancing act, it will have to say, "Here's the interest that have identified, now is it or isn't it acceptable?" Now that could mean

excessive, extravagant, proportionate, it possibly does conjure up arithmetical or scientific calculations which are probably misleading.

So I certainly don't champion "out of all proportion" to the exclusion of everything else and I note the Judges in *Cavendish* use a mixture. I looked in the *New Shorter Oxford Dictionary* yesterday at "extravagant". One of the definitions is "absurdly or astonishingly excessive", and I do commend that as –

WINKELMANN CJ:
Well, the only problem with that though is that you'll have to be saying it's extravagant with regards to something, and that's what "out of all proportion" captures, that you're measuring it against a legitimate interest. So it's extravagant with regard to the legitimate interest.

MR GEDYE QC:
I do suspect – yes. Yes, it's very much a two-part test. Number one, what is the interest? You have to scope that and understand it adequately, and the interest would involve transactional risks, potential losses, harm, inconvenience, a whole collection of issues, and then you have to make an assessment of whether the clause is extravagant, exorbitant or out of proportion or grossly –

WINKELMANN CJ:
Well, it's not the clause, it's the impact the clause…

MR GEDYE QC:
Oh, the impact of the clause, yes.

I do suspect that a lot of this may just be semantic, because there's no doubt that the exercise the Court has to do involves value judgements. But Courts do that all the time and in *Cavendish* they did it, in *ParkingEye* they did it and in *Paciocco* they did it, and in *Wilaci* it was done. I do submit it's difficult and

probably risky to try and prescribe how that weighing process should be carried out.

WILLIAMS J:
What do you mean by that?

MR GEDYE QC:
To lay down rules or methods. One of the problems with *Dunlop* is that it appears that for a hundred years everyone took Lord Dunedin's four tests, which on view were only given as examples or samples, as a code, and the multiplicity of fact situations which the Courts will see in the future with complex transactions really does defy any codification of how you carry out that weighing exercise.

ARNOLD J:
I wonder if the answer is, you know, given the difficulty of the notion of proportionality, that the approach should be basically you accept – and I'm talking now about a commercial contract negotiated between parties who've got, you know, independent advice and so on…

MR GEDYE QC:
Yes.

ARNOLD J:
In that sort of situation you accept the parties' assessment subject only to a sort of really, really, really extreme and obvious example.

MR GEDYE QC:
Yes.

ARNOLD J:
In other words, proportionality here is not a finely-tuned balancing exercise, it's a very crude assessment.

MR GEDYE QC:

Yes.

ARNOLD J:

And basically you've got to have a good reason for interfering with the parties' assessment.

MR GEDYE QC:

Well, Your Honour is echoing almost word-for-word what Mr Justice Wakeling is saying in his judgment in the *Capital Steel* case. He approaches it in one part of his judgment from the point of view of freedom of contract and says that you must have a compelling reason to interfere with freedom of contract and that, in his analysis, there is no compelling reason in the law of penalty to do that. He struggles with what the rationale could or should be and he reaches a place where he says it must be oppressiveness. But I'm anxious not to go too far off the way the law is developed in Australia, the United Kingdom and New Zealand. Tempting though it is, I don't seek to argue for abolition of the rule and I don't propose any different test from the one which *Wilaci* has restated and in this case.

The one – just finally before lunch – the one epithet that I do submit is concerning is the word "unconscionable" –

WINKELMANN CJ:

Yes, well, I was going to ask you, perhaps you can address us on that after lunch, because it does tend to invite people to start looking at bargaining positions, et cetera, and I'm interested to hear what you say about how that sits within the analysis.

MR GEDYE QC:

Yes, well, I will do that, Your Honour.

WINKELMANN CJ:

Right, we'll take the luncheon adjournment.

COURT ADJOURNS: 12.59 PM

COURT RESUMES: 2.17 PM

MR GEDYE QC:

If Your Honours please, the word "unconscionable" is used frequently in *Cavendish* almost always just as a synonym for "extravagant" or "exorbitant". I refer to paragraph 293 of the judgment of Lord Toulson where he says, at the end of paragraph 293 that the words "extravagant" or "unconscionable" are strong words, "I agree with Lord Mance (para 152) that the word 'unconscionable' in this context means much the same as 'extravagant'"…

WINKELMANN CJ:

Sorry, what paragraph was that?

MR GEDYE QC:

That was paragraph 293, and I've noted a number of paragraphs where the term is clearly just used as a synonym, including 142, 152, 185, 249, 266 and 287.

But there's two paragraphs in *Cavendish* which suggest that the word "unconscionable" can engage some wider inquiry. One is at 257, being the judgment of Lord Hodge, and in that paragraph His Lordship refers to the Australian case of *AMEV-UDC Finance Limited v Austin* (1986) 162 CLR 170 and says there the Judges, "Suggested that the rule was aimed at preventing oppression and that the nature of the relationship between the contracting parties was a factor relevant to unconscionableness," and, "In *Philips Hong Kong v Attorney General of Hong Kong* (1998) 61 BLR 41, 59 Lord Woolf suggested that in some cases the fact that one of the contracting parties was able to dominate the other as to the choice of the contract terms was relevant to the application of the rule." He went on to add, "The application of the rule does not depend on any disparity of power." So there's one indication that the relationship between the contracting parties may be considered.

Likewise in 282 Lodge Hodge discussing the test, just below line (g), he said, “Nor were the terms unconscionable for any broader reason. The contract was negotiated in detail by parties of relatively equal bargaining power and with skilled legal advice; a seller could readily comply with the obligations,” in the clause. And, finally, in 287 in relation to the *ParkingEye* case Lord Hodge said, “In so far as the criterion of unconscionableness allows the Court to address considerations other than the size of the penalty in relation to the protected interest, the fact that the motorists entering the car park were given ample warning of both the time limit of their licence and amount of the charge also supports the view that the parking charge was not unconscionable.”

So the term is primarily used as a synonym for “extravagant” and in that sense I submit it is a bad thing because it is really just tautology to use an expression which is generally the third one, “extravagant, exorbitant or unconscionable”, and in that context it doesn’t add anything and it’s undesirable. It also creates the risk of mixing up different areas of the law including, firstly, the contract document of “unconscionable bargain”, which is a separate doctrine in law and has its own tests…

WINKELMANN CJ:
So is he actually referring to a separate document at all here at 287?

MR GEDYE QC:
Well, not specifically, Your Honour, he doesn’t take it that far.

WINKELMANN CJ:
Well, he says, “In so far as the criterion of unconscionableness allows the Court to address considerations other than the size of the penalty in relation to the protected interest.”

MR GEDYE QC:
All of the cases say, in my submission, that account may be taken of the bargaining position of the parties. Leave aside what doctrine that might be linked to, the *Cavendish* Court, and I think all of the leading judgments, have

said that it is one of the considerations. You look at whether the contract was entered freely, whether the parties are on a level playing field, whether there was any impropriety or duress, and things of that nature. But in my submission the basic *Cavendish* test allows that anyway without having recourse to the doctrine of unconscionable bargain or the other area of law where it's apt to confuse, which is the principles of equity, which frequently depend on the concept on unconscionableness, offending the conscience. And the concern I urge upon you is that the hundred years of *Dunlop* have shown that clarity and simplicity and, I'd submit, brevity, are very important in making this test workable into the future, and if you import a word like "unconscionable" people will frequently raise arguments based upon the bargaining positions, the relative strengths, vulnerability, and concepts which the law already addresses. There is a remedy for people who can meet the test for being taken advantage of unconscionably. Unconscionable bargain is probably the most relevant one. But there's the Fair Trading Act 1986, there's the principles of equity, there's misrepresentation and the like. The law has a package and a framework of rules meeting those cases, and it really does confuse things substantially to introduce those concepts as a primary part of the penalty test.

WINKELMANN CJ:

Well, can you just tell us then how, if you apply the *Cavendish* test, which is the question about whether the consequences are out of proportion to the legitimate interest, protected, how does the bargain power, whether someone is legally represented, come into that test?

MR GEDYE QC:

As a matter of strict logic it's very hard to apply that to the consequences, and in my submission a better view is the Courts just use this unconscionable or bargaining position issue as a cross-check or a final check to ensure that there's no patent injustice.

WINKELMANN CJ:

Yes, well, there is some indication, isn't there, in the judgment I think of Lord Neuberger and Sumption that they see the whole, they have a narrow focus on the pre-contractual conduct?

MR GEDYE QC:

Yes.

WINKELMANN CJ:

And only to the extent that it tends to show you what the interest is that's…

MR GEDYE QC:

Yes.

WINKELMANN CJ:

I'm just trying to find where that is. Paragraph 35, so 34 and 35.

MR GEDYE QC:

Yes. The circumstances, "Are not entirely irrelevant."

WINKELMANN CJ:

Well, it's actually 34 is where you want to start, I think.

MR GEDYE QC:

Yes. Yes, those two paragraphs appear to be the best expression of it. The concept is generally raised just in order to clear it away, because in most cases there is no unacceptable disparity of strength.

An example of preliminary conduct which I would raise in this case may be this, that the relationship between Dr James and Mr Parbhu had become disputatious and difficult, they were disagreeing about – this is prior to entry into the collateral deed – they were disagreeing about many things such that Mr James' evidence was that he distrusted Mr Parbhu and was very anxious about him doing what he said he would do and meeting his word, and for that

reason he wanted an effective term. So I would submit that's an example of the relationship between the parties giving rise to an interest in an enforceable term, and an interest in contractual inducement or, the flip side of that, deterrence.

So it would probably be an excessively narrow view to say that you should not look at the relationship between the parties and who they were and where they stood in relation to each other. Certainly in *Wilaci* the Court noted and put some emphasis on that both parties, the lender and the borrower, were sophisticated business persons. But in my submission this is a secondary matter and something of a cross-check. After all, in *ParkingEye* there was no equality of bargaining power there, a motorist had no ability to haggle with the parking company. In *Paciocco* a bank consumer has no ability to bargain with the bank about such terms.

My nervousness, Your Honours, is that if one goes very far into the realm of unconscionability there's a real risk of muddling up the test and making it hard to operate or, more realistically, creating arguments and litigation which centre on respective strengths and weakness. This case is an example. Mr Parbhu has throughout the three Court levels made submissions to the effect that he was in some position of disadvantage, which the respondents say is ironical because if anyone it was Mr James who had never negotiated a lease before and was a research fellow, not really an experienced businessman.

It's impossible to, well, my submission is it's impossible to create a test that is better than the *Cavendish* test. Although that test does raise some issues and some questions, it does capture the essence of what needs to be captured. I would submit that downplaying the use of the word "unconscionable" would be beneficial and that it would be better simply to note that the bargaining position of the parties is a matter which may be taken into account in assessing the legitimate interest.

WINKELMANN CJ:

So can I ask another question about the test then, which comes through in the Court of Appeal judgment and also a little bit in Mr Dillon's submissions, which is this question about whether it's relevant what the purpose of the clause is or whether it's in effect the effect of the clause? And related to that is whether it's relevant for the Court to enquire into whether it operates as a penalty, which I think the Court of Appeal went on to?

MR GEDYE QC:

Yes, Your Honour. The role of punishment as part of the test in my submission should be relegated to very much a secondary role because, as I said in the written submissions, if the Court finds there was a legitimate interest then normally it will not be a clause which serves only to punish. The purpose of the clause logically must be relevant if you are looking at punishment. The key factor on the question of punishment, in my submission, is to recognise and accept the role of deterrence or inducement as legitimate and as different from punishment. Just quoting from *Cavendish* on that point at 31, Lords Neuberger and Sumption talked about the categorisations, including between, "Genuine pre-estimate of loss and a deterrent," and further down, above line (d) it says, "In so far as it refers to 'punishment' and 'an additional or different liability' as opposed to 'in terrorem' and 'genuine pre-estimate of loss', this definition seems to us to get closer to the concept of a penalty." "A damages clause may be neither or both. The fact that the clause is not a pre-estimate of loss does not therefore, at any rate without more, mean that it is penal. To describe it as a deterrent or 'in terrorem' does not add anything. A deterrent provision in a contract is simply one species of provision designed to influence the conduct of the party potentially affected. It is no different in this respect from a contractual inducement. Neither is it inherently penal or contrary to the policy of the law." Lord Hodge said something similar at 248, "I doubt whether it is helpful to rely on the concept of deterrence –

WILLIAMS J:

It's not really a proper use of the word "penalty", is it? Because an inducement and a deterrent can both be penalties and still be proportionate. The question is whether they are penalties that are disproportionate?

MR GEDYE QC:

Well, as I read the cases, Your Honour, and in my submission, there is a line to be crossed between inducement or deterrence and penalty, and the Courts talk about a penal effect being to punish someone.

WILLIAMS J:

Yes, but what does that mean?

MR GEDYE QC:

It means to – well…

WILLIAMS J:

Isn't it all about the proportionality and extravagance question? Because there can be proportionate penalties just in the ordinary usage of that term, but that's now how the Judges are using it.

MR GEDYE QC:

Well, the Courts have looked at whether punishment is a sole or predominant purpose of the term and…

WILLIAMS J:

But what they mean by that is response outside legitimate interest.

MR GEDYE QC:

Well, in my submission the cases treat punishment as something different from inducement or deterrence. It's a concept where you want to penalise someone –

WILLIAMS J:

Yes.

WINKELMANN CJ:

Well, mind you, that's saying let's dance round the head of a pin though…

WILLIAMS J:

Yes.

WINKELMANN CJ:

You induce them by punishing them for failing to perform.

MR GEDYE QC:

Well, what the cases say, those quotes in *Cavendish* and *Wilaci* also echoes this quite strongly, is that it is perfectly legitimate in contract law to have terms which induce performance or deter non-performance, they're the same thing, and those terms may create a strong deterrent or a strong inducement. The point is, in my submission, that it focuses on performance of the contract, not on punishment, and it is a legitimate distinction to draw because as long as there is a purpose or an effect which is focused on performing the term then that is legitimate.

WINKELMANN CJ:

So it's really if it's just the sole purpose is punishment really.

MR GEDYE QC:

Yes, in my submission.

WINKELMANN CJ:

So if it's unconnected to any, proportionately unconnected to any legitimate interest it's protecting? So where you're just taking an opportunity, a windfall gain?

MR GEDYE QC:

Yes. If there were no legitimate interest to protect, that tends to show the sole purpose is punishment. The Courts have engaged –

WINKELMANN CJ:

So some say sole and some say predominant?

MR GEDYE QC:

Well, yes. There may be little practical difference and there's certainly not in this case in my submission, because it's neither. But, as I've submitted in the written submissions, it does become invidious asking a Court to weigh up the weighting of purpose, it starts to become very refined. *Cavendish* doesn't address the point head on, it recites with approval, I think, one of the earlier English decisions talking about predominant purpose, but it doesn't expressly decide whether it should be predominant or sole purpose of punishment.

Paragraph 32, for example, talks about, "The innocent party can have no proper interest in simply punishing the defaulter," which I submit is more consistent with the sole purpose to simply punish.

ELLEN FRANCE J:

The Court of Appeal refers to cross-checking by the "punitive purpose test", at paragraph 36.

MR GEDYE QC:

Yes.

ELLEN FRANCE J:

And I'm not quite sure how that works.

MR GEDYE QC:

As I understand it, Your Honour, "cross-check" in that sense just means it's too, it's another way of assessing whether there's a legitimate interest. Because if there is then ipso factor it won't be purely punishment. There is an argument, which I've put in the submissions, that it's an unnecessary complication for the test to talk about the punishment, it may be better left in the primary assessment which is, is there a legitimate interest?

WINKELMANN CJ:
Well, isn't there an argument that this cross-check is actually just duplicative?

MR GEDYE QC:
Yes, well, I've submitted that.

WILLIAMS J:
One is that they're called penalty clauses.

MR GEDYE QC:
Yes, well, but that's just an outcome of not having a proper interest is it must be just penal.

WILLIAMS J:
I agree. But there's a great deal of circularity in all of this.

MR GEDYE QC:
There is, and a lot of it may just be semantics. There's been an enormous amount of brainpower applied in Britain and Australia and here, certainly in the Court of Appeal, as to how to make this test better or more workable. But I submit it is extremely hard to improve on *Cavendish,* not just because it's there but because you run into trouble if you try and over-refine it.

I want to come on in a minute to freedom of contract, and in my submission this whole discussion bottoms out with the proposition Your Honour Justice Arnold put, which is really the law she not be interfering at all unless it's egregious and so obvious that it will satisfy any formulation of the test without over-analysing the role of punishment.

Freedom of contract is not just an afterthought in my submission, it underpins this whole area of the law. There's no doubt that the Court holding a clause in a contract unenforceable and void is an enormous interference with freedom of contract. I've covered this in the submissions and I don't want to repeat that, but it's self-evidence that interfering with contract is by itself a very bad

thing. The judgment of Justice Wakeling in the Canadian case from 188 onwards collects authorities and quotation about freedom of contract and I have found it helpful and it has added to the discussion of this in the English and Australian cases. He puts it at an even higher level. His heading above 188 is, "Freedom of contract is of fundamental value in societies whose welfare depends on a free market economy." So he links the upholding of contract terms as relevant to the health of an economy and he gives a lot of examples. There's some wonderfully comprehensive footnotes which I won't try and take you into, but there are many quotes about why freedom of contract is so important. A couple of the concepts which he introduces, that it gives negotiation flexibility if parties have confidence that their terms will be upheld, he says, "It also gives competitive advantage secured by promisors over other businesses who are not prepared to accept such a term," and, "The obvious detriments of interfering with freedom of contract are uncertainty."

Cavendish has a number of quotes referring to that substantial advantage, "There's also difficulty in advising parties and difficulties in eroding confidence in commerce," "The spectre of litigation also lies behind of freedom of contract concerns," "The costs and delays of litigation are enormous and burdensome," "Any rule which encourages litigation is something to be avoided." And freedom of contract does underpin the *Cavendish* judgments, and it was also acknowledged in *Paciocco* and in the Court of Appeal in *Wilaci.* So I would urge a very high value to be put on freedom of contract. As Justice Wakeling says, "You do need a compelling reason to depart from it." Now fraud is one, restraint of trade, mentioned by my friend is another, which the law recognises because of the importance to people of earning a living. But Mr Justice Wakeling makes a very compelling case, in my submission, that it is just not possible to find a compelling reason to support the penalty doctrine. But I don't want to veer into an abolition case, it's a little late in the piece to do that. But the Supreme Court in *Cavendish* did acknowledge there was a respectable case to be made for abolition. All of which leads to the single submission really, that the Courts should not interfere except in

egregious cases where the extravagance is, as the Oxford Dictionary said, “Absurd,” I think it said, “Absurdly excessive.”

I’d like to move on now, if appropriate, to the interpretation of clause 2. I will be brief on this because the written submissions cover all that we have to say between paragraph 64 and 69. But if I may take you to the lease and the deed. It’s in volume 4. If we start with page 497, which is the deed of lease, and go to page 500. The first point I’d make is the one mentioned this morning, that the first schedule defines the term as six years. Then if you go to page 511 there is a definitions clause which provides an item “(k) ‘term’ includes, where the context requires, a further term if the lease is renewed,” but the context here does not require that. The collateral deed, nothing about the context of the collateral deed or the wording of the collateral deed require that meaning by its context.

WINKELMANN CJ:
I’m sorry, I’ve lost you, Mr Gedye. I’m sorry, it’s my fault. Where were you?

MR GEDYE QC:
Page 511, the definition of “term” includes, “A further term if the lease is renewed,” but only, “where the context requires.” And that's to cater for the situation where there has been a renewal or one is in prospect.

And I also support the Court of Appeal finding that the definitions and interpretation of the lease does not necessarily govern the interpretation of the collateral deed, and I further rely on the general law in relation to lease renewals, which is in footnote 30 of my submissions under paragraph 65, which is that a renewal of a lease is treated in law as a new lease, and I rely on the excerpt from Hinde, McMorland & Sim, tab 5, the relevant part of which simply says, “A right of renewal normally contemplates the grant of a new lease and clear words are needed to displace this presumption,” and the footnote –

O'REGAN J:
Where does it say that?

MR GEDYE QC:
Oh, if you have the extract from Hine, McMorland & Sim, Sir, it's 11.156 and it's the fourth paragraph.

O'REGAN J:
I see, thank you.

MR GEDYE QC:
And in footnote 8 it refers to case of *Sina Holdings Limited v Westpac* [1996] 1 NZLR 1, which we haven't attached. But I should draw your attention to the fact that this Court has also endorsed the principle in *Wholesale Distributors Limited v Gibbons Holdings Limited*, a well-known case, but it's [2008] 1 NZLR 277. In *Gibbons* at paragraph 14 this Court held, at the end, "This is because the renewal of a lease constitutes a new grant," and it quotes or cites *Sina Holdings Limited*. And I'm not sure that's an issue of law that is in any dispute at all. So the collateral deed does need to be read against the general approach under the law to renewed terms, which is that they are treated as new leases.

And finally and perhaps most powerfully, on any conventional interpretation of the collateral deed it cannot have been the parties' intentions to have the indemnity operate for 22 years. It's an implausible interpretation, and the more implausible an interpretation the less likely the parties, objectively speaking, were to have agreed it.

I make essentially the same submissions about the scope of the clause. The concept of an indemnity applies to make someone whole in respect of payments they have to make, it doesn't sit easily with obligations such as to keep the premises free of rubbish or all of the numerous other obligations my friend spoke of which don't involve payment of money.

And the final point I make about interpretation is although it's not part of the construction process it is something the Court should acknowledge, which is that Honey Bees doesn't not seek the indemnity for any period beyond the first term. And so it's not consistent with justice to be assessing the clause in a way which is foreign to what Honey Bees actually seeks. It does not and has never claimed the indemnity beyond December this year.

O'REGAN J:
Well, it did on its statement of defence, we were told.

MR GEDYE QC:
Well, that Sir was just an error in now answering the pleading in an affirmative way and it was acknowledged as an error in the High Court, as I understand it. That's a very technical…

WILLIAMS J:
It was never positively put by Honey Bees.

MR GEDYE QC:
No, my friend's point was the statement of defence averred –

WILLIAMS J:
Yes, I understand what the point was.

MR GEDYE QC:
Yes, and Honey Bees' reply did not positively deny that allegation. But the operation of that rule is capable of being unjust if it's based on an error, if a party knowingly and consciously and deliberately admits a fact. But that was corrected in the High Court and it's very much a sort of a "gotcha" argument which is not really one leading to justice.

The fact is Honey Bees has not sought payment beyond the first term and does not seek it. So any case based upon a 22-year indemnity is in fact off point, it does not reflect the actual case pursued.

ELLEN FRANCE J:

Just going back to your previous point, in clause 2 what is covered then by the reference to “other payments”?

MR GEDYE QC:

Well, it says, “And other payment as provided under the lease.” In my submission that clause would cover any payments required to be made under the lease but, as I understand it, neither the appellants nor the respondents has ever identified any other payment apart from OPEX or rent, and the case has been argued at all three levels on the basis that, without identifying any other payment, and I’m not aware of any other payment. It’s, with respect, it’s probably just an attempt –

WINKELMANN CJ:

A belts and braces provision?

MR GEDYE QC:

Yes, belt and braces drafting. Any payments in relation to the building will be reflected in operating expense, as I understand it. It certainly covers rates and all the contracts, including ironically for the lift, lift maintenance. A case has never been put on the basis Honey Bees seeks anything other than rent and operating expenses.

If it’s suitable I’d like to move on to the question of whether it is out of all proportion, and there’s two –

WILLIAMS J:

But what would you say to the point that your argument is really the 22-year clause, the 22-year reference, if the reference to the lease covers the full three terms, is so extraordinary, so extravagant, so exorbitant, that it can’t have been what was intended? Isn’t that a little ironic, given the test you're advancing that the only thing that can make the grade is something exorbitant, extravagant or excessive?

MR GEDYE QC:

Yes, well, it can operate both ways in my submission. Contractual intention does and should involve a reality check of whether the parties would ever have intended a term. Some terms advanced are so improbable and out of kilter with the facts that the Court can readily conclude they could not have agreed them. So, yes, I accept that and I accept that if it is a 22-year indemnity it would be more difficult for me to say that it is proportionate. I don't concede it would meet the tests straight away because the test is multi-faceted and looks at the whole situation but, yes, I accept that I have made the submission the parties are unlikely to have intended it because it is so long, so extreme.

WILLIAMS J:

Right, so that Mr Dillon says even if it's a one-term lease it's still disproportionate.

MR GEDYE QC:

Yes.

WILLIAMS J:

You say, on the other hand, if it's the full 2 year you don't have much of an argument?

MR GEDYE QC:

I can't make any concession, but I have little I can add to what I have put except that it would be, you'd still have to assess the interest in the round. But it would be a lot more difficult, I accept that. A 22-year indemnity is, admittedly, an extremely substantial term, there's no getting around that. But it would be unjust, in my submission, given that Honey Bees has never sought it and doesn't seek it, to resolve the matter on that basis. I know it's not a complete answer to the proposition of how the contract should be interpreted, but it is the reality of the remedy which is being sought and it would be unjust to interpret the contract in a way having many times the remedy which is sought and therefore to deny the remedy which is being sought.

ARNOLD J:

I don't know that that can be right, can it? I mean, if in fact the proper interpretation of the clause is that it applies for the full 20-odd years, bearing in mind the assessment is being made at the time the contract's entered into, it's going to be extraordinarily difficult, I would have thought, to argue that that is a legitimate protection of the – and the fact that the person who has the benefit of the clause doesn't in fact, as the case turns out, in force and in full, can't possibly save the position, can it?

MR GEDYE QC:

No, I accept the logic of that, Your Honour, as a matter of contract interpretation, yes.

If it's suitable I'll move on to the assessment itself. Two parts to this test: what was Honey Bees' interest and, secondly, was it extravagant. I'd like to make a preliminary observation. The text I've referred to, which you won't have in front of you, the Halson text, at page 57 –

WINKELMANN CJ:

I have it in front of me but nobody else does.

MR GEDYE QC:

Ah…

WINKELMANN CJ:

Sorry about that.

MR GEDYE QC:

The proposition I want to put at the beginning is that it's wrong to approach this issue – in other words, what is the interest and is it proportionate? – in an overly detailed way. The author refers to – this is paragraph 2.48(3) of Halson – he refers to the classic statement of Lord Woolf in *Phillips Hong Kong*, which is a case we have here and can hand up if you want it, that the Court should not be over-zealous in their approach to policing penalty

clauses. Then he quotes Lady Justice Arden in *Murray v Leisureplay*, referring to a "low level of review", and saying, "The parties are allowed a generous margin," and Lord Justice Clarke, I think also in *Murray,* emphasised it was, "Important to avoid 'nice' calculations and to look at the question in the round." The author says, "The eschewal of an overly detailed approach to their calculation of future losses is supported by Justice Jackson in another case, *Alfred McAlpine Capital Projects Limited v Tilebox Limited,* when he said he did not consider that minute analysis was appropriate." So I endorse those judicial exhortations to approach the whole issue in a way which is not overly detailed or overly zealous.

I would summarise the interests of Honey Bees in these ways. Firstly, the representations which have been made to Mr James prior to the entry of the agreement to lease and prior to the lease itself, and those have been detailed in the submissions, that Mr Parbhu represented there would be a second lift. Second, the interests of Honey Bees in this business. It was a start-up business, creating a market from scratch in the inner city. The second lift was important to Honey Bees for reasons that were logical and rational and reasonable, parking problems added to the risks and potential inconvenience. My friend referred to five drop-off zones. If there's 50 people and 50 caregivers coming and going that leaves 45 caregivers circling round and round Hobson Street. The inconvenience is axiomatic.

WINKELMANN CJ:

It's a one-way system, isn't it?

MR GEDYE QC:

Yes. There was the business' need to build child numbers, you'll have seen that the Ministry of Education granted approval for only 24 children, including children over two, at the outset, Honey Bees' rent was fixed on the basis of 50 children, the business therefore had a direct need to build up child numbers, obviously the lift problems double from 24 to 50.

WINKELMANN CJ:
Yes, but was the Ministry's approval subject, going to 50, subject to the lift?

MR GEDYE QC:
No, it wasn't.

WINKELMANN CJ:
Right.

MR GEDYE QC:
So Mr James saw the lift access issues as fundamental to the fitness for purpose for his business. It's accepted that the Ministry licensed it without that, but he saw in the daily operation of his business fitness issues.

Just addressing the Quest Hotel, in volume 2 of the case is Mr James' brief, at paragraph 79 he addresses the Quest Hotel and refers to – this is page 90 of the case, volume 2, page 90, paragraph 79. Now I acknowledge straightaway that he's talking here about post-contract conduct, but I do submit that it is of some relevance to what could have been expected in December 2013 because it was predictable and a natural consequence of having only one lift. But in any event I just wanted to make clear the facts. I think Your Honour, Justice Arnold raised this this morning.

ARNOLD J:
Yes. Have I got the number wrong? It's 52.

MR GEDYE QC:
Yes, you did. But not the number of people, Sir. There's 52 rooms with approximately 120 guests at all times and 10 staff.

Paragraph 79 says, "We have had problems. The Quest Hotel do not like our parents and children hanging round in the lobby," I'll come back to the email from the Director of the Quest, "And the problems it caused them and the frustration of not having the second lift installed." He said, "The single lift is

problematic indeed," "Of the 50 children in day care there are on average two parents plus a child coming up and down the lift. Parents also hold the lift, which interferes with hotel business at all times." I'll just take you to that letter, if I may, it's 624 in the case on appeal.

WINKELMANN CJ:
What volume is that? It's volume 4, is it?

MR GEDYE QC:
Volume 4, yes, page 624, it's an email from Harsh Khanna, who is the manager of the Quest Hotel. It's quite a long email, I don't think it's necessary to go through it fully. It's just whole catalogue of complaints, many of which centre around the fact that this lift is, they're not enjoying sharing the lift, it's causing problems. Bottom paragraph of the first page he says, "Not the first instance where a parent has got grumpy at our staff, they have done the same to me and frustration is there for everyone which, until we get the second lift will continue. We have six floors of hotel guests and operate on average 85 to 90 percent throughout the year. Our guests can't utilise the lift without their access card," and, "You have provided this to parents."

I submit it's not necessary to go too deeply into the facts, although they're all there. There's also 592, 593 and 595. This time the complaints are in March 2015. The lift was out of action and this cause a great deal of inconvenience because there was no redundancy, no second lift. There's a whole lot of correspondence between Mr Parbhu and the tenants and Honey Bees about the problems with the lift being out of action.

The bottom of page 595, Mr Khanna for Quest says, "Being the only lift and being filthy most of the time is not something either one of you would expect." "People have now started mentioning this on Trip Advisor, which has overall affected our position."

The brief of evidence of Mr James in reply on page 95 of volume 2 adds to the picture with the Quest. In paragraph 12 he said, "The cleaners from the quest

hotel below use the lift to move various combinations of their cleaning trolleys, rubbish bags, laundry bas and rollaway beds between floors. Often this means no one else can fit in the lift. This is most pronounced when the hotel is full and a lot of people are coming and going. The cleaners then work later than they normally would and are using the lift at the time our parents are coming and going." It doesn't take too much imagination to see a very high level of inconvenience and frustration with a busy hotel operation and a childcare centre which has a, probably something of a tsunami of arrivals and departures all at the same time, with caregivers with prams and pushchairs and so on, all of which was objectively foreseeable by Mr James in December 2013.

So the Honey Bees interest includes the reputation of the business, customer loyalty, attracting new customers, competitive advantage and, in the end, profitability. It affected Honey Bees' ability during the long term to operate at capacity, it made them vulnerable to any late breakdown of the single lift and, whatever the Court might assess, this was the importance to the person operating or starting up this business and –

WILLIAMS J:
What do you say about it not being raised until late in the discussions?

MR GEDYE QC:
The lift?

WILLIAMS J:
In writing, yes.

MR GEDYE QC:
Honey Bees' case is that the assurances were given at the outset and it was a given throughout that there would be a second lift. Mr James saw no need to raise it formally and insistently.

WILLIAMS J:

Mr Dillon's response was, "Well, Mr James said it would be done within the year," and 18 months later it still hadn't been done.

WINKELMANN CJ:

Mr Parbhu said.

WILLIAMS J:

Sorry, Mr Parbhu said, and 18 months later it still hadn't been done, but nothing in writing. What do you say to that?

MR GEDYE QC:

I say that none of that can alter the operational and financial and business risk interests which I've run through. The fact that Mr James didn't harp on about it or raise it frequently doesn't negate any of that. His answer is he expected it to be done because he was told it would be done. And it will also be seen from his brief that he was very busy and hard-pressed to try and get Ministry approvals to reinforce the deck so he could build a sandpit, and he spent something like $500,000 fitting out this premise and so he was very, very busy. It think he would say he was putting out fires all the time and just assumed that there would be a second lift.

Further aspects of Honey Bees' interest are the structural interest Honey Bees had in securing a pre-agreed remedy with a view to avoiding expensive and protracted litigation, the interests which he had in having a contract term that was effective and would be enforced. The interest Honey Bees had in not being trapped in a lift – trapped in a lease.

O'REGAN J:

There's no lift, they were never going to get trapped in one.

MR GEDYE QC:

No.

WINKELMANN CJ:

Or if you get trapped in a single one which wasn't serviced but was always running.

MR GEDYE QC:

And was full of the Quest cleaners.

He had an interest in not being trapped in a lease where he had to keep paying rent regardless of the lift, and this was a ground that the Court of Appeal accepted and which I rely on as the substantial part of assessing Honey Bees' interest. 127 Hobson insisted that this term be put in a collateral deed. The reason was it didn't want it to go to the bank, and it pleads that in its statement of defence, didn't want the bank to know it was incurring this obligation. Honey Bees might have simply refused to do that but instead it went along with the collateral deed and as a result it missed out on all the normal safeguards it would have had had this term been a covenant in the lease. Had it been a covenant in the lease a breach of it may well have entitled Honey Bees to stop paying rent or to set off –

WINKELMANN CJ:

Well, it's unlikely though, wasn't it? Because nearly every single lease says, "Without deduction," doesn't it?

MR GEDYE QC:

Well, yes, set-off is normally excluded. But you could draft a lease which says, "Here is a term which must be complied with and if not complied with then you don't have to pay rent or you can set it off." But most of all he couldn't terminate the lease either for breach, he couldn't have the right to argue under the Contractual Remedies Act 1979 – I'm sorry, I don't know the provision under the Contract and Commercial Law Act when you have to have a benefit and burden – you have to satisfy a benefit and burden test to terminate a lease. If the second lift was proving sufficiently burdensome he may have satisfied that and terminated the lease and…

O'REGAN J:
But again that wasn't really going to be much use to him, was it, given how much capital he'd committed?

MR GEDYE QC:
Well, no. It's very much part of his interest that he was between a rock and a hard place. He'd spent half a million dollars setting this place up, which meant two or three things. It meant he wouldn't really want to terminate and he would want to renew, because setting up this business was planned on a longer term basis than just the first six years. The structure of this deal with the collateral deed meant that he didn't have the option to terminate, costly and unwelcome though that may have been it may have been something he thought to do if the access was bad enough. It meant that he had to pay rent regardless, which he continues to do today and has done throughout, with a consequent mismatch between the indemnity benefit and the rent benefit. So suspending the effective payment of rent is an analogue to the right to terminate or right to get out of a lease you're trapped in without the right facilities.

The set-up costs were part of his interests, part of his business plan, part of what he was reasonably assessing, and those costs are roughly commensurate with the amount the clause provides for that's not logically, they're not logically linked but it is one way of comparing the overall proportionality.

WINKELMANN CJ:
I suppose it relieved half the obligation to pay rent that he paid rent for the first, is it half or a third?

MR GEDYE QC:
It's two years seven months without the lift and three years five months with the lift was the deal.

WINKELMANN CJ:

So about 40 percent.

MR GEDYE QC:

Yes. There's a proportionality there in broad terms.

WILLIAMS J:

Do you say the comparison between the cost of the lift and the price of the breach is not the correct comparison?

MR GEDYE QC:

Yes, I do, Sir. Well, I'm not quite sure what you said, but…

WILLIAMS J:

Well, Mr Dillon said the budget for the lift was 220k and…

MR GEDYE QC:

Oh, yes. No, I say that's not a matter that comes to bear because that was just the performance cost that the party had contracted to pay. It's not an impost on him, it was just part of what he had contracted to provide.

WILLIAMS J:

Sorry, I don't follow that.

MR GEDYE QC:

Well, it's not appropriate to take into account the $200,000 installation cost in assessing either Honey Bees' interest or the burden to 127 Hobson, because that wasn't a consequence of the breach, it was something he'd agreed to install and to pay for anyway, it was just part of the whole lease package at the outset, and in my submission no weight can be put on a plea by 127 Hobson that it cost him money to put the lift in and therefore –

WILLIAMS J:

No, that wasn't the point, that the price of the lift was half of the price of the breach.

MR GEDYE QC:

Yes, in my submission the two have, the two are not linked.

WILLIAMS J:

That made it extravagant.

MR GEDYE QC:

The price of the breach was a reflection of Honey Bees' interests and the burden and the inconvenience and…

WINKELMANN CJ:

So you would add the cost of – so you might say, well, if he'd known there wasn't going to be a lift this period of time he would not have gone to the deal, he might have gone and done a deal somewhere else, and he would have a, well, it's quite hard to stack that up.

MR GEDYE QC:

Well, there's been a dispute throughout about whether Honey Bees was obligated to enter this lease and it remains in dispute. Honey Bees' case is it was not obligated to and that the agreement to lease meant that he did not have to enter a lease until or unless there were 45 Ministry of Education licences for these children, and there weren't as at December 2013, there were only 24, and Honey Bees' position is that it therefore could have backed out had it wanted to and for that reason the parties were negotiating whether or not Honey Bees would proceed with this lease. Now leave aside the practicalities of having incurred, having spent $500,000 at that point. The reality was the parties did negotiate the terms of the lease in those last few days and there was give and take on both sides and they negotiated some terms, and that was the deal.

WILLIAMS J:

Perhaps your point could be put that they both had each other in a headlock.

MR GEDYE QC:

I think they did, Sir, yes. Mr Parbhu said he complained that he had to do this to sign up, but his contemporaneous correspondence on two or three occasions, I think they're cited in the submissions, threated and said, "If Jason won't agree with me then there's no deal." He said at one stage, "I have no room to move but to say there's no lease," so that's what he was saying, and the practical reality is the parties were negotiating those terms. And, like every contract, there's positions of strength and weakness and very often one party has the other one, if not over a barrel, under some leverage. But that's contract. None of the respective positions of the parties in this case comes anywhere near meeting unconscionable bargain, and indeed in the High Court Whata J, although it hadn't been pleaded, considered that issue and found that it was not made out, so he –

WINKELMANN CJ:

So you would say that the legitimate interest in not trading for the whole term in premises which were not fit for purpose for that business and which could impact on its value, tradability and value?

MR GEDYE QC:

Yes. Competitiveness, value, operational convenience…

WINKELMANN CJ:

Well, all really to do with…

MR GEDYE QC:

All of it. I don't, I resile, I don't like singling out any particular issue, because it is a package, he's running a business, and I submit it's wrong to –

WINKELMANN CJ:

Well, it's probably wrapped up in the value of it.

MR GEDYE QC:

Well, yes. But I submit it's wrong to deprecate inconveniences, mere inconvenience. Where you have to wait, where 50 caregivers four times a day have to wait long periods for a lift with children round their ankles and so, it must be a very, very fraught and annoying and frustrating business. Why shouldn't you contract to avoid that?

WINKELMANN CJ:

So what do you say to Mr Dillon's point that in a way disproportionality is made out because of the failure of the clause to be calibrated anyway to when to when it came, when the lift was actually build, having regard to its impact on the numbers of children, et cetera.?

MR GEDYE QC:

Well, the correct test is to assess the term as it is, not to look at whether a milder or less onerous term should have been imposed, and my friend's point really involves re-writing the contract, which is something the Court should not do. He's contending for a situation where it would have been acceptable for the parties to have agreed something else, but they didn't. A drop-dead effect or a deadline with a full consequence is very normal in contracts, it's something which has occurred in quite a number of the cases, *ParkingEye* is an obvious one, I think *Cavendish* itself is one, and there are a number of others. My friend's point really is an attack on the concept of a deadline in a contract because if there is a difficulty in enforcing a deadline that would have substantial consequences for many forms of contract because many depend on a deadline. The scenario of one day late is not the facts here, it was 18 months late approximately. The distinction between a clause that has full effect the day after a deadline and a clause that has a graduated effect is not a principle one in this area of the law. It's either out of all proportion or it's not, and to point to a form of clause that would have been milder doesn't help that enquiry.

WINKELMANN CJ:

Right.

MR GEDYE QC:

ParkingEye, Cavendish, Dunlop and *Paciocco* are all examples of a deadline being missed, there are others, *Phillips v Hong Kong* was a construction case.

The other thing about the deadline here, Your Honours, is that Mr Parbhu had two years and seven months, a long period, which he negotiated to his advantage, and the evidence is that he did not prosecute the installation diligently and that the lift only arrived on the 11th of July on the premises and then had to be stored, the consents hadn't been obtained, there was the question of trying to please some other tenant by going into the basement. The buffer against an immediate effect had really been built in, Mr James would say he wanted the lift and had expected the lift by the time of the lease. So when you talk about a deadline that's two years seven months after the time when he had expected to have it, so there's already a deadline built in, the deadline as part of a package.

WINKELMANN CJ:

But if you think about that, that means that really by that point in time it's compensating for the time that he hasn't already had the two lifts, it's not just a forward-looking compensation, it's backwards.

MR GEDYE QC:

Yes, well, that's what I meant by saying it's part of parking. "The deal" incorporated the fact that he had to do without for over two and a half years, something he was reluctant to do.

Two or three other aspects of Honey Bees' interest. It had committed to at least six years, which was a significant term for a start-up business and a substantial transaction, signing up to the lease put Honey Bees past the point of no return and it was then committed to a long-term obligation. So that was part of his interest. Similarly, Mr James had a low appetite for risk, he was a research fellow at the time at the university, he had no fixed income. You'll see on page 135 of the case on appeal he had incurred a lot of debt, in fact he'd mortgaged himself and his mother's house and basically, and

incurred maximum credit, and he'd never negotiated a lease before. So all of those factors come to bear in terms of the interest in having premises that were fit for purpose and would enhance the prospect of the business' succeeding. Having incurred the set-up cost he wanted the ability and the benefit of renewing for up to a further 18 years to justify his investment. If the lift wasn't installed and the premises weren't suitable query whether those renewals would have been prudent, query whether those rights of renewal would have been of the same value.

The question of risk and uncertainty is an important one in assessing Honey Bees' interest. Viewed as at December 2013 he had no way of knowing how many children he could build up and how quickly, what level of risk would arise from access difficulties, parents might have got fed up with the whole thing en masse, he may have needed to find a new location, all of those risks were patent in his mind at the time, he had no way of predicting the future.

So that's a collection of the matters going to Honey Bees' interests. Looking at 127 Hobson's side of things, it's not an equivalent examination but it is appropriate to touch on a few aspects briefly –

WINKELMANN CJ:
So, I'm just looking at the time, Mr Gedye. How long do you think you'll be?

MR GEDYE QC:
Subject to anything Your Honours want to raise, this is my last point. I can be a couple of minutes.

WINKELMANN CJ:
All right.

MR GEDYE QC:
127 Hobson was getting substantial benefits, it was getting a formal lease for six years, but the real prospect of a lease for 24 years, because anyone

setting up this business would renew. He wanted to start and got a start on his rental income flow from a lease, he got a $90,000 lease premium payment when the lease was signed. The obligation he undertook about the lease – sorry, the lift was not unmanageably large or difficult, he was a sophisticated person, he controlled what went to the bank, he wrote forceful emails, and every examination of matters from Mr Parbhu's point of view would suggest that he was entirely comfortable, there was nothing one-sided about this, nothing oppressive and, if you like, nothing unconscionable. To the extent there was any disparity it was Mr James who was in a much weaker position.

Unless there's anything else, that covers the matters I wanted to raise.

WINKELMANN CJ:
No, thank you.

MR GEDYE QC:
Thank you, Your Honours.

WINKELMANN CJ:
Mr Dillon, did you have anything by way of reply, briefly?

MR DILLON:
Yes, briefly. I have taken the opportunity to prepare written submissions in response to my friend's written submissions because, envisaging that it would truncate my oral reply, if I could hand those up there, cross-referenced by paragraph number, it's not a paragraph-by-paragraph analysis.

WINKELMANN CJ:
Well, how long are they?

MR DILLON:
I think – 10 pages.

WINKELMANN CJ:

Because our expectation is that you intend to deal with matters as they come through your submissions by way of reply.

MR DILLON:

I can understand that, but because my friend's written submissions get down into to close-grained factual analysis such as, perhaps, the last hour of his oral submissions, it was easier to deal with it this way because they could be cross-referenced from his written submissions to the case far more easily than could be done orally.

WINKELMANN CJ:

All right.

MR DILLON:

And that then just leaves me with a relatively small number of points to address orally in reply, and perhaps the best place to start was the Canadian case my friend has referred in Court to, the *Chandos Construction Limited* case, and the dissenting judgment of Justice Wakeling. That was a dissenting judgment, and at paragraph 100 of that judgment the Judge opined that the classic penalty rule should not be used any more, and he uses those words. He has defined the classic penalty rule at paragraphs 61 and 62 of his judgment, referencing in particular the dichotomy arising from *Dunlop* between liquidated damages as compared to penalty. Now to the effect that Justice Wakeling is arguing for the entire abolition of the penalty doctrine, which he then goes on to do, it's submitted that that is entirely contrary to the analysis of that express issue in *Cavendish*. All of the Judges in *Cavendish* look at whether the penalty doctrine should be on the one hand abolished or on the other hand extended, and rather than do either they formulate this particular rule that we've address. But in particular they dismiss the idea of abandoning the penalty rule, and the references are in *Cavendish* at paragraphs 36 to 39 and at paragraphs 162 to 170 and at paragraphs 256 to 267. Now each of those sections is headed, words to the effect, "Do we abolish the penalty rule?" and the conclusion in every case is no. And of course if one looks at

Andrews, Paciocco and *Wilaci,* the Courts have accepted the penalty doctrine as extant and the issue really was what does it mean in the current commercial environment? So to that extent the dissenting judgment in the Canadian decision is a bit of an outlier and –

WINKELMANN CJ:
I think Mr Gedye accepts that.

MR DILLON:
I think so too, Your Honour. My friend referred you to *Wilaci* at 76 where the Court rejects the comparison with damages as an appropriate test. However the Court goes on, in fact, as part of its analysis, to do exemplary that. At paragraph 89 the Court is reviewing the principles re-stated from the previous judgments in Australia and the fourth principle is, at 89, applying these principles, "The bank's late payment fees were not penal in nature. On the evidence, late payments adversely affected the bank's economic interests through added operational costs, lost provisioning and regulatory capital costs." In other words, there was an assessment of actual normally compensatable damages in concluding that it wasn't penal. And this is further expressed at paragraph 94, again applying the principles that had just been articulated, "Fourthly, in contrast it may be noted that the late payment fee of $500,000 per week represented a daily cost of credit of $71,428. At first sight, it is unusual that a default credit cost is lower than the equivalent credit cost in the primary transaction. The norm is that on default the cost of credit rises, for two reasons. The first is that the margin encourages due repayment. The second is that the default usually signifies a material increase in risk." As a matter of fact, the Court looked at the actual penalty compared to what would be the normal measure of loss and found that it was less. In other words, this clause was a limitation on damages, not a super-compensatory award.

This same point is picked up at 95, "Against that background the question issue two poses is whether the late payment fee is out of all proportion to any legitimate interest of Wilaci in due repayment in 60 days. We cannot conclude

that it is or, to put it another way, that the predominant purpose of the late payment fee is to punish." That conclusion is based on the fact that it's actually less than a normal damages award. And again at paragraph 99, the last two sentences, "The distinctive feature in this case then is that the loan agreement in fact provides a 'reduced' cost of credit post-default, and it does so despite the extreme level of risk (regardless of the palliative security provided), which was further exacerbated by default." Now on the one hand the Court was saying that this is a false comparison, on the other hand in order to determine what the principles are –

WINKELMANN CJ:
This doesn't really seem a reply, we seem to be going back around, Mr Dillon.

MR DILLON:
Well, my friend referred you to the fact that the comparison was false, and yet the same judgment then does exactly that to reach its conclusion.

WINKELMANN CJ:
We're definitely not just in reply here, Mr Dillon, we're going around the loop.

MR DILLON:
Very well.

My friend referred you to paragraph 71 which refers to the *Clydebank Engineering v Yzquierdo E Castaneda* decision. The legitimate interest of the Spanish government in war preparations, on any normal assessment, would be an extremely expensive exercise. What damages would arise when the preparations for war are imperilled, because that's what was at issue in that particular case. The is very difficult to assess, but on the other hand it's quite imaginable, particular at the time when this decision, the *Clydebank Engineering* case itself, was determined, which was exactly nine years – well, it was reported nine years before the outbreak of World War I, so a British Court assessing it would put it at a pretty high value. The effect of the clause was to limit the damages that might flow from breach rather than to impose a

penalty. As a matter of history, one might recall the Manila Bay episode during the Spanish-American war where a single American warship sailed into Manila Bay in the Philippines and in the course of one morning destroyed the entire Spanish Pacific fleet. The American admiral later characterised that as, a quote, “A nice morning’s work,” end quote.

My friend puts the question of damages and the assessment of damages as fulfilling a completely different purpose than the penalty doctrine. But it’s respectfully submitted that the purpose of the penalty doctrine is to all the parties to agree damages, in other words, to agree what the outcome of a breach will be. Accordingly, damages are at the very heart of what’s being encouraged by the Court. I’ve noted already that often it actually operates as a limit, because it tends to apply in cases where an assessment of damages is difficult and the parties have an interest in making it as straightforward as they can as opposed to a lengthy hearing and extensive evidence addressing just the damages question. It’s convenient to the parties, it avoids the difficulty of calculation, and can operate as a limit. So accordingly when one is considering what is out of all proportion it must hark back to what the Court will allow.

My friend then addressed you on the question of unconscionability and argued against its use, but there is a clause in *Cavendish* at paragraph 31 that he referred you to. And at the foot of paragraph 31 and the foot of page 299 of the appellant’s authorities the Court conditions what it’s addressing when it uses the word “unconscionable” in the context of penalty, “The question whether it is enforceable should depend on whether the means by which the contracting party’s conduct is to be influenced are ‘unconscionable’ or (which will usually amount to the same thing) ‘extravagant’ by reference to some norm.” Now clearly the Court is saying in terms of the penalty doctrine unconscionability does actually equal extravagance, and unconscionability or extravagance is compared by reference to some norm. it’s submitted that this is an argument for harmonising the doctrine of penalty with the general rules of damages, that that is the norm. Unconscionability is contrary to the conscience of the Court. How is the conscience of the Court assessed in the

penalty arena when we're looking at what could otherwise, well, what should otherwise be regarded really at liquidator damages, and the answer is by reference to the general law of damages, that is the norm that, it's submitted, *Cavendish* is pointing to at the foot of paragraph 31.

WINKELMANN CJ:
Well, that seems to be out of sorts with other references to unconscionability by Lord Hodge when he talks about…

MR DILLON:
Yes, there are certainly references in *Cavendish* and other cases to unconscionability in its more classic equitable context of oppression in those types of issues. But as my friend has said, there's no particular reason to bring that equitable conscience of oppression into the penalty doctrine if the penalty doctrine is harmonised with the general law of damages. It's much more consistent if we look at it in terms of the formulation which both my friend and I have adopted, being out of all proportion to the legitimate interests of, in this case, the tenant. It's a question of identifying what legitimate interests are in the context, the appellant submits, of the general law of damages, and my friend is suggesting that legitimate interests are only judged by reference to the commercial interests of a party.

WINKELMANN CJ:
So you agree that the equitable concept of unconscionability is not what they're talking about?

MR DILLON:
I believe that the judgment at paragraph 31 correctly identifies that it's used in the context of an equivalence with extravagance because unconscionability in its classic sense already is a remedy, it doesn't need to be read into the penalty doctrine. I agree with my friend entirely that it just makes it too confusing, and it would be better to step aside with it, from the use of that word. On the other hand, if we look at unconscionability as "the conscience of the Court" in assessing what is out of all proportion to the legitimate interests

of a party, that walks us back in that sense into the general rules of damages. So that's where a proportionality comes from, and our sense of what is a legitimate interest also comes from.

And, finally, the point about freedom of contract, particularly again by reference to Justice Wakeling at 188 of the Canadian decision. My friend pointed to the existing exceptions, being fraud and restraint of trade, but of course it's submitted that in the UK and in Australia and in *Wilaci* relating to Australia and in the Court of Appeal in this case, it's been accepted that penalty is another of those exceptions, and it's consistent with the principles that underlie the restraint of trade clauses, reference the *Mad Butcher* case that it referred the Court to.

WINKELMANN CJ:
Right, we've got that already.

MR DILLON:
Anything else tends to send us back to the 16th century where we have the performance bonds, which were freely entered into, they were free contracts, and the Court found that they were unenforceable in equity because they contravened the basic underlying concept of compensation. And that's really the problem with my friend's position, freedom of contract has never been an absolute open slather, and in these days of international contracting parties and difficulties in enforcement and so forth there is a very real risk if the penalty doctrine is written down too far, because a party can come to the Court and say, "Oh, no, I've global interests to protect," and therefore they are so high that this consumer who has breached it in some innocuous way still has to pay this exorbitant amount, "to my British Virgin Islands' registered company," and that is a real slippery slope, I believe we have enough difficulty without it going down that.

The opportunity here exists for the Court to underline how penalty relates to the general law of damages. My friend has said, "No, completely different purposes, we have to put penalty over here, we have to put the general law of

damages over here." But what is the purpose of penalty if it's not part of this overarching concept of what the Court will allow a party to receive by way of compensation on the most generous basis? Because penalty allows a generous basis, but so does the general law of damages.

Those are the submissions for the appellants.

WINKELMANN CJ:

Thank you, Mr Dillon. Thank you very much, counsel, for your helpful submissions, we've been greatly assisted by them. We'll take some time to consider our decision and let you have it in the usual way.

COURT ADJOURNS: 3 45 PM